Submission

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To **European Commission - Directorate-General for Competition, Unit H2 State aid for R&D, innovation and risk capital**

Re **HT. 347**

Consultation on the revision of the Guidelines on State aid to support SME access to risk capital

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The European Private Equity and Venture Capital Association (EVCA) is a member-based, non-profit trade association that was established in 1983 in Brussels. EVCA is a member of the Transparency register (ID: 60975211600-74).

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General remarks

The EVCA welcomes the publication by the Commission of the Paper containing the draft Union guidelines on State aid to promote risk finance investments (hereafter, "the draft Guidelines") and the opportunity it is given to provide comments.

The EVCA supports the European Commission's effort to provide more clarity on the assessment of national measures and for providing clear and operational assessment rules for measures which would not strictly fall within the General Block Exemption Regulation and which are therefore subject to notification.

The EVCA supports the flexibility reflected overall in the text of the draft Guidelines and of the General Block Exemption Regulation (hereafter, "the draft GBER"), the fact that the Commission takes into account the objectives stated in the State aid modernisation (SAM) and the efforts made to simplify and streamline the relevant assessments under both texts. We hope these improvements may result in fewer formalities and pave the way for the future framework for State aid to be more effective than the current regime and effectively enhance the ability of SMEs to access finance.

Overall, the EVCA welcomes the following:

- The fact that the draft Guidelines recognise the existence of varying market failures and that it recognises the funding gap faced by small and medium enterprises (SMEs);

- The shift away from the previous threshold (an annual tranche of EUR 2.5 million per SME) which is an important step towards the recognition that funding gaps are in fact **significantly higher** and reach up to EUR 10-15 million. However, we still have concerns regarding the absence of any time factor in assessing compliance with the notification threshold; we would therefore suggest **calculating the tranche over a 24-month period**.

In spite of the improvements seen in the draft Guidelines, we believe that the rules would benefit from some additional changes. In particular, the EVCA still has concerns regarding the following:

- The extent of the compatibility assessment and evaluation (Sections 2.2 and 4 of the draft Guidelines), and the fact that the Commission has opted to do away with the two options for assessment (prima facie / detailed assessment) applicable in the current framework;

- The Transparency provisions (Section 3.8 of the draft Guidelines), which seem to go too far in terms of information required;

- Legal certainty regarding the extension of the current Guidelines, the entry into force of the new rules and appropriate measures (Section 5 of the draft Guidelines), for which greater flexibility would be necessary.

Specific comments are provided below. An Annex is included which provides suggestions for amendment of the draft Guidelines where relevant.

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Specific comments

1) Extent of the compatibility assessment and evaluation

The EVCA notes that in its draft Guidelines, the Commission has decided to do away with the distinction which exists in the current Guidelines between prima facie assessment (Section 4 of the 2006 Guidelines) and detailed assessment (Section 5 of the 2006 Guidelines). Instead, the draft Guidelines rely on a general substantive compatibility assessment, set out in Section 3.

The EVCA regrets the fact that there is no "intermediate" assessment track in the draft rules for the future framework: provided it constitutes aid and does not fall below the *de minimis* threshold, a national measure *either* complies with the conditions laid out in the (new) General Block Exemption Regulation and is not subject to notification but only to some reporting requirements; *or* it does not comply with the GBER conditions, in which case Member States must notify and the measure will automatically be subject to an in-depth *ex ante* assessment.

In addition, the EVCA notes that, as indicated in Paragraph 39 and as further explained under Section 4 of the draft Guidelines, certain schemes may be subject both to a limited duration **and** an evaluation. The EVCA agrees that to ensure that possible distortions of competition and trade are kept to a minimum, the schemes should be subject to a limited duration.

The EVCA also understands the relevance of having an evaluation process to better monitor the award of State aid and the impact on markets and competition. However, we are concerned with the constraint such an approach could represent and the fact that the evaluation would constitute an additional burden, almost equivalent to an *ex post* assessment. For instance, in the draft Guidelines, the evaluation covers the question of whether the assumptions underlying the *ex ante* assessment have been "achieved". In our opinion, this requirement goes too far and provides only limited added value to the monitoring which Member States would conduct currently.

Not only does the evaluation appear potentially burdensome, but it is not entirely clear which schemes would be subject to this evaluation. Thus, we note that the draft Guidelines provide a list of aid schemes which may be subject to this requirement. In our opinion, this list is very far-reaching, and open to such an extent that any scheme could potentially be covered. As stated above, while we understand the need for evaluation processes and agree with the monitoring of schemes, we would still welcome clarifications regarding the aid schemes which are to be subject to the evaluation. In this respect, we would like to suggest that **this evaluation should be required <u>only</u> where the Commission so requests in the decision approving a national scheme, and on the grounds of its potential negative effects** (cf. Annex). This would ensure better predictability and legal certainty regarding the measures subject to evaluation.

2) Assessment principles

The EVCA notes that the draft Guidelines list the criteria applicable to notified aid under paragraph 38. The EVCA agrees with the 7 criteria listed, even though it has some concerns, in particular in the way the objective of common interest criterion (Paragraph 38, under (a)) and the transparency criterion (Paragraph 38, under (g)) may be implemented.

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Contribution to a common objective

The EVCA welcomes in particular the recognition under Paragraph 42 of the importance of developing a competitive SME finance market in the Union, which should contribute to overall economic growth.

Regarding the specific policy objectives listed (Paragraph 43 ss.), however, the EVCA notes that the draft Guidelines provide for a list of performance indicators which should be relied upon. We feel that the performance indicators may not always be relevant and that providing such information may be quite burdensome. We therefore suggest making this list indicative rather than prescriptive, and leaving to Member States the responsibility and flexibility to identify the most relevant indicators for the objective(s) identified.

Furthermore, members have expressed concerns regarding the implementation of Paragraph 47 which is too far-reaching. We understand that financial intermediaries involved in a risk finance measure must be aligned with the agreed policy targets. We believe that the requirements provided under Paragraphs 44 and 45 are sufficient. In addition, it is not clear how the Commission intends to take into account penalties if targets are not met; we would welcome clarifications in that respect.

Need for State intervention

The EVCA agrees with the general principles underpinning Section 3.3. of the draft Guidelines. However, when it comes to analysing the structural and the cyclical problems leading to limited levels of private funding, the EVCA would like to submit that it may be difficult to distinguish clearly between the structural and the crisis-related aspects of the sub-optimal involvement of the private sector. Further, the 5-10 year timeframe currently suggested is not likely to be the relevant period for all markets, and in some cases, data may not be available. Rather than specifying a specific amount of time, we would like to suggest including a reference to “the relevant timeframe for the markets concerned”.

We also have some concerns regarding preference for the *ex ante* assessment being led by an independent entity, such an entity’s contribution to “objective and up-to-date evidence” compared with other methods and the costs it may represent. We encourage the Commission to leave the choice to Member States on how to best conduct the assessment.

We also note that the draft Guidelines make reference to the 5-year limit after the first commercial sale in order to identify eligible SMEs (cf. also the draft GBER). We would like to reiterate the concerns we already expressed in previous rounds of consultation regarding this 5-year limit, which we consider to be an arbitrary proxy to help identifying stages of investment/development of SMEs. To avoid any discrimination between SMEs in need of access to finance, **we would like to support an extension of this period to 8 years (rather than 5 years), both in the draft GBER and in the draft Guidelines**.

Proportionality of the aid

The EVCA notes that in the Section on proportionality, Conditions for financial instruments, the draft Guidelines indicate very specific criteria for the remuneration of financial intermediaries, managers and entrusted entities. The EVCA considers the text of the Guidelines to be too rigid.

We understand that for the Commission, the remuneration requirements are meant to minimise the aid, through the alignment of interests. We agree with and support the principles of alignment of interests and of performance-based remuneration. However, the other

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requirements foreseen in para. 128 to 133 are neither necessary nor appropriate to reach the objective of alignment of interests. Rather, the EVCA feels that the additional details and requirements (mandatory open, transparent and non-discriminatory call for selection, use and destination of the management fees, cap on total remuneration) are too prescriptive.

The EVCA would like to recall that in the context of venture capital, there is an alignment of interest between the investors (whether public or private), the fund and the fund manager and the VC-backed companies thanks to the structures used and the remuneration agreements that are typically negotiated with investors. The VC industry remuneration structures are designed in such a way as to foster alignment of interests. But the conditions which are currently enumerated in the draft Guidelines risk being counterproductive and would act as a disincentive towards private investors. The fact that these restrictions – in particular regarding the use of management fees and the cap on total remuneration of managers – could be imposed would make an investment with a state aid component less attractive to the private sector and in the end risk reinforcing the reliance on public money.

The EVCA therefore strongly opposes the inclusion of the requirements regarding the cap on total remuneration and the mandatory use of open selection procedures. At the end of the day, the alignment of interests may be achieved in many different ways, including co-investment by fund managers. The Guidelines should acknowledge this and provide for flexibility in this respect rather than require a specific mandatory and constraining procedure which would apply in all cases; this would better serve the general objective of attracting and encouraging private investors.

Transparency

The EVCA has some concerns with the transparency criterion under Section 3.8 of the draft Guidelines. When comparing the draft provisions with the current transparency-related provisions (cf. Section 7.1 of the current Guidelines), we note that the list of information to be provided has been expanded. We agree with the need for publicity, especially regarding the text of the notified aid scheme and its implementing provisions. But we are concerned with the inclusion in the publicity requirement of information relating in particular to the remuneration of managers, fees and management costs effectively paid, the names of individual beneficiaries and the volumes and forms of finance provided to each beneficiary.

We are concerned with the fact that there is no protection for data which typically would be confidential and reserved for investors. This type of information can also be very sensitive for the final beneficiaries (the undertakings); publishing it and making it available to the general public *without restriction* could have a detrimental impact in terms of commercial development and strategy of the undertakings targeted by the risk finance measures. In addition, we believe this could also represent additional red-tape and prove to be an onerous requirement to fulfil (e.g. remuneration *effectively* paid).

Therefore, the EVCA would like this section to be amended, so as to better protect confidentiality and the commercial interests of the entities involved. **We would request the text to be aligned with the wording of the current Guidelines in this respect.**

3) Funding gap

The EVCA welcomes and supports the fact that risk finance aid for SMEs better reflects actual market failures and the funding gaps. The shift away from the previous threshold (tranche of

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EUR 2.5 million) is an important step towards recognizing that funding gaps are significantly higher and reach up to EUR 10-15 million. However, we have some concerns regarding **the absence of any time factor in assessing compliance with the notification threshold**.

We do acknowledge the fact that this EUR 10 million figure would allow for a number of larger initial investments to be made. We also welcome the confirmation by the Commission under Paragraph 62, that it will take into account the size and the nature of the funding gap identified, as well as the capital-intensive nature of the targeted sector, for example life sciences or green energy investments, a point which we also requested in our response to the consultation on the draft GBER.

However, the lack of time reference is a concern. It appears very impractical and uncertain, and may make things difficult for companies looking to attract funding over a longer period of time. Under the current regime, annual investment limits provide a greater certainty in the calculation of the threshold. It means that there is a possibility for a “reset”. But under the new proposals, once the EUR 10 million cap is reached, there is no possibility to extend it. Even though the rules allow some flexibility for follow-on investments, it may not be sufficient.

Therefore, we would welcome the inclusion of a time reference whenever the equity gap is mentioned - both in the draft GBER and draft Guidelines: **EUR 10 million per SME over a 24-month period.** (cf. Annex).

In the event that our suggestion for a time reference is not taken on, we would like to suggest as an alternative raising the threshold figure used in both the GBER and the draft Guidelines. The industry has provided data in the previous rounds of consultation on the review of State aid rules demonstrating that the equity gap reaches **EUR 15 million**.

4) Cumulation

The EVCA welcomes the flexibility displayed in the Cumulation rules under Section 3.9 of the draft Guidelines, compared with the current Guidelines.

We note that several cumulation scenarios are identified in the Guidelines:

- risk finance aid and other State aid measure with identifiable eligible costs;
- risk finance aid approved under the Guidelines and *de minimis* aid;
- risk finance aid approved under the Guidelines and risk finance aid granted in accordance with Articles 19, 20 or 21 of the draft GBER or according to the 2008 GBER;
- risk finance aid approved under the Guidelines and another risk finance aid approved under the Guidelines or the 2006 Risk Capital Guidelines up to the overall investment approved.

We do not support the prohibition to cumulate risk finance aid approved under the Guidelines and *de minimis* aid (cf. second bullet point). It seems to us that paragraph 162 is not coherent with the approach adopted in the draft GBER, which in some circumstances would allow for State aid exempted under the GBER to be cumulated with *de minimis* aid (cf. Article 9(4) draft GBER). We would like to add that it is highly unlikely that the cumulation of such aid would result in a distortion of competition, and therefore **request that this provision is modified so as to allow cumulation of risk finance aid and *de minimis* aid**.

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5) Entry into force / Appropriate measures

The EVCA notes that the draft Guidelines foresee an extension of the current Risk Capital Guidelines until 30 June 2014. As was suggested for the current GBER, and for the sake of legal certainty, **we would welcome the adoption of a separate decision confirming this extension**. This would ensure that there is no gap or legal uncertainty regarding the legal framework applicable should the new Guidelines not be adopted before 31 December 2013.

In addition, and of greater importance, the draft Guidelines would require Member States to amend their existing risk capital aid schemes previously approved by the Commission. We note that this is required within 6 months after the entry into force of the new Guidelines.

Even though the new Risk Finance Guidelines should be adopted before the end of the year, it is expected that the discussions on the GBER will still continue next year, meaning that the new framework as a whole will not be ready until later in 2014. We therefore feel that this 6-month period is too short and that **it should be extended to a period of 12 months**, so as to guarantee greater legal certainty for investors, financial intermediaries and undertakings which are currently benefitting from authorised aid, and ensure a seamless transition.

6) Definitions

Definition of "equity investment"

We take note of the fact that the definition of equity has been substantially amended. The new definition (of "equity investment") appears problematic from both a conceptual perspective and from a practical perspective. As a concept, we note that the reference to equity, which is mainly used under the current GBER and Guidelines to designate investments by funds into portfolio companies, is now also used to designate the capital contribution from investors (public, private) to the financial intermediaries (funds). A single concept is used to refer to two different movements of capital, even though they may be significantly different.

Further, and of even greater importance, by using this new definition, according to which equity investments mean "*the provision of capital to an undertaking, invested directly or indirectly in return for total or partial ownership of that undertaking <u>and where the equity investor may assume some management control of the undertaking</u> and may share the undertaking's profits*" (our emphasis), there is a significant risk of seeing some funds falling outside this definition. In particular, the reference to management control may not always be relevant, especially for minority participations. There is no similar element in the current definition; we do not see the added value of this element. Rather, **we believe this wording to be potentially problematic and would like to see it removed from the definition** (cf. Annex).

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Annex - Suggestions for amendments[1]

Section 2.3 of the draft Guidelines. Definitions

(f) 'equity investment' means the provision of capital to an undertaking, invested directly or indirectly in return for total or partial ownership of that undertaking ~~and where the equity investor may assume some management control of the undertaking~~ and may share the undertaking's profits;

Section 2.1.3. Aid to the undertakings in which the investment is made

30. Where aid is present at the level of the investors, the financial intermediary or its managers, the Commission will generally consider that it is at least partly passed on to the target enterprises, without prejudice to de minimis aid. This is the case even where investment decisions are being taken by the managers of the financial intermediary with a purely commercial logic. In cases where the investment is made on terms which would be acceptable to a private investor in a market economy in the absence of any State intervention the enterprises in which the investment is made will not be considered as aid recipients. For this purpose, the Commission will consider whether such investment decisions are exclusively profit-driven and are linked to a reasonable business plan and projections, as well as to a clear and realistic exit strategy.

Section 3.2.1. Specific policy objectives pursued by the measure

43. The measure must define specific policy objectives in view of the general policy objectives as set out in paragraph 42 above. To that end, the Member 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, t~~The performance indicators ~~should~~ may include for instance:

(a) the required or envisaged private sector investment (leverage effect);

(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;

[1] Words underlined/barred indicate amendments.

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(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.

Section 3.3.1.(d) Undertakings requiring a higher amount of total risk finance investment than [€10 million]

61. Article 19(9) of the General Block Exemption Regulation sets the total amount of risk finance at maximum EUR 10 million per SME over each period of 24 months, including follow-on investments. However, in certain industries where the upfront research or investment costs are relatively high, this amount may not be sufficient to achieve the necessary initial investments 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.

62. Hence, risk finance measures may support access to risk finance above the maximum overall amount of EUR 10 million per undertaking over each period of 24 months, provided the envisaged amount of funding per undertaking under the risk finance measure reflects the size and nature of the funding gap identified in the ex-ante assessment. The Commission will take into account the capital-intensive nature of the targeted sectors, for example life sciences or green energy investments.

Section 3.8. Transparency

160. Member States must publish on a central website, or on a single website retrieving information from several websites (for example regional websites), ~~at least~~ the following information on notified risk finance aid measures: the text of the notified aid scheme and its implementing provisions, the granting authority, the total amount of the Member State's participation in the measure, and the names of the selected intermediaries~~, the methodology for calculating the remuneration of the managers as well as the management costs and fees effectively paid, the names of individual beneficiaries as well as the volumes and forms of finance provided to each beneficiary~~. Such information must be published after the granting decision to grant aid has been taken, must be kept for at least 10 years and must be available for the general public without restrictions. The transparency rules shall not apply to aid beneficiaries which are natural persons.

Section 4. Evaluation

166. An evaluation may only be required for ~~the following aid schemes:~~

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~~(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 shall be submitted as part of the notification;~~

~~(e) schemes containing novel characteristics in particular with respect to the channels of funding;~~

~~(f)~~ schemes where the Commission so requests in the decision approving the measure, in light of its potential negative effects.

Section 5.2. Appropriate measures

173. The Commission considers that the implementation of these Guidelines will lead to substantial changes in the State aid rules applicable to risk capital aid in the Union. Furthermore, in 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 Commission proposes the following appropriate measures to Member States pursuant to Article 108(1) of the Treaty:

(a) Member States should amend, where necessary, their existing risk capital aid schemes approved by the Commission, in order to bring them in line with these Guidelines within ~~six~~ twelve months after their entry into force;

(b) Member States are invited to give their explicit unconditional agreement to these proposed appropriate measures within two months from the date of entry into force of these Guidelines. In the absence of any reply, the Commission will assume that the Member State in question does not agree with the proposed measures.