ALERT MEMORANDUM

State Aid Temporary Framework to Support the Economy in the Context of the COVID-19 Outbreak

20 March 2020

On March 19, the Commission adopted a communication (the "Temporary Framework") setting out a temporary framework for the implementation of less stringent State aid rules in order to support the economy in the context of the COVID-19 outbreak. Given the limited size of the EU budget, most of the massive public expenses related to the COVID-19 crisis will likely be funded by national budgets and might therefore be subject to the strict State aid rules of Articles 107 and 108 TFEU. The Temporary Framework is based on Article 107 (3) (b) TFEU, which allows the Commission to clear aid aiming at remedying *"serious disturbance in the economy of a Member State"*. The Commission had used the same legal basis (and adopted a similar framework) to allow exceptional aid measures to the real economy following the 2008 financial crisis.

The Temporary Framework, which was adopted in record time after a two-days consultation process with Member States, follows up on the Commission's Communication of March 13 (the "Coordinated Economic Response Communication"), which set out a number of proposals and actions for a coordinated European response to tackle the economic consequences of the COVID-19 sanitary crisis in the EU.[1] While in this earlier Communication the Commission had only expressly mentioned Italy as a possible beneficiary of Article 107 (3) (b), it now recognizes that the outbreak and the severe economic

If you have any questions concerning this memorandum, please reach out to your regular firm contact, the following authors or our COVID-19 task force directly by clicking here.

For more information, please consult the COVID-19 Resource Center.

François-Charles Laprévote
+32 22872184
fclaprevote@cgsh.com

Cesare Rizza
+39 06 6952 2237
crizza@cgsh.com

Theodora Zagoriti
+32 22872140
tzagoriti@cgsh.com

1 *See* "COVID-19: Commission sets out European coordinated response to counter the economic impact of the Coronavirus" available here.

impact of containment measures affect all Member States and the Temporary Framework therefore will likely apply across the EU as a whole (although Member States will arguably still have to demonstrate the existence of a serious disturbance in their economy when they notify aid measures based on the Temporary Framework).

1. Rationale and general rules

The Temporary Framework is designed to serve two goals:

— To ensure that businesses will keep operating as previously and that the disruptions caused by the COVID-19 outbreak will not undermine their viability. As a result, the Temporary Framework puts a heavy emphasis on liquidity, especially for SMEs, and is temporary by nature. It will not apply beyond December 31, 2020 and the Commission leaves open the possibility to "review" the Framework (which seems to leave open the possibility to repeal it if it becomes unnecessary) before that date.

— To ensure that support for businesses in one Member State does not undermine the EU's single market through a "beggar-thy neighbor" subsidies race. The Temporary Framework therefore contains key parameters for public interventions aimed at ensuring that aid granted by Member States remains appropriate and proportionate. For instance, it only covers aid to companies that were <u>not</u> in financial difficulty before the COVID-19 outbreak (i.e. before December 31, 2019).

The Temporary Framework complements other public support tools under other legal bases that are already at the Member States' disposal. These include among others: (i) measures that do not qualify as aid in light of their general character (such as wage subsidies, suspension of payments of corporate and value added taxes or social welfare contributions to the benefit of all undertakings): (ii) measures that qualify as rescue or restructuring aid to companies in financial difficulties under Article 107 (3) (c) TFEU, in particular schemes aimed a meeting acute liquidity needs; and (iii) measures that are aimed at compensating damage directly caused by the COVID-19 outbreak pursuant to Article 107 (2) (b) (in particular in the health, tourism, and transport sectors, which were already mentioned in the Coordinated Economic Response Communication, and to which the Commission now adds the retail and culture sectors).

2. Forms of aid allowed under the Temporary Framework

The Temporary Framework allows Member States to implement aid (subject to prior notification and clearance by the Commission) in four different forms, which can be cumulated with each other: (i) direct grants, repayable advances and tax advantages; (ii) loan guarantees; (iii) subsidized loans; and (iv) short-term export credit insurance.

Direct grants, repayable advances or tax advantages

The Temporary Framework enables Member States to set up schemes granting to each individual company up to €800,000 in direct grants, repayable advances or tax advantages for its urgent liquidity needs. The aid amount will be calculated in gross terms, i.e. before any tax deductions or surcharge. Specific thresholds and rules apply for the fishery and aquaculture (€120,000 per undertaking) and primary production of agricultural products (€100,000).

Loan guarantees

The Temporary Framework enables Member States to provide subsidized State guarantees on bank loans or set up guarantee schemes supporting bank loans taken out by companies. The main conditions are: (i) minimum guarantee premiums ranging from 25 bps to 200 bps depending on the company's size and the loan maturity; (ii) amount of the loan capped to twice the company's 2019 wage bill (or 25% of its 2019 turnover, or the total amount of its liquidity needs for the next 12 months for large enterprises, and 18 months for SMEs), with the possibility to exceed that cap for loans expiring before the end of the year; (iii) guarantee duration limited to 6 years; and (iv) guarantee amount limited to 90% of the underlying loan (or 35% in case of a first-loss guarantee).

Subsidized loans

The Temporary Framework allows Member States to enable public loans with subsidized interest rates. The main conditions imposed under the Framework are similar to those for loan guarantees and include: (i) minimum interest rate of 1-year IBOR plus a credit margin ranging from 25 bps to 200 bps depending on the company's size and the loan maturity; (ii) amount of the loan capped to twice the company's 2019 wage bill (or 25% of its 2019 turnover, or the total amount of its liquidity needs for the next 12 months for large enterprises, and 18 months for SMEs) with the possibility to exceed that cap for loans expiring before the end of the year; and (iii) loan duration of up to 6 years.

Short term export credit insurance

By way of derogation to standard State aid rules on export credit insurance, the Temporary Framework allows for State support to export credit insurance relating to marketable risks, provided the Member State can demonstrate (based on market evidence) that private insurance is no longer available for such risks.

3. Specific provisions on the banking sector

The Temporary Framework recognizes the important role of the banking sector to deal with the economic effects of the COVID-19 outbreak, in particular to channel aid to final customers, in particular small and medium-sized enterprises. Banks and other financial institutions acting as financial intermediaries will be required to introduce some safeguards and operate a mechanism which will ensure that the benefit is passed on to the end consumers through greater lending or lower interest. In addition, because of the limitations on the amounts of the State guarantees described above, they will in effect have to bear at least 10% of any losses, or 65% if the losses are first attributed to the State. Importantly, any support granted on this basis would be considered as direct aid to the banks' customers, not to the banks themselves, and would not qualify as extraordinary public financial support ("EPFS") for the purpose of the Bank Recovery and Resolution Directive ("BBRD"), which entails that it would not trigger placement in resolution of the banks. The Commission also envisages the possibility of more structural COVID-19-related aid to banks in the form of "liquidity recapitalizations" or impaired asset measures, which would (by exception to the applicable BRRD and State aid rules) not trigger a finding that the bank is "failing or likely to fail" or require "burden sharing" measures aimed at shareholders or hybrid bond holders.

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The Temporary Framework will probably be followed very quickly by notifications (and possibly clearances) of aid schemes by Member States. By way of example, France has announced a EUR 300 billion State guarantee on loans to businesses facing a liquidity shock as a result of the COVID-19 outbreak.[2] In Italy the government's first Covid-19 package includes various general measures including additional guarantees that may be granted by the Central Guarantee Fund for SMEs on bank loans.[3] Similar measures from other Member States are expected to follow in the coming days. In parallel, more targeted measures for certain sectors such as aviation or for certain companies could also give rise to State clearances under separate legal bases such as Article 107 (2) (b) TFEU.

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[2] *See* Cleary Gottlieb alert memo here.

[3] *See* Cleary Gottlieb alert memo here.