

PART III: HORIZONTAL RULES

State aid to promote risk finance investments¹

*CONSOLIDATED VERSION**

1. INTRODUCTION

- (1) On the basis of Article 61(3)(c) of the European Economic Area Agreement (“EEA Agreement”), the EFTA Surveillance Authority (“the Authority”) may consider compatible with the EEA Agreement State aid designed to facilitate the development of certain economic activities, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. For the reasons set out in these Guidelines, the Authority takes the view that the development of the risk finance market and the improvement of access to risk finance for small and medium-sized enterprises (SMEs), small mid-cap and innovative mid-cap is of great importance to the EFTA States’ economy at large.
- (2) Encouraging the development and expansion of new businesses, especially innovative and high-growth businesses, can have a great potential to create jobs. Therefore, an efficient risk finance market for SMEs is crucial for entrepreneurial companies to be able to access the necessary funding at each stage of their development.
- (3) Despite their growth prospects, SMEs may face difficulties in gaining access to finance, particularly in the early stages of their development. At the heart of those difficulties lies a problem of asymmetric information: SMEs, especially when they are young, are often unable to demonstrate their credit-worthiness or the soundness of their business plans to investors. In such circumstances, the type of active screening that is undertaken by investors for providing finance to larger companies may not be worth the investment in the case of transactions involving those SMEs because the screening costs are too high relative to the value of the investment. Therefore, irrespective of the quality of their project and growth potential, those SMEs are likely not to be able to access the necessary finance as long as they lack a proven track record and sufficient collateral. As a result of this asymmetric information, business finance markets may fail to provide the necessary equity or debt finance to newly created and potentially high-growth SMEs resulting in a persistent capital market failure preventing supply from meeting demand at a price acceptable to both sides,

**Consolidated version including amendments introduced by Decision 302/14/COL (see paragraphs 166 and 172) and by Decision 090/20/COL (see paragraph 174). The amendments are shown in italicized text. This document is meant purely as a documentation tool and the Authority does not assume any liability for its contents. It is without prejudice to the official text as published in the Official Journal.*

¹ These Guidelines correspond to the Commission Guidelines on State aid to promote risk finance investments (OJ C 1, 22.1.2014, p. 4).

which negatively affects SMEs' growth prospects. Small mid-caps and innovative mid-caps may, in certain circumstances, face the same market failure.

- (4) The consequences of a company not receiving finance may well go beyond that individual entity, due in particular to *growth externalities*. Many successful sectors witness productivity growth not because companies present in the market gain in productivity, but because the more efficient and techno-logically advanced companies grow at the expense of the less efficient ones (or ones with obsolete products). To the extent that this process is disturbed by potentially successful companies not being able to obtain finance, the wider consequences for productivity growth are likely to be negative. Allowing a wider base of companies to enter the market may then spur growth.
- (5) Therefore, the existence of a financing gap affecting SMEs, small mid-caps and innovative mid-caps may justify public support measures including through the grant of State aid in certain specific circumstances. If properly targeted, State aid to support the provision of risk finance to those companies can be an effective means to alleviate the identified market failures and to leverage private capital.
- (6) Access to finance for SMEs is an objective of EEA common interest. At EU and EEA level several initiatives have been adopted to support the development of SMEs. One of the main objectives is to facilitate access to finance for SMEs.
- (7) Within this policy context, the Commission 2011 Action plan to improve access to finance for SMEs² and the debate launched in 2013 by the Green Paper on Long-term finance for the European economy,³ recognises that the Union's success depends largely on the growth of SMEs, which however often face significant difficulties in obtaining financing. The Authority acknowledges these conclusions. The objective is therefore to make SMEs more visible and to make financial markets more attractive and accessible for SMEs.
- (8) Most recently, two initiatives relevant to investments funds were taken⁴: the Regulation on venture capital funds in Europe⁵ adopted in 2013, which enables venture capital funds to market their funds and raise capital across the internal market, and the proposal for a regulation on European Long-term Investment Funds⁶, which aims at introducing framework conditions to facilitate the operation of private investment funds that have a long-term commitment from their investors.

² Communication from the Commission, An action plan to improve access to finance for SMEs, COM(2011) 870 final, 7.12.2011.

³ COM(2013) 150 final, 25.3.2013.

⁴ Regulations with EEA relevance.

⁵ Regulation (EU) No 345/2013 of the European Parliament and the Council of 17 April 2013 on European venture capital funds (OJ L 115, 25.4.2013, p. 1). Regulation to be incorporated into the EEA Agreement.

⁶ Proposal for a Regulation of the European Parliament and of the Council on Long-term Investment Funds, COM(2013) 462 final, 2013/0214 (COD).

- (9) Beyond these specific regulations, the regulatory framework for the management and operation of investment funds active in risk finance, such as private equity funds, is provided by the Directive on Alternative Investment Fund Managers (AIFMD).⁷
- (10) In 2012, the Commission launched a public consultation⁸ to gather information on the extent of the market failure affecting access to debt and equity financing by SMEs and on the adequacy of the 2006 Risk Capital Guidelines.⁹ The outcome of the public consultation revealed that the basic principles enshrined in those guidelines have provided a sound basis for channelling public resources to the intended target SMEs while limiting risks of crowding out. However, the public consultation also showed that the Risk Capital Guidelines were often considered to be too restrictive in terms of eligible SMEs, forms of financing, aid instruments and funding structures.
- (11) The Authority shares these conclusions that can also be applied *mutatis mutandis* to the Authority's State aid Guidelines to promote risk capital investments in small and medium-sized enterprises.¹⁰
- (12) In the Communication on State aid modernisation,¹¹ the Commission set out an ambitious State aid modernisation programme based on three main objectives:
 - a. fostering sustainable, smart and inclusive growth in a competitive internal market;
 - b. focusing the Commission's *ex ante* scrutiny on cases with the biggest impact on the internal market while strengthening the cooperation with Member States in State aid enforcement; and
 - c. streamlining the rules to ensure faster decision-making.
- (13) The Authority has followed the Commission's modernisation initiative. As a consequence, the compatibility conditions set out in these Guidelines are based on those common objectives.
- (14) In the light of the foregoing, it has been deemed appropriate to substantially review the State aid regime applicable to risk capital measures, including those covered by the General Block Exemption Regulation,¹² so as to promote a more efficient and

⁷ Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1). Directive to be incorporated into the EEA Agreement.

⁸ The questionnaire was published online : (http://ec.europa.eu/competition/consultations/2012_risk_capital/questionnaire_en.pdf).

⁹ Community Guidelines on State aid to promote risk capital investments in small and medium-sized enterprises (OJ C 194, 18.8.2006, p. 2).

¹⁰ State aid to promote risk capital investments in small and medium-sized enterprises (OJ C 126, 7.6.2007, p. 19 and EEA Supplement No 27, 7.6.2007, p. 1), as amended by Decision No 484/10/COL of 15.12.2010.

¹¹ Communication on EU State Aid Modernisation (SAM), COM(2012) 209 final, 8.5.2012.

¹² Commission Regulation (EC) No 800/2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (OJ L 214, 9.8.2008, p. 3), currently under review, as amended by the Commission Regulation (EU) No 1224/2013 of 29 November 2013 amending Regulation (EC) No 800/2008 as regards its period of application (OJ L 320, 30.11.2013, p. 22), incorporated as point 1 j into Annex XV of the EEA Agreement by Joint

effective provision of various forms of risk finance to a larger category of eligible undertakings. For block-exempted measures, no notification to the Authority is necessary because they are presumed to address a market failure through appropriate and proportionate means, while having an incentive effect and limiting any distortions of competition to the minimum.

2. SCOPE OF THE GUIDELINES AND DEFINITIONS

- (15) The Authority will apply the principles set out in these Guidelines to risk finance measures which do not satisfy all the conditions laid down in the General Block Exemption Regulation. The EFTA State concerned must notify those measures in accordance with Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement and the Authority will carry out a substantive compatibility assessment as set out in Section 3 of these Guidelines.
- (16) However, EFTA States may also choose to design risk finance measures in such a way that the measures do not entail State aid under Article 61(1) of the EEA Agreement, for instance because they comply with the market economy operator test or because they fulfil the conditions of the applicable *de minimis* Regulation.¹³ Such cases do not need to be notified to the Authority.
- (17) Nothing in these Guidelines should be taken to call into question the compatibility of State aid measures which meet the criteria laid down in any other guidelines, frameworks or regulations. The Authority will pay particular attention to the need to prevent the use of these Guidelines to pursue policy objectives which are addressed principally by other frameworks, guidelines and regulations.
- (18) These Guidelines are without prejudice to other types of financial instruments than those covered herein, such as instruments providing for the securitisation of existing loans, whose assessment shall be carried out under the relevant State aid legal basis.
- (19) The Authority will only apply the principles set out in these Guidelines to risk finance schemes. They will not be applied in respect of *ad hoc* measures providing risk finance aid to individual undertakings, except in the case of measures aiming at supporting a specific alternative trading platform.
- (20) It is important to recall that risk finance aid measures have to be deployed through financial intermediaries or alternative trade platforms, except for fiscal incentives on direct investments in eligible undertakings. Therefore, a measure whereby the EFTA State or a public entity makes direct investments in companies without the involvement of such intermediary vehicles does not fall under the scope of the risk finance State aid rules of the General Block Exemption Regulation and these Guidelines.

Committee Decision No 29/2014 of 14.2.2014 (not yet published in the OJ or EEA Supplement), e.i.f 15.2.2014.

¹³ Commission Regulation (EU) No 1407/2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid (OJ L 352, 24.12.2013, p. 1). Regulation to be incorporated into the EEA Agreement.

- (21) In the light of their more established track record and higher collateralisation, the Authority does not consider that there is a general market failure related to access to finance by large undertakings. Exceptionally, a risk finance measure may be targeted at small mid-caps, in accordance with Section 3.3.1(a), or innovative mid-caps that carry out R&D and innovation projects in accordance with Section 3.3.1(b).
- (22) Companies listed on the official list of a stock exchange or a regulated market cannot be supported through risk finance aid, since the fact that they are listed demonstrates their ability to attract private financing.
- (23) Risk finance aid measures in the total absence of private investors will not be declared compatible with the EEA Agreement. In such cases, the EFTA State must consider alternative policy options which may be more appropriate to achieve the same objectives and results, such as regional investment aid or start-up aid provided for by the General Block Exemption Regulation.
- (24) Risk finance aid measures where no appreciable risk is undertaken by the private investors, and/or where the benefits flow entirely to the private investors, will not be declared compatible. Sharing the risks and rewards is a necessary condition to limit the financial exposure of, and to ensure a fair return to, the State.
- (25) Without prejudice to risk finance aid in the form of replacement capital as defined by the General Block Exemption Regulation, risk finance aid may not be used to support buyouts.
- (26) Risk finance aid will not be considered compatible with the EEA Agreement if awarded to:
 - (a) undertakings in difficulty, as defined by the Authority Guidelines on State aid for rescuing and restructuring firms in difficulty,¹⁴ as amended or replaced; however, for the purposes of the present Guidelines, SMEs within 7 years from their first commercial sale that qualify for risk finance investments following due diligence by the selected financial intermediary will not be considered as undertakings in difficulty, unless they are subject to insolvency proceedings or fulfil the criteria under their domestic law for being placed in collective insolvency proceedings at the request of their creditors;
 - (b) undertakings that have received illegal State aid which has not been fully recovered.
- (27) The Authority will not apply these Guidelines to aid to export-related activities towards third countries or EFTA States, namely aid directly linked to the quantities exported, the establishment and operation of a distribution network or to other current costs linked to the export activity, as well as aid contingent upon the use of domestic over imported goods.

¹⁴ OJ L 97, 15.4.2005 and EEA Supplement No. 18, 15.4.2005, p. 1. Those Guidelines were prolonged by Decision No 438/12/COL of 28.11.2012 (OJ L 190, 11.7.2013, p. 91 and EEA Supplement No 40, 11.7.2013, p. 15).

- (28) The Authority will not apply these Guidelines to measures which entail by themselves, by the conditions attached to them or by their financing method, a non-severable violation of the law in force in the EEA,¹⁵ in particular:
- (a) measures where the aid is subject to the obligation to use nationally produced goods or national services;
 - (b) measures which violate Article 31 of the EEA Agreement on the freedom of establishment, where the aid is subject to the obligation for financial intermediaries, their managers or final beneficiaries to have or move their headquarters in the territory of the EFTA State concerned: this is without prejudice to the requirement for financial intermediaries or their managers to have the necessary licence to carry out investment and management activities in the EFTA State concerned or for final beneficiaries to have an establishment and carry out economic activities in its territory;
 - (c) measures which violate Article 40 of the EEA Agreement on the free movement of capital.

2.1 The market economy operator test

- (29) Risk finance measures often involve complex constructions creating incentives for one set of economic operators (investors) to provide risk finance to another set of operators (eligible undertakings). Depending on the design of the measure, and even if the intention of the public authorities may be only to provide benefits to the latter group, undertakings at either or both levels may benefit from State aid. Moreover, risk finance measures always involve one or more financial intermediaries which may have a status separate from that of the investors and the final beneficiaries in which investments are made. In such cases it is also necessary to consider whether the financial intermediary can be considered to benefit from State aid.
- (30) In general, a public intervention may be considered not to constitute State aid for instance because it meets the market economy operator test. According to that test, economic transactions which are carried out by public bodies or undertakings in line with normal market conditions and do not give rise to an advantage to their counterpart do not constitute State aid. Without prejudice to the ultimate prerogative of the EFTA Court of Justice to rule on the existence of aid, this section provides additional guidance on the application of the market economy operator test in the area of risk finance.

2.1.1 Aid to investors

- (31) In general, the Authority will consider an investment to be in line with the market economy operator test, and thus not to constitute State aid, if it is effected *pari passu* between public and private investors.¹⁶ An investment is considered *pari passu* when

¹⁵ See for instance Case C-156/98 *Germany v Commission* [2000] ECR I-6857, paragraph 78 and Case C-333/07 *Régie Networks v Rhone Alpes Bourgogne* [2008] ECR I-10807, paragraphs 94-116.

¹⁶ Private investors will typically include the EIF and the EIB investing at own risk and from own resources, banks investing at own risk and from own resources, private endowments and

it is made under the same terms and conditions by public and private investors, where both categories of operators intervene simultaneously and where the intervention of the private investor is of real economic significance.

- (32) A transaction is presumed to be made under the same terms and conditions if public and private investors share the same risks and rewards and hold the same level of subordination in relation to the same risk class. If the public investor is in a better position than the private investor, for instance because it receives a priority return in time compared to the private investors, the measure may also be considered to be in line with normal market conditions, as long as the private investors do not receive any advantage.
- (33) In the area of risk finance, transactions by public and private investors will be considered to be made simultaneously if the private and public investors co-invest into the final beneficiaries via the same investment transaction. In the case of investments through public-private financial intermediaries, investments by the public and private investors will be presumed to be made simultaneously.
- (34) An additional condition is that the funding provided by private investors that are independent from the companies in which they invest, is economically significant¹⁷ in the light of the overall volume of the investment. The Authority considers that, in the case of risk finance measures, 30% independent private investment can be considered economically significant.
- (35) Where the investment is in line with the market economy operator test, the Authority considers that the investee undertakings are not beneficiaries of State aid, because the investments they receive are considered to be made on market terms.
- (36) Where a measure allows private investors to carry out risk finance investments into a company or set of companies on terms more favourable than public investors investing in the same companies, then those private investors may receive an advantage (non *pari passu* investments). Such an advantage may take different forms, such as preferential returns (upside-incentive) or reduced exposure to losses in the event of underperformance of the underlying transaction compared to the public investors (downside protection).

foundations, family offices and business angels, corporate investors, insurance companies, pension funds, private individuals, and academic institutions.

¹⁷ For instance, in the Citynet Amsterdam case, the Commission considered that two private operators taking up one third of the total equity investments in a company (considering also the overall shareholding structure and that their shares are sufficient to form a blocking minority regarding any strategic decision of the company) could be considered economically significant (see Commission Decision in Case C 53/2006 Citynet Amsterdam, the Netherlands (OJ L 247, 16.9.2008, p. 27, paragraphs 96-100)). By contrast, in Case N 429/10 Agricultural Bank of Greece (ATE), (OJ C 317, 29.10.2011, p. 5), the private participation only reached 10 % of the investment, as opposed to 90 % by the State, so that the Commission concluded that *pari passu* conditions were not met, since the capital injected by the State was neither accompanied by a comparable participation of a private shareholder nor was it proportionate to the number of shares held by the State.

2.1.2 Aid to a financial intermediary and/or its manager

- (37) In general, the Authority considers that a financial intermediary is a vehicle for the transfer of aid to investors and/or enterprises in which the investment is made, rather than a beneficiary of aid in its own right, irrespective of whether the financial intermediary has legal personality or is merely a bundle of assets managed by an independent management company.
- (38) However, measures involving direct transfers to, or co-investment by, a financial intermediary may constitute aid unless such transfers or co-investments are made on terms which would be acceptable to a normal economic operator in a market economy.
- (39) Where the risk finance measure is managed by an entrusted entity, without that entity co-investing with the EFTA State, the entrusted entity is considered as a vehicle to channel the financing and not a beneficiary of aid, as long as it is not overcompensated. However, where the entrusted entity provides funding to the measure or co-invests with the EFTA State in a manner similar to financial intermediaries, the Authority will have to assess whether the entrusted entity receives State aid.
- (40) Where the manager of the financial intermediary or the management company (hereafter referred to as ‘manager’) are chosen through an open, transparent, non-discriminatory and objective selection procedure or the manager's remuneration fully reflects the current market levels in comparable situations, it will be presumed that the manager does not receive State aid.
- (41) Where the financial intermediary and its manager are public entities and were not chosen through an open, transparent, non-discriminatory and objective selection procedure, they will not be considered recipients of aid if their management fee is capped and their overall remuneration reflects normal market conditions and is linked to performance. In addition, the public financial intermediaries must be managed commercially and their managers shall take investment decisions in a profit-oriented manner at arm's-length from the State. Furthermore, the private investors must be selected through an open, transparent, non-discriminatory and objective selection process, on a deal-by-deal basis. Appropriate mechanisms must be in place to exclude any possible interference by the State in the day-to-day management of the public fund.
- (42) Where the investment by the State through the financial intermediary is in the form of loans or guarantees, including counter-guarantees, and the conditions set out in the Authority's rules on the reference rate¹⁸ or State aid granted in the form of guarantees¹⁹ are fulfilled, the financial intermediary will not be regarded as a recipient of State aid.

¹⁸ Reference and Discount Rates (OJ L 105, 21.4.2011, p. 32 and EEA Supplement No 23, 21.4.2011, p. 1).

¹⁹ State aid granted in form of guarantees (OJ L 105, 21.4.2011, p. 32 and EEA Supplement No 23, 21.4.2011, p. 1).

- (43) The fact that financial intermediaries may increase their assets and their managers may achieve a larger turnover through their commissions is considered to constitute only a secondary economic effect of the aid measure and not aid to the financial intermediaries and/or their managers. However, if the risk finance measure is designed in such a way as to channel its secondary effects towards individual financial intermediaries identified in advance, those financial intermediaries will be considered to receive indirect aid.

2.1.3 Aid to the undertakings in which the investment is made

- (44) Where aid is present at the level of the investors, the financial intermediary or its managers, the Authority will generally consider that it is at least partly passed on to the target undertaking. This is the case even where investment decisions are being taken by the managers of the financial intermediary with a purely commercial logic.
- (45) Where the loan or guarantee investments provided under a risk finance measure to the target undertakings fulfil the conditions set out in the Authority's rules on the reference rate or State aid granted in the form of guarantees, those undertakings will not be considered to be recipients of State aid.

2.2 Notifiable risk finance aid

- (46) EFTA States must notify pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement risk finance measures which constitute State aid within the meaning of Article 61(1) of the EEA Agreement (in particular if they do not comply with the market economy operator test), fall outside the scope of the *de minimis* Regulation, and do not satisfy all the conditions for risk finance aid as laid down in the General Block Exemption Regulation. The Authority will assess the compatibility of those measures with the EEA Agreement under Article 61(3)(c) of the said Agreement. These Guidelines focus on those risk finance measures which are most likely to be found compatible with Article 61(3)(c) of the EEA Agreement, subject to a number of conditions which will be explained in greater detail in Section 3 of these Guidelines. Such measures fall into the following three categories.
- (47) The first category covers risk finance measures which target undertakings that do not fulfil all the eligibility requirements provided for risk finance aid under the General Block Exemption Regulation. For these measures, the Authority will require the EFTA State to conduct an in-depth *ex ante* assessment, since the market failure affecting the eligible undertakings covered by the General Block Exemption Regulation can no longer be presumed. This category encompasses in particular the measures targeting the following undertakings:

- (a) small mid-caps that exceed the thresholds set out in the definition of SME in the General Block Exemption Regulation;²⁰
- (b) innovative mid-caps carrying out R&D and innovation activities;

²⁰ Annex I to Commission Regulation (EC) No 800/2008, see footnote No 12.

- (c) undertakings receiving the initial risk finance investment more than 7 years after their first commercial sale;
 - (d) undertakings requiring an overall risk finance investment of an amount exceeding the cap fixed in the General Block Exemption Regulation;
 - (e) alternative trading platforms not fulfilling the conditions of the General Block Exemption Regulation.
- (48) The second category consists of those measures whose design parameters differ from those set out in the General Block Exemption Regulation, while targeting the same eligible undertakings as defined therein. For those measures, the existence of a market failure needs to be proven only to the extent necessary to justify the use of parameters going beyond the limits set out in the General Block Exemption Regulation. This category encompasses in particular the following cases:
- (a) financial instruments with private investor participation below the ratios provided for in the General Block Exemption Regulation;
 - (b) financial instruments with design parameters above the ceilings provided for in the General Block Exemption Regulation;
 - (c) financial instruments other than guarantees where financial intermediaries, investors or fund managers are selected by giving preference to protection against potential losses (downside protection) over prioritised returns from profits (upside incentives);
 - (d) fiscal incentives to corporate investors, including financial intermediaries or their managers acting as co-investors.
- (49) The third category concerns large schemes which fall outside of the General Block Exemption Regulation by virtue of their large budget as defined therein. When carrying out this assessment, the Authority will verify whether the conditions laid down in the provisions for risk finance aid of the General Block Exemption Regulation are satisfied and, should this be the case, it will evaluate whether the design of the measure is appropriate in the light of the *ex ante* assessment underpinning the notification. If a large scheme does not fulfil all the eligibility and compatibility conditions set out in the above mentioned provisions, the Authority will duly consider the evidence provided in the context of the *ex ante* assessment both as regards the existence of a market failure and the appropriateness of the design of the measure. In addition, it will carry out an in-depth assessment of the potential negative effects that such schemes could have on the affected markets.
- (50) The different features described in paragraphs 47 to 49 may be combined within one risk finance measure subject to appropriate justifications underpinned by a full market failure analysis.
- (51) Apart from the derogations expressly allowed under the present Guidelines, all other compatibility conditions provided for risk finance aid under the General Block Exemption Regulation shall guide the assessment of the above mentioned categories of notifiable measures.

2.3 Definitions

(52) For the purposes of these Guidelines:

- (i) ‘alternative trading platform’ means a multilateral trading facility as defined in Article 4(1)(15) of Directive 2004/39/EC²¹ where the majority of the financial instruments admitted to trading are issued by SMEs;
- (ii) ‘arm's-length’ means that the conditions of the investment transaction between the contracting parties do not differ from those conditions which would be made between independent enterprises and contain no element of influence of the State;
- (iii) ‘buyout’ means the purchase of at least a controlling percentage of a company's equity from the current shareholders to take over its assets and operations;
- (iv) ‘eligible undertakings’ means SMEs, small mid-caps and innovative mid-caps;
- (v) ‘entrusted entity’ means the European Investment Bank, the European Investment Fund, an international financial institution in which a EFTA State is a shareholder, or a financial institution established in a EFTA State aiming at the achievement of public interest under the control of a public authority, a public law body, or a private law body with a public service mission: the entrusted entity can be selected or directly appointed in accordance with the provisions of Directive 2004/18/EC²² or any subsequent legislation replacing that Directive in full or in part;
- (vi) ‘equity investment’ means the provision of capital to an undertaking, invested directly or indirectly in return for the ownership of a corresponding share of that undertaking;
- (vii) ‘exit’ means the liquidation of holdings by a financial intermediary or investor, including trade sale, write-offs, repayment of shares/loans, sale to another financial intermediary or another investor, sale to a financial institution and sale by public offering, including an initial public offering;
- (viii) ‘fair rate of return’ means the expected internal rate of return equivalent to a risk-adjusted discount rate reflecting the level of risk of the investment and the nature and volume of the capital to be invested by the private investors;

²¹ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ L 145, 30.4.2004, p. 1). Directive incorporated as point 31ba into Annex IX (Financial Services) of the EEA Agreement by Decision of the EEA Joint Committee No 65/2005 of 29.4.2005 (OJ L 239, 15.9.2005, p. 50 and EEA Supplement No 46, 15.9.2005, p. 31).

²² Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (OJ L 134, 30.4.2004, p. 114), as corrected by Corrigendum to the Directive (OJ L 351, 26.11.2004, p. 44). Directive incorporated as point 2 into Annex XVI (Procurement) to the EEA Agreement by Decision of the EEA Joint Committee No 68/2006 of 2.6.2006 (OJ L 245, 7.9.2006, p. 22 and EEA Supplement No 44, 7.9.2006, p. 18).

- (ix) 'final beneficiary' means an eligible undertaking that has received investment under a risk finance State aid measure;
- (x) 'financial intermediary' means any financial institution, regardless of its form and ownership, including fund of funds, private investment funds, public investment funds, banks, micro- finance institutions and guarantee societies;
- (xi) 'first commercial sale' means the first sale by an undertaking on a product or service market, excluding limited sales to test the market;
- (xii) 'first loss piece' means the most junior risk tranche that carries the highest risk of losses, comprising the expected losses of the target portfolio;
- (xiii) 'follow-on investment' means additional investment in a company subsequent to one or more previous risk finance investment rounds;
- (xiv) 'guarantee' means a written commitment to assume responsibility for all or part of a third party's newly originated risk finance loan transactions such as debt or lease instruments, as well as quasi-equity instruments;
- (xv) 'guarantee cap' means the maximum exposure of a public investor expressed as a percentage of the total investments made in a guaranteed portfolio;
- (xvi) 'guarantee rate' means the percentage of loss coverage by a public investor of each and every transaction eligible under the risk finance State aid measure;
- (xvii) 'independent private investor' means a private investor who is not a shareholder of the eligible undertaking in which it invests, including business angels and financial institutions, irrespective of their ownership, to the extent that they bear the full risk in respect of their investment; upon the creation of a new company, all private investors, including the founders, are considered to be independent from that company;
- (xviii) 'innovative mid-cap' means a mid-cap whose R&D and innovation costs, as defined by the General Block Exemption Regulation, represent (a) at least 15 % of its total operating costs in at least one of the three years preceding the first investment under the risk finance State aid measure, or (b) at least 10 % per year of its total operating costs in the 3 years preceding the first investment under the risk finance State aid measure;
- (xix) 'loan instrument' means an agreement which obliges the lender to make available to the borrower an agreed amount of money for an agreed period of time and under which the borrower is obliged to repay the amount within the agreed period; it may take the form of a loan, or another funding instrument, including a lease, which provides the lender with a predominant component of minimum yield;
- (xx) 'mid-cap' for the purposes of these Guidelines means an undertaking whose number of employees does not exceed 1 500, calculated in line with Articles 3, 4 and 5 of Annex I to the General Block Exemption

Regulation; for the purpose of the application of these Guidelines, several entities shall be considered as one undertaking if any of the conditions listed in Article 3(3) of Annex I to the General Block Exemption Regulation is fulfilled; this definition is without prejudice to other definitions used for the deployment of financial instruments under EU/EEA programmes involving no State aid;

- (xxi) ‘natural person’ means a person other than a legal entity who is not an undertaking within the meaning of Article 61(1) of the EEA Agreement;
- (xxii) ‘new loan’ means a newly initiated loan instrument designed to finance new investments or working capital, to the exclusion of refinancing of existing loans;
- (xxiii) ‘replacement capital’ means the purchase of existing shares in a company from an earlier investor or shareholder;
- (xxiv) ‘risk finance investment’ means equity and quasi-equity investments, loans including leases, guarantees, or a mix thereof, to eligible undertakings;
- (xxv) ‘quasi-equity investment’ means a type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity and whose return for the holder is predominantly based on the profits or losses of the underlying target undertaking and which is unsecured in the event of default: quasi-equity investments may be structured as debt, unsecured and subordinated, including mezzanine debt, and in some cases convertible into equity, or as preferred equity;
- (xxvi) ‘small and medium-sized enterprise (SME)’ means an undertaking as defined in Annex I to the General Block Exemption Regulation;
- (xxvii) ‘small mid-cap’ means an undertaking whose number of employees does not exceed 499, calculated in accordance with Articles 3 to 5 of Annex I to the General Block Exemption Regulation, the annual turnover of which does not exceed EUR 100 million or the annual balance sheet of which does not exceed EUR 86 million; for the purpose of the application of these Guidelines, several entities shall be considered as one undertaking if any of the conditions listed in Article 3(3) of Annex I to the General Block Exemption Regulation is fulfilled; this definition is without prejudice to other definitions used for the deployment of financial instruments under EU/EEA programmes involving no State aid;
- (xxviii) ‘total financing’ means the maximum overall investment amount made into an eligible undertaking via one or more risk finance investments, including follow-on investments, under any risk finance State aid measure, to the exclusion of entirely private investments provided on market terms and outside the scope of the risk finance State aid measure;
- (xxix) ‘unlisted undertaking’ means an undertaking which is not listed on the official list of a stock exchange, except for alternative trading platforms.

3. COMPATIBILITY ASSESSMENT OF RISK FINANCE AID

3.1 Common assessment principles

- (53) To assess whether a notified aid measure can be considered compatible with the EEA Agreement, the Authority generally analyses whether the design of the aid measure ensures that the positive impact of the aid towards an objective of common interest exceeds its potential negative effects on trade between the contracting parties (“Contracting parties”) to the EEA Agreement and competition.
- (54) The Communication on State aid modernisation of 8 May 2012 called for the identification and definition of common principles applicable to the assessment of compatibility of all the aid measures. For this purpose, the Authority will consider an aid measure compatible with the EEA Agreement only if it satisfies each of the following criteria:
- a) contribution to a well-defined objective of common interest: a State aid measure must aim at an objective of common interest in accordance with Article 61(3) of the EEA Agreement (Section 3.2);
 - b) need for State intervention: a State aid measure must be targeted towards a situation where aid can bring about a material improvement that the market cannot deliver itself by remedying a market failure (Section 3.3);
 - c) appropriateness of the aid measure: the State aid measure must be an appropriate policy instrument to address the objective of common interest (Section 3.4);
 - d) incentive effect: the State aid measure must change the behaviour of the undertaking(s) concerned in such a way that it engages in additional activity which it would not carry out without the aid or would carry out in a restricted or different manner (Section 3.5);
 - e) proportionality of aid (aid limited to the minimum): the State aid measure must be limited to the minimum needed to induce the additional investment or activity by the undertaking(s) concerned (Section 3.6);
 - f) avoidance of undue negative effects on competition and trade between the Contracting parties: the negative effects of State aid measure must be sufficiently limited, so that the overall balance of the measure is positive (Section 3.7);
 - g) transparency of aid: EFTA States, the Authority, economic operators, and the public must have easy access to all relevant acts and to pertinent information about the aid awarded (Section 3.8).
- (55) The overall balance of certain categories of schemes may further be made subject to a requirement of *ex post* evaluation as described in Section 4 below. In such cases, the Authority may limit the duration of those schemes, with a possibility to notify their prolongation.

- (56) In assessing the compatibility of any aid with the EEA Agreement, the Authority will take account of any proceedings concerning infringement of Articles 53 or 54 of the EEA Agreement which may concern the beneficiary of the aid and which may be relevant for its assessment under Article 61(3) of the EEA Agreement.²³

3.2 Contribution to a common objective

- (57) State aid must contribute to the achievement of one or more of the objectives of common interest within the meaning of Article 61(3) of the EEA Agreement. For risk finance aid, the general policy objective is to improve the provision of finance to viable SMEs from their early-development up to their growth stages and, in certain circumstances, to small mid-caps and innovative mid-caps; so as to develop in the longer run a competitive business finance market in the EEA territory, which should contribute to overall economic growth.

3.2.1 Specific policy objectives pursued by the measure

- (58) The measure must define specific policy objectives in view of the general policy objectives as set out in paragraph 57 above. To that end, the EFTA State must carry out an *ex ante* assessment in order to identify the policy targets and define the relevant performance indicators. The size and duration of the measure should be adequate for the policy targets. In principle, the performance indicators may include:
- (a) the required or envisaged private sector investment;
 - (b) the expected number of final beneficiaries invested in, including the number of start-up SMEs;
 - (c) the estimated number of new undertakings created during the implementation of the risk finance measure and as a result of the risk finance investments;
 - (d) the number of jobs created in the final beneficiary undertakings between the date of the first risk finance investment under the risk finance measure and the exit;
 - (e) where appropriate, the proportion of investments made in conformity with the market economy operator test;
 - (f) milestones and deadlines within which certain predefined amounts or percentage of the budget are to be invested;
 - (g) returns/yield expected to be generated from the investments;
 - (h) where appropriate, patent applications made by the final beneficiaries, during the implementation of the risk finance measure.
- (59) The indicators referred to in paragraph 58 are relevant both for the purpose of evaluating the effectiveness of the measure and for assessing the validity of the investment strategies drawn up by the financial intermediary in the context of the selection process.

²³ See Case C-225/91 *Matra v Commission*, [1993] ECR I-3203, paragraph 42.

3.2.2 *Financial intermediaries delivering the policy objectives*

- (60) To ensure that financial intermediaries involved in the risk finance measure deliver the relevant policy objectives, they must comply with the conditions set out in paragraphs 61 and 62 below.
- (61) The investment strategy of the financial intermediary must be aligned with the policy objectives of the measure. As part of the selection process, financial intermediaries must demonstrate how their proposed investment strategy may contribute to the achievement of the policy objectives and targets.
- (62) The EFTA State must ensure that the investment strategy of the intermediaries remains at all times aligned with the agreed policy targets, for instance via appropriate monitoring and reporting mechanisms and the participation of representatives of the public investors in the representation bodies of the financial intermediary, such as the supervisory board or the advisory board. An appropriate governance structure must ensure that material changes to the investment strategy require the prior consent of the EFTA State. For the avoidance of doubt, the EFTA State may not participate directly in individual investment and divestment decisions.

3.3 Need for State intervention

- (63) State aid can only be justified if it is targeted at specific market failures affecting the delivery of the common objective. The Authority considers that there is no general market failure as regards access to finance for SMEs, but only a failure related to certain groups of SMEs, depending on the specific economic context of the EFTA State concerned. This particularly but not exclusively applies to SMEs in their early stages which, despite their growth prospects, are unable to demonstrate their creditworthiness or the soundness of their business plans to investors. The scope of such market failure, both in terms of the affected companies and their capital requirement, may vary depending on the sector in which they operate. Due to information asymmetries, the market finds it difficult to assess the risk/return profile of such SMEs and their ability to generate risk-adjusted returns. The difficulties those SMEs experience in sharing information about the quality of their project, their perceived riskiness and weak creditworthiness lead to high transaction and agency costs and may exacerbate investor risk-aversion. Small mid-caps and innovative mid-caps may be faced by similar difficulties and therefore be affected by the same market failure.
- (64) Therefore, the risk finance measure must be established on the basis of an *ex ante* assessment demonstrating the existence of a funding gap affecting eligible undertakings in the targeted development stage, geographic area and, if applicable, economic sector. The risk finance measure must be designed in such a way as to address the market failures proven in the *ex ante* assessment.
- (65) Both the structural and cyclical (that is to say, crisis-related) problems leading to suboptimal levels of private funding must be analysed. In particular, the assessment must provide a comprehensive analysis of the sources of financing available to the eligible undertakings, taking into account the number of existing financial intermediaries in the target geographic area, their public or private nature, the investment volumes targeted to the relevant market segment, the number of

potentially eligible undertakings and average values of individual transactions. This analysis should be based on data covering the 5 years preceding the notification of the risk finance measure and, on this basis, it should estimate the nature and size of the funding gap, that is to say, the level of unmet demand for finance from eligible undertakings.

- (66) The *ex ante* assessment should preferably be conducted by an independent entity based on objective and up-to-date evidence. EFTA States may submit existing assessments, provided they date from less than 3 years preceding the notification of the risk finance measure. When examining the findings of the *ex ante* assessment, the Authority reserves the right to question the validity of the data in view of the evidence available.
- (67) To ensure that the financial intermediaries involved in the measure target the identified market failures, a due diligence process shall take place to ensure a commercially sound investment strategy focusing on the identified policy objective and respecting the defined eligibility requirements and funding restrictions. In particular, EFTA States must select financial intermediaries which can demonstrate that their proposed investment strategy is commercially sound and includes an appropriate risk diversification policy aimed at achieving economic viability and efficient scale in terms of size and territorial scope of the investments.
- (68) Moreover, the *ex ante* assessment must take account of the specific market failures faced by eligible target undertakings based on the additional guidance set out in paragraphs 69 to 88.

3.3.1 Measures targeted at categories of undertakings outside the scope of the General Block Exemption Regulation

(a) Small mid-caps

- (69) The scope of the General Block Exemption Regulation is restricted to eligible SMEs. However, certain undertakings which do not meet the headcount and/or financial thresholds defining the concept of SME may face similar financing constraints.
- (70) Extending the scope of eligible undertakings under a risk finance measure to include small mid-caps may be justified in so far as it provides an incentive to private investors to invest in a more diversified portfolio with enhanced entry and exit possibilities. Including small mid-caps in the portfolio is likely to decrease the riskiness at a portfolio level and hence to increase the return on the investments. Therefore, this may be a particularly effective way to attract institutional investors to the riskier early stage companies.
- (71) In the light of the above, and provided the *ex ante* assessment contains adequate economic evidence to this effect, it may be justified to support small mid-caps. In its assessment, the Authority will take into account the labour -and capital-intensity of the targeted undertakings, as well as other criteria reflecting specific financing constraints affecting small mid-caps (for example, sufficient collateral for a large loan).

(b) *Innovative mid-caps*

- (72) Mid-caps, in certain circumstances, could also face financing constraints comparable to those affecting SMEs. Such may be the case for mid-caps carrying out R&D and innovation activities alongside initial investment in production facilities, including market replication, and whose track record does not enable potential investors to make relevant assumptions as regards the future market prospects of the results of such activities. In such a case, risk finance State aid may be necessary for innovative mid-caps to increase their production capacities to a sustainable scale where they are able to attract private financing on their own. As observed under point 3.3.1(a), including such innovative mid-caps in its investment portfolio can be an effective way for a financial intermediary to offer a more diversified set of investment opportunities appealing to a wider range of potential investors.

(c) *Undertakings receiving the initial risk finance investment more than 7 years after their first commercial sale*

- (73) The General Block Exemption Regulation covers SMEs which receive the initial investment under the risk finance measure before their first commercial sale on a market or within 7 years following their first commercial sale. Only follow-on investments are covered by the block exemption beyond this 7-year period. However, certain types of undertakings may be regarded as still being in their expansion/early growth stages if, even after this 7-year period, they have not yet sufficiently proven their potential to generate returns and/or do not have a sufficiently robust track record and collaterals. This may be the case in high-risk sectors, such as the biotech, cultural and creative industries, and more in general for innovative SMEs.²⁴ Moreover, undertakings that have sufficient internal equity to finance their initial activities may require external financing only at a later stage, for instance to increase their capacities from a small-scale to a larger-scale business. This may require a higher amount of investment than they can meet from their own resources.
- (74) Therefore, it may be possible to allow measures whereby the initial investment is carried out more than 7 years after the first commercial sale of the target undertaking. In such circumstances, the Authority may require that the measure clearly defines the eligible undertakings, in the light of evidence provided in the *ex ante* assessment regarding the existence of a specific market failure affecting such undertakings.

(d) *Undertakings requiring a risk finance investment of an amount exceeding the cap fixed in the General Block Exemption Regulation*

- (75) The General Block Exemption Regulation sets a maximum total amount of risk finance per eligible undertaking, including follow-on investments. However, in certain industries where the upfront research or investment costs are relatively high, for example in life sciences or green technology or energy, this amount may not be sufficient to achieve all the necessary investment rounds and set the company on a sustainable growth path. It may therefore be justified, under certain conditions, to allow for a higher amount of overall investment to eligible undertakings.

²⁴ The innovative character of an SME is to be appraised in the light of the definition set out in the General Block Exemption Regulation.

(76) Hence, risk finance measures may provide support above such a maximum total amount, provided the envisaged amount of funding reflects the size and nature of the funding gap identified in the *ex ante* assessment with respect to the target sectors and/or territories. In such cases, the Authority will take into account the capital-intensive nature of the targeted sectors and/or the higher costs of investments in certain geographic areas.

(e) *Alternative trading platforms not fulfilling the conditions of the General Block Exemption Regulation*

(77) The Authority recognises that alternative trading platforms are an important part of the SME financing market because they both attract fresh capital into SMEs and facilitate the exit of earlier investors.²⁵ The General Block Exemption Regulation recognises their importance by facilitating their activity either through fiscal incentives targeted at natural persons investing in companies listed on these platforms, or by allowing for start-up aid to the platform operator, subject to the condition that the platform operator qualifies as a small enterprise and up to certain thresholds.

(78) However, operators of alternative trading platforms may not necessarily be small enterprises when they are established. Equally, the maximum amount of aid permissible as start-up aid under the General Block Exemption Regulation may not be sufficient to support the establishment of the platform. Moreover, in order to attract sufficient resources for the establishment and the roll-out of new platforms, it may be necessary to provide fiscal incentives to corporate investors. Finally, the platform may not only list SMEs, but also undertakings which exceed the thresholds in the definition of SME.

(79) Therefore, it may be justified, under certain conditions, to allow fiscal incentives to corporate investors, to support platform operators that are not small enterprises, or to allow investments for the establishment of alternative trading platforms the amount of which exceeds the limits provided for start-up aid under the General Block Exemption Regulation, or to allow aid to alternative trading platforms where the majority of the financial instruments admitted to trading are issued by SMEs. This is in line with the policy objective of supporting access to finance for SMEs through a seamless funding chain. Therefore, the *ex ante* assessment must demonstrate the existence of a specific market failure affecting such platforms in the relevant geographic market.

²⁵ The Authority recognises the growing importance of crowdfunding platforms in attracting funding for start-up companies. Therefore, if there is an established market failure and in cases a crowd funding platform has an operator which is a separate legal entity, the Authority may apply, by analogy, the rules applicable to alternative trading platforms. This applies equally to fiscal incentives to invest via such crowdfunding platforms. In the light of the recent appearance of crowdfunding in the Union/EEA, risk finance measures involving crowdfunding are likely to be subject to an evaluation as mentioned in Section 4 of these Guidelines.

3.3.2 *Measures with design parameters not complying with the General Block Exemption Regulation*

(a) *Financial instruments with private investors' participation below the ratios provided for in the General Block Exemption Regulation*

- (80) The market failures affecting enterprises in particular regions or EFTA States may be more pronounced due to the relative underdevelopment of the SME finance market within such areas in comparison to other regions in the same EFTA State or other EFTA States. This may particularly be the case in EFTA States without a well-established presence of formal venture capital investors or business angels. Therefore, the objective of encouraging the development of an efficient SME finance market in these regions and overcoming the structural barriers which may prevent SMEs from having effective access to risk finance, may justify a more favourable stance of the Authority towards measures allowing for private investor participation below the ratios provided for in the General Block Exemption Regulation.
- (81) Moreover, for risk finance measures with private investor participation below the ratios set out in the General Block Exemption Regulation, the Authority may take a positive stand, in particular if they specifically target SMEs before their first commercial sale or at the proof-of-concept stage, that is to say, undertakings affected by a more pronounced market failure provided that part of the risks of the investment are effectively borne by the participating private investors.

(b) *Financial instruments with design parameters above the ceiling provided for in the General Block Exemption Regulation*

- (82) The benefit of the General Block Exemption Regulation is reserved for measures whereby *non-pari passu* loss sharing between public and private investors is so designed as to limit the first loss assumed by the public investor. Similarly, in the case of guarantees, the block exemption sets limits on the guarantee rate and the total losses assumed by the public investor.
- (83) However, in certain circumstances, by taking a riskier financing position, public funding may allow private investors or lenders to provide additional financing. In assessing measures with financial design parameters exceeding the ceilings in the General Block Exemption Regulation, the Authority will take into account a number of factors as outlined in Section 3.4.2 of these Guidelines.

(c) *Financial instruments other than guarantees where investors, financial intermediaries and their managers are selected by giving preference to down side protection over asymmetric profit-sharing*

- (84) In accordance with the General Block Exemption Regulation, the selection of financial intermediaries, as well as the investors or the fund managers, must be based on an open, transparent and non-discriminatory call setting out clearly the policy objectives pursued by the measure and the type of financial parameters designed to achieve such objectives. This means that the financial intermediaries or their managers have to be selected via a procedure compliant with Directive 2004/18/EC²⁶ or any subsequent legislation replacing this directive. If this directive is not

²⁶ Directive 2004/18/EC, see footnote No 22.

applicable, the selection procedure must be such as to ensure the widest possible choice amongst qualified financial intermediaries or fund managers. In particular, such a procedure shall enable the EFTA State concerned to compare the terms and conditions negotiated between the financial intermediaries or the fund managers and potential private investors so as to ensure that the risk finance measure attract private investors with the minimum State aid possible, or the minimum divergence from *pari passu* conditions, in the light of a realistic investment strategy.

- (85) According to the General Block Exemption Regulation, the applicable criteria for the selection of managers must include a requirement whereby, for instruments other than guarantees, ‘profit-sharing shall be given preference over downside protection’ in order to limit a bias towards excessive risk-taking by the manager selecting the undertakings in which the investment is made. This is meant to ensure that whatever the form of the financial instrument foreseen by the measure, any preferential treatment granted to private investors or lenders has to be weighed against the public interest which consists in ensuring the revolving nature of the public capital committed and the long-term financial sustainability of the measure.
- (86) In certain cases, however, it may prove necessary to give preference to downside protection, namely when the measure targets certain sectors in which the default rate of SMEs is high. This may be the case for measures targeting SMEs before their first commercial sale or at the proof-of-concept stage, sectors faced with important technological barriers, or sectors where the companies have a high dependence on single projects requiring large upfront investment and entailing high risk-exposure, such as the cultural and creative industries. A preference for downside protection mechanisms may also be justified for measures operating via a fund of funds and aiming at attracting private investors at this level.

(d) *Fiscal incentives to corporate investors including financial intermediaries or their managers acting as co-investors*

- (87) While the General Block Exemption Regulation covers fiscal incentives granted to independent private investors who are natural persons providing risk finance directly or indirectly to eligible SMEs, EFTA States may find it appropriate to put in place measures applying similar incentives to corporate investors. The difference lies in the fact that corporate investors are undertakings within the meaning of Article 61 of the EEA Agreement. The measure must therefore be subject to specific restrictions in order to ensure that aid at the level of the corporate investors remains proportionate and has a real incentive effect.
- (88) Financial intermediaries and their managers may benefit from a fiscal incentive only insofar as they act as co-investors or co-lenders. No fiscal incentive can be granted in respect of the services rendered by the financial intermediary or its managers for the implementation of the measure.

3.4 Appropriateness of the aid measure

3.4.1 *Appropriateness compared to other policy instruments and other aid instruments*

- (89) In order to address the identified market failures and to contribute to the achievement of the policy objectives pursued by the measure, the proposed risk finance measure must be an appropriate instrument, while at the same time being the least distortive to competition. The choice of the specific form of the risk finance measure must be duly justified by the *ex ante* assessment.
- (90) As a first step, the Authority will consider whether and to what extent the risk finance measure can be considered as an appropriate instrument compared to other policy instruments aimed at encouraging risk finance investments into the eligible undertakings. State aid is not the only policy instrument available to EFTA States to facilitate the provision of risk finance to eligible undertakings. They can use other complementary policy tools both on the supply and demand side, such as regulatory measures to facilitate the functioning of financial markets, measures to improve the business environment, advisory services for investment-readiness or public investments in line with the market economy operator test.
- (91) The *ex ante* assessment must analyse the existing and, if possible, the envisaged national and EEA policy actions targeting the same identified market failures, taking into account the effectiveness and efficiency of other policy tools. The findings of the *ex ante* assessment must demonstrate that the identified market failures cannot be adequately addressed by other policy tools that do not entail State aid. Moreover, the proposed risk finance measure must be consistent with the overall policy of the EFTA State concerned regarding SME access to finance and be complementary to other policy instruments addressing the same market needs.
- (92) As a second step, the Authority will consider whether the proposed measure is more appropriate than alternative State aid instruments addressing the same market failure. In this respect, there is a general presumption that financial instruments are less distortive than direct grants and therefore constitute a more appropriate instrument. However, State aid to facilitate the provision of risk finance can be granted in various forms, such as selective fiscal instruments or sub-commercial financial instruments, including a range of equity, debt or guarantees instruments with different risk-return characteristics, as well as various delivery modes and funding structures, the appropriateness of which depends on the nature of the targeted undertakings and the funding gap. Therefore, the Authority will assess whether the design of the measure provides for an efficient funding structure, taking into account the investment strategy of the fund, so as to ensure sustainable operations.
- (93) In this respect, the Authority will look positively at measures which involve sufficiently large funds in terms of portfolio size, geographic coverage, in particular if they operate across several EFTA States, and diversification of the portfolio, as such funds may be more efficient and therefore more attractive for private investors, compared to smaller funds. Certain fund of funds structures may meet these conditions provided that the overall management costs resulting from the different levels of intermediation are offset by substantial efficiency gains.

3.4.2 Conditions for financial instruments

- (94) For financial instruments falling outside the scope of the General Block Exemption Regulation, the Authority will consider the elements set out in paragraphs 95 to 119.
- (95) Firstly, the measure must mobilise additional funding from market participants. Minimum private investment ratios below those set out in the General Block Exemption Regulation may only be justified in the light of more pronounced market failures established in the *ex ante* assessment. In this regard, the *ex ante* assessment must reasonably estimate the level of private investment sought in the light of the market failure affecting the specific range of eligible undertakings targeted by the measure, that is to say the estimated potential to raise additional private investment on a portfolio or deal-by-deal basis. Furthermore, it must be demonstrated that the measure leverages additional private funding that would not have been provided otherwise or would have been provided in different forms or amounts or on different terms.
- (96) In the case of risk finance measures targeting specifically SMEs before their first commercial sale, the Authority may accept that the level of private participation is lower than the required ratios. Alternatively, for such investment targets, the Authority may accept that the private participation is non-independent in nature, that is to say, provided for instance by the owner of the beneficiary undertaking. In duly justified cases, the Authority may accept levels of private participation lower than those established in the General Block Exemption Regulation also in respect of eligible undertakings that have been operating on a market for less than 7 years from their first commercial sale, in the light of the economic evidence provided in the *ex ante* assessment regarding the relevant market failure.
- (97) A risk finance measure targeting eligible undertakings that have been operating on a market for more than seven years from their first commercial sale at the time of the first risk finance investment must contain adequate restrictions whether in terms of time limits (e.g. 10 years instead of 7) or other objective criteria of a qualitative nature relating to the development stage of the target undertakings. For such investment targets the Authority would normally require a minimum private participation ratio of 60 %.
- (98) Secondly, together with the proposed level of private participation, the Authority will also take into account the balance of risks and rewards between the public and private investors. In this regard, the Authority will consider positively measures whereby the losses are shared *pari passu* between the investors, and private investors only receive upside incentives. In principle, the closer the risk and reward sharing is to actual commercial practices, the more likely that the Authority will accept a lower level of private participation.
- (99) Thirdly, the level of the funding structure at which the measure aims to leverage private investment is of importance. At the level of the fund of funds, the ability to attract private funding may depend on a more extensive use of downside protection mechanisms. Conversely, an excessive reliance on such mechanisms may distort the selection of eligible undertakings and lead to inefficient outcomes where private

investors intervene at the level of the investment into the undertakings and on a transaction- by-transaction basis.

- (100) In assessing the necessity of the specific design of the measure, the Authority may take into account the importance of the residual risk retained by the selected private investors relative to the expected and unexpected losses assumed by the public investor, as well as the balance of expected returns between the public investor and the private investors. Thus a different risk and reward profile could be accepted if this maximises the amount of private investment, without undermining the genuine profit-driven character of the investment decisions.
- (101) Fourthly, the exact nature of incentives must be determined through an open and non-discriminatory process of selecting financial intermediaries, as well as fund managers or investors. By the same token, the managers of the fund of funds should be required to legally commit as part of their investment mandate to determine via a competitive process for the selection of eligible financial intermediaries, fund managers or investors, the preferential conditions which could apply at the level of the sub-funds.
- (102) To prove the necessity of the specific financial conditions underpinning the design of the measure, EFTA States may be required to produce evidence demonstrating that, in the process of selecting private investors, all participants in the process were seeking conditions that would not be covered by the General Block Exemption Regulation, or that the tender was inconclusive.
- (103) Fifthly, the financial intermediary or the fund manager may co-invest alongside the EFTA State, so long as this avoids any potential conflict of interests. The financial intermediary must take at least 10 % of the first loss piece. Such co-investment could contribute to ensure that investment decisions are aligned with the relevant policy targets. The ability of the manager to provide investment from its own resources can be one of the selection criteria.
- (104) Finally, risk finance measures making use of debt instruments must provide for a mechanism ensuring that the financial intermediary passes on the advantage it receives from the State to the final beneficiary undertakings, for instance in the form of lower interest rates, reduced collateral requirements or a combination of the two. The financial intermediary may also pass on the advantage by investing in undertakings that although potentially viable, according to the financial intermediary's internal rating criteria, would be in a risk class where the intermediary would not invest in the absence of the risk finance measure. The pass-on mechanism must include adequate monitoring arrangements, as well as a clawback mechanism.
- (105) EFTA States can deploy a range of financial instruments as part of the risk finance measure, such as equity and quasi-equity investment instruments, loan instruments or guarantees on a non-*pari passu* basis. In paragraphs 106 to 119 below are set out the elements that the Authority will take into account in its assessment of such specific financial instruments.

(a) *Equity investments*

- (106) Equity investment instruments may take the form of equity or quasi-equity investments into an undertaking, by which the investor buys (part of) the ownership of that undertaking.
- (107) Equity instruments can have various asymmetric features, providing a differentiated treatment of investors as some may participate in a larger part of the risks and rewards than others. To mitigate private investors' risks, the measure may offer upside protection (the public investor giving up a part of the return) or protection against a part of the losses (limiting the losses for the private investor), or a combination of the two.
- (108) The Authority considers that upside incentives create a better alignment of interests between public and private investors. Conversely, downside protection whereby the public investor may be exposed to the risk of poor performance may lead to misalignment of interests and adverse selection by financial intermediaries or investors.
- (109) The Authority considers that equity instruments with capped return,²⁷ call option²⁸ and asymmetric income cash split²⁹ offer good incentives, especially in situations characterised by a less severe market failure.
- (110) Equity instruments with non-*pari passu* loss-sharing features going beyond the limits set out in the General Block Exemption Regulation may only be justified for measures addressing severe market failures identified in the *ex ante* assessment, such as measures targeting predominantly SMEs before their first commercial sale or at the proof-of-concept stage. To prevent extensive downside risk protection, the first loss piece borne by the public investor must be capped.

(b) *Funded debt instruments: loans*

- (111) A risk finance measure may cover the provision of loans at the level of either the financial intermediaries or the final beneficiaries.
- (112) Funded debt instruments may take different forms, including subordinated loans and portfolio risk-sharing loans. Subordinated loans may be granted to financial intermediaries to strengthen their capital structure, with a view to providing additional financing to eligible undertakings. Portfolio risk-sharing loans are designed to provide loans to financial intermediaries who commit to co-finance a portfolio of new loans or leases to eligible undertakings up to a certain co-financing rate in combination with credit risk-sharing of the portfolio on a loan-by-loan (or lease-by-lease) basis. In both cases, the financial intermediary acts as a co-investor in the eligible undertakings but

²⁷ Capped return for the public investor: at a certain predefined hurdle rate: if the predefined rate of return is exceeded, all returns above are distributed to the private investors only.

²⁸ Call options on public shares: private investors are given the right to exercise a call option to buy out the public investment share at a pre-agreed strike price.

²⁹ Asymmetric income cash split: cash is drawn from both public and private investors on a *pari passu* basis, but returns are shared whenever they arise in an asymmetric way. Private investors receive a larger share of the distribution proceeds than they should receive pro rata their respective holdings, up to the predefined hurdle rate.

enjoys preferential treatment compared to the public investor/lender as the instrument mitigates its own exposure to credit risks resulting from the underlying loan portfolio.

- (113) In general, where the risk mitigation characteristics of the instrument lead the public investor/lender to assume, with respect to the underlying loan portfolio, a first loss position exceeding the cap set out by the General Block Exemption Regulation, the measure may only be justified in the event of a severe market failure which must be clearly identified in the *ex ante* assessment. The Authority will consider positively measures which provide for an explicit cap on the first losses assumed by the public investor, notably where such a cap does not exceed 35 %.
- (114) Portfolio risk sharing loan instruments should ensure a substantial co-investment rate by the selected financial intermediary. This is presumed to be the case if such a rate is not lower than 30 % of the value of the underlying loan portfolio.
- (115) If funded debt instruments are used to refinance existing loans, they are not considered to generate an incentive effect and any aid element in such instruments cannot be regarded as compatible under Article 61(3)(c) of the EEA Agreement.

(c) Unfunded debt instruments: guarantees

- (116) A risk finance measure may cover the provision of guarantees or counter-guarantees to the financial intermediaries and/or guarantees to the final beneficiaries. Eligible transactions covered by the guarantee must be newly originated eligible risk finance loan transactions, including lease instruments, as well as quasi-equity investment instruments, to the exclusion of equity instruments.
- (117) Guarantees should be provided on a portfolio basis. Financial intermediaries may select the transactions they wish to include in the portfolio covered by the guarantee, so long as the included transactions meet the eligibility criteria as defined by the risk finance measure. Guarantees should be offered at a rate ensuring an appropriate level of risk and reward sharing with the financial intermediaries. In particular, in duly justified cases and subject to the results of the *ex ante* assessment, the guarantee rate may be higher than the maximum rate provided for in the General Block Exemption Regulation, but must not exceed 90 %. This could be the case of guarantees on loans or quasi-equity investments in SMEs before their first commercial sale.
- (118) In the case of capped guarantees, the cap rate should cover in principle only the expected losses. Should it also cover the unexpected losses, the latter should be priced at a level that reflects the additional risk coverage. In general, the cap rate should not exceed 35 %. Uncapped guarantees (guarantees with a guarantee rate, but with no cap rate) may be provided in duly justified cases and be priced to reflect the additional risk coverage provided by the guarantee.
- (119) The duration of the guarantee should be limited in time, normally up to a maximum of 10 years, without prejudice to the maturity of individual debt instruments covered by the guarantee, which can be longer. The guarantee shall be reduced if the financial intermediary does not include a minimum amount of investment in the portfolio during a specific period. Commitment fees shall be required for unused amounts.

Methods such as commitment fees, trigger events or milestones can be used in order to incentivise the intermediaries to achieve the agreed volumes.

3.4.3 Conditions for fiscal instruments

- (120) As pointed out in Section 3.3.2(d), the scope of the General Block Exemption Regulation is limited to fiscal incentives targeted at investors who are natural persons. Therefore, measures using tax incentives to encourage corporate investors to provide finance to eligible undertakings, either directly or indirectly through the acquisition of shares in a dedicated fund or other types of investment vehicles that invest into such undertakings, are subject to notification to the Authority.
- (121) As a general rule, EFTA States have to base their fiscal measures on the findings of a market failure in the *ex ante* assessment, and therefore target their instrument towards a well-defined category of eligible undertakings.
- (122) Tax incentives to corporate investors may take the form of income tax reliefs and/or tax reliefs on capital gains and dividends, including tax credits and deferrals. In the context of its enforcement practice, the Authority has generally considered compatible income tax reliefs that are designed in such a way so as to contain specific limits as to the maximum percentage of the invested amount that the investor can claim for the purposes of the tax relief, as well as a maximum tax break amount which can be deducted from the investor's tax liabilities. Moreover, capital gains tax liability on disposal of shares can be deferred if reinvested in eligible investments within a certain period, while losses arising upon disposal of such shares may be deducted from profits accruing from other shares subject to the same tax.
- (123) In general, the Authority considers that such types of fiscal measures are appropriate and therefore have an incentive effect if the EFTA State can produce evidence demonstrating that the selection of the eligible undertakings is based on a well-structured set of investment requirements, made public through appropriate publicity, and setting out the characteristics of the eligible undertakings which are subject to a demonstrated market failure.
- (124) Without prejudice to the possibility of prolonging a measure, fiscal schemes must have a maximum duration of 10 years. If, after 10 years, the scheme is prolonged, the EFTA State must carry out a new *ex ante* assessment together with an evaluation of the effectiveness of the scheme during the period of its implementation.
- (125) In its analysis, the Authority will take account of the specific characteristics of the relevant national fiscal system and the fiscal incentives that already exist in the EFTA State, as well as the interplay between those incentives, devoted to fight against tax fraud and evasion. It should also be ensured that the rules on information exchange between tax administrations to prevent tax fraud and evasion duly apply.
- (126) The fiscal advantage must be open to all investors fulfilling the required criteria, without discrimination as to their place of establishment and provided that the EFTA State concerned complies with minimum standards on good governance in tax matters. EFTA States should therefore ensure an adequate publicity regarding the scope and the technical parameters of the measure. These should include the

necessary ceilings and caps defining the maximum advantage that each individual investor may draw from the measure, as well as the maximum investment amount which can be made in individual eligible undertakings.

3.4.4 Conditions for measures supporting alternative trading platforms

- (127) As regards aid measures supporting alternative trading platforms beyond the limits set out in the General Block Exemption Regulation, the operator of the platform must provide a business plan demonstrating that the aided platform can become self-sustainable in less than 10 years. Moreover, plausible counterfactual scenarios must be provided in the notification, comparing the situations with which the tradable undertakings would be confronted if the platform did not exist, in terms of access to the necessary finance.
- (128) The Authority will look favourably at alternative trading platforms set up by and operating across several EFTA States, because they may be particularly efficient and attractive to private investors, in particular to institutional investors.
- (129) For existing platforms, the proposed business strategy of the platform must show that, due to a persistent shortage of listings, and therefore a shortage of liquidity, the platform concerned needs to be supported in the short-term, despite its long-term viability. The Authority will consider positively aid for the setting up of an alternative trading platform in EFTA States where no such platform exists. Where the alternative trading platform to be supported is a sub-platform or subsidiary of an existing stock exchange, the Authority will pay particular attention to the assessment of the lack of finance such a sub-platform would face.

3.5 Incentive effect of the aid

- (130) State aid can only be found compatible with the EEA Agreement if it has an incentive effect that induces the aid beneficiary to change its behaviour by undertaking activities which it would not carry out without the aid or would carry out in a more restrictive manner due to the existence of a market failure. At the level of the eligible undertakings, an incentive effect is present when the final beneficiary can raise finance that would not be available otherwise in terms of form, amount or timing.
- (131) Risk finance measures must incentivise market investors to provide funding to potentially viable eligible undertakings above the current levels and/or to assume extra risk. A risk finance measure is considered to have an incentive effect if it mobilises investments from market sources so that the total financing provided to the eligible undertakings exceeds the budget of the measure. Hence, a key element in selecting the financial intermediaries and fund managers should be their ability to mobilise additional private investment.
- (132) The assessment of the incentive effect is closely linked to the assessment of the market failure discussed in Section 3.3. Further, the suitability of the measure to achieve the leverage effect ultimately depends on the design of the measure as regards the balance of risks and rewards between public and private finance-providers, which is also closely related to the question whether the design of the risk finance State aid measure is appropriate (see Section 3.4 above). Therefore, once the market failure has

been properly identified and the measure has an appropriate design, it can be assumed that an incentive effect is present.

3.6 Proportionality of the aid

- (133) State aid must be proportionate in relation to the market failure being addressed in order to achieve the relevant policy objectives. It must be designed in a cost-efficient manner, in line with the principles of sound financial management. For an aid measure to be considered proportionate, aid must be limited to the strict minimum necessary to attract funding from the market to close the identified funding gap, without generating undue advantages.
- (134) As a general rule, at the level of the final beneficiaries, risk finance aid is considered to be proportionate if the total amount of syndicated funding (public and private) provided under the risk finance measure is limited to the size of the funding gap identified in the *ex ante* assessment. At the level of the investors, aid must be limited to the minimum necessary to attract private capital in order to achieve the minimum leverage effect and bridge the funding gap.

3.6.1 Conditions for financial instruments

- (135) The measure must ensure a balance between the preferential conditions offered by a financial instrument in order to maximise the leverage effect while addressing the identified market failure and the need for the instrument to generate sufficient financial returns to remain operationally viable.
- (136) The exact nature and value of the incentives must be determined through an open and non-discriminatory selection process in the context of which financial intermediaries, as well as fund managers or investors are called to present competing bids. The Authority considers that where any asymmetric risk-adjusted returns or loss-sharing is established through such a process, the financial instrument is to be regarded as proportionate and to reflect a fair rate of return (FRR). Where the fund managers are selected through an open, transparent, and non-discriminatory call requiring the applicants to present their investor base as part of the selection process, the private investors are considered to be duly selected.
- (137) In the case of co-investment by a public fund with private investors participating on a deal-by-deal basis, the latter should be selected through a separate competitive process in respect of each transaction, which is the preferred way of establishing the FRR.
- (138) Where private investors are not selected through such a process (for instance because the selection procedure has proven to be ineffective or inconclusive) the FRR must be established by an independent expert on the basis of an analysis of market benchmarks and market risk using the discounted cash flow valuation methodology in order to avoid over-compensation of investors. On that basis, the independent expert must calculate a minimum level of FRR and add to that an appropriate margin to reflect the risks.
- (139) In such a case, there must be appropriate rules in place for the appointment of the independent expert. As a minimum, the expert must be licensed to provide such

advice, be registered with the relevant professional associations, comply with deontological and professional rules issued by those associations, be independent and be liable for the accuracy of its expertise. In principle, independent experts are to be selected via an open, transparent and non-discriminatory selection procedure. The same independent expert may not be used twice within a period of 3 years.

- (140) In the light of the above, the design of the measure may contain various asymmetric profit-sharing or asymmetrically timed public and private investments, as long as the expected risk-adjusted returns for the private investors are limited to the FRR.
- (141) As a general principle, the Authority considers that economic alignment of interests between the EFTA State and the financial intermediaries or their managers, as appropriate, can minimise the aid. The interests must be aligned both as regards the achievement of the specific policy targets and the financial performance of the public investment into the instrument.
- (142) The financial intermediary or the fund manager may co-invest alongside the EFTA State, as long as the terms and conditions of such a co-investment are such as to exclude any possible conflict of interests. Such co-investment could incentivise the manager to align its investment decisions with the set policy targets. The ability of the manager to provide investment from its own resources can be one of the selection criteria.
- (143) The remuneration of the financial intermediaries or the fund managers, depending on the type of risk finance measure, must include an annual management fee, as well as performance-based incentives, such as carried interest.
- (144) The performance-based component of the remuneration must be significant and designed to reward the financial performance, as well as the attainment of the specific policy targets set in advance. Policy-related incentives must be balanced with the financial performance incentives which are required to ensure an efficient selection of eligible undertakings in which investments will be made. In addition, the Authority will take into account possible penalties provided for in the funding agreement between the EFTA State and the financial intermediary, which apply if the defined policy targets are not met.
- (145) The level of performance-based remuneration should be justified based on the relevant market practice. The managers must be remunerated not only for the successful disbursement and the amount of private capital raised, but also for the successful returns on investments, such as income receipts and capital receipts above a certain minimum rate of return or hurdle rate.
- (146) The total management fees must not exceed operational and management costs necessary for the execution of the financial instrument concerned, plus a reasonable profit, in line with market practice. The fees must not include investment costs.
- (147) As financial intermediaries or their managers, as appropriate, must be selected through an open, transparent and non-discriminatory call, the overall fee structure can be evaluated as part of the scoring of that selection process and the maximum remuneration can be established as a result of such selection.

- (148) In case of direct appointment of an entrusted entity, the Authority considers that the annual management fee should in principle not exceed 3 % of the capital to be contributed to the entity, excluding the performance-based incentives.

3.6.2 Conditions for fiscal instruments

- (149) Total investment for each beneficiary undertaking may not exceed the maximum amount fixed by the risk finance provision of the General Block Exemption Regulation.
- (150) Irrespective of the type of tax relief, eligible shares must be full-risk, ordinary shares, newly issued by an eligible undertaking as defined in the *ex ante* assessment, and they must be held for at least 3 years. The relief cannot be available to investors who are not independent from the company invested in.
- (151) In the case of income tax relief, investors providing finance to eligible undertakings may receive relief of up to a reasonable percentage of the amount invested in eligible undertakings, provided the maximum income tax liability of the investor, as established prior to the fiscal measure, is not exceeded. The Authority considers reasonable capping the tax relief at 30 % of the invested amount. Losses arising upon disposal of the shares may be set against income tax.
- (152) In the case of tax relief on dividends, any dividend received in respect of qualifying shares may be fully exempt from income tax. Similarly, in the case of capital gain tax relief, any profit on the sale of qualifying shares can be fully exempt from capital gain tax. Moreover, capital gains tax liability on disposal of qualifying shares can be deferred if reinvested in new qualifying shares within 1 year.

3.6.3 Conditions for alternative trading platforms

- (153) In order to allow a proper analysis of the proportionality of the aid to the operator of the alternative trading platform, State aid can be granted in order to cover up to 50 % of the investment costs incurred for the establishment of such a platform.
- (154) In the case of fiscal incentives to corporate investors, the Authority will assess the measure against the conditions set out for fiscal instruments in these Guidelines.

3.7 Avoidance of undue negative effects on competition and trade

- (155) The State aid measure must be designed in such a way that it limits distortions of competition within the EEA. The negative effects have to be balanced against the overall positive effect of the measure. In the case of risk finance measures, the potential negative effects have to be assessed at each level where aid may be present: the investors, the financial intermediaries and their managers, and the final beneficiaries.
- (156) To enable the Authority to assess the likely negative effects, the EFTA State may submit, as part of the *ex ante* assessment, any study at its disposal, as well as *ex post* evaluations carried out for similar schemes, in terms of the eligible undertakings, funding structures, design parameters and geographic area.

- (157) Firstly, at the level of the market for the provision of risk finance, State aid may result in crowding out private investors. This might reduce the incentives for private investors to provide funding to eligible undertakings and encourage them to wait until the State provides aid for such investments. This risk becomes more relevant, the higher the amount of the total financing into the final beneficiaries, the larger the size of those beneficiary undertakings and the more advanced their development stage, as private financing becomes progressively available in those circumstances. Moreover, State aid should not replace the normal business risk of investments that the investors would have undertaken even in the absence of State aid. However, to the extent that the market failure has been properly defined, it is less likely that the risk finance measure will result in such crowding out.
- (158) Secondly, at the level of financial intermediaries, aid may have distortive effects in terms of increasing or maintaining an intermediary's market power, for example in the market of a particular region. Even where aid does not strengthen the financial intermediary's market power directly, it may do so indirectly, by discouraging the expansion of existing competitors, inducing their exit or discouraging the entry of new competitors.
- (159) Risk finance measures must be targeted at growth-oriented undertakings which are unable to attract an adequate level of financing from private resources but may become viable with risk finance State aid. However, a measure which provides for the setting up of a public fund the investment strategy of which does not demonstrate sufficiently the potential viability of the eligible undertakings is unlikely to meet the balancing test, as in such a case the risk finance investment may amount to a grant.
- (160) Since the conditions on commercial management and profit-oriented decision-making set out in the risk finance provisions of the General Block Exemption Regulation are essential to ensure that the selection of the final beneficiary undertakings is based on a commercial logic, those conditions cannot be derogated from under these Guidelines, including where the measure involves public financial intermediaries.
- (161) Investment funds of a small scale, with limited regional focus and without adequate governance arrangements will be analysed with a view to avoiding the risk of maintaining inefficient market structures. Regional risk finance schemes may not have sufficient scale and scope due to a lack of diversification linked to the absence of a sufficient number of eligible undertakings as investment targets, which could reduce the efficiency of such funds and result in the granting of aid to less viable companies. Those investments could distort competition and provide undue advantages to certain undertakings. Moreover, such funds may be less attractive to private investors, in particular institutional investors, as they may be seen more as a vehicle to serve regional policy objectives, rather than a viable business opportunity offering acceptable returns on investment.
- (162) Thirdly, at the level of the final beneficiaries, the Authority will assess whether the measure has distortive effects on the product markets where those undertakings compete. For instance, the measure may distort competition if it targets companies in underperforming sectors. A substantial capacity expansion induced by State aid in an underperforming market might, in particular, unduly distort competition, as the creation or maintenance of overcapacity could lead to a squeeze on profit margins, a

reduction of competitors' investments or even their exit from the market. It may also prevent companies from entering the market. This results in inefficient market structures which are also harmful to consumers in the long run. Where the market in the targeted sectors is growing, there is normally less reason to fear that the aid will negatively affect dynamic incentives or will unduly impede exit or entry. Therefore, the Authority will analyse the level of production capacities in the given sector, in the light of the potential demand. In order to enable the Authority to carry out such an assessment, the EFTA State must indicate whether the risk finance measure is sector specific, or gives preference to certain sectors over others.

- (163) State aid may prevent the market mechanisms from delivering efficient outcomes by rewarding the most efficient producers and putting pressure on the least efficient to improve, restructure or exit the market. Where inefficient undertakings receive aid, this may prevent other undertakings from entering or expanding in the market and weaken incentives for competitors to innovate.
- (164) The Authority will also assess any potential negative delocalisation effects. In this regard, the Authority will analyse whether regional funds are likely to incentivise delocalisation within the EEA. Where the financial intermediary's activities are focused on a non-assisted region bordering assisted regions, or a region with higher regional aid intensity than the target region, the risk of such distortion is more pronounced. A regional risk finance measure focussing only on certain sectors might also have negative delocalisation effects.
- (165) Where the measure has negative effects, the EFTA State must identify the means to minimise such distortions. For instance, the EFTA State may demonstrate that the negative effects will be limited to the minimum, taking into account, for example, the overall investment amount, the type and number of beneficiaries and the characteristics of the targeted sectors. In balancing positive and negative effects, the Authority will also take into account the magnitude of such effects.

3.8 Transparency

- (166) EFTA States must publish the following information on a comprehensive State aid website, at national or regional level:
 - (i) the text of the aid scheme and its implementing provisions;
 - (ii) the identity of the granting authority;
 - (iii) the total amount of the EFTA State's participation in the measure;
 - (iv) the identity of the entrusted entity, if applicable, and the names of the selected financial intermediaries;
 - (v) the identity of the undertaking supported under the measure, including information about the type of undertaking (SME, small mid-cap, innovative mid-cap); the region (at Statistical regions level ²³⁰) in which the

³⁰ The term "Statistical region" is used instead of the acronym "NUTS" in the corresponding Commission Guidelines. NUTS is derived from the title "Nomenclature of Territorial Units for Statistics" according to Regulation (EC) No 1059/2003 of the European parliament and of the

undertaking is located; the principal economic sector in which the undertaking has its activities at NACE group level; the form and amount of investment. *Such a requirement can be waived with respect to SMEs which have not carried out any commercial sale in any market and for investments below EUR 500 000 into a final beneficiary undertaking;*

- (vi) in the case of fiscal risk finance aid schemes, the identity of the beneficiary corporate investors³¹ and *the amount of the fiscal advantage received, where the latter exceeds EUR 500 000. Such amount can be provided in the following ranges (in EUR million): [0.5-1]; [1-2]; [2-5]; [5-10]; [10-30]; [30 and more].* Such information must be published after the decision to grant the aid has been taken, must be kept for at least 10 years and must be available for the general public without restrictions.³²

EFTA States will not be required to publish the abovementioned information before 1 July 2016.⁽ⁱ⁾

3.9 Cumulation

- (167) Risk finance aid may be cumulated with any other State aid measure with identifiable eligible costs.
- (168) Risk finance aid may be cumulated with other State aid measures without identifiable eligible costs, or with *de minimis* aid, up to the highest relevant total financing ceiling fixed in the specific circumstances of each case by a block exemption regulation or a decision adopted by the Authority.
- (169) EFTA funding centrally managed by the institutions, agencies, joint undertakings or other bodies of the EEA that is not directly or indirectly under the control of the EFTA States does not constitute State aid. Where such EEA funding is combined with State aid, only the latter will be considered for determining whether notification thresholds and maximum aid amounts are respected, provided that the total amount of public funding granted in relation to the same eligible costs does not exceed the most favourable funding rate laid down in the applicable rules of EEA law.

4. EVALUATION

- (170) To further ensure that distortions of competition and trade are limited, the Authority may require that certain schemes be subject to a limited duration and to an evaluation, which must address the following issues:

Council of 26.5.2003 on the establishment of a common classification of territorial units for statistics (NUTS) (OJ L 154, 21.6.2003, p.1). This regulation has not been incorporated into the EEA Agreement. However, in order to achieve common definitions in an ever-increasing demand for statistical information at a regional level, the Statistical Office of the European Union, Eurostat, and the National Institutes of the candidate countries and EFTA have agreed that statistical regions would be established similar to the NUTS classification.

³¹ This does not apply to private investors that are natural persons.

³² This information should be regularly updated (e.g. every 6 months) and should be available in non-proprietary formats.

(i) *Publication of information on aid awards granted before 1 July 2016, and for fiscal aid, publication for aid claimed or granted before 1 July 2016, will not be required.*

- a) the effectiveness of the aid measure in the light of its predefined general and specific objectives and indicators; and
- b) the impact of the risk finance measure on markets and competition.

(171) An evaluation may be required for the following aid schemes:

- (a) large schemes;
- (b) schemes with a regional focus;
- (c) schemes with a narrow sectoral focus;
- (d) schemes which are modified, where the modification impacts on the eligibility criteria, the amount of investment or the financial design parameters; the evaluation may be submitted as part of the notification;
- (e) schemes containing novel characteristics;
- (f) schemes where the Authority so requests in the decision approving the measure, in the light of its potential negative effects.

(172) The evaluation must be carried out by an expert independent from the State aid granting authority on the basis of a common methodology³³ and must be made public. The evaluation must be submitted to the Authority in sufficient time to allow for the assessment of the possible prolongation of the aid scheme and in any case upon expiry of the scheme. The precise scope and methodology of the evaluation that is to be carried out will be defined in the decision approving the aid scheme. Any subsequent aid measure with a similar objective must take into account the results of that evaluation. *In the case of aid schemes excluded from the scope of a block exemption Regulation exclusively on the ground of their large budget, the Authority will assess their compatibility solely on the basis of the evaluation plan.*

5. FINAL PROVISIONS

5.1 Prolongation of the Risk Capital Guidelines

(173) The Authority's Guidelines to promote risk capital investments in small and medium-sized enterprises would be applied until 30 June 2014.

5.2 Applicability of the rules

(174) *The Authority will apply the principles set out in these Guidelines for the compatibility assessment of all risk finance aid to be awarded from 1 July 2014 to 31 December 2021.*

(175) Risk capital aid unlawfully awarded or to be awarded before 1 July 2014 will be assessed in accordance with the rules in force at the date on which the aid is awarded.

³³ Such a common methodology may be provided by the Authority.

- (176) In order to preserve the legitimate expectations of private investors, in the case of risk finance schemes that provide for public funding to private equity investment funds, the date of the commitment of the public funding to the private equity investment funds, which is the date of signature of the funding agreement, determines the applicability of the rules to the risk finance measure.

5.3 Appropriate measures

- (177) The Authority considers that the implementation of the present Guidelines will lead to substantial changes in the assessment principles for risk capital aid in the EFTA States. Furthermore, in the light of the changed economic and social conditions, it appears necessary to review the continuing justification for and effectiveness of all risk capital aid schemes. For these reasons, the Authority proposes the following appropriate measures to EFTA States pursuant to Article 1(1) in Part I of Protocol 3 to the Surveillance and Court Agreement:

- (a) EFTA States should amend, where necessary, their existing risk capital aid schemes, in order to bring them into line with these Guidelines, within 6 months after the date of their publication;
- (b) EFTA States are invited to give their explicit unconditional agreement to these proposed appropriate measures within 2 months from the date of publication of these Guidelines: in the absence of any reply, the Authority will assume that the EFTA State in question does not agree with the proposed measures.

- (178) In order to preserve the legitimate expectations of private investors, EFTA States do not have to take appropriate measures with respect to risk capital aid schemes in favour of SMEs where the commitment of the public funding to the private equity investment funds, which is the date of signature of the funding agreement, was made before the date of publication of these Guidelines and all the conditions provided for in the funding agreement remain unchanged. These financial intermediaries may continue to operate thereafter and invest in accordance with their original investment strategy until the end of the duration foreseen in the funding agreement.

5.4 Reporting and monitoring

- (179) In accordance with Article 21 of Part II of Protocol 3 to the Surveillance and Court Agreement, in conjunction with Articles 5 and 6 of Decision No 195/04/COL, EFTA States must submit annual reports to the Authority.
- (180) EFTA States must maintain detailed records regarding all aid measures. Such records must contain all information necessary to establish that the conditions regarding eligibility and maximum investment amounts have been fulfilled. These records must be maintained for 10 years from the date of award of the aid and must be provided to the Authority upon request.

5.5 Revision

- (181) The Authority may decide to review or change these Guidelines at any time if this should be necessary for reasons associated with competition policy or in order to take

account of other EEA policies and international commitments, developments in the markets, or for any other justified reason.