


EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

OF 7 DECEMBER 1994

ON THE CONSOLIDATION GUARANTEE SCHEME OF THE
FINNISH GUARANTEE BOARD (FINLAND)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area¹, in particular to Protocol 26 and to Articles 61 to 63 of the Agreement,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice², in particular to Article 24 and Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. The notification

By letter dated 29 September 1994, received by the EFTA Surveillance Authority on 30 September 1994 (ref. 94-14705A), the Finnish Government notified, in accordance with Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, a proposal to alter the consolidation guarantee scheme of the Finnish Guarantee Board (Case No. 93-015), which was notified to the Authority as an existing aid scheme by letter dated 18 February 1994 (ref. 94-3057A). An amended notification was submitted to the Surveillance Authority by letter dated 29 November 1994 (ref. 94-17490A), received by the Authority on the following day.

¹ Hereinafter referred to as the EEA Agreement.

² Hereinafter referred to as the Surveillance and Court Agreement.

2. The aim and contents of the existing aid scheme

The act on State guarantees for consolidation of credits³ aims at consolidating the financing of economically viable small and medium-sized enterprises (SMEs). Finnish SMEs are considered to be undercapitalised which reduces their ability to withstand business difficulties and may inhibit their growth.

The primary objective of the consolidation guarantee scheme is, therefore, to secure the viability of indebted small and medium-sized enterprises (SMEs) while at the same time the solvency of deposit banks is being improved by strengthening their balance sheet. This is done by consolidating a bank credit of an individual SME and by granting a guarantee on the credit.

The scheme is administered by the Finnish Guarantee Board. State guarantees are granted to the bank as a security for the principal, interest and other payments determined in the terms of the consolidated credit. The guarantee covers at most 50 % of the bank loan of the SME. Other loans, such as those issued by insurance companies, and bank guarantees are, therefore, excluded from the application of the scheme. A guarantee can also be granted for credits that have had outstanding payment obligations on the principal or on the interest during the past three months.

A precondition for issuing the guarantee is that the enterprise, whose credits are to be consolidated, is estimated to be economically viable in the long run. Another precondition is that the bank agrees to alter the terms of the loan to be consolidated in its entirety by lowering the financing costs of the company. The deposit bank, therefore, cannot demand the repayment of the loan during a period of at least five years from the date when the guarantee is given. Moreover, the bank must commit itself to lower the interest of the loan.

When applying for the guarantee, the bank presents a corporate analysis of the company in question in order to demonstrate that the enterprise has the possibilities to operate profitably in the future. Furthermore, the bank presents to the Guarantee Board its evaluation on how the financing situation of the company shall change as a result of the consolidation arrangement. It shall also disclose the proposed terms of the arrangement, including the lowering of the interest.

The Guarantee Board undertakes its own evaluation of the cash flow that is considered sufficient to cover financing costs borne by the enterprise. The interest of the loan should, therefore, be lowered by the bank to a level which the enterprise is estimated to be able to finance. The extent of the lowering of the interest is, therefore, determined by the financial situation of the company. The bank cannot, however, while lowering the interest, raise other management expenses of the loan. Neither can the terms of other credits the bank may give to the company be formulated in a way which would allow the bank to compensate for its losses while lowering the interest of a consolidated credit.

³ *Laki valtion vakauttamistakauksista, 529/93.*

The aim of the scheme is to ensure that the financier participates in restoring the viability of the company. As the burden of the indebted company is eased, the company is able to develop its activities and contribute to profitable operations. In selecting eligible companies, the Guarantee Board favours enterprises which are committed to develop their business activities according to a plan of reorganisation or which have recently invested significantly in developing their operations.

Unless otherwise agreed between the deposit bank and the company, the credit terms after the end of the consolidation period are determined in accordance with the credit terms valid on the date when the guarantee was granted. The loan term remaining on the date when the guarantee was granted is not, however, shortened during the consolidation period. Single-payment credits shall be paid back after the end of the consolidation period, within a period corresponding to the loan term remaining on the date when the guarantee was granted, in equal instalments, unless otherwise agreed between the bank and the company.

According to the act on the Finnish Guarantee Board⁴, the operations of the Board have to be self-supporting in the long run. When concluding a guarantee contract, the Guarantee Board charges a single fee of 0,75% of the amount of the guarantee. However, a minimum fee is set at FIM 5,000 while the maximum is FIM 50,000. In addition, premiums are charged annually which vary between 0,25-2,0% during the period of validity of the guarantee. These are determined by the risk element of each project and the value of the collateral provided.⁵

Any collateral existing as security for the consolidated credits at the time when the State guarantee is granted shall be pledged in the Guarantee Board's favour, as a collateral for the guarantee, inasmuch as the guarantee covers the consolidated credit.

Without notice, the Guarantee Board has the right to call in the credit insofar as it is covered by a State guarantee, if, *inter alia*, the value of the collateral has fallen considerably owing to the company's action or if the company has entered into liquidation or bankruptcy. The credit can be called in by the Guarantee Board also if the circumstances have changed so that the guarantee no longer meets the purpose for which it was granted.

The guarantee is granted as a direct liability guarantee. The total amount of all outstanding guarantees may not exceed FIM 3,500 million at any one time, excluding interest and other charges that may be payable in addition to the principal of the loan. It is estimated that the average guarantee amount will be FIM 2-4 million. The scheme may be cumulated with other aid schemes.

The scheme applies to SMEs operating in the following sectors: industry, workshops, tourism, fur farming, fish farming, market gardening and peat production⁶. Guarantees are primarily granted for the credits of industrial companies. A small and medium-sized

⁴ *Laki Valtiontakaukeskuksesta (111/89)*.

⁵ Decision of the Ministry of Trade and Industry (*Kauppa- ja teollisuusministeriön päätös valtion vakauttamistakaukista perittävien maksujen perusteista, 1.7.1993*).

⁶ Act on State guarantees for certain branches of trade and industry (*Laki eräiden elinkeinoalojen valtiontakauksista (375/63)*).

enterprise is defined as an enterprise which has not more than 500 employees and whose fixed assets do not exceed FIM 350 million. Moreover, the enterprise cannot be more than 1/3 owned by large companies.

3. The proposed changes to the scheme

As the present act on State guarantees for consolidation of credits expires at the end of 1994, the Finnish authorities propose to extend the period of validity of the law until the end of 1995. The act would cover State guarantees applied by banks during 1993-1995. At the same time the law is to be amended in such a way that the sole objective of the scheme is to secure the viability of indebted SMEs. This is further reflected by the fact that the company, for whose credits the State guarantees are being applied, must by law deliver a plan of reorganisation or some other kind of plan which states how the company's prerequisites for profitable operations are to be safeguarded or how its business activities are to be developed.

Moreover, the definition of SMEs eligible for the scheme is amended in order to comply with the EEA provisions on State aid. A small and medium-sized enterprise shall, therefore, be defined in the law as an enterprise which has not more than 250 employees and has either an annual turnover not exceeding FIM 120 million or a balance sheet total not exceeding FIM 60 million. Furthermore, the enterprise cannot be more than 25 % owned by one or more companies not falling within this definition.

In order to harmonise the guarantee fees charged by the Finnish Guarantee Board, the Ministry of Trade and Industry has reviewed the fee policy of the Board⁷. A single fee charged on all types of guarantees is determined on a case-by-case basis when concluding a guarantee contract. Such a fee is charged also if the contract is being changed or prolonged. As regards the annual premiums on the consolidation guarantees, these can now vary between 0,25-3,0% during the period of validity of the guarantee.

4. Justification advanced by the Finnish authorities

The act on State guarantees on the consolidation of credits entered into force on 1 July 1993. Within a year the Finnish Guarantee Board had received altogether 338 applications. During the same period of time the Guarantee Board had granted guarantees for credits worth FIM 1,150 million. The Finnish authorities claim that the consolidation guarantee scheme has been a useful means in safeguarding the economic viability of SMEs.

The difficult economic conditions in Finland and severe problems in the banking sector have postponed the recovery of SMEs. Due to weakened domestic demand, high interest rates and financing difficulties relating to international credits as a result of changes in exchange rates SMEs have become highly indebted. The main bulk of the

⁷ Decision of the Ministry of Trade and Industry (*Kauppa- ja teollisuusministeriön päätös Valtiontakuukeskuksen perimien maksujen perusteista, 9.11.1994*).

bank credits with outstanding payment obligations are estimated to be credits of SMEs.

Despite the revival of the markets, SMEs continue to be highly indebted. Weak balance sheets in the banking sector have raised risk-awareness among Finnish banks. At the same time the economic value of securities such as real estate provided by SMEs have diminished considerably. The possibilities of Finnish banks to increase credits for SMEs shall, therefore, be limited during the next few years. Accordingly, SMEs will have difficulties in raising the necessary funds for working capital and investments. In view of these problems the Finnish authorities regard the prolongation of the scheme necessary.

The prolongation is further justified, in view of the Finnish authorities, by the fact that deposit banks have not been able to analyse all of their new client enterprises that were transferred to them from the Savings Bank of Finland in the context of its splitting up in late 1993. Credits of these companies cannot, hence, be consolidated under the present legislation which expires at the end of 1994 as the analysis of the financial situation of an eligible company is a precondition for applying for the guarantee. Moreover, both the definition of SMEs, which is brought in line with the EEA rules on State aid, and the requirement of a plan of reorganisation of the eligible company are introduced into the law. By evaluating the company's prerequisites for profitable operations and its plan of reorganisation or the like it is ensured that only companies with good viability prospects benefit from the scheme.

II. APPRECIATION

The guarantee granted for credits of SMEs confers an indirect competitive advantage to enterprises which can improve their operational conditions while the terms of the consolidated credits are eased. By offering the guarantee to deposit banks they are direct beneficiaries of the aid measure and their solvency is improved. While these aid measures are not available to all enterprises nor to all banks or other lending institutions, the aid threatens to distort competition and affect trade within the EEA, particularly since the products of the favoured undertakings may be in competition with that of undertakings in other States participating in the EEA. Therefore, the foreseen guarantee scheme constitutes aid in the meaning of Article 61(1) of the EEA Agreement.

Consequently, the EFTA Surveillance Authority is obliged to assess whether any of the exemption clauses under Article 61(2) and (3) are applicable in order to exempt the aid measure from the general prohibition of aid under Article 61(1).

The Surveillance Authority notes that the guarantees to be granted could be used for consolidating credits of SMEs operating in a number of different sectors. In some of these sectors the Authority is not competent to assess the aid. However, this fact does not prevent the Authority from assessing the compatibility of the proposed aid as regards those sectors which fall within its competence in accordance with Article 24 of the Surveillance and Court Agreement.

The scheme has clear horizontal objectives in consolidating the financing of small and medium-sized enterprises which for the reasons, as described in part I.4 above, have greater difficulty in raising finance. The definition of SMEs stated in the law bill is compatible with the EEA provisions on State aid, as stated in chapter 10 of the Procedural and Substantive Rules in the Field of State Aid, adopted by the Surveillance Authority on 19 January 1994.⁸ Due to the importance of SMEs in job creation and job maintenance, the Finnish authorities aim to promote SMEs through the consolidation guarantee scheme in order to change the financial structure of these enterprises and to restore their economic viability which has been hampered by the severe economic problems prevailing in Finland.

The scheme is not intended to keep unprofitable enterprises in business but to consolidate credits of highly indebted SMEs which are considered to have the prerequisites for profitable operations in the long run. The financial situation and plans to develop the business activities of the company are carefully studied both by the bank applying for the guarantee and by the Finnish Guarantee Board administering the scheme. The company must, therefore, to this effect deliver a plan of reorganisation or the like in order to fulfil the conditions stated in the law.

During the consolidation period the bank must grant the company, whose credits are being consolidated, at least a 5-year grace period and lower the interest of the credit for the same period of time. The lowering of the interest is agreed upon between the bank and the Finnish Guarantee Board on a case-by-case basis depending on the financing situation of the company in question. The fact that the enterprise is able to continue to pay the interest indicates that, regardless of its high degree of debts and temporary financing difficulties, it has the prerequisites for profitable operations. In consolidating the credits of an SME the bank cannot restrict the terms of other loans the enterprise may have or will take up with the bank.

The guarantee covering 50 % of the consolidated credits, half of non-performing loans of the bank become good credits in the bank's balance sheet. As the solvency and the balance sheet of the bank improve, its credit worthiness, thus, appears to become better in the short term. In order to receive the guarantee, the bank must, however, agree to the above mentioned long-term commitments during the consolidation period. Moreover, as the instalments of the loan are postponed by at least 5 years the bank may have to arrange refinancing for the consolidated credits. In addition, the bank must pay fees and premiums on the guarantee. Following a review of the fee policy of the Guarantee Board, this reflects market rates as the fee is now determined on a case-by-case basis not only by the risk element of each project but also by the administrative costs relating to the handling of each application.

The securities of the consolidated credits are shared between the bank and the Guarantee Board. Furthermore, the Guarantee Board may call in the credit insofar as it is covered by a State guarantee if, among other things, the value of the counter-security has fallen significantly as a result of the company's action or if the company has entered into liquidation or bankruptcy. The mobilisation of the guarantee is, therefore, contractually linked to specific conditions such as the declaration of

⁸ Hereinafter referred to as the State Aid Guidelines.

bankruptcy of the benefiting enterprise or any similar procedure. The scheme, therefore, fulfils the requirements as laid down in chapter 17 of the State Aid Guidelines, on contractual requirements of State guarantees.

The aid intensity, which is difficult to be quantified for guarantees, is limited by the fact that the guarantee can cover only up to 50 % of the consolidated credit. While the aid element of a guarantee is lower than in the case of an outright grant to enterprises, the total amount of compensation paid out to banks, when a guarantee is called in, may be reduced by the liquidation of the securities. Furthermore, the Guarantee Board may terminate the consolidation arrangement by calling in the credit. By collecting premiums and other charges and by granting the guarantees only to companies and projects with a sound basis, the Guarantee Board should cover the possible losses of the scheme. Moreover, the Guarantee Board must by law be self-supporting in the long run. This requirement also applies to the present scheme as no specific budget has been allocated for this purpose.

In promoting the activities of SMEs, the potential distortions of trade between banks and other lending institutions are outweighed by the positive effects of the aid as SMEs may strengthen their financial structure and, thus, contribute to improvement of employment and economic growth.

The scheme is limited in time covering State guarantees granted on the basis of the applications received by the Finnish Guarantee Board by the end of 1995. The maximum total amount of outstanding guarantees is set at FIM 3,500 million at any one time while it is estimated that the number of recipients shall be 75-120 a year.

The Finnish authorities commit themselves to observe the rules on notification obligations applicable to particular sectors of industry, as laid down in Part V of the State Aid Guidelines and in the Act referred to in point 1 a of Annex XV to the EEA Agreement establishing Community rules for aid to the steel industry (Commission Decision No. 3855/91/ECSC). Furthermore, the Finnish authorities shall submit an annual report on the application of the scheme to the EFTA Surveillance Authority.


The scheme is in line with the EEA provisions on State aid as regards the granting of State guarantees. Furthermore, when adopting the State Aid Guidelines, the EFTA Surveillance Authority expressed a general presumption in favour of the compatibility of aid to SMEs. Therefore, it is concluded that the consolidation guarantee scheme qualifies for exemption under Article 61(3)(c) of the EEA Agreement by facilitating the development of certain economic activities.

HAS ADOPTED THIS DECISION:

1. The EFTA Surveillance Authority has decided not to raise objections to the consolidation guarantee scheme of the Finnish Guarantee Board, as notified by letters dated 29 September and 29 November 1994.
2. The Finnish Government is obliged to submit a simplified annual report (according to chapter 30 of and Annex IV to the State Aid Guidelines) on the application of the scheme to the EFTA Surveillance Authority.

Done at Brussels, 7 December 1994

For the EFTA Surveillance Authority


Knut Almestad
President


Heinz Zourek
College Member