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EAPB position on possible extension and possible future adjustment of the Temporary Framework

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General comments

In the context of the survey sent by the European Commission to Member States concerning a possible extension and possible future adjustment of the Temporary Framework, the European Association of Public Banks (EAPB) is pleased to provide its comments on the basis of the EAPB members' experience with the implementation of COVID specific support measures deployed during the crisis as regards the State aid aspects.

At a moment when the level of COVID infections is decreasing in most parts of Europe and the economic outlook is positive, it must be carefully examined if and when the Temporary Framework to support the economy in the COVID crisis can be withdrawn.

Despite the positive developments, our members consider that an extension is necessary. This is because regardless of the expected economic recovery, the economy will remain underperforming for some time to come. In addition, there is the risk that a considerable part of the economic costs of the pandemic may only become visible with delay. So far, thanks to the comprehensive public aid measures, the consequences of the economic slump have not had any major negative impact on banks' balance sheets and the feared massive wave of insolvencies in the corporate sector has failed so far to materialise. Nevertheless, there is a risk that there will be catch-up effects in insolvencies and that credit risks in the banking system may be underestimated. This is because the COVID crisis has put a considerable strain on the financial situation of many companies.

In May 2021, around 24 % of small and medium-sized enterprises (SMEs) in Germany, one of the EU's major economies, reported that their equity ratio was below pre-crisis levels. This ratio risks being even higher in other Member States. The consequences of the crisis on company balance sheets are expected to have a longer-lasting effect - with repercussions for the creditworthiness of companies and their access to credit. Should commercial banks suffer as a result of the pandemic access to credit could become more difficult. In this case, it would be important to strengthen the lending capacity of the banking system, including with the help of the instrument of State credit guarantees, in order to prevent downward spirals between the real and the financial economy and to safeguard the recovery.

At the same time, the risks from the pandemic that continues to smoulder globally are still significantly elevated. It is possible that even more dangerous mutations of the virus will develop and spread worldwide in the future, which in the worst case could even overcome the partial immunisation of the population that has already been achieved. In that case, considerable restrictions on public life would again become necessary, with correspondingly negative consequences, especially for those companies whose business model is based on personal contacts.

Given that new COVID waves in autumn/winter 2021 cannot be completely ruled out, the Temporary Framework should continue to provide a stable framework for granting aid. The pandemic has already had an impact on the equity base of the companies; in the context of new waves, these effects could intensify and have a significant impact on the companies' ability to act. There would also be a renewed need for liquidity. In this case, the instruments of the Temporary Framework will be needed in their full flexibility.

Please see below our answers to the questions circulated by the European Commission:

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1. Do you think that the Temporary Framework should be extended beyond 31 December 2021? Please explain why/why not and, if so, until when.

In light of the assessment above we would expressly welcome an extension of the Temporary Framework beyond 31 December 2021. This is based, on the one hand, on the continuing need for liquidity and equity capital of many companies, even though the number of applications in some funding programmes is declining. On the other hand, in our view, the Temporary Framework also forms a good basis under State aid law for the post-COVID period of economic recovery and transformation, both for equity financing and for loan financing to strengthen liquidity and investments.

Only if the Temporary Framework is extended beyond the end of 2021 can regional and national governments react quickly and appropriately to negative scenarios. This necessary flexibility will only become obsolete once the pandemic has been sustainably overcome and a self-sustaining upswing has been established. The decision on the continuation or termination of the Temporary Framework should therefore not be time-dependent, but path-dependent, just as in the data-oriented decision on the deactivation of the escape clause of the Stability and Growth Pact. This suggests that the **Temporary Framework should be terminated in parallel with the deactivation of the escape clause, which the European Commission recommends should not happen before 2023.**

2. If extended, do you think that the Temporary Framework should be phased out? If so, please explain which of the various types of measures set out in section 3 of the Temporary Framework should be maintained/removed. Please also explain whether there is a need to adapt the aid ceilings and/or other compatibility conditions of the various measures, and/or whether there is a need to limit the scope of eligible beneficiaries based on their size.

Against the background of our general comments and those on the 1st question and for reasons of consistency and transparency, no phasing out should take place at this point. The scope of eligible beneficiaries should not be further limited based on their size. The aid ceiling detailed in section 3.1 was increased from EUR 800 000 to EUR 1.8 million per beneficiary company in the context of a previous extension of the Temporary Framework. With a further extension of the TF, a further **increase of this limit would be become necessary, i.e. to at least EUR 3 million** - as well as an extension of the maturities for the individual financial instruments. The limit of the ceiling in section 3.3 regarding subordinated public loans appears low since the Temporary Framework has been extended on several occasions and will cover approximately a far longer period than originally intended it would therefore also be necessary that this ceiling is increased.

3. Do you think that the Temporary Framework should be further adapted to address the needs of small and medium enterprises? If so, what measures could be introduced and/or which measures could be adapted to achieve that result?

With regard to SME funding, we consider the current possibilities under the Temporary Framework to be sufficient.

4. Do you think that the Temporary Framework should be further adapted to prevent corporate insolvencies (e.g., by additional possibilities to enable debt restructuring and/or expanding the possibility to convert repayable aid instruments into other forms of aid such as direct grants)? If so, what measures could be introduced and/or which measures could be adapted to achieve that result? What would be the appropriate period of time to implement those measures?

EAPB members have faced practical difficulties in the implementation of temporary aid measures. The temporary nature of COVID 19 schemes does not allow to easily extend the maturity of a loan after the expiry of these schemes (31/12/2021), if this possibility is not clearly defined initially in the contracts. This limitation is based on the fact that (i) aid cannot be granted outside the regulatory framework that authorises it and (ii) that a modification of loan conditions would be qualified as the granting of a new aid. This has often created major problems for national COVID 19 aid already granted in the form of loans and guarantees. For these products, the issue of maturity rescheduling could lead to two types of risk: i) a transfer of the solvency risk of a significant part of the portfolio to the banks' balance sheet and/or ii) an acceleration of the liquidation of companies that encounter difficulties, even temporary, in honouring their debt. Rescheduling is a common practice, which helps to ensure better repayment of loans.

In our view, the Temporary Framework should therefore **clearly provide for the possibility of granting deferrals, which also entail longer loan maturities.** Equally necessary would be the possibility for creditors to waive parts of the claims. Deferment and waiver decisions are already pending at the present time, because companies have increasingly exhausted the possibilities of the Temporary Framework and are unable to repay their loans. The obligation to repay COVID 19 loans should not lead to the wave of insolvencies that the very measures were intended to prevent.

In addition, the definition of undertakings in difficulty (UID), and in particular the criterion of the disappearance of own funds, also causes difficulties for many companies, especially SMEs. Since during the COVID 19 crisis many companies had a high loss of equity, and this problem is expected to intensify. In this respect, it is important to correctly reflect the economic circumstances in the UID and, in particular, **to offset subordinated loans as fully-fledged equity capital in the calculation of capital loss.**

Outside of the Temporary Framework, the UID definition should be changed. Only by adapting the UID definition to the post-COVID 19 situation can it be prevented that- after the expiry of the Temporary Framework- companies are classified as UID due to their crisis-related high equity loss and are thus excluded from many support programmes. One such adjustment could be **to use 31 December 2019 as the cut-off date for the UID definition even after the expiry of the Temporary Framework, or to generally abandon the application of the criterion of equity loss**.

A similar approach was already chosen in the last amendment of the General Block Exemption Regulation (GBER). This measure should be also applied to all State aid rules after the expiry of the Temporary Framework. Such a Corona-UID exemption could be granted for a limited period until 31st of December 2024.

5. Do you think that the current rules set out in the Temporary Framework are sufficient to address the needs of specific sectors of the economy and to facilitate their recovery from the COVID-19 outbreak? If not, please explain how existing rules could be adapted and/or new rules could be introduced to allow those sectors to restart. Please also explain which sectors should be covered by such new and/or amended rules, how to identify those sectors and why those sectors should be distinguished from other non-covered sectors.

In addition to our comments under question 1, we do not see a need for further sector-specific changes.

6. Taking into account the need for green and digital investments as well as the potential need for solvency support (e.g., with the involvement of private investors, involving State guarantees, as proposed in the Commission Solvency Support Instrument), do you see scope to further adapt the Temporary Framework and/or new measures to accompany and speed up recovery? If so, what measures could be introduced and/or which measures could be adapted to achieve that result? Please also explain why you would expect the revised State aid rules (e.g., GBER, State aid guidelines) to be insufficient in this regard.

The most important point from our point of view is that, in addition to rescuing companies in the crisis, it must now also be a matter of using the "recovery phase" to support the desired qualitative growth and transformation of the EU economy. Therefore, significant additional regulatory leeway should be granted for public support to companies in the areas of innovation, digitalisation and sustainability (SDGs). State aid rules in these areas need to be simplified so that they can contribute to the achievement of EU long-term objectives such as the European Green Deal. For example, eligible costs - including operating costs, information and advisory services - for SMEs in the field of energy efficiency, CO_2 reduction and biodiversity should be further favoured via Art. 18 GBER as well as aid for "green products".

Since the Temporary Framework was created as a basis to be able to react flexibly to the economic effects of the COVID 19 pandemic and is limited in time to the duration of the pandemic, it is in our view not the right legal framework for environmental protection, climate protection or digitalisation funding.

* ***The European Association of Public Banks (EAPB)*** *gathers over 30 member organisations which include promotional banks such as national or regional public development banks and local funding agencies, public financial institutions, associations of public banks and banks with similar interests from 17 European Member States and countries, representing directly and indirectly the interests of over 90 financial institutions towards the EU and other European stakeholders.*

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