

EAPB comments on the evaluation of the State guarantee notice and the lack of clarity regarding municipal funding provided by specialized lenders with the support of public guarantees, 19 December 2022

EAPB welcomes the possibility to provide comments on the State guarantee Notice. Our members' experiences with the Notice, reveal a certain lack of clarity that has led to a number of cases of "overcompliance", for example within different areas of public utilities such as water supply, sewage treatment, education and other public services, notably when financing is provided with the support of a municipal guarantee.

There seems to be great confusion, especially among municipalities but also academia, on the purpose of the Notice and in which cases it should be complied with. This has resulted in cases where public guarantee decisions taken by local authorities have referred to the Guarantee Notice in situations in which they do not seem relevant for the purpose of the Notice. It is sometimes considered that the Notice is applicable to all situations where a public sector guarantee is given and thus kicking in notification obligation nearly in all cases where 100% guarantees are given. This often leads municipalities to only grant 80% guarantees in order to avoid notification obligations. This leads to numerous situations where the municipalities will charge a guarantee fee that is high enough to be considered in accordance with the Guarantee Notice (and the "safe-harbour premiums"), when granting a loan guarantee to e.g. a public purpose company.

Most often the investments financed by such institutions are carried out within the public sphere – in some cases implying that borrower should not be considered an undertaking/ does not perform economic activity (for instance a municipal hospital or kindergarten), or implying an activity/ infrastructure which is not in direct competition with market actors (for instance local waterworks or a municipality's collection of domestic waste).

Example

A municipality has established a school with the legal status of a company but which provides a public service. When the "school company" has investment needs the borrowing should be supported by a 100% guarantee by the owning municipality (as the school company itself is not economically entirely viable and provides a public service). Based on its interpretation of the Guarantee Notice the municipality however has only granted a 80% guarantee to the school, although the funding of the municipality and could have been done directly by the municipality (and not via a special finance institution, benefiting from a public guarantee).

We believe the legal structure and the type of guarantee needed for the school's borrowing should not be decisive in relation to the assessment of whether or not support of the activity – a public purpose school – is State aid in the first place (and therefore whether or not the Guarantee Notice applies to the particular guarantee)

In these cases, a guarantee fee, which is set in accordance with the Guarantee Notice, can have the effect that a public purpose investment – instead of being financed at the lowest possible costs and on favorable terms by a non-profit special credit institution – either will not be carried out at all or will be financed at a higher cost (market terms).

Therefore EAPB believes that the purpose of the Guarantee Notice should be more clearly defined and it should be clearly stated that public guarantees may cover also 100 % of the outstanding loan or financial obligation when State Guarantees are granted to undertakings whose sole activities

remain outside the scope of State aid control (like for example undertakings exercising of public powers, solidarity - based security schemes, health care, education and research activities, culture and heritage conservation etc., i.e. to the entities exercising activities which remain outside the scope of State aid control). We suggest adding the following amendment to the last paragraph of the Section 1.3. Structure and Scope of the Notice as follows:

“The Notice will not apply to guarantees granted to entities whose sole activities remain outside the scope of State aid control. The provisions of the Treaties do not affect in any way the competence of Member States to fund such activities.

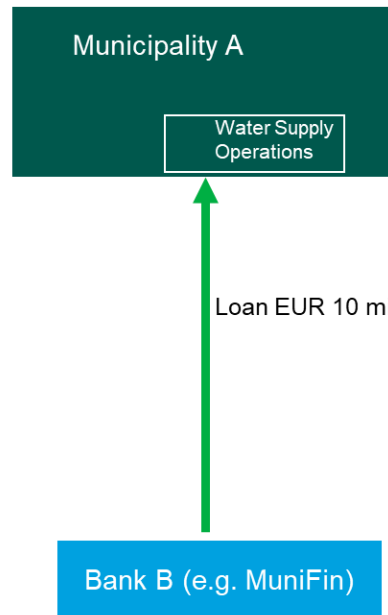
Where the same entity carries out activities of both economic and non-economic nature, the public funding of the non-economic activities will not fall under Article 107(1) of the Treaty if the two kinds of activities and their costs, funding and revenues can be clearly separated so that cross-subsidisation of the economic activity is effectively avoided. Evidence of due allocation of costs, funding and revenues can consist of annual financial statements of the relevant entity.

This Notice does not apply to export credit guarantees.”

Annex: Further examples of local funding in Finland provided by EAPB member Munifin, a specialised lender

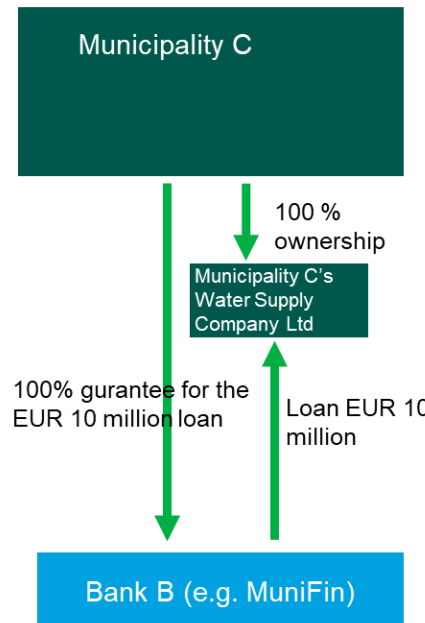
Example 1 and 2 show different alternatives of financing investment of water supply operations of Finnish municipalities. Water supply is part of obligatory duties of Finnish municipalities and thus not offered by private sectors entities. These two alternatives should be treated similarly under State aid regulation. Consequently, the EC Guarantee Notice should be clarified to avoid misinterpretations. Example 3 and 4 show cases where Munifin cannot grant loans on competitive markets

Example 1



- Municipality A has decided to run its water supply operations as part of the municipality itself (i.e. it has not established these services under any separate legal entity).
- Municipality decides to make an investment to renew infrastructure of its water supply operations, and to perform the investment it needs to borrow EUR 10 million.
- Municipality sends a tender offer request on the loan to several banks and decides to take the loan from the Bank B.
- Loan to a Finnish municipality enjoys 0% risk-weight in capital adequacy calculation of a bank.
- No state aid challenges as water supply is not covering operations on competitive markets (as no state aid criteria of SEUT 107 Article is met) and thus can be performed as part of the municipality itself.

Example 2



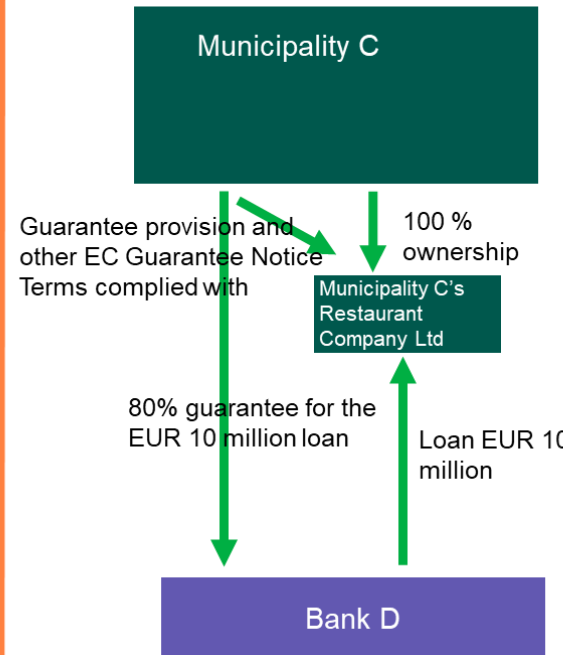
- Municipality C has decided to run its water supply operations under a separate legal entity (e.g. to have separate book-keeping and allow more transparent management) fully owned by the municipality.
- Water Supply Company makes a decision to renew infrastructure of its water supply operations, and to perform the investment it needs to borrow EUR 10 million.
- Water Supply Company sends a tender offer request on the loan to several banks and decides to take the loan from the Bank B.
- Municipality C gives a 100% guarantee to the loan of the Water Supply Company for the benefit of the Bank B. Through this, the loan to the Water Supply Company enjoys 0% risk-weight in capital adequacy calculation of a bank.
- No state aid challenges as water supply is not covering operations on competitive markets (as no state aid criteria of SEUT 107 Article is met). Position of Bank B is similar in both cases (and should not be different). Water supply company is only a legal structure and not independent market operation. EC Guarantee Notice shall not be applicable to ensure subject matter to be treated similarly under both examples.

Example 3



- Municipality A has decided to establish a restaurant to attract tourists to enjoy the area.
- Restaurant business needs a EUR 10 million loan for necessary investments.
- Such an operation of a municipality (local authority) **would be competing with private sector and thus cannot be operated within the municipality itself.**

Example 4



- Municipality C has decided to establish a restaurant to attract tourists to enjoy the area.
- Restaurant operations would be operations on competitive markets and shall be performed by a company that bears business risk independently, and thus Municipality C establishes a separate company.
- Restaurant business needs a EUR 10 million loan for necessary investments. The Restaurant Company sends a tender offer request on the loan to several banks and decides to take the loan from the Bank D.
- To get the loan the Restaurant Company needs the Municipality C to give a guarantee to the Bank D. The guarantee needs to be given according to the terms of the EC Guarantee Notice and can be given only up to 80% of the nominal of the loan.
- MuniFin cannot grant loans under examples 3 or 4 as MuniFin's financing (due to guarantees to its funding operations by the Municipal Guarantee Board) cannot be used for operations on competitive markets.