

## **HT.5886 - Response of the Dutch authorities on the draft Communication from the Commission Guidelines on State aid to promote risk finance investments**

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*This response reflects the views of the Dutch ‘Interdepartementaal Steun Overleg (ISO)’. The ISO is a national State aid committee composed of all Dutch ministries and representatives of the regional and local authorities.*

In this revision of the Risk Finance guidelines the Commission proposes to further simplify and clarify the application of the rules to facilitate the deployment of State aid schemes in support of risk finance. With this aim, the following categories of targeted amendments of the Risk Finance Guidelines are envisaged:

- i. reordering the existing provisions to increase readability and ease of application, including the consolidation of existing requirements for the ex ante assessment, which are currently dispersed among different parts of the Guidelines (Category 1);
- ii. further clarifying the specific content and level of evidence needed to demonstrate a specific market failure or another relevant obstacle in access to finance in line with existing case practice (Category 2);
- iii. focusing the Guidelines on compatibility of State aid to avoid overlaps with the Notice on the Notion of Aid (Category 3);
- iv. streamlining existing formulations and aligning definitions to increase consistency with the GBER without changing the substance of the rules (Category 4).

The provisions of the Risk Finance Guidelines are complemented by the General Block Exemption Regulation (“GBER”) , which lays down ex ante compatibility conditions on the basis of which Member States can implement State aid measures without prior notification to the Commission. The Commission is carrying out, in parallel to the revision of the Risk Finance Guidelines, a targeted revision of the GBER, which will also include a targeted amendment of the Risk Finance-relevant GBER provisions and which will ensure consistency with the revised Risk Finance Guidelines.

The Dutch authorities welcome these targeted revisions and propose some further improvements, specifically for the GBER.

### **1.1 General remarks**

#### **Funding of innovative SME’s and innovative mid-caps in RDI Framework and GBER**

Risk capital is needed for all (digital) innovations and critical technologies. Upscaling activities in this context will also have to be stimulated. Innovative SME’s and innovative mid-caps who develop such innovations and technologies face high financial risks for a long period of time, but the payoff for society will be worth it if the innovation succeeds. The Dutch authorities are currently developing new instruments such as deeptech investment funds to address market failures regarding the scale up of European companies in key technologies. The Dutch authorities notice cash lock ups by Venture Capital funds, the refusal to roll over hybrid loans, a lack of access to risk finance funding as existing funds and investors are retrenching and unwilling to facilitate new funding rounds, especially for innovative SME’s and innovative mid-caps which have limited cash income but high R&D expenditures. Therefore, the Dutch authorities consider that in these segments EU Member States should be able to provide “replacement or follow up risk finance” to allow continued development of innovative SME’s and innovative midcaps. Increasingly, companies are faced with large amounts of Foreign Direct Investment (FDI) that EU Member States might find undesirable when applied to

strategically important sectors and critical value chains. It is important that the EU Member States have the right possibilities to defend their financial participation but also to make it more difficult for an FDI investor to quickly take over the target company. A key development in the Netherlands to deal with FDI risks is the increased use of subordinated debt with conversion possibilities and venture debt. In both cases the possibility and right is introduced to either convert the debt into equity or the right to participate in a next funding round. One of the triggers for conversion or participation is a change of control or new funding round. This allows the EU Member States both to defend their financial participation but also to make it more difficult for an FDI investor to quickly take over the target company.

The current State aid rules do not provide adequate possibilities to provide risk funding for innovative SME's and innovative mid-caps. First, due the high burn rate these companies require high aid amounts in the early stages of a company's life cycle. Maximum State aid amounts under the GBER are capped too low for companies working on digital innovations and critical technologies. Second, the transparency provisions of the GBER are too limiting for funding of these companies. Especially in R&D intensive SME's and innovative mid-caps risk finance is normal market practice to promote investments in such companies. Risk finance (both under MEOP conditions and as State aid) at the level of eligible undertakings, may take the form of equity, quasi-equity investments, loans, guarantees, or a mix thereof. However, risk financing is currently only possible under the GBER if all provisions of Article 21 GBER are respected. This poses problems, because there is not enough private funding available for innovative SME's and innovative mid cap due to poorly developed risk capital markets or such private funding might pose FDI risks (see above). For these reasons Article 21 GBER cannot always be used to provide adequate funding for these companies. Due to the transparency provisions of Article 5 GBER risk financing specifically for RDI aid under Article 25 GBER is not allowed without respecting the provisions of Article 21 GBER. Specifically in relation to the COVID- 19 pandemic the Dutch authorities see the need to incorporate in both the RDI Framework and the GBER the possibility for financial support when engaging in clinical trials and follow up research and development and scale up when medical products and vaccines are placed on the market. The key there is the need for a balance between the downsides and upsides for the tax payer and health authorities.

- The Dutch authorities ask the Commission to consider solutions for adequate funding of innovative SME's and innovative mid-caps, such as:
  - A targeted aid category under the GBER for risk financing (equity and hybrid financing) of early stages of a company's life cycle that addresses the needs of startups and scale-ups for digital innovations and critical technologies (including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies). Such a category should also have a higher notification threshold than the current thresholds for aid for risk financing or research and development. Due the high burn rate these companies require high aid amounts in the early stages of a company's life cycle.
  - Changes in article 5 GBER to allow for risk financing for aid under Article 25 GBER and more flexibility in the definition for 'repayable advances' to provide hybrid financing which is not solely dependent on the result of the project.
- The Dutch authorities use the possibility of a direct grant for startups under article 22(3)(c) of the GBER. However the scope of this article doesn't cover small (innovative) midcaps. Does the Commission consider introducing a separate article for small (innovative) midcaps such as article 22, which allows for aid in the form of a loan, guarantee, equity and direct grant or a mix of these ?

- The Dutch authorities would like to point that with regard to paragraph 2.3, point 33 that there are more relevant procurement procedures than exclusive development and pre-commercial procurement. It would be appropriate to also mention the innovation partnership (Article 31 of Directive 2014/24). These procedures can also be relevant in the field of defense and security technologies.

As the Commission has encouraged the Member States also to give input on the relevant articles in the GBER, the Dutch authorities would like to point out that the GBER should also be available for individual 'ad hoc' aid to SMEs, not only on the basis of a scheme but also on the basis of an individual ad hoc aid measure. Therefore, the requirement of the necessity of a *scheme* in the articles 21 and 22, paragraph 1, for SMEs should be deleted.

### **Undertaking in difficulty**

The definition of 'undertaking in difficulty' in State aid rules poses problems for startups and scale ups. Many undertakings would have to be excluded from State aid measures due to a low equity ratio in the short-term even if they could be considered viable in the mid- and long-term. Start-ups in their early stages, particularly with a focus on research and development activities in high-technology sectors, usually show losses during several years after being set up and have to undergo a phase, which is called a "valley of death", until they succeed on the market.

In the definition of 'undertaking in difficulty' innovative SME's and innovative mid-caps should also be excluded within the 7 years of their first commercial sale, even when it is not eligible for risk financing under the current strict conditions of Article 21 GBER. If a new aid category for risk financing for innovative SME's and innovative mid-caps is introduced, the definition could refer to eligibility under that new article of the GBER.

### **Article 2 GBER**

*(18) 'undertaking in difficulty' means an undertaking in respect of which at least one of the following circumstances occurs:*

*(a) In the case of a limited liability company (other than an SME that has been in existence for less than **five years** or, for the purposes of eligibility for risk finance aid, an SME within 7 years from its first commercial sale that qualifies for risk finance investments following due diligence by the selected financial intermediary **or for the purpose of eligibility for aid for research and development and innovation, an SME within 7 years from its first commercial sale**), where more than half of its subscribed share capital has disappeared as a result of accumulated losses. This is the case when deduction of accumulated losses from reserves (and all other elements generally considered as part of the own funds of the company) leads to a negative cumulative amount that exceeds half of the subscribed share capital. For the purposes of this provision, 'limited liability company' refers in particular to the types of company mentioned in Annex I of Directive 2013/34/EU ( 4 ) and 'share capital' includes, where relevant, any share premium.*

*(b) In the case of a company where at least some members have unlimited liability for the debt of the company (other than an SME that has been in existence for less than **five years** or, for the purposes of eligibility for risk finance aid, an SME within 7 years from its first commercial sale that qualifies for risk finance investments following due diligence by the selected financial intermediary **or for the purpose of eligibility for aid for research and development and innovation, an SME within 7 years from its first commercial sale**), where more than half of its capital as shown in the company accounts has disappeared as a result of accumulated losses. For the purposes of this provision, 'a company where at least some members have unlimited liability for the debt of the company' refers in particular to the types of company mentioned in Annex II of Directive 2013/34/EU.*

*[...]*

Alternative could be to add innovative SMEs and innovative mid-caps as an exception into Article 1, fourth paragraph, part c, of the GBER:

4. This Regulation shall not apply to:

(..)

(c) aid to undertakings in difficulty, with the exception of aid schemes to make good the damage caused by certain natural disasters, **innovative SMEs and innovative mid-caps**, start-up aid schemes and regional operating aid schemes, provided that such schemes do not grant undertaking in difficulty more favorable treatment than other undertakings.

#### **Supporting private investment funds aimed at supporting recovery**

The Commission should facilitate Member States in setting up a **guarantee scheme on private investment funds aimed at supporting recovery from the serious economic disturbance due to the COVID-19 outbreak**. Under such schemes, Member States can guarantee and thus mobilise private funding (subordinated debt, hybrids and equity instruments) rather than provide capital themselves. Those schemes can be approved directly under the Treaty (Article 107(3)(b) TFEU). The Dutch authorities would like to suggest to implement a transitory regime in the new guidelines for Risk Finance to facilitate the transition from the Temporary Framework COVID-19 to the regular state aid frameworks.

#### **Introduce small innovative midcaps in all relevant State aid guidelines or exemption Regulations**

Small (innovative) midcaps are only mentioned in the Risk Finance Aid Guidelines, not even in the Commission Notice on the notion of State aid. The Dutch authorities ask the Commission to consider using this 'intermediate category' also in the GBER, the SME user manual and other relevant State aid guidelines.

#### **Bottlenecks in article 21 and 22 of the GBER**

The Dutch authorities encounter a number of bottlenecks in articles 21 and 22 of the GBER, which are indicated below.

##### **Article 21 of the GBER**

5. Eligible undertakings shall be undertakings which at the time of the initial risk finance investment are unlisted SMEs and fulfil at least one of the following conditions:

(a) they have not been operating in **any market**;

➔ To qualify for article 21 aid supported undertakings must have a track record. While start-ups could be supported under article 22 of the GBER, there seems to be a bottleneck for already running SMEs because of the 'any market' requirement in the fifth paragraph, part a.

(b) they have been operating in **any market for less than 7 years following their first commercial sale**;

➔ This requirement doesn't seem to take into account that undertakings could change their economic activities and start operating on a different market. Does the Commission consider to take this into account so that any market could be adjusted to 'the relevant market to which the investment refers' ?

(c) they require an initial risk finance investment which, based on a business plan prepared in view of entering a new product or geographical market, is higher than 50 % of their average annual turnover in the preceding 5 years.

- The particular provision doesn't seem to be easily applicable in the daily State aid practice when working with article 21 of the GBER. The possibility of the sixth paragraph of article 21 is available however each of the conditions of that paragraph must be met and the paragraph only covers for follow-up investments.

#### **Article 22 of the GBER**

Eligible undertakings shall be unlisted small enterprises up to **five years** following **their registration**.

- In practice, undertaking are established and need time to start, so the 5-year limit is often reached before a company really starts. The Dutch authorities propose to turn 5 years into 7 years, and thus the 7 years from Article 21 of the GBER into 10 years.
- Registration is a good starting point because it is easy to check. Only the following undertakings are excluded, which are quite common:
- The so called 'sleeping undertakings', which revive after a while.
  - Undertakings that first focused on a different market but have switched in terms of the type of economic activity (and can demonstrate this).

#### **Article 4 of the GBER**

h. for aid for start-ups: the amounts laid down **per undertaking** in Article 22(3), (4) and (5);

- Because start-ups often also need follow-up investment could this be adjusted into 'per investment' instead of 'per undertaking'?

(80) 'innovative enterprise' means an enterprise:

(a) that can demonstrate, by means of **an evaluation carried out by an external expert** that it will in the foreseeable future develop products, services or processes which are new or substantially improved compared to the state of the art in its industry, and which carry a risk of technological or industrial failure, or

(b) the research and development costs of which represent at least 10 % of its total operating costs in at least one of the three years preceding the granting of the aid or, in the case of a start-up enterprise without any financial history, in the audit of its current fiscal period, as certified by an external auditor;

In the daily State aid practice this requirement doesn't seem to work well. It is unclear what the evaluation of an external expert should entail.

#### **Article 1 of the GBER**

3. a. aid granted in the fishery and aquaculture sector, (..) with the exception of training aid, **aid for SMEs' access to finance**, (..);

3. b. aid granted in the primary agricultural production sector, with the exception of .., aid for consultancy in favour of SMEs, **risk finance aid**, ....

- Difference between 3a and 3b (narrowly formulated), also allow the primary agricultural sector for Article 22 GBER: (3a) aid for SMEs' access to finance and (3b) risk finance aid

## 1.2 Specific remarks

### Category 1: reordering of provisions to increase readability and ease of application

- a. A new subsection 4.1 was introduced to consolidate all requirements linked to the ex ante assessment which in the current Risk Finance Guidelines are dispersed over several subsections. This not only streamlines the structure of the Risk Finance Guidelines but also provides more clarity to the Member States.

The Dutch authorities support this streamlining.

- b. Section 4 of the Risk Finance Guidelines on the compatibility assessment applicable to risk finance aid measures which need to be notified to the Commission has been revised to incorporate the judgment of the Court of Justice of 22 September 2020 in Case C-594/18 P.4

### Category 2: further clarifying the specific content and level of evidence needed to demonstrate a specific market failure or another relevant obstacle in access to finance in line with existing case practice

The fitness check showed that Member States have difficulties to quantify the funding gap. Therefore, the requirement to quantify the funding gap has been made more proportionate, i.e. it will only remain in place for schemes with the largest amounts of aid for individual beneficiaries. The revised Risk Finance Guidelines would hence have different requirements depending on the situation as follows:

1. For most cases (e.g. small mid-caps, innovative mid-caps, companies receiving the aid more than ten years after registration) an ex ante assessment demonstrating a specific market failure (or another relevant obstacle in access to finance) remains required but provided that the investment per company is below the GBER threshold of EUR 15 million, a quantification of the funding gap is no longer required;

The Dutch authorities support this clarification.

2. For risk finance measures that concern financial instruments with private investor participation below the minimum ratios provided for in the GBER, the ex ante assessment should furthermore provide a detailed assessment of the level and structure of supply of private funding for the type of eligible undertaking in the relevant geographic area and demonstrate that the identified market failure or the other relevant obstacle cannot be addressed with measures designed according to the requirements set out in the GBER;
3. For risk finance investments exceeding the cap fixed per eligible undertaking in the GBER (i.e. EUR 15 million), the ex ante assessment should also quantify the funding gap (i.e. the level of unmet demand for finance from eligible undertakings) due to the identified market failure (or another relevant obstacle).

Overall, the Commission considers that this proposal reduces the administrative burden for Member States but keeps the requirement of quantification in place for the schemes providing the largest aid amounts to individual companies. For the other schemes, an ex ante assessment demonstrating a market failure (or another relevant obstacle) remains necessary in combination with other safeguards to ensure the aid remains proportional to the market failure (or the other relevant obstacle).

The Dutch authorities support this proposal.

- b. For fiscal instruments, point 149 of the Risk Finance Guidelines so far limited the total investment per beneficiary to the EUR 15 million set out by the GBER. However, for financial instruments no such constraint applies. Therefore, this point of the Risk Finance Guidelines has been aligned with the rule for financial instruments and hence allows also for fiscal instruments risk finance investments above EUR 15 million if this can be justified on the basis of the ex ante assessment.

The Dutch authorities support this alignment.

#### Category 3: focusing the Guidelines on compatibility of State aid to avoid overlaps with the Notice on the Notion of Aid

In 2016, two years after the entry into force of the 2014 Risk Finance Guidelines, the Commission published, as part of the State Aid Modernisation package, the Notice on the Notion of Aid ("NoA"). In the NoA, the Commission clarified its understanding of how the notion of State aid laid down in the Treaty should be interpreted, including on when a public support measure does not constitute State aid due to being carried out under normal market conditions. The guidance provided in the NoA to that effect allows the removal of Section 2.1 "The market economy operator test" of the revised Risk Finance Guidelines to streamline their content towards the determination of compatibility of aid measures.

The Dutch authorities consider it important that the NoA clarifies under which conditions a public support measure doesn't qualify as state aid as it is being carried out under normal market conditions. Could the Commission clarify in the NoA under which conditions State involvements in equity is in line with market conditions. For example the 'market economy investor principle' requires that the price paid for the shares corresponds to their value. Are below mentioned methods all to be used and valid in that respect?

- Net Asset Value Equity
- Profitability value Profitable capacity
- Synthesis of Net Asset Value and Profitability Value Equity and Earning Capacity (Weighted)
- Comparative Market Values (Ratios) Price (=price)/profit or price/cash flow ratio at "comparable" undertakings
- Return value Return on a package of shares without strategic control
- Market value Share price of listed shares (marginal investor)
- Improved Profitability Value Profit Capacity With Adjustment For Excess/Deficit Power
- Discounted cash flow future cash flows

#### Category 4: streamlining existing formulations and aligning definitions to increase consistency with the GBER

- a. The 2014 Risk Finance Guidelines provided an ad hoc definition of 'innovative midcaps', which would be those mid-caps with research and development (R&D) and innovation costs reaching at least 15 % of their total operating costs in at least one of the three years preceding the first investment under the risk finance State aid measure, or at least 10 % per year of their total operating costs in the three years preceding the first investment under the risk finance State aid measure. The current text proposes to align this definition with the GBER, by defining 'innovative mid-caps' as mid-caps that are at the same time 'innovative enterprises' within the meaning of Article 2(80) of the GBER. As a consequence, more mid-caps can be considered 'innovative mid-caps' and are

therefore eligible for risk finance aid under the Risk Finance Guidelines, because the innovative character can be established, as in the GBER, either by an external expert evaluation certifying this feature or when R&D costs reach at least 10% of the total operating costs in at least one year of the three preceding the aid.

The Dutch authorities support this alignment.

- b. In Section 3 on notifiable aid, it is proposed to modify the current point 47(c) so that measures that allow companies to receive risk finance aid more than ten years after registration will be assessed under the Risk Finance Guidelines, while under the current rules the limit is set at more than seven years after their first commercial sale. This aims to avoid uncertainties regarding the identification of the “first commercial sale” that have been pointed out during the fitness check evaluation. Replacing the “first commercial sale” date by “registration” date as starting date for the period during which enterprises can generally receive risk finance aid will simplify the application of the rules, given that registration is more straightforward to interpret than “first commercial sale”. For eligible undertakings that are not subject to registration, the ten-year eligibility period may be considered to start from the moment when the enterprise either starts its economic activity or is liable to tax for its economic activity. Furthermore, the use of the registration date as a baseline is consistent with certain GBER provisions (such as Article 22 regarding start-up aid).

It is proposed to extend the relevant time period from seven to ten years to avoid reducing de facto the time period of eligibility, because registration usually takes place before the first commercial sale. In this context, the study conducted in the evaluation points to ten years as the appropriate cut-off for eligibility given that SMEs that are ten years old or younger are more likely to face issues when accessing finance compared to more experienced SMEs.

The Dutch authorities support this clarification.

#### Threshold for publication of aid

In addition to the revisions mentioned by the Commission in the explanatory note, a new threshold for publication of aid on a State aid website is introduced in point 178 of the draft Risk Finance Guidelines. The threshold is lowered from 500,000 EUR to 100,000 EUR.

The Dutch authorities consider that this new threshold would lead to a disproportionate administrative burden for Member States and consider this highly undesirable. The Dutch authorities request the Commission to maintain the threshold of 500,000 EUR as this threshold will ensure enough transparency.