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EFTA SURVEILLANCE AUTHORITY DECISION

of 16 December 1998

on the New Business Venture Fund
('*Nýsköpunarsjóður atvinnulífsins*')
(Iceland)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area[1], in particular 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 Justice[2], in particular to Article 24 and Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. Notification

By letter from the Ministry of Industry and Commerce dated 30 December 1997, received and registered by the Authority on 5 January 1998 (Doc. No. 98-7-A), the Icelandic authorities notified, pursuant to Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, the foundation of a fund named the New Business Venture Fund ('*Nýsköpunarsjóður atvinnulífsins*').

The matter had earlier been the subject of informal consultation, *inter alia* at a general meeting on State aid matters between the Icelandic authorities and the EFTA Surveillance Authority, which took place in Reykjavík on 11 December 1997.

Supplementary information was provided by letter of 10 March 1998, received and registered on 16 March 1998 (Doc. No. 98-1666-A).

[1] Hereinafter referred to as the EEA Agreement.
[2] Hereinafter referred to as the Surveillance and Court Agreement.

2. General description of the New Business Venture Fund

2.1 Background

By Act No. 61/1997 of 26 May 1997, the Icelandic Parliament authorised the foundation of the New Business Venture Fund (‘*Nýsköpunarsjóður atvinnulífsins’*), henceforth abbreviated as NBVF. At the end of 1997, implementing regulations were issued for the New Business Venture Fund and its operative divisions.[3] The Fund began operations on 1 January 1998.

The establishment of the Fund is linked to comprehensive structural changes in the Icelandic financial market. On the one hand, the two state commercial banks, *Landsbanki Íslands* and *Búnaðarbanki Íslands*, have been converted into limited liability companies, effective from 1 January 1998, and sale of the State's shares in the banks has commenced. On the other hand, the Icelandic Parliament has also decided, with effect from the same time, to merge four investment credit funds, the Fisheries Fund (‘*Fiskveiðasjóður Íslands’*), the Industrial Loan Fund (‘*Iðnlánasjóður*’), the Industrial Development Fund (‘*Iðnþróunarsjóður’*) and the Export Credit Fund (‘*Útflutningslánasjóður*’) into two new entities, the Icelandic Investment Bank Ltd. (‘*Fjárfestingabanki atvinnulífsins hf.*’) and the New Business Venture Fund.

The combined equity capital of the “old” investment credit funds was split between the two new entities. The foundation capital of the NBVF was set at IKR 4 billion (approx. ECU 48,8 million). The Icelandic Investment Bank Ltd. was to receive the remainder (in the region of 8-10 billion IKR, according to initial estimates). In addition to the foundation capital, the Treasury was to allocate to the NBVF the amount of ISK 1 billion (approx. ECU 12,2 million) of the proceeds from the intended sale of its share capital in the Icelandic Investment Bank Ltd. This capital shall be kept separate from the Fund's other resources, cf. the description of the Fund's organisation given below.

2.2 Legal status

According to Article 1 of the NBVF Act No. 61/1997, the New Business Venture Fund is an independent entity owned by the State (i.e. not in the form of a limited company). Overall supervision of the Fund is in the hands of the Minister of Commerce. However, the Treasury shall not be liable for the Fund’s obligations, except for certain commitments related to the separate Export Credit Guarantee Department.

Article 17 of the Act provides that the NBVF shall be exempt from income tax and property tax, and that loans taken or granted by the Fund shall be exempt from stamp duties.

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[3] Regulation on the New Business Venture Fund issued by the Ministry of Commerce on 30 December 1997, Rules concerning the Initiative Fund of the New Business Venture Fund issued by the Ministry of Commerce on 30 December 1997, Guidelines for the New Business Venture Fund adopted by the Board of the NBVF and approved by the Minister on 29 December 1997, and Rules governing the activities of the Product Development and Marketing Division of the New Business Venture Fund adopted by the Board of the NBVF and approved by the Minister on 30 December 1997.

According to Art. 10, the NBVF may take short-term loans only to balance its cash flow. Loans may not be taken through the issue and sale of bonds and other redeemable debt instruments to the public.

The Board of Directors of the NBVF consists of five members appointed by the Minister of Commerce, three of which shall be nominated by associations of employers and employees and the remaining two selected by the Minister of Industry and the Minister of Fisheries.

2.3 Objectives and main areas of activity

The role of the NBVF is to encourage development and growth in all sectors of the Icelandic economy through participation in innovation-oriented investment projects and support for development and marketing projects. For this purpose, the Fund may advance share capital or provide loans, guarantees or grants.

According to Article 3 of the Regulation, the NBVF is intended to provide venture capital in fields where the supply of risk capital is considered inadequate.

The regulation on the NBVF (Art. 12) makes it clear that its financing of investment projects will be predominantly in the form of share capital. Only when equity participation is not considered possible or otherwise special circumstances exist, may the Fund provide special loans (convertible loans or loans with share purchase option). The Fund may also, in special instances, issue guarantees for the purpose of attracting financing for an innovative project from other parties. In cases of guarantees, the Fund shall charge guarantee fees reflecting the Fund's risk in the project. Support for development projects, etc. (cf. points 1 and 3 below) will be in the form of grants.

The Fund's activity will be divided between the following areas, each of which shall have separate finances and accounting:

1. Foundation Fund ('*Stofnsjóður*')
   The foundation capital of the NBVF, initially ISK 4 billion, is held and invested in the Foundation Fund. Returns on investment and other disposable funds of the Foundation Fund are to be allocated to the general activities of the NBVF, apart from those specified for its three other divisions, cf. points 2-4 below. The Foundation Fund handles all day-to-day operations of the NBVF and its funds and divisions.

   The NBVF shall seek any and all ways of ensuring the most favourable return on the capital of its Foundation Fund and thus maximise the funds at its disposal each year. The NBVF may not reduce the initial capital of the Foundation Fund. For the first five years of operation this means that the initial nominal amount, IKR 4 billion, shall be maintained. Subsequently, this limit shall be adjusted by the consumer price index.

Provision shall be made for losses of the Foundation Fund, in accordance with good accounting practice and risk assessment. In each case when the Fund decides on an investment in share capital or to provide a loan or a guarantee, a decision shall be taken concurrently on provisions for losses.

Distinction is made between investment projects (i.e. venture capital projects) on the one hand and investment of own capital on the other (i.e. portfolio investment). For investment of its own capital (portfolio investment), the NBVF may only invest in transferable securities which have been registered on organised securities markets. There are also further limits intended to ensure normal distribution of risk exposure in the Fund's asset portfolio.

Article 15 of the Regulation on the NBVF provides explicitly that the NBVF may not grant companies rescuing and restructuring aid, as defined in the EFTA Surveillance Authority's State Aid Guidelines, "unless such complies with those provisions".

Besides the above obligations on loss provisions and preservation of the Fund's initial capital, the Act and Regulation stipulate a number of other conditions intended to limit the Fund's risk exposure, particularly as concerns its venture capital investments. These conditions will be considered below.

Up to 15% of the disposable funds of the Foundation Fund each year may be used for special grants for preliminary investigations and development and promotional projects. Such projects can include applied research and development, market research, promotion of investment opportunities, feasibility studies and preparation of business plans. As will be examined below, the Regulation on the NBVF provides for limits on the amounts of grants from the Foundation Fund by reference to the rule on *de minimis* aid in the Authority's State Aid Guidelines.

The activities of the Foundation Fund are further discussed below.

2. Initiative Fund ('*Framtakssjóður*')

According to the Act on the Fund, the NBVF is to receive from the Treasury ISK 1.000 million from the proceeds of the Treasury's intended sale of its share capital in the Icelandic Investment Bank. This amount, which comes in addition to the founding capital of the Foundation Fund, is to form the start-up capital of a separate fund within the NBVF, the so-called Initiative Fund. The Initiative Fund shall be used for the purchase of share capital in order to encourage innovation and industrial development, with emphasis on regions outside the capital, in particular in the fields of information technology and high technology industry.

The Initiative Fund will, however, not make these investments directly itself, as the fund shall be split in several units or sub-funds, and their disposition and management will be tendered out to operators in the market. It is aimed to dissolve each of the units for which capital is provided within 7 - 10 years of receiving the allocation from the NBVF. The proceeds from the sale of the shares, net of operators' profits and handling costs by the NBVF, are to be transferred to the Treasury.

The NBVF will supervise and monitor the application of the Initiative Fund.

3. Product Development and Marketing Department

This department received for its start-up the equity of a corresponding department operated within the Industrial Loan Fund, in the projected amount of ISK 700 million (approx. ECU 8,5 million). The Department shall make contributions to support product development and marketing projects. Contributions shall be in the form of non-repayable grants, which may amount to up to 50% of the eligible costs of each project, but may not, however, exceed ISK 3 million (approx. ECU 36.600) for each project.

It is foreseen that the Department will disburse each year to product development and marketing projects an amount similar to the annual average of grants and risk loans to comparable projects provided by its predecessor, the Product Development and Marketing Department of the Industrial Loan Fund, during the period 1995-97.

Article 9 of the Rules for the Department reflects EEA rules on State aid. It provides that as a main rule, all grants from the Department shall be subject to the limits of the *de minimis* rule, as set out in the EFTA Surveillance Authority's State Aid Guidelines. There can be two exceptions to this. They will be considered below.

The Department will furthermore contribute to the Foundation Fund of the NBVF an amount equivalent to that allocated by the Foundation Fund to preliminary investigations, and developmental and promotional projects.

The Department shall, however, only have a transitory existence, as it shall be operated only until the end of the year 2000, whereupon it shall be abolished. Any remaining net assets that the Department may still have at that time shall be devoted to the general activities of the NBVF.

4. Export Credit Guarantee Department

This department will take over the assets and liabilities of a corresponding department previously operated by the Industrial Loan Fund. The foundation capital of the Department is not part of the foundation capital of the NBVF.

The role of the Department is to guarantee loans for export financing, to underwrite claims held by Icelandic exporters against foreign buyers, to sell performance guarantees for services provided by Icelandic parties abroad, and to insure investments and project equipment by domestic parties abroad against political risks.

The department will be governed by a separate committee, but it will be administered by the NBVF. The governing committee will adopt further guidelines for the operations of the Department, subject to the approval of the Minister of Finance.

II. APPRECIATION

1. The presence of State aid

1.1 The concept of State aid

Article 61(1) of the EEA Agreement reads as follows:

> Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.

This implies that in order for a measure to constitute State aid, four cumulative criteria must all be fulfilled. The measure must: (1) represent a financial advantage to a firm or firms, (2) be granted through State resources, (3) be specific in nature, and (4) be capable of distorting competition and affecting intra-EEA trade.

The NBVF being fully state-owned, any financial contribution from the Fund is granted through State resources. In most cases the Fund's financial participation will relate to certain enterprises and therefore be specific in nature. Save for limitations related to specific EEA State aid rules applicable to certain sectors, which will be considered below, the services of the NBVF are open to enterprises in all sectors of the Icelandic economy, including those engaged in export and import-competing production and services. Any financial benefits that the Fund may accord to such enterprises are capable of distorting competition and affecting intra-EEA trade. The conditions referred to in points (2) to (4) above are therefore fulfilled. The extent to which the Fund's services may involve financial advantages to certain undertakings and thus constitute State aid will be considered in sections 1.3 to 1.5 below.

1.2 The general operating conditions of the NBVF

The legislation on the NBVF exempts the Fund from income tax and property tax as well as from stamp duties on loans taken and granted by the Fund. From a *prima facie* point of view, this preferential tax treatment represents a financial advantage in favour of the NBVF and could possibly come within the scope of Article 61(1) of the EEA Agreement, assuming that other relevant conditions were also fulfilled. However, it must be recognised in this context that the activities of the NBVF are specialised in nature and limited in scope, as will be explained below.

The broad objective of the NBVF is to promote innovation and development in industry by providing venture capital to promising start-ups. Apart from providing grants for development projects - an activity clearly outside the scope of any commercially based financial enterprise - the activities of the NBVF are concentrated on equity participation in innovation-oriented companies. The Fund grants loans and issues guarantees only in exceptional cases. The NBVF is not authorised to accept deposits from the public or otherwise to raise loans through the issue and sale of bonds or other redeemable debt instruments to the public. It may take short-term loans only to balance its cash flow. Nor does the Fund engage in any other activities customary for credit institutions, e.g. the provision of payment transmission services.

Nevertheless, it cannot be excluded that in individual cases the competitive position of e.g. asset management companies might be affected by the operating conditions of the NBVF. In practice, however, such effects are likely to be limited and on the whole possibly beneficial, given that it is foreseen that the NBVF shall seek to encourage the participation of other operators in the capital market rather than to crowd them out. It can be said that the NBVF is essentially intended to compensate for perceived market imperfections at the riskier end of the capital market, by acting as a catalyst for mobilising also private risk capital for promising new ventures, capital that would otherwise not be forthcoming[4]. For these reasons, the NBVF is expected to be in only limited direct competition with other economic operators in the capital market.

It shall furthermore be noted that while the NBVF received a certain amount of capital for its foundation, the legislation does not provide for any regular or further financial contributions from the State to the NBVF. The NBVF is in other words designed as a revolving, self-financing fund, with main emphasis on equity investments.

It should finally be noted, concerning the NBVF's operating conditions, that having examined relevant Commission decisions from 1994 onwards, the Authority is not aware that specialised public financial institutions within the EU, entrusted with the provision of venture capital finance, have effectively been subjected to the application of State aid rules with respect to their own operating conditions and competitive conditions vis-à-vis other financial institutions.[5]

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[4] There is clear evidence that the Icelandic authorities are not alone in their perception that there can be valid grounds for public support measures to promote venture capital investments. A report issued by the OECD in 1997, "Government Venture Capital for Technology-based Firms", portrays a variety of such government initiatives in most OECD countries. The following first paragraph in the summary section of the report is indicative of its basic findings:
"Governments can stimulate the supply of venture capital by modifying fiscal and regulatory frameworks. In addition, OECD governments are implementing a number of more direct programmes to mobilise venture capital in support of small, innovative firms. These programmes aim to fill "funding gaps" that prevent small businesses, particularly technology-based firms, from obtaining sufficient capital and from producing public benefits in terms of innovation and job creation. Government venture capital schemes aim to remedy deficiencies in private capital markets, to leverage private sector financing and to nurture technology-based firms over the longer-term."
Furthermore, it can be noted that the European Commission has taken an active role in stimulating the creation of start-up capital funds, by launching in 1989 the European Seed Capital Scheme and providing capital for the establishment of some 23 Seed Capital Funds.

[5] The Authority is aware of only one case concerning venture capital schemes, where the EC Commission has opened the investigation procedure in Article 93(2) of the EC Treaty (Case C 3/98, Austria, OJ No. C 154/7, 1998). However, that case addresses dispositions from the fund concerned, but not its own operating conditions. Reference cases are otherwise limited to cases where the Commission has decided to raise no objection, which implies that the published information on the cases is relatively limited. As examples of cases of some relevance, the following can be mentioned:

- N 178/94 & N 275/97 Guarantee scheme for venture capital companies, Denmark
- N 788/96 Venture capital fund of the Land of Mecklenburg-Vorpommern, Germany
- N 935/95 Industry fund, Sweden
- N 835/96 Highland Equity Capital (Highlands & Islands, Scotland), Great Britain
- N 84/98 Start-up, Diversification and Development Fund Ardenne-Famenne, Belgium
- N 657/97 Measures in favour of new entrepreneurs (Trento), Italy
- N 285/97 Economic incentives scheme of North Rhine-Westphalia, Germany
- N 503/97 Investment facility for emerging economies, Netherlands
- N 124/97 Venture Capital Guarantee Scheme, Finland
- N 317&318/98 cf N 554/94 Participation capital for technology-oriented SMEs, Germany
- N 226/98 Guarantee funds in favour of SMEs (Molise), Italy.

In view of the above facts and considerations, the Authority considers it sufficient, for the purpose of determining to what extent the legislation on the NBVF may involve elements of State aid, to focus on the provisions of the legislation concerning the foreseen disposition by the NBVF and its individual departments of the funds invested in it by the State Treasury. However, this conclusion is without prejudice to the Authority's position regarding the operating conditions of the Export Credit Guarantee Department, cf. section 1.6 below.

1.3 Foundation Fund

The core activities of the NVBF are organised under the Foundation Fund. The activities of the Foundation Fund are divided into two areas: (i) investment activity, and (ii) grants for feasibility studies, development and promotional projects. The investment activity, in turn, falls into two categories: venture capital equity investments on the one hand and portfolio investment in market securities on the other.

The question whether and to what extent investments by the Foundation Fund may involve State aid is to be assessed in the light of the guidelines on public authorities' holdings set out in Chapter 19 of the Authority's State Aid Guidelines. This implies that the expected disposition of the funds is to be compared against the benchmark of the market economy investor principle, which is further developed in Chapter 20 of the same Guidelines. The essence of these rules is that where a public authority provides equity finance to a company under conditions that would be acceptable to an investor operating under normal market economy conditions, the transaction does not involve State aid within the meaning of Article 61(1) of the EEA Agreement. When, on the other hand, this is not the case, the aid must be assessed as the difference between the terms on which the funds were made available by the public authority and the terms which a private investor would find acceptable in providing funds to a comparable private enterprise.

In Chapter 19 of the State Aid Guidelines, paragraph 6 seeks to provide guidance on how to distinguish between the two situations. Sub-paragraph (b) of that paragraph gives *inter alia* the following indicative examples of circumstances that are likely to be acceptable to a private investor and not to involve State aid: (i) where an increase in the public holding in a company is proportionate to the number of shares held by the authorities and goes together with the injection of capital by a private investor, whose holding in the company has real economic significance; (ii) even where injection of new public capital into a company is more than proportionate to contributions of private shareholders and thus leads to relative disengagement of private shareholders or where it implies that the amount of holdings exceeds the company's real value, this can be taken as not to involve State aid, provided that the company concerned is an SME whose prospects are such as to warrant the public holding; (iii) where the recipient company has a particular development potential and innovative capacity, the transaction may be regarded as an investment involving a special risk but likely to pay off ultimately.

On the other hand, sub-paragraph (c) gives *inter alia* the following examples of circumstances that would not be acceptable to a private investor: (i) where the financial performance of the company is such that a normal return (in dividends and capital gains) on the capital invested cannot be expected within a reasonable time; (ii) where the company would be unable to raise the funds needed for an investment programme on the capital market; (iii) where the public authorities' holding involves the taking over or the continuation of all or part of the non-viable operations of an ailing company through the formation of a new legal entity; (iv) where the injection of new public capital into a company is disproportionate to private contributions and leads to relative disengagement of private shareholders or where it implies that the amount of holdings will exceed the company's real value.

When it is possible, it is customary to assess whether or not equity investments and other risk financing by public funds involve elements of State aid by examining the past performance of such funds. However, as the NBVF is a new establishment and does not have any substantial track record, such an approach is not possible in the present case. Instead, the assessment has to be based on examining the intended investment policy of the NBVF, as provided for in the legislation.

1.3.1 General limitations

It is recalled that according to the legislation, the management of the NBVF is not authorised to take decisions which imply that the founding capital of the Foundation Fund is diminished. The management is also under an obligation to seek any and all ways of ensuring the most favourable return on the capital of the Foundation Fund and thus to maximise the funds at its disposal each year. The NBVF is obliged to maintain a reserve account for share/loan losses in accordance with good accounting practice and risk assessment. Each time when the NBVF decides to make investments in share capital or to provide loans or guarantees, a decision on the respective provisions for losses shall be taken concurrently. The Fund’s annual financial plan shall be devised so as to secure that the founding capital is not diminished. The Fund is not authorised to make investments the provisions in respect of which cannot be accommodated within the annual financial plan.

1.3.2 Portfolio investments

As for portfolio investments, the NBVF is only authorised to invest in transferable securities registered on organised securities markets.

The structure of and rationale behind the Foundation Fund is such that it will in the long run only be able to perform its basic role of providing venture capital to promising start-ups and grants for development projects to the extent it succeeds in securing a favourable return on the founding capital. Considering this fact and in view of the limitations cited above, there is no reason to doubt that with respect to portfolio investments, the conduct of the NBVF will correspond to that of a rational market economy investor, i.e. seek to maximise return on investments.

1.3.3 Venture capital investments

As for the Foundation Fund's equity participation in investment projects, it can firstly be noted that according to Article 3 of the Regulation, the NBVF is entrusted with handling the provision of risk capital in fields where the supply of such capital is considered inadequate. The question could be raised whether this implies an intention, on the part of the Fund, to provide financing under circumstances which would not be considered acceptable to a private market investor. However, as has been stated above, the objective with the establishment of the NBVF is obviously not to crowd out private capital, but on the contrary the public capital is expected to serve as a catalyst for mobilising private capital. Furthermore, it is noted that the market economy investor principle and the guidelines on public authorities' holdings (cf. paragraph 19(6) of the State Aid Guidelines) acknowledge that whereas minority holdings in companies are typically characterised by short-term and speculative motives, investors holding a significant portion of shares, able and intending to exercise influence over the management of the company, can have a more long-term and strategic perspective. This applies equally to private and public investors. In other words, the State's right to pursue long-term and strategic investment objectives must, according to the State Aid Guidelines, be acknowledged.

At any rate what matters is that the public investor, in line with the behaviour of a market economy investor, should only decide to make funds available when the expected return fully reflects the risk. In other words, high risk investment can be justified and need not involve aid, if the expected return on investment is correspondingly high.

In addition to the general constraints referred to above, the legislation on the NBVF contains several provisions aimed at further limiting the risk exposure of the Foundation Fund with regard to its venture capital investments, and to secure the Fund a return on such investments commensurate with the risk it takes. The following points can in particular be cited:

- The NBVF is not authorised to devote more than 4% of the equity of the Foundation Fund to the financing of any individual project, and not more than 8% for projects under the responsibility of one party or related parties.
- The financing share of the Fund for each project shall, as a general rule, not exceed 49% of total financing for the project in question. The Fund’s participation shall, on the other hand, be such as to secure it management influence. According to the Icelandic authorities, this can in practice be taken to imply that the Fund aims generally to purchase shares in the region of 25-35% in the companies which it enters.
- The general conditions for the Fund’s participation in an investment project are otherwise that: (i) the investment can be expected to give an acceptable return, taking account of the risk, and cover the Fund’s costs; (ii) the partners in the project have the necessary financial means, technical and managerial expertise and business connections; (iii) the investment project is well defined, its overall financing is secured and a detailed business plan has been made, which allows assessment of the risks involved.
- According to Article 15 of the regulation, the NBVF is not authorised to grant companies rescue and restructuring aid, as defined in the EFTA Surveillance Authority’s State Aid Guidelines, except when such aid complies with the provisions of the Guidelines.

In the Authority's opinion, the above provision in Article 15 of the regulation on the NBVF represents a clear undertaking by the Icelandic authorities to respect the Authority's guidelines on rescue and restructuring aid. Those guidelines allow for the possibility of approving aid schemes for rescuing or restructuring small and medium-sized enterprises, but otherwise rescue and restructuring aid must be notified to the Authority on a case-by-case basis. The schemes operated by the NBVF are, however, not designed as rescue and restructuring aid and do not comply with the Authority's guidelines on such aid. It follows that the commitment to respect the Authority's guidelines on aid for rescue and restructuring firms in difficulty (Chapter 16 of State Aid Guidelines) requires that any measures falling within the scope of those guidelines (cf. section 16.2 of the State Aid Guidelines) must be notified in advance to the EFTA Surveillance Authority and cannot be put into effect until the procedure before the Authority has resulted in a final decision (cf. Article 1(3) of Protocol 3 to the Surveillance and Court Agreement).

The regulation on the NBVF has also a number of monitoring provisions, which are of some relevance in this context. Thus, it provides that in agreements with recipients of financing from the Fund (shareholder, loan or grant agreements), express provision shall be made entitling the NBVF to supervise the utilisation of financing contributed by the Fund. Shareholder and loan agreements shall provide for the right of the Fund to influence decision making in proportion to its contribution. The NBVF shall use its voting rights as a shareholder to secure the financial interests of the Fund. Provisions may be made in shareholder and loan agreements for preferential payment of interest or dividends to the NBVF exceeding that of other partners in the project. This is an indication that as a shareholder (or lender) the NBVF can be expected to make no less stringent requirements on return on its investments than other partners to a project. Finally, the activities of the NBVF shall be subject to the supervision of the Bank Inspectorate of the Central Bank of Iceland, which shall ensure that the law and regulation on the Fund as well as other relevant rules are complied with.

The various limitations to be respected by the NBVF’s management must be regarded as being indicative of the State’s intention that the Fund shall follow a prudent investment policy. As has been stated above, the actual performance of the NBVF's investments is subject to a certain degree of uncertainty, particularly as there is no track record to rely on for assessing its investment behaviour. The conclusion here is therefore subject to the uncertainty of an ex-ante analysis. However, considering the various restrictions in the legislation aimed at limiting the NBVF's risk exposure, both the general limits for the Fund and the specific limits on its venture capital investments, the Authority does not have grounds to expect that the investments of the NBVF will involve elements of State aid.

In reaching the above conclusion, the Authority has also taken due account of the fact that SMEs, even those having a good development potential, tend to face special difficulties in raising finance on private capital markets, as has been recognised both in the Authority's State Aid Guidelines (cf. para. 6(b) of Chapter 19 reviewed above) and in the decision practice of the EC Commission. Companies possessing a particular innovative capacity have also been accorded favourable treatment. The NBVF aims specifically at financing innovation-oriented investment projects. The Fund's activity is not explicitly restricted to SMEs. However, considering the industrial structure in Iceland[6] and given the fact that the venture capital investments by the NBVF will for instance not be directed to companies listed on the stock-market, it is clear that the beneficiaries of its financing will predominantly be SMEs. Furthermore, the Authority has taken note that the Fund will focus on injecting not only equity capital but also financial and managerial skills into the companies concerned, such expertise being typically of great importance for the development prospects of SMEs.

As has been mentioned above, the Foundation Fund is authorised, in cases where it is not considered possible to participate in a project by means of equity capital, to grant special loans, e.g. loans convertible to shares. The Fund is also authorised in special circumstances to grant guarantees aimed at encouraging financial participation by other parties. A premium shall be charged for such guarantees corresponding to the risk in each case. The granting of such loans and guarantees is also subject to similar limits on risk exposures as those applicable to venture capital investments, which have been reviewed above. On this basis, the same presumption can be made with respect to loans and guarantees as for investments, that they are expected not to involve elements of State aid.

1.3.4 Feasibility studies, product development and promotional projects

The NBVF is authorised to use up to 15% of the disposable funds of the Foundation Fund each year for grants to support preliminary investigations, and developmental and promotional projects. Such projects can include applied research and development, market research, promotion of investment opportunities, feasibility studies and preparation of business plans.

According to Article 10(1) of the NBVF Regulation, the Fund's authorisation to provide grants in support of projects of the above kind is subject to the limitation that grants to individual parties may not exceed, over any three-year period, an amount equivalent to ECU 100.000, including the amounts of any other financial assistance which the party in question may have received from other public sources on the basis of the *de minimis* rule, cf. the EFTA Surveillance Authority's State Aid Guidelines. The granting of such *de minimis* aid is furthermore made subject to other limits relevant for *de mini*mis aid. However, Article 10(2) provides that under special circumstances, the NBVF may offer grants to the above mentioned projects in excess of the *de minimis* limits, provided that such aid complies with the provisions of the Authority's State Aid Guidelines on aid to small and medium-sized enterprises, aid for research and development or other types of aid, as applicable in the individual instances.

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[6] According to information from the National Economic Institute, the size-distribution of enterprises in Iceland, excluding agriculture, fisheries and the public sector (i.e. sectors largely not covered by Article 61 EEA), was such in 1996 that in terms of number of enterprises, 99,4% had employment of below 60 man-years. When counted in terms of share of employment, 62,2% of total employment in the same sectors is accounted for by enterprises below the size of 60 man-years. Statistics for the share of companies with up to 250 employees (cf. the SME definition in section 10.2 of the State Aid Guidelines) are not available.

Save for their low amount, grants from the Foundation Fund represent State aid. What needs to be assessed is to what extent they remain within the confines of *de minimis* aid, and, to the extent that this is not the case, whether they qualify for an exemption.

According to point 12.1.(6) of the State Aid Guidelines, the *de minimis* rule does not apply to the steel industry covered by the ECSC Treaty nor to the shipbuilding or transport sectors[7]. In the notification, the Icelandic authorities have made clear their undertaking to respect this sectoral limitation. The Authority notes that this undertaking necessarily implies that any grants to the sectors not covered by the *de minimis* rule are subject to prior notification and approval by the EFTA Surveillance Authority on a case-by-case basis.

Taking into account the above observation concerning excluded sectors, the formulation in Article 10(1) of the NBVF Regulation is found to be in conformity with the *de minimis* rule in the Authority's State Aid Guidelines.

The compatibility with the EEA Agreement of the aid, which the NBVF is, according to Article 10(2), authorised to grant beyond the limits of the *de minimis* rule will be considered in section 3 below.

1.4 Initiative Fund

The Initiative Fund shall supervise and monitor the disposition of ISK 1.000 million to be received from the Treasury through its sale of shares in the Icelandic Investment Bank Ltd. This capital shall be used to purchase shares for the purpose of encouraging innovation and industrial development, with emphasis on regions outside the capital, in particular in the area of information technology and high technology industry.

Up to four operators (asset management companies) are to be entrusted with the custody and disposition of the capital of the Initiative Fund, through contracts based on tenders. An operator shall be required to make a complementary contribution which as a rule shall amount to at least 30% of the total investment. An operator is entitled to a share of the profits on investments. The proportion of the complementary contribution and the profit share are elements which operators are required to specify in their bids for contracts with the Initiative Fund.

The Initiative Fund will only have a temporary existence, as Article 7 of the NBVF act provides that the units tendered shall be deinvested after 7-10 years and the proceeds shall be transferred to the Treasury.

The considerations relevant for assessing whether or not investments through the Initiative Fund may involve elements of State aid are much the same as those relevant for investments by the Foundation Fund. Just like the Foundation Fund, the Initiative

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[7] It shall be noted that according to Council Regulation (EC) No 1540/98 establishing new rules on aid to shipbuilding, the *de minimis* rule will become applicable to the shipbuilding sector, cf. Article 10(2)(b) of that Regulation. Provided that the same provisions will be included in the EEA Agreement, the *de minimis* rule will become applicable to the shipbuilding sector also in the EEA context.

Fund is a new fund, without any track record to rely on. The Rules concerning the Initiative Fund provide that operators who have concluded a new business venture contract with the Initiative Fund, for management of its units, shall in their investment decisions be subject to a number of conditions and limitations. These conditions relate both to investments in new business ventures and to portfolio investments. Although somewhat less detailed, they are similar in nature to corresponding provisions concerning investments by the Foundation Fund. Their aim is to limit the investor's risk exposure. As far as investment activity is concerned, what mainly distinguishes the Initiative Fund from the Foundation Fund is that in the former case, disposition of the funds will take place through a competitive tendering procedure, where, given that any gains will be split between operators and the NBVF (and ultimately the State Treasury), the operators have a clear incentive to maximise return on investments. It can in fact be said that in this area of activity, the NBVF will be operating as a capital investor in venture capital companies. In view of these considerations, it is concluded that the Authority does not have reasons to expect that investments through the Initiative Fund will involve elements of State aid. The same caveat applies, however, relating to the uncertainty of an ex-ante analysis.

1.5 Product Development and Marketing Department

This department received for its start-up the equity of a corresponding department operated within the Industrial Loan Fund.[8] The Department shall make contributions to support product development and marketing projects. Contributions shall be in the form of non-repayable grants, which may amount to up to 50% of the eligible costs of each project, but may not, however, exceed ISK 3 million (approx. ECU 36.600) for each project.

Eligible costs for product development projects include expenses incurred through preliminary investigations, needs analysis, design, construction of prototypes, testing and adaptation of production.

Eligible costs for marketing actions include costs of market research, preparation of marketing plans, visits to the market, preparation of promotional material and participation in exhibitions. Action intended to strengthen the position of domestic producers competing with foreign parties in the Icelandic market are also eligible for support. Support for marketing actions is not granted for fixed costs of operating sales offices or for payment of salaries arising directly from general sales activities.

The Department can make contributions to organisations or institutions for actions to encourage development and advancement in production, in particular to increase productivity in industry. Applications for such grants are subject to the same evaluation criteria as applications from individual companies

Grants from the Product Development and Marketing Department have the character of State aid. However, as a main rule, the grants shall be subject to the limits of *de minimis* aid. Article 9 of the Rules for the Department provides a formulation of this limitation, which is practically identical to the one applicable to grants from the

[8] The Product Development and Marketing Department of the Industrial Loan Fund was registered with the Authority as existing aid scheme No. 93-278, predating the entry into force of the EEA Agreement.

Foundation Fund, cf. Article 10 of the Regulation on the NBVF, which has been reviewed above. As in the case of the Foundation Fund, this implies *inter alia* that the Icelandic authorities have undertaken to respect the requirement that any grant to be awarded in favour of sectors not covered by the *de minimis* rule is subject to prior notification and approval by the EFTA Surveillance Authority. The formulation is therefore in line with the *de minimis* rule, as set out in the Authority's State Aid Guidelines.

According to the Rules for the Department, there can be two exceptions from the above main rule. Firstly, grants for projects undertaken by organisations and institutions are not explicitly subject to the *de minimis* rule. Secondly, under special circumstances grants to individual parties may exceed *de minimis* limits, provided they comply with the relevant provisions of the State Aid Guidelines on aid for small and medium-sized enterprises, aid for research and development, or other types of aid, as applicable in the individual cases. The compatibility of this aid with the EEA Agreement will be considered in section 3 below.

1.6 Export Credit Guarantee Department

This Department took over the activities of a corresponding department previously operated by the Industrial Loan Fund. Its finances and accounts are separate from those of the NBVF. Operations began on 1 January 1998, on the basis of the same rules as were applied for this activity under the Industrial Loan Fund, given that no new rules have yet been adopted for this purpose.

In the notification the Icelandic authorities refer to the fact that the European Commission had recently adopted a communication on short-term export-credit insurance. With reference to informal consultations with the EFTA Surveillance Authority, they also requested that issues concerning this Department be examined at a later stage.

On 4 March 1998, the EFTA Surveillance Authority adopted guidelines, corresponding to the Commission communication referred to above, on the application of State aid rules to short-term export-credit insurance. The guidelines included a proposal of appropriate measures to the EFTA States to take all actions which might be required to eliminate distortions of competition in currently existing systems of short-term export-credit insurance. The EFTA States were requested to inform the Authority, by 1 January 1999 at the latest, of the action which they have taken to comply with the recommendation. By letter from the Ministry of Finance of 26 August 1998, the Icelandic authorities signified their agreement to the proposed appropriate measures and announced that they would in due course inform the Authority of the action taken to comply with the recommendation.

The activities of the Department are operated under the same rules as previously used by the Industrial Loan Fund, which in turn had predated the entry into force of the EEA Agreement. Any possible aid involved would therefore qualify as existing aid. In view of this fact and the circumstances reviewed above, the activities of the Department will be considered separately and will not form part of the subject matter of the current decision.

2. Procedural obligations

Article 1(3) of Protocol 3 to the Surveillance and Court Agreement provides that the EFTA States are obliged to notify to the Authority any plans to grant or alter aid in sufficient time to allow the Authority to decide on the case, and not to put the proposed measures into effect until the Authority has taken a decision on the case. According to provisions on time limits in Part II of the Authority's State Aid Guidelines, which in turn are based on established case law, "sufficient time" in this context means two months as from the date when the Authority has received a complete notification.

As has been concluded above, although the legislative provisions stipulate the main rule that grants, both from the Foundation Fund and the Product Development and Marketing Department, shall remain within the limits of *de minimis* aid, they nevertheless allow for the possibility of offering grants beyond those limits. The NBVF is in other words authorised to provide grants falling within the obligation to notify the Authority in advance of plans to grant new aid and to await its approval before the measures are put into effect. Given the nature of the Fund's other activities, in particular its venture capital investments, it must also be considered prudent that the Icelandic authorities notified the legislation in its totality.

The Icelandic authorities informally consulted the Authority during their preparation of the legislation. However, the measures were first formally notified by letter from the Ministry of Industry and Commerce of 30 December 1997, received and registered by the Authority on 5 January 1998. Supplementary documents were transmitted by letter from the same ministry dated 10 March 1998, received and registered on 16 March 1998. The New Business Venture Fund began operations on 1 January 1998.

In view of the above facts, it must be concluded that the notification was submitted late and the Icelandic authorities thus failed to fully respect the above procedural obligations. Under such circumstances the Authority is not bound by the usual two-month time limit to decide on notified new aid.

3. Application of the relevant State aid rules

As was noted above, the regulation on the NBVF authorises the Foundation Fund, in exceptional cases, to provide grants in excess of the limits of *de minimis* aid. Similarly, the rules governing the Product Development and Marketing Department foresee that grants from the Department can exceptionally exceed *de minimis* limits.

Concerning both these items the legislation does not specify in full detail all relevant limitations according to the relevant State aid rules, such as those on eligible costs and aid intensity. However, in both cases, the legislation provides for an explicit undertaking by the Icelandic authorities to respect the relevant State aid rules concerning aid to small and medium-sized enterprises, aid for research and development or other types of aid, as appropriate in the individual cases.

The Authority notes that this undertaking implies *inter alia* the following:

- Grants for promotional projects falling outside the scope of research and development, as defined in section 14.2.1. of the State Aid Guidelines, but meeting the definition of "consultancy services, training and dissemination of knowledge" ("soft aid") in section 10.3.2.3 of the Guidelines or of other admissible activities in the same chapter, are subject to the condition that the beneficiaries can only be small and medium-sized enterprises (SMEs) as defined in section 10.2 of the State Aid Guidelines. Such measures must neither cover aid to finance investments nor continuous or periodic aid not acting as an incentive but relating only to the enterprise's usual operating expenditure (routine tax consultancy services, regular legal services, advertising, etc.) (operating aid).

- Grants for research and development must in particular respect the rules on aid intensity and eligible costs in sections 14.5 and 14.6 of the State Aid Guidelines, which imply *inter alia* that when the beneficiaries are non-SMEs outside areas qualifying for regional aid, aid for precompetitive development activities must not exceed 25% of the eligible costs.

Given the expectation that grants above the *de minimis* limit will truly be exceptional and the undertaking by the Icelandic authorities to respect the relevant State aid rules, the Authority considers that the formulation in the legislation on the NBVF, although not ideal, can be accepted as being compatible with the exemption in Article 61(3)(c) of the EEA Agreement, as aid to facilitate the development of certain economic activities which does not adversely affect trading conditions to an extent contrary to the common interest. This conclusion is without prejudice to the Authority's obligation to keep this system of aid under constant review, cf. Article 1(1) of Protocol 3 to the Surveillance and Court Agreement.

4. Reporting

4.1 Investments, loans and guarantees

As has been concluded above, the Authority considers, on the basis of presently available information, that investments by the NBVF as well as loans and guarantees granted by it will not involve State aid. It was noted, however, that this assessment is subject to a certain degree of uncertainty. In case such investments were in individual cases to contain elements of State aid, the possibility that the aid might benefit from an exemption could depend on several factors, e.g. on whether or not the beneficiary is an SME and whether or not the beneficiary is located in an area qualifying for regional aid (assisted area). As a main rule, non-SMEs located outside assisted areas are not eligible for investment aid. Furthermore, in order to benefit from an exemption as investment aid, the equity finance must be linked to investments in tangible or non-tangible assets by the recipient company.

In view of the above circumstances, and with reference to the reporting obligations outlined in Chapter 19 of the State Aid Guidelines, the Authority finds it appropriate to request the Icelandic authorities to submit an annual report on participation by the NBVF in venture capital investment projects. Besides a general overview of the

Fund's venture capital investments, loans and guarantees, the report shall include a list of investments and current holdings in non-SMEs.

4.2 Grants

In view of the brevity of the provisions in the NBVF legislation concerning grants, it is appropriate to request the Icelandic authorities to include in their annual report on the NBVF a list of all grants exceeding *de minimis* limits.

HAS ADOPTED THIS DECISION:

1. Without prejudice to its position on the provisions relating to the Export Credit Guarantee Department, which the Authority will consider separately at a later stage, and its obligation to keep under constant review all systems of aid, cf. Article 1(1) of Protocol 3 to the Surveillance and Court Agreement, the EFTA Surveillance Authority has decided not to raise objections to the legislation on the New Business Venture Fund, as notified by the Icelandic authorities by letter from the Ministry of Industry and Commerce dated 30 December 1997 and 10 March 1998.
2. With reference to Chapter 19 and 32 of the State Aid Guidelines, the Icelandic authorities are requested to submit an annual report on the activities of the NBVF. This report shall include a copy of the Fund's annual report, and, in so far as they are not specified therein, also the following details:
   - general overview of the NBVF's venture capital investments, loans and guarantees (including information on the return on such investments) and a list of investments and current holdings in non-SMEs, specifying in each case the name of the company concerned, the amount of the holding, capital of the company before the holding was acquired, industry in which the company operates and the number of employees.
   - general overview of grants awarded and a list of all grants exceeding *de minimis* limits, specifying the names of recipients, the amount of the grant in each case as well as the purpose, main cost categories and total costs of the projects which they are intended to finance.

Done at Brussels, 16 December 1998

For the EFTA Surveillance Authority

Knut Almestad
President

Hannes Hafstein
College Member