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COMMISSION STAFF WORKING DOCUMENT

EVALUATION

of the

Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees

{SWD(2025) 331 final}

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GLOSSARY

Term	***Definition***
Adverse selection	Adverse selection refers to a situation when the quality of products that are traded in a market degrades due to the fact that the quality of the product is not observable by the buyers ("lemons problem"). Since buyers cannot distinguish higher quality items from lower ones, the market price reflects the average quality of products for sale. Faced with such prices, sellers of high quality products drop out of the market, which lowers the average quality – and the price – of the products sold. In credit markets, adverse selection may result in "credit rationing", where lenders may not want to provide any funding to a certain category of borrowers, even if the latter are willing to pay high interest rates. This extreme form of adverse selection can be overcome by the provision of guarantees or collateral requirements. Thus, from the point of view of national authorities, a certain degree of adverse selection may be desirable if this results in the provision of funding to targeted, albeit high-risk, firms that would not received it otherwise.
Aid element	Monetary size of the selective advantage in a State aid measure.
Aided measures	Measures that involve an element of aid.
Borrowers in financial difficulty	The definition of financial difficulty is set out in section 2.1 of the Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004, p. 2). In broad terms, a firm must be defined by Member States as facing financial difficulties if it is unable to stem losses either through its own resources or funds from its shareholders or creditors, which would, in the absence of a public intervention, condemn it to go out of business.
BRRD	Bank Recovery and Resolution Directive (Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190-348.)
CDS	Credit default swap (CDS) is a bilateral contract between two parties, where one party ('protection buyer') agrees to make periodic payments to its counterpart ('protection seller') in exchange for compensation in the event of the default of a third party ('debtor') on its debt obligations.

Comparable market transactions	In the absence of specific market information on a given debt transaction, the debt instrument's compliance with market conditions may be established on the basis of a comparison with comparable market transactions (that is to say through benchmarking). In the case of loans and guarantees, information on the financing costs of the undertaking may, for example, be obtained from other (recent) loans taken by the undertaking in question, from yields on bonds issued by the undertaking or from credit default swap spreads on that undertaking. Comparable market transactions may also be similar loan or guarantee transactions undertaken by a sample of comparator companies, bonds issued by a sample of comparator companies or credit default swap spreads on a sample of comparator companies, as described in point 111 of the Notice on the Notion of Aid.
Comparable non-guaranteed loans	In the case of guarantees, if no corresponding price benchmark can be found on the financial markets, the total financing cost of the guaranteed loan, including the interest rate of the loan and the guarantee premium, should be compared to the market price of a similar non-guaranteed loan, as described in point 111 of the Notice on the Notion of Aid.
Competition distortions	In the State aid context, competition distortions are generally found to exist when the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition (see Section 6.2. of the Notice on the Notion of Aid)
CRD	Capital Requirements Directive (Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338–436)
Credit rationing	Credit rationing refers to a situation in which lenders are unwilling to provide credit to borrowers at the prevailing market interest rates. In real world situations, credit rationing also arises in situations where the lender would only agree to provide the funding with substantial amount of collateral or guarantees.
Crowding out	Crowding out refers to a situation where the public supply of a good or services replaces the supply of the same good or services that would have been provided by market operators, typically on the grounds that the public supply is offered at below market terms.
CRR	Capital Requirements Regulation (Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 1–337.)

de minimis Regulation	Commission Regulation (EU) No 1407/2013 of 18 December 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. 1–8.
DG Competition	Commission Directorate-General for Competition
EAPB	European Association of Public Banks
ECB	European Central Bank
Effective interest rate (EIR) safeguard	The EIR safeguard aims to introduce a floor for the implied guarantee premium from the interest rate charged by the lender on the guaranteed loan. The calculations for the floor rely on a theoretical no-arbitrage equilibrium condition whereby a lender would be indifferent between being exposed to pure credit risks arising from (a) a guaranteed loan; and (b) a mixed portfolio of credit default swap (CDS) exposures to both the borrower and the Member State providing the guarantee. The mixed portfolio will be composed to ensure that the risks borne by the lender under option (b) would be equivalent to those under option (a).
EIR	Effective Interest Rate
External Credit Assessment Institution (ECAI)	Credit rating agencies that are registered or certified in accordance with Regulation 1060/2009 on credit rating agencies or a central bank issuing credit ratings which are exempt from the application of Regulation 1060/2009.
FCG	Italian Guarantee Fund
GBER	General Block Exemption Regulation (Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.)
GFDD	Global Financial Development Database
Gross grant equivalent	Gross grant equivalent measures the aid element, discounting the amount of aid provided by an aided measure through its lifetime and resulting in a present value of what that aid would amount to if provided in the form of a grant.

Guarantee measure	A guarantee is a financial obligation in which a third party is contractually obliged to cover a proportion of the debt obligations of a borrower in the event the latter defaults. Although guarantees are usually associated with a loan, other financial obligations, such as bonds, may also be covered by a guarantee. A guarantee measure may refer to an individual guarantee (i.e. on a single financial obligation) or a guarantee scheme (i.e. guarantees provided on financial obligations of a number of borrowers).
Guarantee Notice	Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C 155, 20.6.2008, p. 10-22.
Guarantee schemes	Guarantee measures involving guarantees provided to a broader set of undertakings.
HHI	Herfindahl-Hirschmann Index
IAS 39	International Accounting Standard 39
IFRS 9	International Financial Reporting Standards 9
Individual guarantees	Guarantee measures involving guarantees to individual undertakings.
Internal Ratings Based Approach (IRB Approach) (A-IRB and F-IRB)	Denotes a rating-based approach based on internal models, as provided for in Regulation 575/2013 (Capital Requirements Regulation). In the Advanced IRB approach (A-IRB Approach), the credit institutions use own estimates of loss given defaults (LGD) as model inputs. In the foundational IRB approach (F-IRB Approach), a credit institution uses supervisory LGDs and conversion factors as model inputs.
ISSG	Inter-service steering group
LGD	Loss-given-default
Market conformity	Market conformity means ‘in line with market terms’, i.e. terms that would be granted by a profit-oriented market economy operators in the same circumstances and under normal market conditions, for the same company, bearing the same risk. This comparison with market operators is called the ‘market economy investor principle’ and is used by Union courts to determine whether a public body’s investment or guarantee leads to the granting of an advantage, one of the conditions of State aid. For more details, see Section 4.2. of the Notice on the Notion of Aid.

MEO Test	Market Economy Operator Test, which is described in section 4.2 of the Notice on the Notion of Aid. More specifically, the MEO test is a tool to assess whether a public intervention constitutes State aid under EU law. It examines whether the State's actions are remunerated at terms that are comparable to what a private investor would accept under normal market conditions. If the State's actions are deemed to be market conform following the application of the MEO test, then the intervention is considered to be free of aid.
Minimum Premium Rate	A single credit risk element for the calculation of export credit subsidies and guarantees. Article 21 of the OECD's Export Credit Arrangement foresees the identification of a common element, or the so-called "Minimum Premium Rate", which is to be applicable for both market conform interest rate and guarantee premium calculations.
Moral hazard	In the literal sense of the term, moral hazard refers to the adverse effects (i.e. greater risk-taking) of having an insurance coverage on the behaviour of the covered party. More generally, moral hazard arises in situations where the actions of one party to a contract are not observable or verifiable by the other party to the contract (i.e. "hidden action" problem). For the purposes of this report, moral hazard refers to situations where the provision of the public guarantee may undermine the screening, monitoring and risk management efforts of the lender. The extent of these adverse effects are inversely related to the guarantee coverage ratio. In other words, moral hazard would be at a maximum if the guarantee measure provides a 100% coverage of the risks of the lender.
No-aid measures	Measures that do not involve an element of aid.
No-arbitrage condition	The condition states that there should be no opportunities for a market operator to generate profits by exploiting price differences in different markets or at different times.
Non-performing loan (NPL)	A loan becomes non-performing when there are indications that the borrower is unlikely to repay the loan, or if more than 90 days have passed without the borrower paying the agreed instalments.
Notice on the Notion of Aid	Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU, OJ C 262, 19.7.2016, p. 1–50.
Notional or nominal amount of debt	The amount that the debtor owes to the creditor at the time of reference (i.e. the outstanding debt).
OECD's Export Credit Arrangement	OECD Arrangement on Officially Supported Export Credits is an agreement among participating countries to establish a framework for export credit support measures that are backed by the State.

Pari passu transaction	As detailed in points 86 to 88 of the Notice on the Notion of Aid, a transaction can be deemed to be a *pari passu* transaction when the State and private operators have comparable starting positions (e.g. same prior exposures to the borrower), enter into a guarantee agreement with the borrower at the same time, when the terms and conditions of the two guarantees are the same, and when the private guarantee is not merely symbolic or marginal.
Pass-through	Pass-through refers to a situation where an entity (e.g. a financial intermediary) that receives an advantage (e.g. a guarantee) fully passes that advantage to the "ultimate beneficiary" (e.g. the borrower).
Reference Rate Communication	Communication from the Commission on the revision of the method for setting the reference and discount rates, OJ C 14, 19.1.2008, p. 6–9.
Risk based – Effective interest rate – CDS methodology	A combination of three calculation methods, whereby the guarantee premium is first determined by a risk-based methodology, which is then subject to floors as determined by effective interest rate methodology and/or market benchmarks based on the credit default swap.
Risk weighted assets (RWA)	A measure of the riskiness of a financial institution's exposures to particular counterparties, whereby the total nominal value of the asset is weighted by a factor, i.e. risk weight, that reflects the riskiness of the exposure.
SAFE	Survey on the Access to Finance of Enterprises is conducted by the Commission and the ECB since 2008 on a quarterly basis. SAFE database provides firm-level data on the financial situation of enterprises, the need for and availability of external financing, and the firm's expectations about prices, costs, and employment. The survey results are broken down by firm size, sector, country, firm age, financial autonomy and ownership.
Safe harbour methodology	A methodology based on the fixed guarantee premiums for SMEs as described in section 3.3. of the Guarantee Notice.
Safe harbour premium	A guarantee premium described under Section 3.3 of the Notice, that is considered sufficiently high to avoid a (material) selective advantage to the guarantee buyer.
Sample of comparable undertakings	Sample of comparator companies as described in point 111 of the Notice on the Notion of Aid.
Section 6 data	The analysis based on reports submitted by Member States in line with Section 6 of the Guarantee Notice.

Selective advantage	In the State aid context, a public measure is selective if it grants an advantage to certain undertakings, categories of undertakings or to certain economic sectors (for more details, see Section 4.1 of the Notice on the Notion of Aid).
Self-financing guarantee scheme	The self-financing nature of the scheme and the proper risk orientation are viewed by the Commission as indications that the guarantee premiums charged under the scheme are in line with market prices, as described in points (d) to (f) of section 3.4 of the Guarantee Notice.
SMEs	Small and medium-sized enterprises, as defined in the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises.
SRMR	Single Resolution Mechanism Regulation (Regulation 806/2014/EU of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, OJ L 225, 30.7.2014, p. 1–90).
SSM	Single Supervisory Mechanism.
Study	The external study commissioned by the Commission services with the specific aims to assess the effectiveness, efficiency, and coherence of the Guarantee Notice over the evaluation period. The Study was conducted by Prometeia and its academic partners. It was carried out in the course of 2024. The Study is 'backward-looking', focusing on the period 2010 to 2023.
SWD	Staff Working Document.
TFEU	Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47–390.
Zombie firms	A firm which fulfils cumulatively the following characteristics for two consecutive years: (i) a negative return on assets; (ii) negative net investments; and (iii) a low debt servicing capacity, which is characterised as net earnings over financial debt.

1 INTRODUCTION

This Staff Working Document ("SWD") summarises the results of the evaluation of the Guarantee Notice, launched in August 2022.

1.1 Background

The Guarantee Notice was first adopted in 2000[1] and last revised in 2008[2]. It sets out the Commission's approach to State aid granted in the form of guarantees and provides detailed guidance to Member States on the principles on which the Commission intends to base its interpretation of Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU)[3] in the context of State guarantees.

A typical guarantee measure involves three parties, where the guarantor undertakes to pay the lender's credit losses if the borrower fails to meet its payment obligations towards the lender and defaults on its loan. In this respect, credit guarantees transfer the risks that are typically borne by the lender to the guarantor. When the guarantee covers less than the full amount of credit losses, the 'guarantee coverage' is partial since the lender also bears some of the losses. In addition to credit guarantees, guarantees may also cover the losses of other guarantors (which are often referred to as 'counter-guarantees'), the losses of debt investors, or the losses of an exporter if a foreign buyer does not pay for goods ('export guarantees').[4] However, given their predominance, the term "guarantee" will refer to credit guarantees in the rest of the text, unless otherwise noted.

Public guarantee measures may be put in place involving no element of aid ('no-aid measures'), implying that the guarantor, or the State, receives a remuneration in line with what a market operator would accept in exchange for the guarantees it has provided. However, guarantee measures may also involve a certain amount of aid ('aided measures'). The aim of these aided measures is to enable borrowers to obtain funding either at lower interest rates than what would otherwise be available on the market or in situations where no funding would be available at *any* interest rate. The Commission's assessments of aided measures focus primarily on the existence and compatibility of aid at the level of the borrower. However, aided guarantee measures may also entail aid to the lender, where the advantages that a lender obtains from the risk transfer are not 'passed through' to the borrower in full.

Section 3.4 of the Guarantee Notice sets out the qualitative criteria and conditions for the calculation of market conform guarantee premiums. While the calculation methodologies that take these criteria and conditions into account tend to be complex, section 3.3 of the Guarantee Notice also offers a simpler alternative for small and medium-sized enterprises (SMEs) i.e., the so-called "safe harbour premiums". In addition to the calculation of market conform premiums, section 4 of the Guarantee Notice also sets outs conditions for the quantification of the aid amount (or the 'gross grant equivalent') for aided measures, which are defined as the difference between the market conform premium and the guarantee premium actually paid. This element of the Guarantee Notice is also

1 Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C 71, 11.3.2000, p. 14–18.
2 Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C 155, 20.6.2008, p. 10-22.
3 Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47–390.
4 The Guarantee Notice is not applicable to export guarantees.

referenced for the calculation of the aid amount under the General Block Exemption Regulation (GBER)[5] and the *de minimis* Regulation[6]. Lastly, section 2.3 of the Guarantee Notice provides examples where aid to the lender may be present, including for cases when the State guarantee is provided for an existing loan without the terms of this loan or financial obligation being adjusted, or when the guaranteed loan is used to pay back another, non-guaranteed loan.

In August 2022, the Commission launched the process of evaluating the Guarantee Notice, in particular its Sections 2.3 (on how aid to the lender can be avoided), 3.3 (safe harbour premiums for aid-free guarantees to SMEs) and 3.4 (methodologies to establish aid-free guarantee schemes).

1.2 Purpose of the evaluation

The purpose of this evaluation was to check whether the Notice remained 'fit for purpose' and to identify any shortcomings. The Guarantee Notice has not been revised since 2008 and does not contain any fixed review clause or expiry date. Furthermore, there was a growing need to evaluate the Guarantee Notice due to changing market conditions since the global financial crisis that erupted in 2008, changing capital requirements and risk assessment methodologies that have been put in place, and of the growing number of approved guarantee methodologies.[7]

Against this background, the evaluation analyses how the Notice has functioned since its adoption in 2008 and to what extent it achieved its main objectives, which comprise of:

i. Providing guidance on market-compliant guarantee premiums to rule out the presence of State aid and prevent distortions of competition;

ii. increasing legal certainty for stakeholders and increasing transparency on the Commission's policy, so that its decisions are predictable and ensure equal treatment; and,

iii. introducing easy-to-apply rules, especially for SMEs to improve their access to finance.

The evaluation will furthermore inform the Commission about the necessity for a revision of the Notice.

The SWD reflects the findings and views of the Commission's staff and does not represent the formal position of the Commission itself. It verifies the extent to which the evaluation criteria – effectiveness, efficiency, value added, relevance and policy coherence – have been met and summarises those findings. Thus, the SWD does not make any policy proposals or prejudge the final nature or the content of any act or decision by the Commission.

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5 Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

6 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.

7 See section 3 for further details on the evolution of market conditions, regulatory developments and insights from recent case practice.

1.3 Scope of the evaluation

The evaluation covers only the Notice and its implementation through approved guarantee methodologies. It does not cover any other secondary State aid legislation or the broader financial services legislation under which lenders and other relevant financial institutions operate. However, for the purposes of the coherence analysis in section 4.2, the evaluation does assess whether the Guarantee Notice is consistent in relation to other State aid legislation and guidance.

The public guarantee measures cover both individual guarantees and guarantee schemes on commercial loans with an aid element or without an aid element that were notified to the Commission, extended to all types of companies, including SMEs. The evaluation period extends from the entry into force of the Notice in 2008 until the present day while the external study (see also section 1.5) covers data on guarantee measures over the period 2010-2022. In terms of geographical scope, the evaluation covers the 27 Member States.

Annex III provides more details on the evaluation matrix, including the questions that this evaluation aims at addressing.

1.4 Evaluation criteria

The evaluation assesses five main criteria, namely the effectiveness, efficiency, coherence, relevance, and EU added value of the Guarantee Notice:

- **Effectiveness:** Extent to which the Guarantee Notice contributed to determining market-compliant guarantee premiums, limiting distortion of competition in product and credit markets as well as between financial intermediaries;

- **Efficiency:** Extent to which the requirements of the Guarantee Notice have been proportionate to the cost of implementing guarantee schemes and helped simplify the implementation of schemes, especially for small and medium-sized enterprises;

- **Coherence:** Extent to which the Guarantee Notice is internally coherent (i.e. how much do the rules in the Guarantee Notice complement each other) and externally coherent (i.e. how consistent is the Notice with other EU legislation);

- **Relevance:** Extent to which the Guarantee Notice has remained relevant over time amidst the macroeconomic, market and regulatory developments since 2008; and,

- **EU added value:** Extent to which the Guarantee Notice has provided added value compared to a situation without such guidance.

1.5 Methodology

The evaluation was launched by a call for evidence in August 2022 and was based on the following elements:

- <u>A public consultation</u> conducted between 29 August 2022 and 19 December 2022 with high-level questions addressed to the general public.

- A targeted consultation conducted between 29 August 2022 and 19 December 2022 in the form of a request for information to Member States and a targeted questionnaire. The targeted questionnaire aimed at selected stakeholders directly involved in or affected by the provision of State guarantees or with relevant expertise in the field of credit risk, featuring questions of a more technical nature than the public consultation.

- A request for information ('REQ') was launched alongside the targeted consultation to gather the necessary data on existing State guarantee measures. The aim was to use the information to assess the effectiveness of those measures. The request for information was submitted to Member States via their Permanent Representations to the EU, and they were able to reply in all 24 official EU languages.

- An external study ('the study') undertaken by a team of external independent experts ('independent experts') in the course of 2024 and focussed on three areas: (i) characteristics of guarantee measures and identification of existing types of methodologies based on data collection on past/present measures; (ii) development of benchmark methodologies based on the literature review on pricing of guarantees; and (iii) quantitative and qualitative assessment of the effectiveness, efficiency and coherence of the Guarantee Notice by analysing the information on existing pricing methodologies put in place by the Member States and the developed benchmark methodologies. The Commission's services were closely involved in defining the study's research questions and methodology, had regular follow-up meetings with the independent experts, thoroughly reviewed the study's findings and challenged them to ensure their robustness.

- Other sources of information such as the Commission's case practice or annual reports by Member States based on Section 6 of the Guarantee Notice. For further information on the methodology, see Annex II.

In the evaluation process, a comprehensive dataset was constructed with the help of the independent experts to analyse the Guarantee Notice's application and pricing methodologies. The comprehensive dataset includes several samples developed for the purpose of the external study, which are as follows[8]:

- Sample A. Provides detailed information on a total of 283 guarantee measures between 2010 and 2022, based on information obtained from the REQ, DG Competition's State Aid Register (SAR) and interactions of independent experts with guarantee granting and administering bodies of specific Member States.

- Sample B1. Provides data on the parametrisation details for the pricing methodologies contained in Sample A, based on similar information sources.

- Sample B2. Provides data on the parametrisation details for benchmarks developed by the independent experts, based on publicly available market indicators.

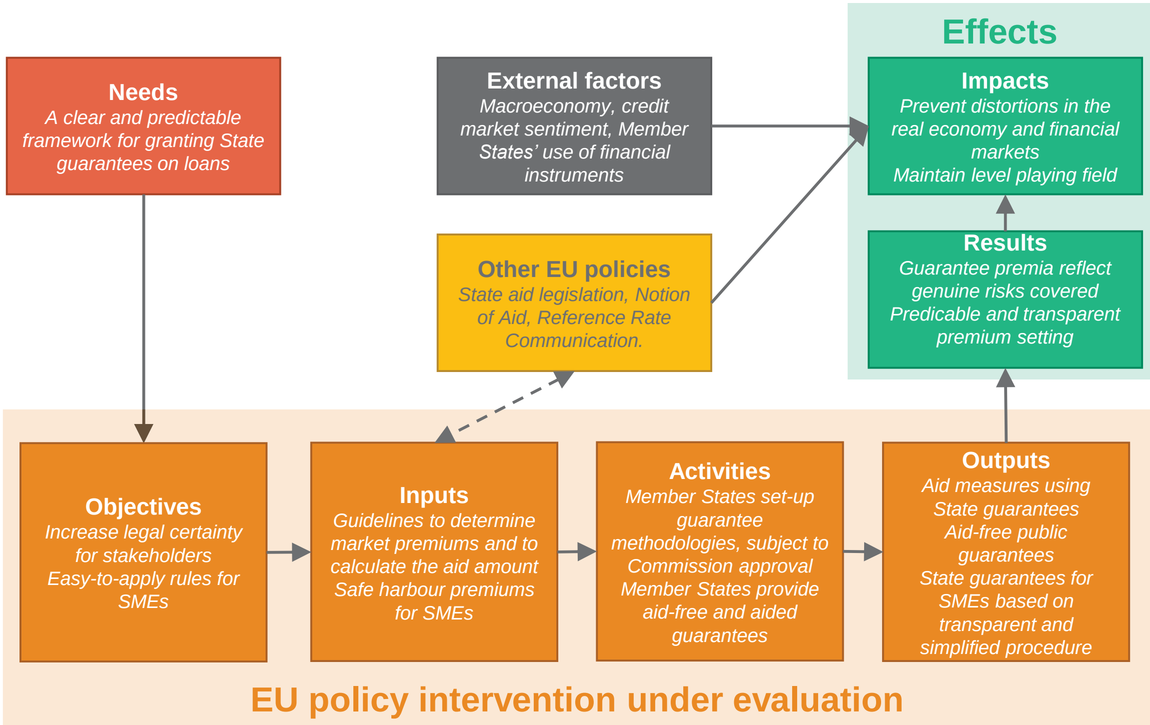
[8] See Annex II for more details.

- <u>Sample C.</u> Provides the data used for the empirical estimations referred to in section 4, covering from 2010 to 2022. The data sources a number of publicly-available and paid information sources (see Annex II for more details).

2 WHAT WAS THE EXPECTED OUTCOME OF THE INTERVENTION?

This section explains the elements of the intervention, from addressing the identified needs to the expected outcomes and the intended results. The intervention logic describes the elements of the intervention, which is further elaborated in Figure 1.

Figure 1: Intervention logic of the Guarantee Notice



2.1 The need for a Guarantee Notice

The Guarantee Notice responded to a need for a clear and predictable framework for granting State guarantees by providing guidance on how to achieve market conformity of guarantee premiums. Establishing market conform terms is essential not only to establish no-aid measures, but also to calculate the amount of aid a Member State may grant in aided-measures. If provided at below market terms, State guarantees may enable a borrower to obtain more advantageous financial terms for a loan than those available on financial markets, which may be considered as State aid within the meaning of Article 107(1) of the TFEU. In addition to market conformity, the Guarantee Notice is also used to minimise a potentially distortive effect of State guarantees through the provision of selective advantages to the lender. Putting these elements together, the Guarantee Notice addresses the need for a clear and predicable framework by establishing conditions for determining market-conform guarantee premiums, calculating the aid element and ruling out aid to unintended beneficiaries.

In general terms, a guarantee premium is deemed by the Commission to be market conform if it is in line with what a market operator would expect as remuneration for a similar transaction under normal market conditions. The specific conditions for the so-called 'Market Economy Operator Test' or the 'MEO Test' are described in section 4.2 of the Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU (the 'Notice on the Notion of Aid').[9]

The Commission's market conformity assessments typically focus on whether the transaction's compliance with market conditions can be directly established through transaction-specific market data or, in cases where such transactions are absent or the data is unavailable, whether other methods could be used. More specifically, the Notice on the Notion of Aid sets the following ranking for the determination of market conformity of a guarantee measure:

- The most direct way to rule out aid is when the remuneration that the State obtains in return for a guarantee is equivalent to the guarantee premium that is charged by a private operator, or a private guarantor, in a *pari passu* transaction, where the private guarantee is on the same exposure and subject to the specific conditions described in points 86 to 88 of the Notice on the Notion of Aid.[10]

- When a *pari passu* transaction does not exist, market conformity may also be established by market benchmarks on "comparable market transactions" for the same undertaking or on "a sample of comparable undertakings", as described in point 111 of the Notice on the Notion of Aid. In the absence of any comparable transactions, the interest rate on the guaranteed loan, including the guarantee fee, should be compared to the market price of "comparable non-guaranteed loans".

- Where no acceptable market benchmarks exist, the Member States may develop their own methodologies to calculate their own market proxies. As described in point 114 of the Notice on the Notion of Aid, the guidance for the calculation of the market proxies is provided by the Guarantee Notice.[11]

Due to data limitations and the lack of observable and comparable transactions, most of the guarantee measure assessments conducted by the Commission focus on the third option, the development of market proxies. By providing the sufficient conditions to rule out the presence of aid, the Guarantee Notice also binds the Commission in its assessments of guarantee measures.[12]

As noted in point 109 of the Notice on the Notion of Aid, the assessment of State guarantee measures requires an assessment of the "triangular situation involving a public entity as a guarantor, a borrower and a lender". Under point 116 of the Notice on the

9 OJ C 262, 19.7.2016, p. 1–50.

10 As detailed in points 86 to 88 of the Notice on the Notion of Aid, a transaction can be deemed to be a *pari passu* transaction when the State and private operators have comparable starting positions (e.g. same prior exposures to the borrower), enter into a guarantee agreement with the borrower at the same time, when the terms and conditions of the two guarantees are the same, and when the private guarantee is not merely symbolic or marginal.

11 One valid question is why the Commission may be involved in the assessment of a no-aid measure. Indeed, under Article 108(3) TFEU, Member States are only required to notify the Commission for measures involving aid. However, the Commission is also often involved in the assessment of no-aid measures when Member States notify such measures for a variety reasons, most notably to obtain legal certainty.

12 The binding nature of the Guarantee Notice for determining the sufficient conditions to rule out aid was confirmed by the decision of the Court of Justice of the European Union (First Chamber), C-211/20 P, *Valencia Club de Fútbol v Commission*.

Notion of Aid, all “foreseeable effects” of the measure “should be examined from an *ex ante* point of view”. Such an examination would therefore consider not only the direct advantages to the borrower but also unintended advantages to the lender.[13] A lender may obtain such indirect advantages by holding onto, or not fully passing-through, the risk-reduction benefits they obtain through public guarantees, i.e. by not reducing the interest rates sufficiently. The possibility that a lender may obtain indirect advantages in the context of State guarantees are highlighted in point 2.3.1 of the Guarantee Notice that describes specific situations by way of examples. Attention is also drawn to the fact that “such aid might, in principle, constitute operating aid,” which, in turn, could assist in preserving or restoring the viability, liquidity or solvency of the lender. As a result, such aid could qualify as extraordinary public financial support under the Bank Recovery and Resolution Directive (‘BRRD’)[14] and the Single Resolution Mechanism Regulation (‘SRMR’)[15] and could, in principle, trigger a determination that the lender is failing or likely to fail. Therefore, it is important that any advantage channelled through lenders benefits only the final beneficiaries.

2.2 The objective of the Guarantee Notice

Before the Guarantee Notice of 2000 was adopted, Member States had to notify all aided guarantee measures, while the Commission provided limited details on its approach to the assessment of how it would assess the existence of aid in these measures. There was thus a lack of certainty for stakeholders regarding the presence and amount of aid in public guarantees.

In 1989, the Commission addressed two letters[16] on State guarantees to the Member States, pointing out that it would regard all guarantees given by a State as falling within the scope of Article 107(1). According to the letters, the Commission would have to be notified of any plans by Member States to set up guarantee measures, even if these measures were intended as no-aid measures. In 1993, the Commission adopted a communication[17] which echoed these positions. Thus, without a notification, Member States did not have any legal certainty on whether the pricing of guarantees provided by public bodies or authorities would be considered by the Commission as market-conform. In addition, the Member States were provided very little guidance on when a guarantee measure could be considered as being free of aid. The Guarantee Notice of 2000 was

[13] The possibility that “an advantage can be conferred on undertakings other than those to which State resources are directly transferred (indirect advantage)” is also confirmed in point 115 of the Notice on the Notion of Aid.

[14] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190-348.

[15] Regulation 806/2014/EU of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund, OJ L 225, 30.7.2014, p. 1–90.

[16] Commission letter to the Member States, SG(89) D/4328 of 5 April 1989 and Commission letter to the Member States, SG(89) D/12772 of 12 October 1989.

[17] Commission Communication to the Member States on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, 13.11.1993, p. 3).

adopted to address these concerns, outlining the specific conditions for excluding the existence of aid as well as distinguishing between aid to the borrower and the lender.

The Guarantee Notice of 2008 updated the Commission's approach on State guarantees and gave more detailed guidance about the principles used for the assessment while retaining the content of the Guarantee Notice of 2000. It introduced safe-harbour guarantee premiums for SMEs as an additional way to establish market conform premiums in a transparent and predictable way.

The objective of the Guarantee Notice[18] of 2008 is to provide Member States with detailed guidance on the Commission's approach to its assessments of notified guarantee measures and to determine whether a guarantee constitutes State aid according to the Article 107(1) of the TFEU. For this, the Guarantee Notice sets out conditions to guide Member States to establish market conform guarantee premiums and to calculate the aid amount, or the gross grant equivalent, contained in aided measures. By adopting the Guarantee Notice, the Commission has therefore intended to make its policy in this area as transparent as possible, thereby ensuring that its decisions are predictable and ensuring a level playing-field among the Member States.

2.3 The scope of the Guarantee Notice ('input')

Any guarantee granted directly by the State, i.e. by central, regional or local authorities, and any guarantee granted by undertakings under the dominant influence of public authorities may constitute State aid under Article 107(1) of the Treaty. The Guarantee Notice applies without prejudice to Article 345 TFEU and is thus not aimed at providing a preference between public or private ownership.

Guarantees are usually associated with a loan or other financial obligation, where risks arising from the default of the borrower are transferred to the guarantor. The Guarantee Notice not only covers guarantees on loans, but also distinct[19] guarantees on other forms of financial transactions, such as counter-guarantees provided to a first-level guarantor are also covered. Export credit guarantees are excluded from the scope of the Guarantee Notice.

In terms of the scope of beneficiaries, the Guarantee Notice covers both guarantee measures involving guarantees to individual undertakings ("individual guarantees") or guarantees provided to a broader set of undertakings ("guarantee schemes"). The Guarantee Notice applies to all economic sectors, including the agriculture, fisheries and transport sectors.

2.4 The description of the Guarantee Notice ('input' and activities')

As described in point 114 of the Notice on the Notion of Aid, the Guarantee Notice sets out the sufficient principles and conditions that may be used in the assessment of the calculation of market benchmarks for guarantee transactions.

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[18] See Annex VI on the case practice of guarantee measures before the adoption of the Guarantee Notice in 2000 as well as the key amendments of the 2008 Guarantee Notice.

[19] The Guarantee Notice covers guarantees granted to a distinct, i.e. an identifiable beneficiary, and does not cover so-called portfolio guarantees, when the guarantee is not connected to distinct, identifiable beneficiaries.

The Commission considers that there is State aid to the borrower in following specific cases where:

- The State accepts a premium lower than the market premium, enabling the borrower to obtain better financial terms for a loan than those normally available on the financial markets;

- the State provides guarantees that are not limited in amount or duration; or,

- the State guarantee is not linked to a specific transaction, such as when the State guarantees rule out the bankruptcy or insolvency of the borrower.

Section 2.3.1 of the Guarantee Notice also describes specific examples where the Commission would consider aid to be present if the guarantee is provided on an existing loan or if the guaranteed loan is used to pay back another, non-guaranteed loan to the same credit institution. In these cases, it is possible that the lender may also receive part of the aid if no adjustments are made to the terms and conditions applicable to the loan to account for the fact that credit risks associated with the default of the borrower have been transferred to the State.

The Commission sets out in section 3 of the Guarantee Notice the conditions that are sufficient to rule out the existence of aid. In general terms, if an individual guarantee or a guarantee scheme does not bring any advantage to a business, it will not constitute State aid.

To determine whether an advantage is being granted through an individual guarantee or a guarantee scheme, the Commission should base its assessment on the 'market economy guarantor principle', which, as described in section 4.2 of the Notice on the Notion of Aid, examines whether the State's actions are remunerated at terms that are comparable to what a private investor would accept under normal market conditions. The Guarantee Notice sets out general conditions to determine whether this principle is met for guarantee measures.

Overall, the Commission considers that individual State guarantees and guarantee schemes do not constitute aid if the following conditions described in section 3.2 (for individual guarantees) and section 3.4 (for guarantee schemes) of the Guarantee Notice are met cumulatively:

a. The borrower is not in financial difficulty[20], as described in point (a) of sections 3.2 and 3.4 of the Guarantee Notice, corresponding to the differentiated description of this condition for individual guarantees and guarantee schemes, respectively;

b. the extent of the guarantee can be properly measured and must be linked to a specific financial transaction, valid for a fixed amount and limited in time, as described in point (b) of sections 3.2 and 3.4 of the Guarantee Notice[21];

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[20] Financial difficulty is defined as in Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p. 2.

[21] As an additional requirement applicable only for guarantee schemes, the State must publish the eligibility criteria as well as the size, amount and duration of the guarantees, as described in point (g) of section 3.4 of the Guarantee Notice.

c. the guarantee does not cover more than 80% of the outstanding loan, as described in section 3.2, point (c) and 3.4, point (c) of the Guarantee Notice[22];

d. the remuneration that the State receives in exchange for the guarantee must be commensurate with the risks it assumes, which is described as follows:

   - For individual guarantees provided to a single entity, a market conform remuneration, as described in point (d) of section 3.2 of the Guarantee Notice, must be paid, corresponding to either (i) a comparable benchmark that can be found on the financial markets or, (ii) if no such benchmark can be found, the interest rate of the loan and the guarantee premium, taking into account the characteristics of the guarantee and the exposure, including amount and duration of the transaction, collateral provided, other economic conditions, and the risk rating of the borrower;

   - For guarantee schemes provided to several entities, a market conform remuneration has to, in all likelihood, remain "self-financing", as described in points (d) and (e) of section 3.4 of the Guarantee Notice. In addition, under point (f) of section 3.4 of the Guarantee Notice, the guarantee premiums must cover the "normal risks associated with granting the guarantee", administrative costs, and the opportunity cost of setting aside capital for regulatory purposes for the duration of the guarantee.

Existing measures that fall within the scope of section 3.2 or section 3.4 of the Guarantee Notice, complying with the conditions described above, will be referred to as 'existing risk-based methodologies' or 'risk-based methodologies' in the rest of the text.

For SMEs whose ratings are higher than CCC/Caa, section 3.3 (for individual guarantees) and 3.5 (for guarantee schemes) of the Guarantee Notice also provide the so-called 'safe harbour premiums', which serve as a simpler method to set the market conform premiums. These fixed premiums will be referred to as 'existing safe harbour premiums' in the rest of the text.

These fixed premiums are differentiated by the rating of the recipient SMEs. Guarantee schemes for SMEs can also use a single premium determined for the whole scheme as long as the scheme remains self-financing, and the guarantee amount per SME does not exceed EUR 2.5 million, as described under Section 3.5 of the Guarantee Notice. Existing measures that have been assessed in line with these specifications will be referred to as 'existing single premium methodologies' in the rest of the text.

For aided measures, the aid amount, or the gross grant equivalent, is measured using the guidelines provided under section 4 of the Guarantee Notice. In broad terms, the aid

[22] The guarantee coverage limitation of 80% does not apply to guarantees on debt securities, or if a the guarantee aims to finance company that is entrusted with a Service of General Economic Interest (SGEI), in compliance with Community rules such as Commission Decision 2005/842/EC of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (OJ L 312, 29.11.2005, p. 67), and the Community framework for State aid in the form of public service compensation (OJ C 297, 29.11.2005, p. 4). Moreover, a Member State may argue that a guarantee coverage above 80% is free of aid provided that it notifies the measure to the Commission to substantiate its claim.

element will be determined by the difference between the appropriate market price of the guarantee, as calculated by an approved methodology in line with sections 3.2 or 3.4 of the Guarantee Notice or by the safe harbour rates in line with sections 3.3 and 3.5 of the Guarantee Notice, and the actual price paid for that measure.

As set out in section 5 of the Guarantee Notice, aided measures within the scope of Article 107(1) TFEU must be examined by the Commission with a view to determining whether or not they are compatible with the common market.

Finally, section 6 of the Guarantee Notice requires Member States to monitor and submit reports to the Commission, in accordance with the general monitoring obligations[23] under State aid rules. For measures involving aid, the reports should be provided at least at the end of the period of validity of the measure and for the notification of an amended scheme. However, the Commission may choose a more frequent reporting schedule on a case-by-case basis. The reporting covers a number of elements, including, but limited to, the number and value of guarantees issued and outstanding, the number and value of defaulted guarantees, guarantor's income from guarantee premiums and recovery (defaulted positions), administrative costs borne by the guarantor, and guarantee indemnifications.[24] For no-aid measures, the Commission may also request such reporting, clarifying on a case-by-case basis the frequency and the content of the reporting requirements.

The Guarantee Notice thus provides a comprehensive and differentiated set of guiding provisions that allow Member States to provide guarantees on aided and aid-free terms, individually or within a scheme, subject to individual guarantee methodologies or using safe harbour premiums.

2.5 What the Guarantee Notice is expected to achieve (results and impacts)

By adopting the Guarantee Notice, the Commission aimed to (i) reduce the number of State guarantees requiring a Commission decision and (ii) help the Member States design no-aid guarantee measures without any notifications to the Commission, thus ensuring a much quicker implementation. In addition, by transparently outlining the conditions for the establishment of market conform guarantee premiums and the calculation of the aid amounts, the Commission aimed to ensure that its decisions are predictable while at the same time ensuring a level playing-field among the Member States. With the application of the safe harbour premiums for SMEs, the Commission also wanted to offer a simple and transparent method to determine the level of the guarantee premium in order to facilitate their access to finance, especially through the use of guarantee schemes.

[23] Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EU) 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 140, 30.4.2004, p. 1).

[24] For aided schemes, the reporting should cover (a) the number and amount of guarantees issued; (b) the number and amount of guarantees outstanding at the end of the period; (c) the number and value of defaulted guarantees (displayed individually) on an annual basis; (d) the annual income from the premiums charged, income from recoveries, and other revenues (e.g. interest received on deposits or investments); (e) the annual costs (administrative costs and indemnifications paid on mobilised guarantees); (f) the annual surplus or shortfall; and (g) the accumulated surplus or shortfall since the beginning of the scheme. For aided individual guarantees, only the relevant information mentioned in in points (d) to (g) should be similarly reported.

By facilitating the establishment of market conform guarantee premiums, the Guarantee Notice aimed at ensuring that the premiums reflect genuine risks covered. This helps preventing distortions in the real economy and in financial markets.

2.6 Point of comparison of the evaluation

Since 1989 (see Annex VI), the Commission has adopted a stance through several communications that public guarantees on loans may constitute State aid. The Commission communicated that an assessment of the aid element of guarantees requires an analysis of the borrower's financial situation and that the aid element would be the difference between the market conform guarantee premium and the premium actually paid, it fell short of providing concrete guidance on how Member States were to calculate the market conform premium.

Since the communications adopted prior to the 2000 Guarantee Notice provided no details on the calculation of a market conform premium, Member States needed to notify all aided guarantee measures.

The Guarantee Notice of 2000 highlighted the principles needed for an assessment, excluding companies unable to obtain loans on market conditions, limiting the guarantee cover to 80% of the outstanding loan notional amount and introduced the notion of schemes being self-financing as proxy for market conformity of the premiums and the need to review premiums at least once a year. These conditions were further expanded and described more in detail in the Guarantee Notice of 2008. A particular need was identified for the development of safe harbour premiums, with Member States contacting the Commission services to verify the market conformity of simplified pricing methodologies in schemes. In the absence of the safe harbour premium provided by the Guarantee Notice, there was no simplified assessment method to determine the market premium. This hampered the access to finance for SMEs and was eventually remedied with the 2008 Guarantee Notice.

Since the Guarantee Notice of 2000 and 2008 represent a clear inflection point for the guidance provided to Member States on the calculation of the market conform guarantee premiums, the point of comparison for this evaluation will be what is expected to have happened in the absence of both the 2000 and 2008 Guarantee Notices.

Notably, in the absence of a Guarantee Notice, Member States would have to rely solely on the jurisprudence of the Court of Justice on the notion of aid and the summary thereof in the Commission’s Notice on the Notion of Aid for establishing market-conform guarantees and measuring the aid element in aided measures. Also, the Commission would have to take decisions on guarantee methodologies using the TFEU directly as its legal basis. Given the large and diverse number of methodologies that Member States have in place, this would have significantly deteriorated the State aid enforcement capacity of the Commission. In addition, the Commission would have no already established detailed reference to rely on when investigating complaints from applicants with legal standing. Lastly, it would reduce the legal certainty of Member States for establishing no-aid measures that are not notified to the Commission as there would be no detailed Commission guidance available for them to consult concerning guarantees.

3 HOW HAS THE SITUATION EVOLVED OVER THE EVALUATION PERIOD?

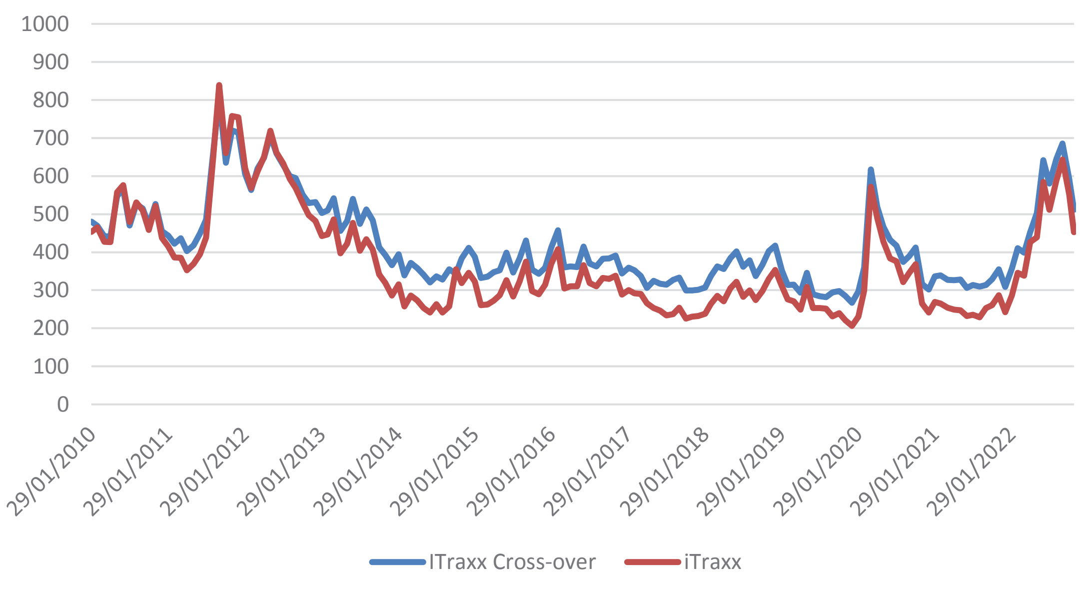
3.1 Macroeconomic developments and the evolution of EU Credit Markets

The Guarantee Notice's provisions are related to macroeconomic developments in two ways. First, market credit risk margins vary in line with the financial cycle. The safe harbour premiums of the Guarantee Notice, in contrast, have remained fixed. This implies that the suitability of the safe harbour premiums to serve as market proxy may have varied[25]. Second, the ability and willingness of private creditors to supply credit may vary in line with the financial cycle. Public authorities typically provide guarantees in a stable, or even countercyclical way. The relevance of the Guarantee Notice, by providing guidance to public authorities and facilitating the provision of public guarantees, may thus be higher in times where companies face greater access-to-finance problems.

3.1.1 Macro-economic developments

Since the entry into force of the Guarantee Notice in 2008, the EU credit markets have faced a sequence of macro-economic shocks. The global financial crisis erupted in 2008 and spread, in the years 2008-2011, through the European financial and real economy sectors. The crisis has triggered the European Central Bank ("ECB") to lower interest rates and engage in quantitative easing, which has led to very low interest rates until 2022 when the ECB started to normalise monetary policy. Inflationary pressure has increased in the wake of the COVID-19 pandemic and the Russian military aggression against Ukraine. This resulted in shocks to the real economy and led the ECB to increase interest rates significantly. Since 2024, interest rates have been decreasing again.

Figure 2: CDS prices iTraxx Europe index (5 years)



Source: Bloomberg

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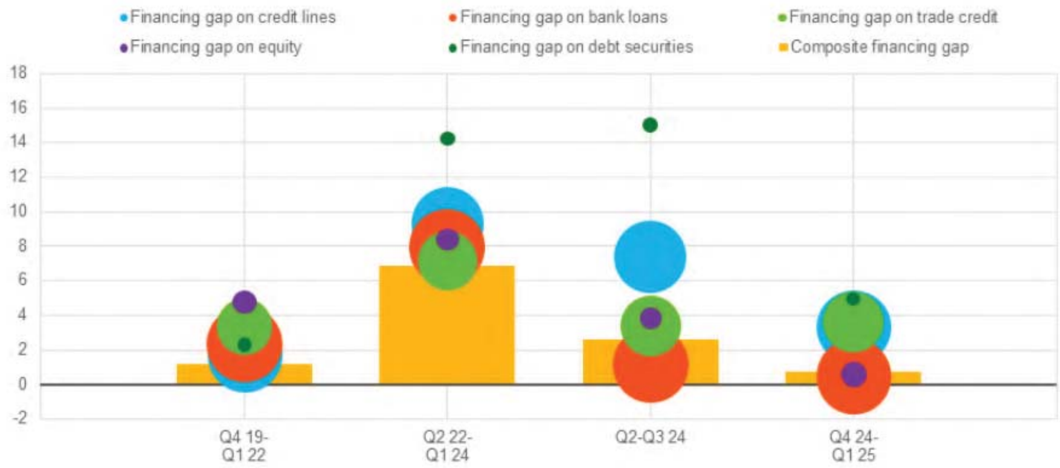
[25] The Guarantee Notice allows that the safe harbour premiums may be revised to take account of the market situation. The Commission has not made use of this possibility since the Guarantee Notice came into force.

These macroeconomic developments have influenced the evolution of credit risk margins. Figure 2 shows, as example, the volatility of the credit default swap ("CDS") prices of the 5 years iTraxx index and the iTraxx Crossover index[26] for European companies since 2010. CDS prices are a widely used market proxy for credit risk.

The macro-economic developments have also had an impact on the ability of companies to access market funding, especially for SMEs. Figure 3 shows the SAFE[27] composite financing gap and its components covering the evaluation period. The financing gap on credit lines and bank loans was elevated in the period up to Q1 2014 and in the period following Russian military aggression against Ukraine starting from Q2 2022. This evolution broadly mirrors the evolution of CDS markets and shows that on average European companies could not fully meet their financing needs.

Figure 3: SAFE Composite financing gap and its components



Source: SAFE.

Notes: The financing gap indicators combine both financing needs and the availability of bank loans, trade credit, equity, debt securities and credit lines at firm level. For each of the five financing instruments, the indicator of the perceived change in the financing gap takes a value of 1 (-1) if the need increases (decreases) and the availability decreases (increases). If enterprises perceive only a one-sided increase (decrease) in the financing gap, the variable is assigned a value of 0.5 (-0.5). The composite financing gap is computed at firm level by adding together the financing gaps for each relevant source of financing and then dividing this total by the number of these sources. A positive value for the indicator points to an increase in the financing gap. Values are multiplied by 100 to obtain weighted net balances in percentages. In the chart, the centre of each bubble

26 The iTraxx Europe Crossover Credit Derivate Index is composed of up to 75 European corporates with a rating below investment grade. The 5 years series covers credit guarantees with an average maturity of 5 years.

27 The survey on the access to finance of enterprises (SAFE) provides information on the latest developments in the financial situation of undertakings, including on trends in the need for and availability of external financing (https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html)

represents the financing gap of the corresponding source of financing, while the size represents the shares of firms using the instrument.[28]

3.2 Regulatory developments applicable to credit institutions

The regulatory requirements faced by financial institutions are crucial for determining whether a guarantee measure can be deemed to be self-financing. In particular, all regulated financial institutions have to set aside a proportion of their exposures to a borrower or other counterparties as regulatory capital to cover for possible losses. For example, the amount of required capital that a lender has to set aside for its loan exposures is directly linked to riskiness, or the 'risk-weighted assets', of the lender's loan portfolio. The same also applies for guarantees, in that a regulated financial institution has to set aside capital for its guarantee exposures. Thus, to be deemed as self-financing, a guarantee measure should ensure that the State is renumerated for not only its direct costs, such as expected guarantee payments or administrative costs, but also the opportunity cost of setting aside capital.

Since 2008, the regulatory and risk management framework for credit institutions has considerably evolved.

- The capital requirements for credit institutions have been increased following the global financial crisis through the Capital Requirements Regulation ('CRR') and the Capital Requirements Directive ('CRD'). Before the financial crisis, credit institutions were holding around 8% of capital against their risk-weighted assets[29]. Under the CRR and CRD, credit institutions typically hold capital of around 15% of their risk weighted assets, consisting of Pillar 1 and Pillar 2 capital requirements. On average, EU credit institutions face capital requirements of 15.6% as of end-2024, according to data by the European Central Bank[30]. In addition, revised definitions of default in the CRR and in supervisory guidelines have contributed to more harmonised and stricter criteria for identifying defaults[31].

- The implementation of International Financial Reporting Standard 9 (IFRS 9) has had a significant impact on the credit risk assessment process of credit institutions, by, among other things, requiring the use of more forward-looking information in the credit risk appraisal. IFRS 9 employs an expected credit loss accounting model, while previously credit institutions employed International Accounting Standard 39's (IAS 39) incurred loss accounting model[32]. The use of forward-looking data tends to be complex and requires robust data and models[33]. Together with enhanced disclosure requirements under IFRS 9, these new

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[28] See https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/ecb.safe202411~451cceb0f4.en.html for more details.

[29] https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000450356/Where_do_European_banks_stand%3F_10_years_after_the_.pdf

[30] https://www.bankingsupervision.europa.eu/banking/srep/html/index.en.html

[31] https://www.eba.europa.eu/activities/single-rulebook/regulatory-activities/credit-risk/guidelines-application-definition

[32] https://eba.europa.eu/publications-and-media/press-releases/eba-publishes-final-guidelines-credit-institutions-credit

[33] https://assets.kpmg.com/content/dam/kpmg/na/pdf/IFRS9-for-Banks.pdf

standards have also increased the pressure on credit institutions to manage credit risks more effectively.

- The establishment of the Single Supervisory Mechanism (SSM) and the introduction of new supervisory tools such as regulatory stress testing have contributed to a harmonised and greater sophistication of the credit risk management practices of credit institutions in the EU.

- Finally, in 2014 a harmonised bank crisis management and deposit insurance framework (CMDI[34]) was established. This framework has links to the Guarantee Notice, e.g. when it comes to indirect aid to lenders.

3.3 Key figures and types of guarantee measures

EU Member States have made extensive use of guarantees subject to the Guarantee Notice since the last revision of the Guarantee Notice in 2008. Since the Guarantee Notice does not provide for sufficient reporting requirements for the purpose of this evaluation, the Commission services and the experts conducting the external study undertook significant efforts to provide an as comprehensive as possible description of the public guarantees implemented by Member States since 2010 (see section 1.5 above). The comprehensive data (i.e. 'Sample A')[35], which underpins the figures and tables in this section, is not complete, but the Commission's services consider that it amounts to a sample that is sufficiently representative to allow for a description of the main characteristics of the use of State guarantees across Member States.[36]

3.3.1 Overall use of guarantee measures

The data gathered by the external study estimates that in the period 2010 – 2022, public authorities granted guarantees for an amount of EUR 22.1 billion under the Guarantee Notice, which amounts to 0.13% of the EU's GDP of EUR 16.8 trillion in 2023. Figure 4 shows the guaranteed amount per Member State (total amounts and as % of 2023 GDP). There are significant disparities across Member states - Italy and Germany issue substantial amounts of guarantees based on the Guarantee Notice, but these represent only a small percentage of their economic output (around 0.2% and 0.1% of GDP respectively). The opposite is the case for Member states like Romania, Lithuania, Latvia and Cyprus where the guarantees represent between 0.8% (Cyprus) and 1.3% (Latvia) of their respective GDP.

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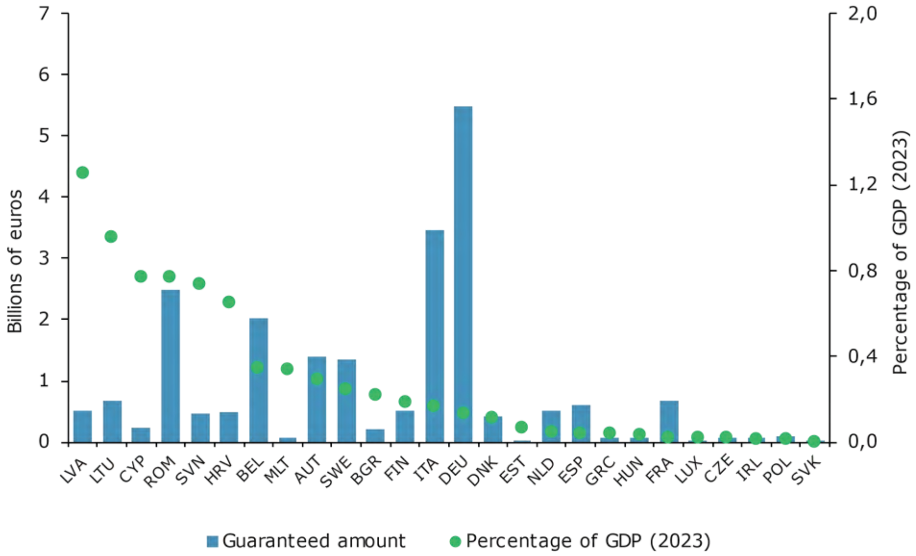
[34] The CMDI framework consists of three legislative texts, acting together with national legislation: the BRRD, the SRMR and the Deposit Guarantee Schemes Directive (DGSD – Directive 2014/49/EU).

[35] Sample A contains data on 283 guarantee measures within the Scope of the Guarantee Notice, covering the period 2010 to 2022. Each measure includes 96 datapoints, whereas the average completeness rate of the datapoints across all measures is 63% (see page 28 of the external study).

[36] See page 25 of the external study.

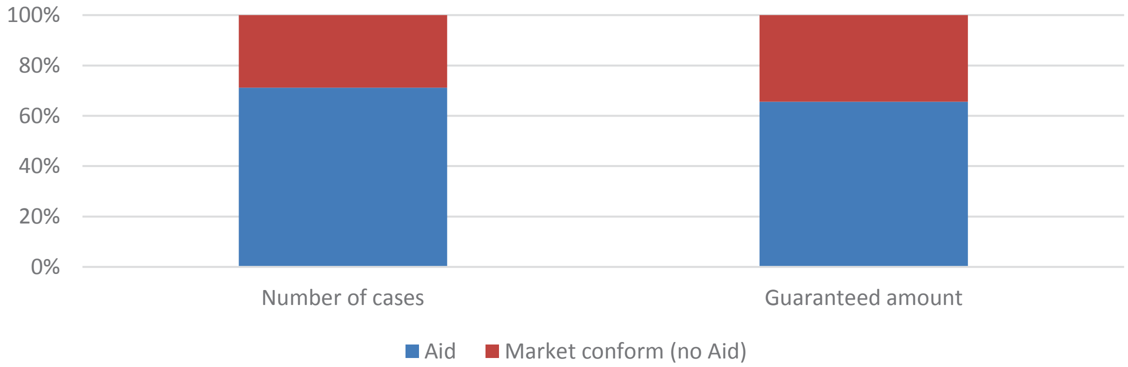
Figure 4: Total guaranteed amount (2010-2022) and share over total GDP (2023) by Member State



Source: External study ('Sample A')

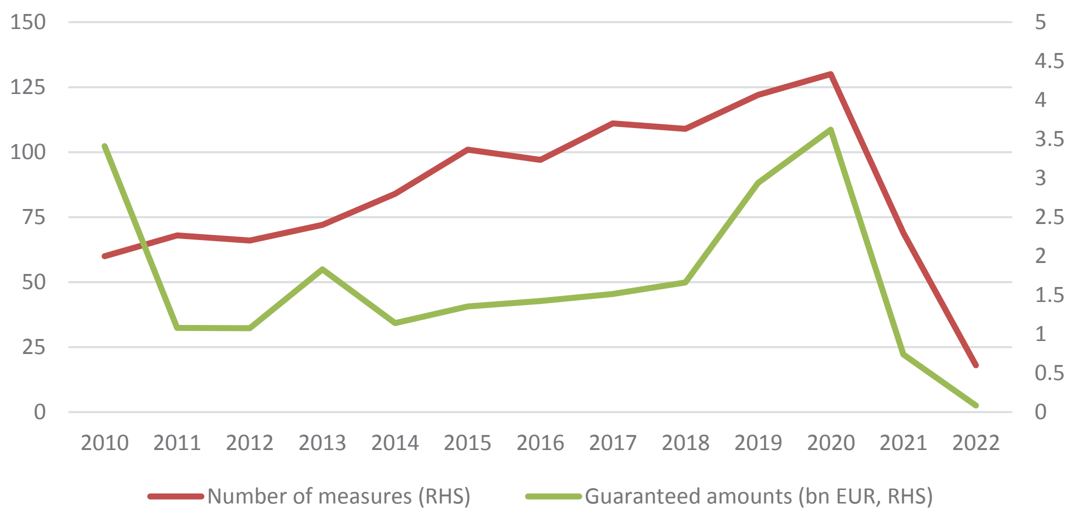
The comprehensive database contains both information on aided and no aid measures. The information on market conform guarantees is likely to be incomplete, as Member States are not, in principle, required to report market conform public guarantees. Figure 5 shows that ca. 34 % of guaranteed amount (29% in terms of number of measures) consists of no-aid guarantees. Considering this likely underreporting of market conform guarantees, this shows that Member States make ample use of public guarantees not only for aid schemes, but also for market conform measures.

Figure 5: Guaranteed amount and number of measures by market conformity



Source: External study ('Sample A')

Figure 6: Active measures and guaranteed amounts by year, 2010-2022[37]



Source: External study ('Sample A')

Figure 6 shows the amount of public guarantees provided under the Guarantee Notice over the observation period. The number of 'active' measures (i.e. measures under which Member states granted new guarantees) declined as of 2020 as Member States made ample use of the EU Temporary State aid Frameworks as basis for the granting of State guarantees. In response to the COVID-19 pandemic and the Russian military aggression against Ukraine, the Commission has implemented, starting in March 2020 and going beyond the end of the observation period of December 2022, a series of State aid Temporary Frameworks[38], which offered public authorities alternative flexible ways to offer public guarantees outside the scope of the Guarantee Notice[39].

3.3.2 Types of guarantee measures

Table 1 shows the number of cases under the different methodologies covered by the Guarantee Notice (see Section 2.4 for the methodologies within the scope of the Guarantee Notice). Overall, the most frequently used calculation methods are, by far, the risk-based and the safe harbour methodologies/approaches. The following subsections provide more detailed information on these.

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[37] The data on guaranteed amounts shows a similar trend as active measures, but exhibits occasional spikes, which are largely attributable to some measures being reported as active only in a specific year.

[38] The first Temporary Framework was the 'Communication from the Commission Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak', 2020/C 91 I/01, C/2020/1863, OJ C 91I, 20.3.2020, p. 1–9, which was amended several times and then replaced by the 'Communication from the Commission Temporary Crisis Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia', 2022/C 131 I/01, C/2022/1890, OJ C 131I, 24.3.2022, p. 1–17. This framework was replaced, after the observation period of the data, by the 'Communication from the Commission Temporary Crisis and Transition Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia', 2023/C 101/03, C/2023/1711, OJ C 101, 17.3.2023, p. 3–46.

[39] The Temporary Frameworks provide for a simple parameterisation of guarantees which does not require to establish market benchmarks premiums and to calculate the aid element.

Table 1: Pricing methodologies and number of measures[40]

Pricing Methodology	No. cases	Guaranteed Amounts (million EUR)
Individual guarantee	8	1,348
Effective interest rate	1	9
EU Reference Rate	6	776
OECD methodology	1	436
Risk based	140	12,022
Risk based - Effective interest rate - CDS	1	2
Safe harbour	88	5,056
TOTAL	**245**	**19,649**

Source: External study ('Sample A')

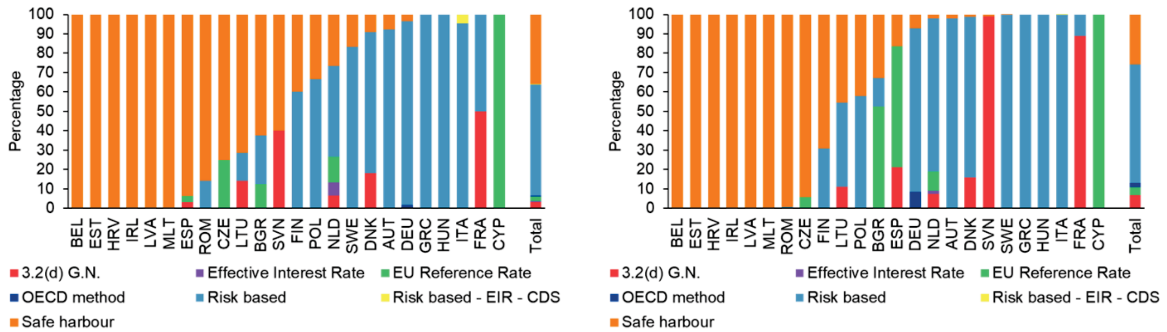
Notes: The 'Individual guarantee methodology' is approved under section 3.2 of the Guarantee Notice relating to an individual guarantee provided on a loan to a single entity. The 'Effective interest rate' methodology determines the guarantee premium using the interest rate charged on the guaranteed loan. The 'OECD methodology' is a risk-based approach to compute premium rates for untied loan guarantees based on the OECD's Arrangement on Officially Supported Export Credits. The 'Risk-based methodology' is approved under section 3.4 of the Guarantee Notice relating to a guarantee scheme provided on loans to multiple entities or under section 3.5 of the Guarantee Notice using single premium schemes. The 'Risk based – Effective interest rate – CDS methodology' is a combination of the three calculation methods, whereby the guarantee premium is first determined by a risk-based methodology, which is then subject to floors as determined by effective interest rate methodology and/or market benchmarks based on the credit default swaps (CDS). The 'Safe harbour methodology' is based on the fixed guarantee premiums for SMEs as described in section 3.3. of the Guarantee Notice.

Figure 7 shows the distribution of the different pricing methodologies per Member States. Some Member states rely almost only on the safe harbour method (Belgium, Estonia, Croatia, Ireland, Latvia, Malta, Spain and Romania, while others rely almost only on the risk-based method (Sweden, Denmark, Austria, Germany, Greece, Hungary, Italy).

Figure 7: Distribution of premium calculation method by Member States

By number of cases

By guaranteed amounts



Source: External study ('Sample A')

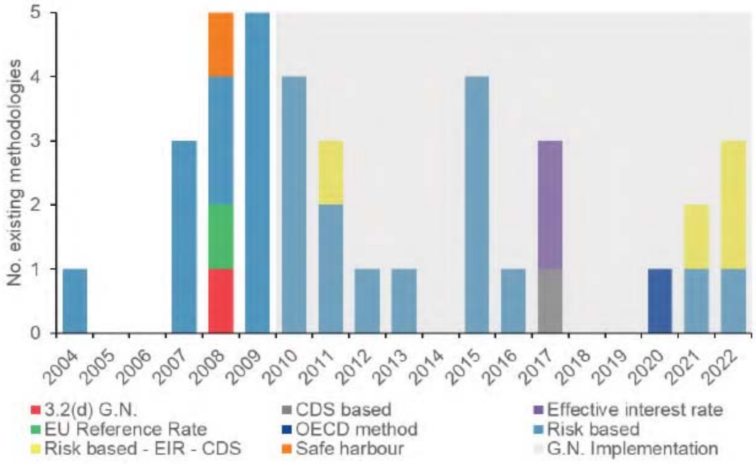
Risk-based methodologies

Figure 8 shows the number of decisions approving pricing methodologies under Section 3.4 of the Guarantee Notice over time. Most of the pricing methodologies were approved

[40] For 38 out of the 283 measures, amounting to EUR 2.45 bn guaranteed amounts, that are part of Sample A, it was not possible to identify the pricing methodology.

around the year of the Guarantee Notice publication in 2008. Since 2021, a bulk of more sophisticated pricing methodologies, combining elements of the Risk-based, Effective Interest Rate and CDS approaches altogether, have been adopted for Croatia, Greece, Italy, and Portugal[41].

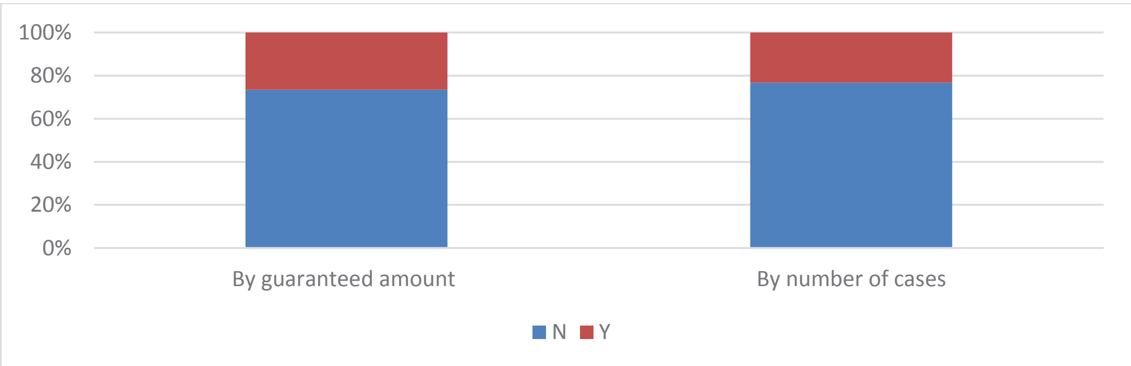
Figure 8: Number of pricing methodology approval decisions by year and premium calculation methodology



Source: Consortium's elaborations on Sample B1.

Member States can also devise guarantee methodologies under Section 3.4 of the Guarantee Notice with a simplified option of using single premiums. Figure 9 shows the share of single premium schemes of the risk-based (section 3.4) guarantee schemes. The data shows that Member states have made significant use of single-premium schemes under Section 3.4 of the Guarantee Notice, which account for almost a quarter of all risk-based methodologies in terms of number of cases and guaranteed amounts). Single premium schemes can only be used for guarantees of amounts of less than EUR 2.5 million to SMEs. It is expected that they involve lower administrative costs as they do not require a rating of the beneficiary company.

Figure 9: Share of guarantees granted under single premium methodologies ('Y') vs. all risk-based guarantee schemes



[41] Since 2023, the Commission has approved or amended eight methodologies.

Guarantees granted under the safe harbour premiums

Member States have implemented schemes and provided individual guarantees to SMEs on an aided or no-aid basis using the fixed safe harbour rates listed in Section 3.3. of the Guarantee Notice. The fixed safe harbour premiums for SMEs were originally introduced as a simple and attractive way for Member States to provide aid-free guarantees. However, as they are fixed and do not respond to market developments, they may have become less attractive relative to approved methodologies. Public guarantees under the safe harbour premium account for 36% of all public guarantees (see Table 1 above).

3.4 Case practice

This section reviews some of the issues and problems faced by the Commission services working on the assessment of the guarantee measures that are based on the Guarantee Notice.

Use of safeguards to rule out aid to lenders

As already noted in sections 2.1 and 2.4, the Guarantee Notice highlights that aid to lenders may result in operating aid, which should, under point 116 of the Notice on the Notion of Aid, be "examined from an *ex ante* point of view". In order to rule out such aid, recent guarantee decisions have incorporated a so-called "effective interest rate (EIR) safeguard".[42] In simple terms, the safeguard aims to elicit a floor for the implied guarantee premium from the interest rate charged by the lender on the guaranteed loan.[43] The Commission services have experienced some issues in the application of the safeguard relating to the unavailability of evidence/data on the correct funding and administrative costs to be subtracted from the interest rate to estimate the credit risk margins and the sensitivity of the calculated floor to estimations errors.[44] As a response to these issues, the Commission services and the Member States have agreed on specifically tailored solutions to determine what costs may be netted off the interest rates and, where necessary, by incorporating an adjustment factor over the applicable floor.

Validity of safe harbour premiums and older methodologies

Over the past few years, there have been a number of decisions oriented towards SMEs for which the Member States have opted to develop a methodology under section 3.4 of

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42 These more sophisticated methodologies include the 2021 Portuguese guarantee methodology (SA.61340), the 2022 Greek guarantee methodology (SA.102741), the 2022 Croatian guarantee methodology (SA.64359), and the 2022 Italian guarantee methodology (SA.100837).

43 More specifically, the calculations rely on a theoretical no-arbitrage equilibrium condition whereby a lender would be indifferent between being exposed to credit risks arising from (a) a guaranteed loan; and (b) a portfolio of credit default swap (CDS) exposures to both the borrower and the Member State providing the guarantee. The portfolio will be composed to ensure that the risks borne by the lender under option (b) would be equivalent to those under option (a). In particular, while the exposures to the borrower would replicate the credit risks borne by the lender for the non-guaranteed part of the loan, the exposures to the Member State would cover the counterparty credit risk, i.e. the possibility that the guarantor may fail to honour its obligations, for the guaranteed portion.

44 The issues are as follows: First, since the costs faced by a lender on a typical lending transaction may be quite distinct from those associated with CDS instruments, the calculation necessitates a careful estimation of the interest rate cost components (e.g., administrative, funding, etc.) that need to be subtracted from the interest rate. Second, the implied premium is highly sensitive to small changes in the credit risk margin, especially for measures with a high guarantee coverage ratio. Together with the first point, this implies that small errors in the estimation of the cost components may be magnified.

the Guarantee Notice, rather than relying on the safe harbour premiums under section 3.5 of the Guarantee Notice. The interactions of the Commission services with Member States demonstrate that this development may be explained by the possibility that the safe harbour premiums might have become less attractive in the wake of the global financial crisis, driven by significantly changing market dynamics, especially the low-interest rate environment, which could have made the fixed premiums obsolete, at least for certain risk categories. More broadly, a similar situation is also present for some of the methodologies with no specific expiry dates, which do not incorporate the changing market conditions and practices into the calculation of the market conform premiums.

Role of self-financing condition

In their assessments of guarantee schemes, the Commission services have found that the guidance provided with respect to the condition that the scheme must be self-financing, as described under points (d) and (e) of section 3.4 of the Guarantee Notice, is not sufficiently clear. In particular, there have been many discussions with Member State authorities on whether point (f) of section 3.4, which requires that the premiums must also cover the “normal risks associated with granting the guarantee”, would be automatically satisfied if the self-financing condition was met.

Limited use of market benchmarks

There has been a very limited use of market benchmarks to determine the market conform guarantee premiums. This has been a particularly challenging task in smaller Member States or those with less developed financial markets. More generally, typically no comparable market transactions exist for the same undertaking or for a sample of comparable undertakings, as described under point 111 of the Notice on the Notion of Aid and section 2.1 above. Part of the reason is that the market for private guarantees on corporate loans is relatively small, except for niche segments such as export credit, at least for the moment. In addition, the Guarantee Notice appears to discuss the possibility of using market benchmarks to set the market conform premiums only for individual guarantees under section 3.2 of the Guarantee Notice, which could be the reason for which Member State authorities usually do not even consider such a possibility for guarantee schemes under section 3.4 of the Guarantee Notice. Moreover, the example cited in footnote 17 of section 3.4 of the Notice to compute the capital cost as 0.32% has been extrapolated by some Member States to apply to all risk categories. The resulting premium of 0.32% for the remuneration of adequate capital plus an administrative cost between 0.10% to 0.40% plus annualized expected losses for credit risk generally underestimates the guarantee premium derived from all market benchmarks. As a result, Member States are intrinsically motivated to *avoid* the use of market benchmarks, which would force them to charge higher premiums to avoid a selective advantage.

Omission of sovereign risk

The existing risk-based methodologies based on sections 3.2 (individual guarantees) or 3.4 (guarantee schemes) of the Guarantee Notice typically have no consideration for sovereign risk. However, in market transactions, the default likelihood of the guarantor has a direct impact on the premium. In particular, when the guarantor is more likely to default on its financial obligations, the guarantee it provides is less valuable. Discussions with Member States reveal that this omission may result in slightly higher premiums, although the impact is usually limited, especially for Member States with relatively high ratings.

Guarantees on financial transactions other than loans or debt

Although sections 1.3 and 1.4 of the Guarantee Notice suggests that the conditions outlined in sections 3 and 4 of the Guarantee Notice could be applicable to guarantees on financial transactions that are not loans, there is very little guidance on how the relevant conditions would translate in those situations. For example, performance guarantees incorporate specific elements that are not clearly addressed by the Guarantee Notice, e.g. if and how the risk parameters on a single borrower would matter. As another example, most of the conditions outlined in sections 3 and 4 of the Guarantee Notice would not be applicable to guarantees on liabilities. The Commission services therefore refrained from using the Guarantee Notice as the basis of their assessments for guarantee measures involving financial transactions other than loans.

Portfolio guarantees

The Commission services have assessed several proposed measures involving guarantees provided on a portfolio of loans of a lender. These cases present specific challenges and require a careful interpretation of the conditions outlined in section 3.4 of the Guarantee Notice. First, point (b) of section 3.4 of the Guarantee Notice requires that the guarantee must be linked to a specific financial transaction, for a fixed maximum amount and limited in time. An *ex ante* guarantee on a portfolio, which a lender would fill up as it sees fit, may not adhere to this criterion. Second, it is not clear how the risk assessments mentioned in points (d) and (f) of section 3.4 of the Guarantee Notice would be conducted for a portfolio of loans, or whether the State as a guarantor would be in a position to assess risk factors associated with each individual exposure in a portfolio.

Capital remuneration

Point (f) of section 3.4 of the Guarantee Notice requires the guarantee premium to incorporate the opportunity costs of setting aside capital for regulatory purposes for the duration of the guarantee. Footnote 17 of the Guarantee Notice provides an example involving the amount of capital to be set aside for exposures to a BBB-rated undertaking as 8% of the risk weighted assets. As noted in section 3.2 above, however, the capital requirements have increased substantially since 2008. As a result, the Commission services have required Member States to consider a higher requirement amount to 10.5% of risk weighted assets. In some recent cases, the discussions with Member States also involved the appropriateness of setting the required return on capital at 400 basis points, as described under point (f) of section 3.4 of the Guarantee Notice, especially given the fact that return on equity for figures have shown some wide variability since 2008.

Risk assessment systems and ratings

In some cases, the guarantee methodologies following sections 3.2 or 3.4 of the Guarantee Notice rely on the ratings of individual exposures based on the risk assessments made by the lender. In others, the methodologies rely on internal ratings of the guarantor or a public rating mechanism. In all cases, a correspondence needs to be established between the rating scales used by the lender/guarantor and the scales used by international credit rating agencies (S&P, Moody's, Fitch), which are referenced in the Guarantee Notice. Moreover, the Commission services typically require the lender's rating systems to be those that are used for the calculation of the capital requirements and other risk assessments.

4 EVALUATION FINDINGS (ANALYTICAL PART)

4.1 To what extent was the intervention successful and why?

4.1.1 Effectiveness

Effectiveness refers to the assessment of how successful the Guarantee Notice has been in assisting Member States to set up methodologies that help identify accurately market-consistent benchmarks or proxies for guarantee premiums, while preventing potential unwanted effects.

4.1.1.1 Accuracy of identified proxies

The independent experts have developed several benchmarks that provide the basis for the evaluation of the accuracy of the methodologies currently in use under the scope of the Guarantee Notice. The benchmarks are developed from quantitative approaches that are anchored in how market operators price the credit risk, which is a key component of the guarantee premium, as well as market benchmarks, following the academic literature on credit risk and credit derivatives. The benchmarks are therefore used as market indicators against which the accuracy of a methodology is assessed.

The benchmarks proposed by the independent experts have been subject to explicit approval of the Contracting Authority. The benchmarks were developed to describe market conform guarantee premiums where each benchmark is derived using a specific methodological approach identified by the independent experts. Where necessary, the independent experts were requested to make the necessary adjustments to ensure that the benchmarks could be calculated using data that is typically available to a creditor or a guarantor, without resulting in an undue amount of administrative cost or complexity. The assessments also identified the main strengths and weaknesses of each benchmark.

The four types of benchmarks using alternative methodological approaches identified by the independent experts and approved by the Commission services are as follows:

(1) **Risk-based benchmark** derives the guarantee premiums in a similar way as the loan pricing models readily used in the banking industry.[45] More specifically, the methodology derives the fee premiums in line with credit risk premiums set by commercial banks, ensuring that a guarantee scheme that uses the methodology would be in line with point (f) of Section 3.4 of the Guarantee Notice. This would mean that the premiums paid by the beneficiaries are just enough to cover all the relevant costs, including the expected losses that the guarantor would bear through the triggering of the guarantees, administrative costs of running such a scheme, and the opportunity costs associated with setting aside regulatory capital corresponding to the risky exposures. To that extent, the benchmark methodology is not based on a theoretical market equilibrium concept and simply produces a fee that ensures that the guarantor earns just enough profits to earn its expected return on capital.[46]

[45] For references, see section 2.2.3 of the External Study.

[46] The independent experts have developed two guarantee premiums using the risk-based methodology, distinguishing between the internal rating based (IRB) approach and the standardised approach to

(2) **Credit default swap (CDS) and bond-based benchmarks** are closely linked to the pricing estimations used in the credit derivatives market to determine the cost of a guarantee provided by a protection against the default of a borrower. The methodology identifies guarantee premiums corresponding to borrowers with a specific risk rating by extracting the probabilities of default from CDS spreads and bond yields with identical risk ratings using market data (i.e. iTRAXX, Bank of America Merrill Lynch indices). Extrapolations are made where the available market data does not cover all of the relevant risk categories contained in sample B2. Adjustments are also made to incorporate costs, such as administrative costs, that would typically not be embedded in the market prices of CDS and bond transactions. Unlike the risk-based methodology, this methodology derives the probabilities of default from observable market data based on a market equilibrium concept, or a so-called "no-arbitrage" condition based on the assumption that in a competitive market a market operator would be indifferent between being a protection buyer or a seller.

(3) **Effective interest rate (EIR)[47] benchmark** is also based on a market benchmark and uses the pricing information available given by observed interest rates. More specifically, the methodology extracts a borrower's default risk from the effective interest rate that the lender charges on that partially guaranteed loan. The formulation is closely linked to the approaches used in more recent existing methodologies approved by the Commission, although the independent experts have developed a more bottom-up approach by using the market information to derive the borrower's default risk rather than dissecting the interest rate to its basic components, such as credit risk spread and various costs, i.e. administrative costs, cost of capital, etc.[48] The methodology also relies on a no-arbitrage condition based on the assumption that a market operator would be indifferent between providing a loan or holding onto the principal amount. Due to limited data availability on interest rates for guaranteed loans, the independent experts have employed statistical techniques to associate the interest rate charged (on a guaranteed loan) with a borrower's default risk.

(4) **Safe harbour benchmark** is a simplified approach for guarantees on loans to SMEs. Unlike the other methodologies, it takes as a given the borrower's credit risk rating, which are then converted to (cumulative or annualized) default probabilities, to estimate the corresponding guarantee premium. To that extent,

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calculate the minimum regulatory requirements and the corresponding cost of capital, where the latter approach also takes into account the SME supporting factors, where relevant. Since most of the larger banks use the IRB approach for corporate loans, the standardised approach is not referred to in the comparisons below.

47 The effective interest rate (EIR) takes into account all the costs borne by borrowers, including, most notably, the interest rate on the loan as well as any other fees, with the exception of any guarantee premiums paid to the State in exchange for the public guarantees.

48 For more specifics on recent decisions that have approved the use of the EIR methodology as a backstop or a floor for the risk-based methodologies, see the Commission decisions on the Portuguese pricing model proposed for guarantee schemes under the SNGM (Sistema Nacional de Garantia Mutua) (SA.61340); Croatian methodology to compute guarantee premiums to mid-caps and large undertakings (SA.64359); the Italian calculation method ISMEA (Institute of Agricultural Food Market Services) for the provision of direct guarantees at market conditions for undertakings active in the agricultural, agri-food and fisheries sectors (non-aid) (SA.100837); and the Greek calculation methodology for guarantee premiums to banks for large corporate financing (SA.102741).

the simplicity comes with a cost: The guarantor should be able to obtain a reliable credit rating for each borrower. This could be done either by the guarantor's own risk assessment system or, more realistically, based on the risk ratings that are assigned to the borrower by the lender. The methodology is similar to the approach described in Sections 3.3 or 3.5 of the Guarantee Notice. However, there are three key differences. First, the guarantee premiums calculated under a safe harbour benchmark methodology also differ across a second dimension, the maturity of the guarantee, which was not considered in the Guarantee Notice. Second, the correspondence between ratings and default probabilities are established by using either the **Risk-based methodology** or the **CDS- and bond-based methodology**. Third, under the benchmarks developed by the independent experts, the correspondence tables between the rating and the guarantee premium have to be regularly updated based on market dynamics.

To facilitate comparisons between the existing and the benchmark methodologies, the independent experts have constructed a database of both benchmark and existing methodologies (samples B1 and B2) containing a set of common input parameters, including most notably the default probability of the borrower, the type of borrower (e.g. SME, large), guarantee coverage ratio (i.e. the ratio of the total loan principal that is guaranteed) and the maturity (or, more specifically weighted average life) of the guaranteed loan. These common input parameters have been constructed as a sample of typical operations and were fed through the different methodologies to obtain the resulting guarantee premiums. To determine how these input parameters were distributed, the independent experts have utilised the granular data ("REQ Q11") collected by the Commission from Member States (e.g. on maturity of guaranteed loan and guarantee coverage ratios).

Although the EIR methodology is, arguably, the most natural benchmark, especially since the pricing of the loan and the guarantee share many common elements, the unavailability of data on interest rates is a major challenge. Once again, REQ Q11 was used to establish a statistical relationship between default probabilities and effective interest rates charged following the approach described under the Risk-based methodology. This statistical relationship is then used to construct estimates where the interest rate data is missing. This approach was not possible for lower maturity brackets due to limited availability of data. As a result, The independent experts have truncated the data on interest rates for maturities lower than 5 years to the 5-7 year bucket.

Since interest rates on guaranteed loans can only be estimated, the guarantee premiums calculated by the independent experts using the EIR methodology may exhibit three specific sources for estimation errors:

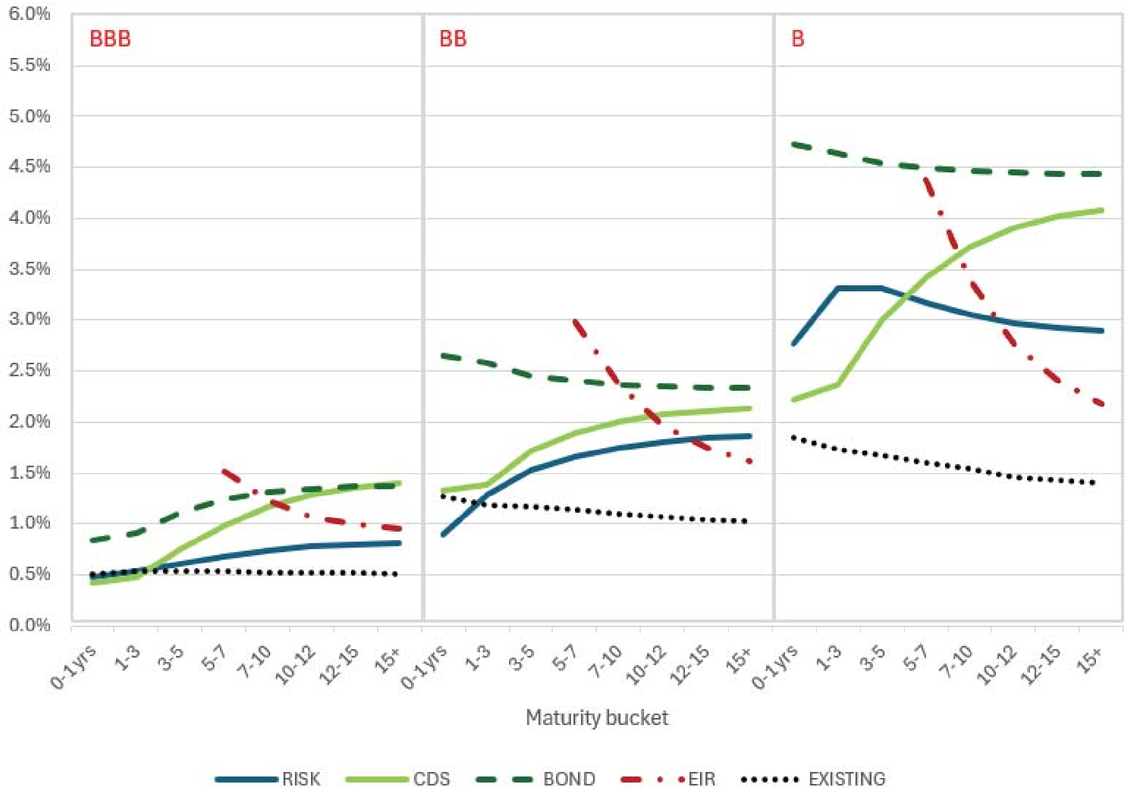
- The first source of error is related to whether sovereign risk is considered or not in the derivation of the guarantee premium from the effective interest rate. Since a public guarantee effectively exposes the lender to the joint failure of both the sovereign and the borrower, omission of this risk may result in unrealistically high guarantee premiums.

- The second source of error is related to the fact that the equation used to calculate the guarantee premiums under EIR methodology is very sensitive to the borrower's default risk. This implies that even a small misspecification of some of the key variables could result in a much larger impact on the calculated guarantee premiums. The independent experts specifically identify lending costs as a potential source of error and shows that increasing funding cost assumptions by 40 basis points, or 0.4 percentage points, would lower the calculated guarantee premiums by 1.6 percentage points.

- As a third potential source of error, most of the existing methodologies do not contain a safeguard to rule out or minimise (indirect) aid to lenders. Thus, one cannot exclude the possibility that the estimated interest rates may be positively biased, resulting in unrealistically high guarantee premiums. Indeed, using existing data from REQ Q11, the independent experts have shown that nearly 67% of the guarantee loans have actual interest rates that are greater than the interest rates calculated under the risk-based approach.

With these elements in mind, Figure 10 provides a comparison of the average guarantee premiums corresponding to borrowers with different risk attributes, with a S&P/Fitch equivalent ratings of BBB, BB or B, which represent nearly 97% of Sample B1, excluding existing safe harbour premiums. The guarantee coverage ratio is fixed at 80%. The comparisons exclude the administrative cost in order to focus on the overall risk sensitivity and time variability of the comparisons. For the reasons outlined above, the comparisons also rely on lower-end estimates for the guarantees produced by the EIR approach.

Figure 10: Comparison of average guarantee premiums (net of administrative costs) for BBB to B-rated borrowers across maturity buckets



Note: In all comparisons, guarantee coverage was set at 80%. The BBB, BB, and B risk categories are as described by S&P and Fitch. RISK stands for guarantee premiums calculated under the risk-based methodology using the IRB-based regulatory requirements to calculate the capital costs. CDS and BOND stand for CDS-and bond-based methodologies, respectively. EIR stands for the lower-end estimates for the guarantees produced by the EIR methodology. Due to limited data availability, fee estimations produced by

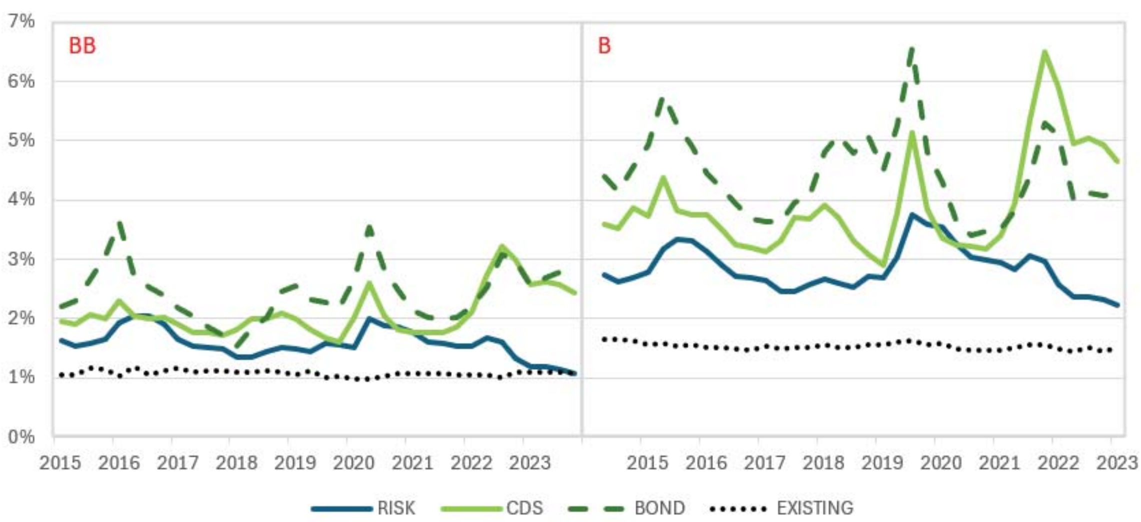
EIR-methodology were not available for shorter maturities than 5 years. EXISTING stands for the average guarantee premiums the existing risk-based methodologies in sample B1.

As it is immediately clear from Figure 10, the guarantee premiums produced by the existing methodologies are almost always lower than those produced by the benchmark methodologies. The differences are particularly large for longer maturity buckets and higher risk categories.

Another striking finding is the variation of guarantee premiums calculated under different benchmark methodologies. It is clear that both EIR and bond-based methodologies result in higher guarantee premiums for lower maturities, especially for lower ratings. This finding may reflect the fact that lenders and investors are more likely to provide loans and debt to borrowers with higher risk at only short maturities. It is also notable that market-based benchmarks, such as the CDS- and bond-based methodologies, result in generally higher fees than the risk-based methodology. This is most likely due to the fact that market-based approaches often incorporate elements that are not taken into account in the risk-based benchmark, which is entirely based on the fundamental idea that the guarantee scheme remains self-financing. To that end, the premiums produced by the risk-based methodology should be seen as a floor for the market prices.

Adding a time dimension, Figure 11 depicts how the guarantee premiums as calculated under the existing methodologies compare to the benchmark methodologies for the period between the first quarter of 2015 and the last quarter of 2023 for loans with a maturity between 7 to 10 years. The comparison for BBB+ to BBB- rated borrowers was omitted due to limited data on existing methodologies. The data for EIR-based methodology was also omitted due to limited data availability for shorter maturities, which significantly undermines the time-series data. The guarantee coverage ratio, i.e. the ratio of the total loan principal that is guaranteed, is once again fixed at 80%.

Figure 11: Comparison of average guarantee premiums (net of administrative costs) for BB and B-rated borrowers over 2015-2023

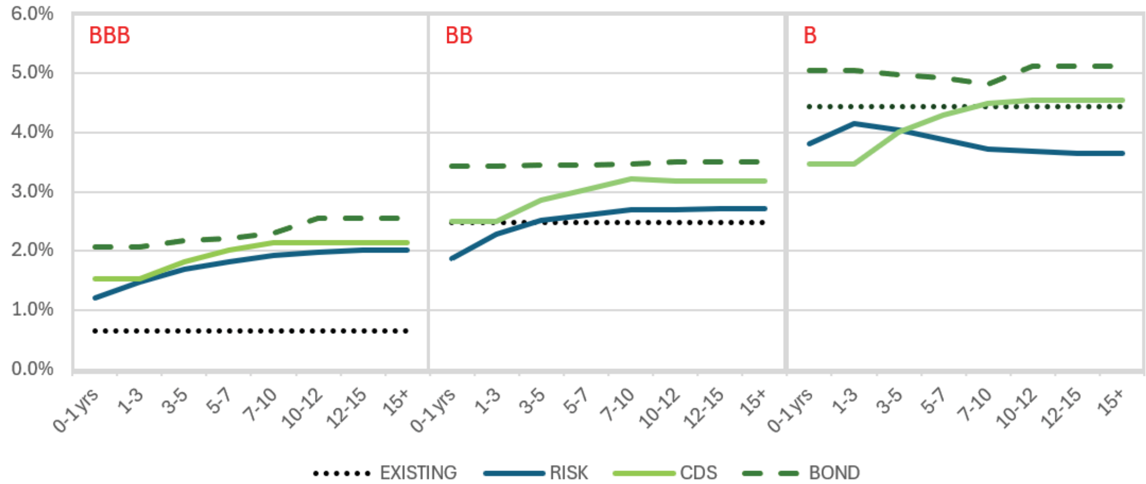


Note: In all comparisons, guarantee coverage was set at 80% and the maturity of the guaranteed loan at 7-10 years. The BB and B risk categories are as described by S&P and Fitch. The results for BBB were not displayed due to limited number of observations. RISK stands for guarantee premiums calculated under the risk-based methodology using the IRB-based regulatory requirements to calculate the capital costs. CDS and BOND stand for CDS-and bond-based methodologies, respectively. EXISTING stands for the average guarantee premiums the existing risk-based methodologies in sample B1.

It is clear from Figure 11 that the guarantee premiums generated by existing risk-based methodologies have remained lower than all other benchmarks. Moreover, the existing risk-based methodologies do not appear to take into account the market dynamics and changing risks. Indeed, the guarantee premiums as calculated by all of the three depicted benchmarks have responded positively to the COVID-19 crisis in 2020 and Russia's military aggression against Ukraine in 2022. However, the fees generated by the existing risk-based methodologies have remained relatively flat in both instances.

Turning to safe harbour methodologies, Figure 12 provides a comparison of the existing safe-harbour premiums, as described in Sections 3.3 or 3.5 of the Guarantee Notice, and different safe harbour benchmark methodologies for borrowers with different risk attributes, ranging from a S&P/Fitch equivalent rating of BBB+ to a B-, which represents the entirety of Sample B1 for safe harbour benchmarks. Once again, the coverage ratio is fixed at 80%.

Figure 12: Comparison of average safe harbour guarantee premiums for BBB to B-rated borrowers across maturity buckets

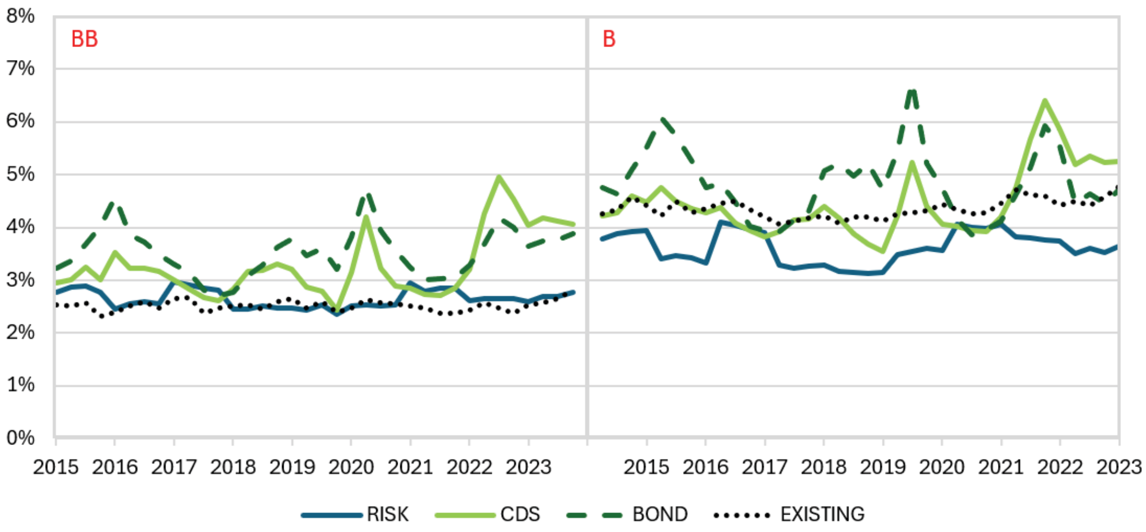


Note: In all comparisons, guarantee coverage was set at 80%. The BBB, BB and B risk categories are as described by S&P and Fitch. RISK stands for guarantee premiums calculated under the risk-based methodology using the IRB-based regulatory requirements to calculate the capital costs. CDS and BOND stand for CDS-and bond-based safe harbour methodologies, respectively. EXISTING stands for the averages for existing safe harbour premiums in sample B1.

The comparison of the safe harbour guarantee premiums summarised in Figure 12 shows that for lower-risk borrowers with a rating between BBB+ to BBB-, the guarantee premiums calculated using the existing methodology are generally lower than those produced by the benchmark methodologies. For higher risk profiles, the existing safe harbour premiums appear to be comparable to those generated by the benchmark methodologies. For example, for borrowers with a BB+ to BB- rating, the existing methodology is entirely comparable with the risk-based safe harbour methodology, with the exception of very short maturities below 1 year. For higher-risk borrowers, the existing safe harbour premiums range from 3.8% for borrowers with a rating of B+ or B and going all the way up to 6.3% for a borrower with rating of B-. These fees are higher than those generated by both risk-based and CDS-based methodologies, although the bond-based methodology always produces the highest possible fees.

The differences between the benchmark safe harbour methodologies with the existing methodology become even more pronounced once one adds the time dimension, which is shown in Figure 13. The comparison for BBB+ to BBB- rated borrowers was omitted due to limited data on existing methodologies. Although the safe harbour premiums under the existing methodology have been unaltered since the beginning of the application of the Guarantee Notice, the guarantee premiums on existing methodology show some limited amount of variability due to changes in the distribution of credit ratings within each depicted segment, i.e. distribution of B-, B and B+ rated borrowers within the B-rating segment.

Figure 13: Comparison of average safe harbour guarantee premiums for BB and B-rated borrowers over 2015-2023



Note: In all comparisons, guarantee coverage and the maturity of the guaranteed loan were set at 80% and 7-10 years, respectively. The BB and B risk categories are as described by S&P and Fitch. RISK stands for guarantee premiums calculated under the risk-based methodology using the IRB-based regulatory requirements to calculate the capital costs. The results for BBB were not displayed due to limited number of observations. CDS and BOND stand for CDS-and bond-based safe harbour methodologies, respectively. EXISTING stands for the averages for existing safe harbour premiums in sample B1.

The time-series evolution of guarantee premiums depicted in Figure 13 closely follow the general results as depicted in Figure 12. In particular, the existing safe harbour guarantee premiums remain below CDS- and bond-market safe harbour methodologies for BB-rated borrowers and comparable to the risk-based safe harbour methodology. However, the existing safe harbour premiums are higher than those produced by the risk-based methodology for higher risk B-rated borrowers and remain comparable (on average) to the CDS-based safe harbour methodology, except in more recent years. In addition, much like in Figure 12, the CDS- and bond-market methodologies are responsive to market dynamics, whereas the existing safe harbour premiums remain unchanged.

The main takeaways from the results discussed in this section can be summarised as follows:

- The guarantee premiums produced by the existing risk-based methodologies are almost always lower than those produced by the benchmark methodologies, across different risk categories, maturities, and time horizons. The differences between the guarantee premiums produced by the benchmark and existing risk-based methodologies are particularly large for longer maturity buckets and higher risk categories.

- For safe harbour methodologies, the comparisons show a more nuanced picture. The existing safe harbour premiums are below those generated by benchmark methodologies only for lower risk BBB-rated borrowers. For higher risk borrowers, the existing methodology produces fees that are higher than the risk-based safe harbour methodology.

- More generally, existing methodologies exhibit lower sensitivity to market dynamics and changing risk conditions, which are clearly taken into account in the market-based benchmarks such as the bond- and the CDS-based methodologies.

- These results imply that the existing methodologies may not be sufficiently accurate in producing market conform fees across different risk categories and over time, especially for existing risk-based methodologies.

4.1.1.2 Crowding out of private investors

The question of whether a public guarantee may crowd out private involvement is closely linked to the question of whether the same borrower could obtain the same loan from a commercial lender without a guarantee. To get a better grasp of this issue, it may be worthwhile to first explain why a borrower may *not* be able to obtain such a loan, or, more succinctly, why some borrowers may be rationed out of the credit market.

A defining aspect of credit markets is the asymmetric information that exists between a lender and a borrower. Lenders are concerned that the interest rate on a loan should adequately cover, among other things, the risk of default of the borrower. Assuming that the only observable information on the riskiness of a loan is whether the borrower accepts a loan offer, the interest rate charged may well affect the riskiness of the pool of borrowers that agree to such an offer. Less risky and less cash-strapped borrowers will not accept higher interest rates since they can find cheaper alternatives or make do without borrowing at all. Thus, only higher risk borrowers will accept loans carrying high interest rates. Charging a higher interest rate would thus increase the riskiness of a lender’s loan portfolio and, beyond a certain interest rate, may even lower its profits. This so-called adverse selection problem results in credit rationing, whereby a lender may not offer *any* loans beyond a certain interest rate, (Stiglitz and Weiss, 1981)[49]. Although lenders may also use collateral requirements to screen their borrowers (Bester, 1985)[50], the outcome remains less-than-optimal since borrowers with limited collateral, e.g. start-ups, young entrepreneurs, or less affluent borrowers, may still be credit rationed, (Stiglitz and Weiss, 1992)[51].

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[49] Stiglitz, J. E., & Weiss, A. (1981). Credit Rationing in Markets with Imperfect Information. The American Economic Review, 71(3), 393–410.

[50] Bester, H. (1985). Screening vs. Rationing in Credit Markets with Imperfect Information. The American Economic Review, 75(4), 850–855.

[51] Stiglitz, J. E., & Weiss, A. (1992). Asymmetric Information in Credit Markets and Its Implications for Macro-Economics. Oxford Economic Papers, 44(4), 694–724.

Putting these points together, crowding out is less likely to occur if a borrower is rationed out of the market, implying the presence of a market failure.

Crowding out could be distortive if publicly guaranteed loans replace private loans or prevent the development of private guarantee markets for similar loans. In either case, the public guarantor is effectively competing with other commercial entities that would otherwise provide the funding. Crowding out also implies that lenders shift some or all of the risks that they would have otherwise taken to the State, (Gale, 1990)[52].

The empirical literature, which is reviewed in section 3.1.2.1 of the External Study, generally supports the positive impact of public guarantees on funding availability and growth rate of debt of new businesses in France, Italy, Spain, and Portugal, (Lelarge et al., 2010[53]; De Blasio et al., 2018[54]; Bonfim et al., 2023[55]; Jimenez et al., 2024[56]). The empirical tests conducted by the independent experts confirm these results. In particular, using the European Commission's and the ECB's Survey on the Access to Finance of Enterprises (SAFE) database covering the entire EU-27, the independent experts show that firms that have obtained a public guarantee at one point in time will be 12% more likely to participate in the credit market and 2% less likely to be rationed out of credit markets in subsequent periods, which are statistically significant even when the firm-level effects are controlled. In addition, using a large firm-level dataset from the Italian Guarantee Fund (FCG), which contains more granular information than the SAFE database, the independent experts also show that obtaining a guaranteed loan significantly improves the debt growth levels by around 14% in subsequent periods.

Using the SAFE databases, the independent experts also investigated statistically the extent to which public guarantees bridge the gap between SMEs and large firms in terms of participation in credit markets and credit rationing, after controlling for country, time and firm-specific factors. If the impact of public guarantees on this gap is relatively small, then one may suspect that the guarantees may not be adequately targeting SMEs with limited access to financing. Based on this analysis, SMEs without any guarantees are around 19% less likely to participate in the credit market when compared to the larger firms without any guarantees. Public guarantees help bridge 74% of this gap, which is clearly significant. However, for credit rationing the findings are less positive: SMEs are around 7% more likely to be rationed out of credit markets compared to larger firms and that public guarantees bridge only 27% of this gap.

These results effectively rule out *full* crowding out. It is clear that some of the recipients of public guarantees would not have participated in the credit markets and would be rationed out. However, it is also unlikely that no crowding out takes place, especially since the impact of public guarantees on credit rationing is relatively small. Finally, the extent to which partial crowding out may be present remains an open question.

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52 Gale, W. (1990). Federal lending and the market for credit. Journal of Public Economics. 42(2), 177-193.

53 Lelarge, C. & Sraer, D. & Thesmar, D. (2010). Entrepreneurship and Credit Constraints Evidence from a French Loan Guarantee Program, NBER Working Paper

54 De Blasio, G. & De Mitri, S. & D'Ignazio, A. & Russo, P. F. & Stoppani, L. (2018). Public guarantees to SME borrowing. A RDD evaluation., Journal Banking & Finance 96, 73-86.

55 Bonfim, D. & Custódio, C. & Raposo, C. (2023). Supporting small firms through recessions and recoveries, Journal of Financial Economics 147, no. 3, 658-688.

56 Jiménez, G. & Laeven, L. & Martinez-Miera, D. & Peydró, J. (2024). Public Guarantees, Private Banks' Incentives, and Corporate Outcomes: Evidence from the COVID-19 Crisis, ECB Working Paper Series

The main takeaways from the results discussed above can be summarised as follows:

- The empirical results suggest that public guarantees do provide some form of additionality, ruling out *full* crowding out.
- Additional empirical analysis shows that public guarantees may not be sufficient in bridging the entire gap that exists between SMEs and large corporations, especially in terms of rationing. This result makes it more likely that some amount of crowding out does take place.
- Putting these two elements together, it is possible that some of the measures could be crowding out private (non-guaranteed) lending and potentially preventing the development of private guarantee markets. These distortions imply that the State may effectively be competing with commercial entities that would otherwise provide the funding, although the limitations make it impossible to determine the extent and the conditions under which such distortions could be materialising.

4.1.1.3 Unintended selective advantages

There are two ways in which public guarantees may provide unintended selective advantages.

First, lenders may not pass through to the ultimate borrowers the reduced risk costs they obtain through a public guarantee. The straightforward way to do this is by lowering the interest rate on the guaranteed loan. If the interest rate differential between a guaranteed loan and an identical non-guaranteed loan is smaller than the reduced risk costs, then a partial pass through is present.

Second, the use of public guarantees may result in higher risk-taking, by undermining either the lenders' monitoring or screening incentives, resulting in a misallocation of resources through the provision of funding to financially non-viable or less viable firms. Thus, public guarantees may be allocated to firms facing financial distress, including the so-called "zombie firms", or the guarantees may lower entry and exit rates in a market, implying that certain firms that would have otherwise exited the market may remain within the market thanks to a public guarantee.[57,58]

The results from the empirical literature are somewhat mixed on these channels through which public guarantee measures may provide unintended selective advantages to lenders or to zombie firms.

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[57] Following Storz, M. & Koetter, M. & Setzer, R. & Westphal, A. (2017). Do We Want These Two To Tango? On Zombie Firms and Stressed Banks in Europe, ECB Working Paper N.2104, the independent experts define a zombie firm as one that fulfils all of the following characteristics for two consecutive years: (i) a negative return on assets; (ii) negative net investments; and (iii) a low debt servicing capacity, which is characterised as net earnings over financial debt.

[58] Public guarantees cannot be provided to "borrowers in financial difficulty" under point of (a) of Sections 3.2 and 3.4 of the Guarantee Notice, where the definition of financial difficulty is set out in section 2.1 of the Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004, p. 2). In broad terms, a firm must be defined by Member States as facing financial difficulties if it is unable to stem losses either through its own resources or funds from its shareholders or creditors, which would, in the absence of a public intervention, condemn it to go out of business.

- De Blasio et al. (2018) find that interest rates of guaranteed and non-guaranteed loans are statistically indistinguishable, implying an incomplete pass through. The authors also show that the likelihood that a firm becomes unable to repay its debt is higher for firms that are eligible for a guarantee.

- Lelarge et al. (2010), in turn, find that obtaining a guaranteed loan helps newly created French firms pay substantially lower interest rates. Default probabilities for those are also higher, but not because the recipients are *ex ante* non-viable but because public guarantees increase default rates[59].

- Bonfim et al. (2023) uses Portuguese data to confirm that the guaranteed loans have lower interest rates. The authors also show that firms eligible for loan guarantees tend to have lower default probabilities. Interestingly, these results only apply in the immediate aftermath of the global financial crisis, covering the years between 2008 and 2013. In more stable times, both the interest rates and the default probabilities for guaranteed and non-guaranteed loans are statistically indistinguishable.

As noted in section 2.4 above, section 2.3.1 of the Guarantee Notice acknowledges the possibility that the lenders may receive part of the aid if proper adjustments are not made to the terms and conditions applicable to the loan to account for the fact that credit risks associated with the default of the borrower have been transferred to the State. However, the Guarantee Notice is not very prescriptive on what those adjustments should be calculated and when they would be deemed to be sufficient.

With regard to aid to firms in financial distress, point (a) of sections 3.2 and point (a) 3.4 of the Guarantee Notice explicitly rule out the possibility that measures providing guarantees to borrowers in financial difficulty may be seen by the Commission as free of aid.[60]

Do lenders pass through risk reduction advantages to borrowers?

The empirical tests conducted by the independent experts to determine the extent of pass through focus on whether a borrower with a guaranteed loan is offered a lower interest rate than a borrower without a guarantee, after controlling for a number of country, time, firm-size and other firm-specific factors. The results based on the EU-wide SAFE data show that obtained a publicly guaranteed loan within the past six-month period reduces the interest rates by 4 percentage points. However, this effect almost entirely disappears

59 The authors explain that firms with guaranteed loans may be more inclined to file for a formal bankruptcy procedure, rather than exiting the market informally, e.g. due to presence of the State as a stakeholder and the need to trigger the guarantee. Altavilla, C. & Ellul, A. & Pagano, M. & Polo, A. & Vlassopoulos, T. (2021). Loan Guarantees, Bank Lending and Credit Risk Reallocation, CSEF Working Paper No. 629, Core, F. & De Marco F. (2023). Information Technology and Credit: Evidence from Public Guarantees, Management Science, Forthcoming and Pelosi, M. & Rodano, G. & Sette, E. (2022). Zombie Firms and the Take-up of Support Measures During Covid-19, Bank of Italy Occasional Paper 650 confirm that guarantee recipients are not *ex ante* riskier since firms that are in the middle of the risk distribution are more likely to receive guaranteed loans compared to those in distress.

60 As described in section 2.4, for the purposes of the Guarantee Notice, financial difficulty is defined as in Community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p. 2.

once firm-specific effects, such as firm size, age, sector, country of origin, are controlled for.

The empirical tests conducted using the Italian Guarantee Fund (FCG) dataset provides a more positive picture. Although the dataset does not incorporate information on non-guaranteed loans by construction, the independent experts utilise an alternative empirical specification to test whether loans with a higher guarantee coverage obtain a lower interest rate. The results show that a one percentage point increase in the coverage ratio results in a statistically significant reduction of 2.1 basis points in the interest rate for the guaranteed loan.

The independent experts also analysed the question of whether such a reduction is sufficient or whether it may still point at a possibility that the lender still benefits from the transaction. To determine a natural benchmark for an interest rate reduction, the experts leverage on the theoretical formulations utilised to derive the risk-based benchmark methodology (see description in section 4.1.1.1). In particular, in order for the guarantee measure to remain self-financing, the formulations predict that a one percent increase in the guarantee coverage should result in an interest reduction between 2.8 and 4.6 basis points. A smaller reduction would imply that the lender is better off and may be benefiting (indirectly) from the measure. Given the 2.1 basis point reduction found in the empirical specifications described above, there is evidence that actual pass-through is incomplete and that the actual interest rate reduction corresponds to approximately 46% and 75% of the reduction that would need to be granted to maintain the measure as being self-financing.

Do public guarantees provide funding to non-viable firms or undermine market dynamics?

The independent experts extended the Italian Guarantee Fund (FCG) dataset by merging it with Bureau van Dijk's Orbis database for Italian firms[61] to respond to the various questions over whether guarantees may be allocated to firms facing financial distress or whether those guarantees may make defaults more likely.

The independent experts first show that firms with higher credit worthiness levels and those that are not classified as zombie firms are more likely to obtain guaranteed loans. In particular, safe firms, which are defined with respect to those with a high Altman Z-score[62], are 50% more likely to receive guaranteed loans compared to firms in distress.

The independent experts then find that zombie firms are less likely to receive public guarantees with less than 0.1% zombie firms receiving public guarantees. Moreover, a firm is less likely to become a zombie if it receives a public guarantee. More specifically, if a firm receives a public guarantee, it has a 68% higher probability of exiting the

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61 See Section C.1.2 of Annex C of the External Study for more details on the construction of the merged database.

62 The Altman Z-score is the Z" = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4 (Altman, E.I. (1983). Corporate Financial Distress. A Complete Guide to Predicting, Avoiding, and Dealing with Bankruptcy. Wiley Interscience. John Wiley and Sons), where X_1 is Working Capital/Total Assets; X_2 is Retained Earnings/Total Assets; X_3 is EBIT/Total Assets; X_4 is Book Value Equity/Total liabilities. According to Altman, E. I. & Danovi, A. & Falini, A. (2013). Z-Score Models' Application to Italian Companies Subject to Extraordinary Administration, Journal of Applied Finance 23, No. 1, who calibrate the Z-scores for Italian firms, safe firms have a Z'' score higher than 5.83, middle risk firms between 5.83 and 4.15, and distressed firms lower than 4.15.

zombie status the next year compared to those that have not received such a public guarantee, which could be pointing at the effectiveness of public guarantee measures. Due to limited long-term observations, it is not clear if this result holds over several years, or whether those firms eventually fall back into zombie status. However, it is noteworthy that the opposite effect is less forceful as a non-zombie firm receiving a public guarantee only has a 0.1% lower probability of becoming a zombie than in the case of no public guarantee.

The experts show that public guarantees tend to have a negative effect on the entry and exit dynamics of a specific sector. In particular, increasing the share of firms receiving a public guarantee by one percentage would induce a slight reduction of entry and exit rates by 0.04 and 0.14 percentage points, respectively. This could be highlighting an alternative explanation of the earlier results on zombie firms, in that firms receiving a guarantee may be more likely to remain in the market.

The main takeaways from the results discussed above can be summarised as follows:

- The empirical results suggest that public guarantees do reduce the interest rate charged on the guaranteed loan, although the EU-wide results are mixed, with smaller interest rate reductions and weaker statistical significance.

- There is strong evidence from Italian data that guaranteed loans with a higher guarantee coverage ratio do have lower interest rates and that the relationship is statistically significantly. However, the estimated interest rate reduction is smaller than the theoretical benchmark of a full pass-through, implying that lenders may still be obtaining a benefit from the public guarantee.

- The Italian data also suggest that firms in distress or zombie firms are significantly less likely to obtain guaranteed loans than safer firms. However, public guarantees slightly lower the entry and exit rates within a given sector, highlighting that public guarantees may make a sector less dynamic.

4.1.1.4 Other competition distortions

Public guarantees may also result in a number of competition distortions that have not been addressed above. Eligible firms may obtain a competitive advantage over non-eligible firms that compete in the same relevant market, resulting in a higher concentration. This issue was already mentioned in section 4.1.1.3, in that sectors with a higher prevalence of public guarantees tend to exhibit lower entry and exit rates. This section will address whether public guarantees could result in other competition distortions, such as a higher market concentration in sectors with higher use of public guarantees or benefits to lenders with a higher share of guaranteed loans.

Do public guarantees result in a higher market concentration for firms or lenders?

The independent experts first turn to the question of whether recipients of public guarantees tend to create a competition distortion by increasing market concentration, at the expense of competitors with no guarantees. Alternatively, it could be that public guarantees *enhance* competition by reducing market concentration by ensuring that a sufficient number of entrants and incumbents survive within the market and be driven out by adverse credit conditions.

The evidence based on the Italian FCG data merged with the Orbis database shows that that the firms that have obtained guaranteed loans are more likely to be smaller ones in each sector. More specifically, large firms are 90% less likely to receive public guarantees than smaller firms, including SMEs and micro-firms, which is not surprising since FCG principally focuses on smaller firms.

The empirical specifications, based on the merged FCG-Orbis database for Italy, suggest that sectors with a higher prevalence of publicly guaranteed loans tend to be associated with substantially lower market concentration, as measured by the Herfindahl-Hirschmann Index (HHI)[63]. The estimated correlation coefficients suggest that a one percentage point increase in the percentage of firms receiving a public guarantee in a sector leads to a decrease in the HHI for that sector by 19.8 HHI points out of a maximum of 100 points (i.e. single firm).

The independent experts also conduct a similar empirical analysis of concentration among lenders by using data from the World Bank GFDD (Global Financial Development Database) on the concentration in the banking sectors of 26 EU Member States, measured by the asset share of the top three or five largest banks in each county, and public guarantee intensities for those Member States, measured by the fraction of firms reporting the use of public guarantees in the SAFE database. The results show that there is no statistically significant correlation between public guarantee intensity and banking market concentrations.

Do public guarantees provide competitive advantages to lenders?

Lenders may benefit from a public guarantee measure as they may not pass through the reduced cost of risk they obtain from the guarantee to the borrower, thereby obtaining a premium over their normal net interest incomes. This issue was discussed in section 4.1.1.3 with mixed findings. This section turns to the question on whether these findings result in any perceivable benefits to lenders using lender-specific data.

The independent experts use the bank-specific data for 54 large EU lenders for end-2020 and end-2022 on guarantees from EBA’s 2021 and 2023 Stress Test reports, comprising the public guarantees put in place under the Temporary Framework[64], to determine whether public guarantees provide any benefits. These measures are not directly covered by the Guarantee Notice and therefore the results are only partly informative. However, all of the measures do include a requirement[65] that the lender “operates a mechanism that ensures that the advantages [from the public guarantee] are passed on to the largest extent possible to the final beneficiaries.”

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63 Herfindahl-Hirschman Index (HHI) is a commonly used measure of market concentration that is calculated by squaring the market share of each firm competing in a specific sector and then summing the resulting numbers for each firm present in that sector. For the purposes of the External Study, the independent experts rely on a market share figure based on the annual turnover of each firm.

64 Communication from the Commission - Temporary framework for State aid measures to support the economy in the current COVID-19 outbreak (OJ C 91I, 20.3.2020, p. 1), as amended by Commission Communications C(2020) 2215 (OJ C 112I, 4.4.2020, p. 1), C(2020) 3156 (OJ C 164, 13.5.2020, p. 3), C(2020) 4509 (OJ C 218, 2.7.2020, p. 3), C(2020) 7127 (OJ C 340I, 13.10.2020, p. 1), C(2021) 564 (OJ C 34, 1.2.2021, p. 6), C(2021) 8442 (OJ C 473, 24.11.2021, p. 1), and C(2022) 7902 (OJ C 423, 7.11.2022, p. 9).

65 For more details, see point of section 3.4 of Communication from the Commission - Temporary framework for State aid measures to support the economy in the current COVID-19 outbreak (OJ C 91I, 20.3.2020, p. 1).

The experts first show that publicly guaranteed loans represent on 1.3% of the total assets of the lenders in the database. This is a surprising result that shows that public guarantees represent only a very modest fraction of the lenders’ balance sheets, despite the significant number of measures put in place in response to the COVID-19 crisis.

The independent experts then analyse whether lenders that have a higher proportion of guaranteed loans in their balance sheets have higher net interest margins, after controlling for country fixed effects. The results of the empirical assessments show that there is no statistically significant relationship between the exposures of the lenders to public guarantees and profitability. The experts also conduct an additional analysis using pre-COVID-19 data for the years 2015-2019, which also point at no statistically significant correlation between public guarantee exposures and profitability.

While data availability has not allowed the independent experts to conduct additional empirical analyses, empirical literature provides a second way in which banks may benefit from public guarantees by shifting a significant portion of their credit risks to the State, thereby freeing up costly capital and improving profits. Marsh and Sharma (2024)[66] use US data from COVID-19 public guarantee measures under the Paycheck Protection Program (PPP) to show that the lenders’ decisions to participate in the public guarantee measures could be motivated by risk-aversion (i.e. shifting risks to the State) rather than improving their net interest income. Using the French data on a guarantee measure that was also put in place during the COVID-19 pandemic, Nicolas et al. (2023)[67] confirm that the measure encouraged lenders that were undercapitalised and more exposed to non-performing loans to expand activity and clean their balance sheets by shifting risks to the State, thereby obtaining some indirect advantages to lenders in the form of lower regulatory capital requirements.

Several studies have also shown that banks may get substantial benefits from public guarantees by engaging in the substitution of pre-existing non-guaranteed loans that are riskier with guaranteed loans. Altavilla et al. (2021)[68] find that guaranteed loans resulted in a moderate degree of substitution, with each additional EUR of guaranteed loan resulting in a drop in non-guaranteed lending by EUR 0.10-0.14. This effect is significantly stronger for borrowers with a larger share of late payments, or arrears, with the drop in lending increasing by another EUR 0.16-0.19. Jiménez et al. (2022)[69] find that firms that have obtained a publicly guaranteed loan reduce their non-guaranteed loan stock by around 15% and that this effect is stronger for riskier firms. These results highlight that, more than simply crowding out non-guaranteed loans, public guarantees may also result in benefits to lenders by significantly reducing their risk exposures.

The main takeaways from the results discussed above can be summarised as follows:

- There is no evidence that public guarantee measures have impacted in a statistically significant manner the degree of competition among firms. Evidence

66 Marsh, W. B. and Sharma, P. (2024). Loan guarantees in a crisis: An antidote to a credit crunch?, Journal of Financial Stability, vol. 72, issue C

67 Nicolas, T., Ungaro, S., and Vansteenberghe, E. (2023) Public-Guaranteed Loans, Bank Risk-Taking and Regulatory Capital Windfall, Débats Economiques et financiers, vol 41, Banque de France.

68 Altavilla, C. & Ellul, A. & Pagano, M. & Polo, A. & Vlassopoulos, T. (2021). Loan Guarantees, Bank Lending and Credit Risk Reallocation, CSEF Working Paper No. 629

69 Jiménez, G. & Laeven, L. & Miera, D. M. & Peydró, J. (2022). Public Guarantees, Relationship Lending and Bank Credit: Evidence from the COVID-19 Crisis, CEPR Discussion Paper No. DP17110

from Italy suggests that sectors with a higher degree of guarantee intensity actually have a lower degree of concentration, which is most likely linked to the fact that public guarantees are often targeted towards those sectors – even if indirectly due to the higher prevalence of smaller businesses.

- Similarly, based on bank-specific data obtained on public guarantees granted under COVID-19 measures, the market concentration and net interest earnings of lenders also are not statistically linked to public guarantees. However, these results may be undermined by the relatively modest share that public guarantees represent in the overall balance sheets of EU banks during COVID-19. Whether the same conclusion would hold for measures that are based on the Guarantee Notice is an open question.

- The empirical studies using COVID-19 data also suggest an additional manner in which lenders may benefit from public guarantees in that lenders might have substituted a greater share of their pre-COVID-19 (non-guaranteed) loans with publicly guaranteed loans, especially for riskier borrowers, resulting in a greater crowding out for that segment, which could be pointing to another profitability motive for lenders.

4.1.1.5 Summary of the findings concerning effectiveness

Effectiveness refers to whether the Guarantee Notice has helped Member States set up methodologies that identify accurately market-consistent guarantee premiums. But a key evaluation criterion is whether the Guarantee Notice has also helped to prevent potential unwanted effects, such as crowding out, resulting in unintended selective advantages, especially to lenders, or affecting competition among firms and lenders.

The results discussed in section 4.1.1.1 clearly highlight that the existing methodologies may not be sufficiently accurate in producing market conform fees across different risk categories and over time, especially for existing risk-based methodologies.

With regard to unwanted effects, the first concern is that the Guarantee Notice does not sufficiently rule out the possibility of the use of measures that may reduce the incentives of private guarantors or lenders to provide funding to eligible undertakings at their own risk, i.e. without any form of support, thereby deterring the development of private markets.

The empirical results summarised in section 4.1.1.2 suggest that public guarantee measures do not fully crowd out private guarantees. Thus, at least some of those measures benefit undertakings that would otherwise not receive any funding from private markets. However, the findings also suggest that some degree of crowding out may be present, implying that the Guarantee Notice may not be fully successful in ruling out the use of measures where private funding would in any manner be available.

A second concern is the possibility that the Guarantee Notice does not fully address the unintended selective advantages to lenders. There are two main forms of benefits that lenders may enjoy from public guarantee measures. First, lenders may not pass-through all the benefits they obtain from the transfer of risk to public guarantors. Second, lenders may substitute their riskier loans with guaranteed loans. These actions could distort competition in the funding markets, where lenders compete with other financial institutions, or even within credit markets if certain lenders are more likely to benefit from such measures.

With regards to aid to lenders, the empirical results surveyed in section 4.1.1.3 suggest that public guarantee measures do decrease the interest rates charged on the guarantee below the counterfactual interest rates without any form of support. However, the amount of interest reduction appears to fall well short of the theoretical estimation, pointing at the possibility that some of the benefits may not be passed-through. The empirical results provided in section 4.1.1.4 demonstrate that the amount of guarantee lending business does not contribute significantly to the lenders' market concentration or their earnings, although this result could be explained by the modest share of public guarantees in those lenders' loan books. In contrast, there is some evidence that lenders might have substituted a greater share of their (non-guaranteed) loans with publicly guaranteed loans, especially for riskier borrowers.

Lastly, a third concern is that the Guarantee Notice does not provide adequate safeguards to prevent aid to borrowers that should otherwise exit the market, such as zombie firms. Moreover, it could be that the aid provided to specific sectors or firms could deter entry into those sectors or enhance the market power of the recipients, which could harm competition and undermine the healthy development of those sectors.

The results provided in sections 4.1.1.3 and 4.1.1.4 provide a response to these concerns. Zombie firms are less likely to receive aid, as intended by the criteria under point (a) of sections 3.2 and 3.4 of the Guarantee Notice. There is some limited evidence that public guarantees may lower the entry and exit rates within a given sector. However, there is no evidence that public guarantee measures have impacted in a statistically significant manner the degree of competition among firms.

4.1.2 Efficiency

Efficiency refers to the determination of how successful the Notice has been in producing methodologies that are cost-effective. The relevant costs include the operational and administrative costs borne by all parties involved, most notably the national authorities[70], financial intermediaries and guarantee applicants, including those arising from delays, complexities and any amount of aid that may benefit parties other than the final beneficiary. Costs borne by smaller beneficiaries, such as micro-enterprises, SMEs, and start-ups, are also considered as those firms may by overburdened by complex application and monitoring procedures as well as the credit ratings procedures, which are key in the determination of market conform guarantee premiums.

Addressing the above research question is made difficult due to general unavailability of data on efficiency indicators, such as time and other resources spent on exchanges with the Commission until the adoption of a measure as well as for the implementation of the adoption. The highly incomplete nature of the available data through mandatory reporting under Section 6 of the Guarantee Notice has been a key constraint on the experts' ability to address the relevant questions. Nevertheless, the experts did use the limited data to the fullest extent to draw some results on the administrative costs

[70] See Annex IV for the Commission's estimates on the direct cost of associated with developing methodologies.

associated with putting in place and implementing a guarantee methodology that is in line with the Guarantee Notice.

4.1.2.1 Qualitative analysis

The qualitative analysis is based on structured interviews of a sample of relevant stakeholders involved in the design, set-up and implementation of guarantees. The qualitative analysis also took into account the feedback from the public and expert consultations conducted by the Contracting Authority between August and December 2022. Other voluntary contributions received from different entities, such as the European Association of Public Banks (EAPB), were also incorporated into the analysis.

After consultation with the Commission services, the independent experts have selected a sample of 16 guarantee measures based on the insights obtained on those measures in Area 1 and with the aim to ensure sufficient variability in geographical coverage, pricing methodology, and eligibility criteria.[71] Between April and June 2024, The independent experts have conducted interviews with nine guarantee granting and administering authorities on a total of ten different measures.[72] Insights on two additional measures were collected through written communications.

The results of these interviews demonstrate significant variability with regards to the efficiency of the Guarantee Notice.

Design and setup of guarantee measure or methodology

With regard to costs borne by the authorities in the design and the setup of a guarantee measure or methodology, a commonly quoted bottleneck is that the current State Aid framework was too convoluted, generating difficulties in the design and the setting up of a measure or a calculation methodology. As an example, one authority argued that the interpretation of the Guarantee Notice was not straightforward, and it considered it necessary to consult legal experts for this purpose.

Another widespread critique relates to the official communication lines between the guarantee granting and administering authorities and the Commission. Two respondents noted that although informal support and partial answers are provided relatively quickly by the Commission services, official replies and adoption of Commission decisions tend to take much longer, creating critical delays in putting the measures in place. Due to the lengthy pre-notification, notification and adoption stages, several respondents argued that they often wait for approval without a clear schedule. One authority highlighted that these uncertainties have disrupted workflow and caused further delays as it necessitated re-setting of teams and other resources. In addition to Commission's internal delays, one respondent also identified the routing of questions and responses through permanent representations or ministries as an additional contributing factor.

Four respondents also note they face significant resistance from lenders to share any data on risk assessments. Bank often cite legal provisions on banking secrecy and rules on

[71] See Annexes C.14 and C.18 of the External Study for more details on the interviews.

[72] For more, see https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13466-State-aid-rules-for-assessing-State-guarantees-on-loans-evaluation_en (public consultation) and https://competition-policy.ec.europa.eu/public-consultations/2022-guarantee-notice_en (expert consultation).

information privacy to argue against any data sharing. Enhancing cooperation with financial intermediaries is seen as being instrumental to avoid duplication of risk assessments. This issue is particularly important in the design of measures targeting SMEs, where lack of any reliable alternatives often make it compelling for authorities to rely on lenders.

Two respondents emphasized that there was no high-level exchange of information platform in place with the involved stakeholders, especially those from other Member States, regarding best practices. The respondents note that such a platform could help reduce costs, especially by acting as a forum where the authorities could discuss both among themselves and with the Commission specific issues relating to their guarantee measures and methodologies.

Application procedures, screening and monitoring

With regards to the application and screening process, streamlined application procedures relying on online tools generally result in significant cost savings and quicker approvals. As an example, in one Member State, beneficiaries that are approved after an online or physical (face-to-face) interaction (directly with the granting authority) receive a certificate confirming their eligibility for a guarantee, which can then be used at any lender for a loan application. This procedure not only reduces costs to the authorities but also ensures competition among lenders, as the borrower can literally shop around for the best priced loan.

Several respondents highlight that online application procedures may not be applicable for larger firms, which are typically more complex and require a more time-consuming tailored assessment. The approval of such complex applications usually implies the involvement of different grades of the authority's staff and may take significantly longer.

More generally, the lenders are also instrumental in the application stages. This is especially the case for measures targeted towards SMEs and agricultural companies, where the lender gathers all the relevant information from the applicant and applies for the guarantee on behalf of that borrower. While the arrangement clearly shifts some of the administrative costs towards the lender, it is not clear how the lender is remunerated.

The interviews also demonstrate that the guarantee administering and granting authorities rarely perform any monitoring activity, which are typically delegated to the lender. In most cases, the authorities only receive a quarterly or yearly monitoring report. In some measures, the authorities only receive an update for borrowers that have defaulted.

The main takeaways from the results discussed above can be summarised as follows:

- The qualitative results backed by interview data suggest that the State aid framework is considered as being too complex, calling for a significant amount of resource allocations from Member States, especially in the design and setting up stages. Several respondents highlighted that collaboration among stakeholders, including the public authorities responsible for administering and granting guarantee measures, to learn from best-practices could help in this manner.

- Interview data also highlights that the lengthy pre-notification, notification and adoption stages relating to individual decisions result in uncertainty and costly staff re-allocations over time.

- The interviews also show that there is significant resistance from lenders to share any data on risk assessments with the authorities in some cases, which is particularly problematic in guarantees covering smaller firms and start-ups for which data availability is limited. This issue increases administrative costs both in the design, setup and implementation stages.

4.1.2.2 Quantitative analysis

Due to the general unavailability of dataset that would allow the comparison of administrative costs of different public guarantee measures, including those that are not within the scope of the Guarantee Notice, the quantitative analysis will focus solely on design elements that may help reduce costs to Member States. The analysis is based on reports submitted by Member States in line with Section 6 of the Guarantee Notice ("Section 6 data").

The final dataset contains data on a yearly basis for 43 measures covering 12 Member States (Belgium, Bulgaria, Croatia, Czechia, Denmark, Estonia, Greece, Hungary, Latvia, Netherlands, Poland, Romania). The reports contain general information on each measure, including the name of the measure, the start and end dates, the number and the amount of guarantees issued, as well as the administrative costs and costs associated with triggering of guarantees, income from premiums charged and the number of defaults.

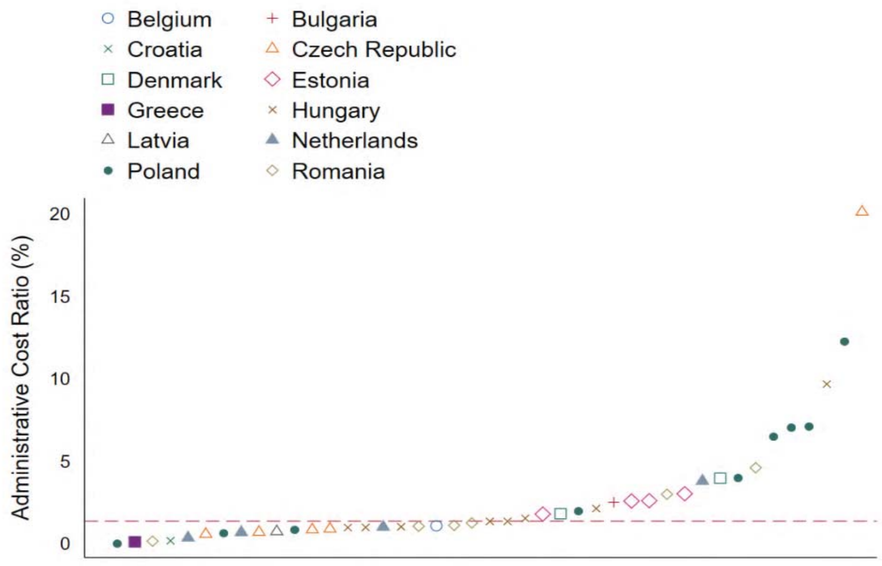
The independent experts have faced a number of data issues during the analysis, which undermines some of the results. In particular, there are some missing elements in the dataset (e.g. no default data although default costs are reported). In addition, there were significant outliers, which were removed using conventional methods[73].

The indicators below, unless mentioned otherwise, are aggregated by summing values across years. Thus, they should not be seen as estimates of what is borne by a guarantor as annual administrative costs, but a cumulation of those costs across the years for which data was reported.

The results of quantitative analysis based on the Section 6 data show that the median cumulative administrative costs represent 1.4% of the total value of guarantees issued while the average figure is around 2.8%, which is significantly higher given the presence of extremely high values. This is also clear from Figure 14, which clearly depicts the significant variability in administrative costs not only across but also within some Member States.

[73] See Annex C.19 of the External Study for more details.

Figure 14: Administrative costs as a share of total value of guarantees issued



Note: The dotted line depicts the median (1.4%) value for the 43 measures across 12 Member States.

Another question is the extent to which the cumulative revenues from guarantee premiums compare to the total costs, i.e. the administrative costs and the guarantee claim disbursements following the default of borrowers. This issue clearly goes to the heart of the question of whether the measures are self-financing. While one would expect non-aid schemes to be self-financing, as required under point (d) of Section 3.4 of the Guarantee Notice, guarantee premium collections may well fall short of total costs for other measures.

The data confirms these expectations, although only to some extent. The median guarantee premium collections, depicted by a dotted line in Figure 15, represent 69% of the total costs, mainly due to the predominance of aid measures in the sample. In particular, all but 4 of the 21 observations below the median line correspond to measures involving aid. More specifically, for the 29 measures for which guarantee premium collections are below total costs, or below 100% in the nearly two thirds are aided measures. These results imply that in some cases the measures are not necessarily self-financing, at least based on the information provided.

Figure 15: Guarantee premium collections as a share of total costs, including administrative costs and guarantee claim disbursements

Note: The dotted line depicts the median (69%) value for the 43 measures across 12 Member States.

The independent experts' statistical analysis incorporates annual reports sent by Member States for each of the 43 measures, resulting in a total of 293 observations. The regression results based on this data show that the size of the measure, as proxied by the total value of the guarantees issued, has a statistically significant negative impact on administrative costs (as a share of total value of guarantees issued). This result is a clear indication that there are economies of scale, implying that larger measures tend to be associated with lower unit administrative costs. More specifically, increasing the size of the measure by EUR 10 million of guarantees issued results in a reduction of the administrative costs by up to 0.016 percentage points.

Furthermore, no-aid measures tend to have statistically significantly larger administrative costs, by up to 1 percentage points. This result may be explained by the fact that a no-aid measure may involve closer monitoring to ensure that the measure remains both self-financing and market conform to ensure a healthy take up of the measure by borrowers.

Beyond these results, none of the other explanatory variables exhibit a statistically significant relationship with the administrative costs. The main findings are as follows:

- Administrative costs are only weakly linked to default costs following the triggering of a guarantee. In particular, a 1 % increase in the default ratio appears to increase administrative costs by 0.01 to 0.02 percentage points.

- Measures based on safe harbour premiums under Sections 3.3 or 3.5 of the Guarantee Notice do have lower administrative costs, up to 0.5 percentage points when compared to other measures. However, the statistical significance of the result is very weak, which may be driven by the general unavailability of data on safe harbour measures, i.e. only 3 of the 43 measures in the sample are identified as safe harbour measures. Nonetheless, it is likely that the result reflects some realism. It is conceivable that risk-based methodologies involve higher administrative costs as they require complex procedures to demonstrate the self-financing nature of the scheme as well as a proper risk orientation of the guarantee premiums.

- Single premium measures for SMEs covered by Section 3.5 of the Guarantee Notice have lower administrative costs than other measures by around 0.09 percentage points. However, the relationship is weak, both in terms of its magnitude and its statistical significance.

In addition to the above empirical assessments, the independent experts also provide an overview of the average administrative costs associated with different tasks as a percentage of the outstanding guaranteed amounts on an annual basis. Since the data on task-related costs is mostly incomplete, the dataset is reduced once again to 24 observations covering 11 Member States. The analysis reveals that the risk monitoring and management tasks cost between 0.10% to 0.15% with an average of 0.13% of the guaranteed amounts on an annual basis. However, the more involved task of risk assessments cost between 0.15% to 1.15%, with an average of 0.61% of the guaranteed amounts, also on an annual basis. Putting these together, the annual administrative costs range from a low of 0.25% to a high of 1.3% of the guaranteed amounts, with an average of 0.74%.

The main takeaways from the results discussed above can be summarised as follows:

- The quantitative analysis highlights that guarantee premium collections may well fall short of total costs, including in some cases, no-aid schemes. This result is somewhat disturbing given that point (d) of Section 3.4 of the Guarantee Notice requires such measures to be self-financing. However, data limitations may also be an additional explanatory factor behind this finding.

- There is clear evidence that larger measures are associated with lower (unit administrative costs), i.e. economies of scale. Moreover, no-aid measures tend to have higher administrative costs, which could be explained by the fact that in addition to remaining self-financing, Member States may have to devote further resources to ensure that the measure does not become too costly for borrowers, resulting in a healthy take up.

- The annual costs related to risk assessment are substantially greater than other administrative costs, with an average of 0.61% of the total guaranteed amounts. The total annual administrative costs, including all relevant risk assessment, monitoring and management tasks, is around 0.74% of the total guaranteed amounts.

4.1.2.3 Summary

Efficiency refers to whether the Guarantee Notice has helped Member States in setting up methodologies in a cost-effective manner, without introducing undue complexities, bureaucratic obstacles and red tape while recognising any cost synergies or other elements that could reduce costs. Due to data limitations, the section has been divided into a discussion of the qualitative and quantitative results.

The qualitative results reviewed in section 4.1.2.1 highlight that the Member States view the State aid framework as being complex, especially in the design and setting up stages, including the pre-notification, notification and adoption stages. The respondents to the interviews, which mostly include public guarantee administering and granting bodies, generally lack the information and data sources that are crucial for their risk assessments, worsened in some cases by the reluctance of lenders to share their own data or assessments. There is no formal forum where the relevant stakeholders may discuss issues on a timely manner. All of these elements drive up the administrative costs, not only for the administrators but also for the final beneficiaries, thereby undermining the efficiency of the measures.

Owing to the limited nature of the available data, the quantitative results surveyed in section 4.1.2.2 focus more on whether the administrative costs of the public measures are covered by the premium collections as well as elements that could be identified as the source of high costs. First, and foremost, empirical results show that guarantee premium collections may well fall short of total costs, including in some cases, no-aid schemes. Second, there is clear evidence that larger measures are associated with lower (unit administrative costs), i.e. economies of scale, which implies that smaller Member States may be particularly prone to higher costs. Once again, no-aid measures tend to have higher costs, which could be explained by additional resources that the authorities may need to devote to remain competitive. Lastly, the results highlight that administrative costs associated with risk assessments are several multiples of any other costs, including monitoring and management costs.

4.2 Coherence

The evaluation of the coherence[74] of the Guarantee Notice assesses whether the Notice is legally and economically sound and consistent, both on a stand-alone basis (internal coherence) and in relation to other State aid legislation and guidance (external coherence). Whether or not the Guarantee Notice is coherent with the broader financial services legislation does not fall within the scope of the evaluation, as explained in section 1.3.

Issue #1. Preference over direct pricing information vs. benchmarks vs. proxies

The independent experts identified the relative ranking of market information on a specific transaction, market benchmarks and market proxies as a potential incoherence between the Guarantee Notice and the Notice on the Notion of Aid.

In particular, the Notice on the Notion of Aid envisages[75] that comparable market transactions, i.e. benchmarks, should only be used in the absence of *direct pricing information* on a given loan transaction. Applying this point by analogy to guarantees on loans would imply that pricing information relating to a specific transaction should be prioritised over market benchmarks, such as pricing information relating to comparable transactions, i.e. *market benchmarks*. For example, if a public guarantee is accompanied by a private guarantee on the same loan, then this information should take precedence over market benchmarks (i.e. prices of guarantees for similarly rated firms).

In addition, the Notice on the Notion of Aid also envisages a preference for market benchmarks over *market proxies*, (i.e. market prices generated by a pricing methodology).[76] Once again, although the relevant text in the Notice on the Notion of Aid

[74] Results of the public and expert consultations were inconclusive with regard to coherence, so the evaluation mainly relied on the expert study.

[75] See point 111 of the Notion of Aid: "*In the absence of specific market information on a given debt transaction, the debt instrument's compliance with market conditions may be established on the basis of a comparison with comparable market transactions (that is to say through benchmarking).*"

[76] This is clear from point 113 of the Notion of Aid: "*If comparable transactions have typically taken place at a lower price than that indicated as a proxy by the reference rate, the Member State can consider this lower price to be the market price. If, on the other hand, the same company has carried*

refers only to loan subsidies, applying them by analogy to guarantees would imply that the market proxies generated by, say a guarantee methodology, should be overridden by market benchmarks (e.g. from comparable guarantee transactions) if the two deviate from one another.

This implicit preference structure is only indirectly (and incompletely) mentioned for individual guarantee measures under point (d) of section 3.2 of the Guarantee Notice, i.e. "[i]*f no corresponding guarantee premium benchmark can be found on the financial markets…*".

In this context, the safe harbour premiums for SMEs as set out in section 3.3. of the Guarantee Notice are referred to as "*proxies (and irrebuttable presumptions* […] *for SMEs)*" under the Notice on the Notion of Aid.[77] Accordingly, the hierarchy as set out in the Notion of Aid would normally have to be applied with regard to these proxies, as well. However, the Guarantee Notice explicitly notes that the application of safe harbour rates is optional and within the discretion of the Commission.[78] This derogation from the aforementioned hierarchy could be explained by the fact that the Guarantee Notice aims at simplifications and improved access to finance for SMEs.[79] As a result, the hierarchy is not applied with regard to safe harbour premiums for SMEs. This is also reflected in the Commission's case practice.[80]

Issue #2. Use of pricing of non-guaranteed loan in the Notice on the Notion of Aid

The Notice on the Notion of Aid envisages[81] that the interest rate of the non-guaranteed loan must be used to determine the total cost of the guaranteed loan, i.e. the interest rate of the guaranteed loan plus the guarantee premium. This possibility is only mentioned for individual guarantee measures under point (d) of section 3.2 of the Guarantee Notice, "[i]*f no corresponding guarantee premium benchmark can be found on the financial markets, the total financial cost of the guaranteed loan, including the interest rate of the loan and the guarantee premium, has to be compared to the market price of a similar non-guaranteed loan*." More generally, the wording in the Notice on the Notion of Aid and point (d) of section 3.2 of the Guarantee Notice raises the question whether the interest rate on a non-guaranteed loan should, in effect, be preferable to the market proxies generated by a given pricing methodology. This incoherence may undermine the consistency and comparability of public measures that are based on similar financial instruments, such as interest rate subsidies and credit guarantees. Perhaps more importantly, it could also result in legal uncertainty with respect to aid-free measures that

out recent similar transactions at a higher price than the reference rate, and its financial situation and the market environment have remained substantially unchanged, the reference rate may not constitute a valid proxy of market rates for that specific case."

77 Point 114 of the Notion of Aid.

78 As an example, see Section 3.3. of the Guarantee Notice: "*the Commission can by way of derogation from point 3.2(d) accept a simpler evaluation of whether or not a loan guarantee involves aid.*"

79 See Section 2.4 of this document on the background of the introduction of safe harbour premiums and Section 3.5. of the Guarantee Notice: "*In view of the specific situation of SMEs and in order to facilitate their access to finance*".

80 See e.g. SA.109147 (2023/N) – Slovakia Calculation of aid elements in the provision of guarantees to SME.

81 See point 111 of the Notion of Aid: "*In the case of guarantees, if no corresponding price benchmark can be found on the financial markets, the total financing cost of the guaranteed loan, including the interest rate of the loan and the guarantee premium, should be compared to the market price of a similar non-guaranteed loan*".

respect the relevant provisions of the Notice on the Notion of Aid and whether those same measures may be considered to be in line with the Guarantee Notice.

Issue #3. Incompatibility of guarantee premiums under Guarantee Notice with risk margins under the Reference Rate Communication

As is clear from point 112 of the Notice on the Notion of Aid, the Guarantee Notice and the Reference Rate Communication share a common aim of producing market proxies to determine the aid character of loans and guarantees. To that extent, one would expect a degree of comparability between the two frameworks. This expectation would, in particular, apply to any common factor that enter into the pricing of a loan or a guarantee, such as the so-called credit risk margin or the loan margin.[82]

The independent experts highlight that the two frameworks are quite distinct when it comes to what a market conform credit risk margin should be. For example, a firm with a low credit risk, corresponding to a AAA to A rating, is associated with loan margins between 60 to 100 basis points under the Reference Rate Communication, depending on the degree to collateralisation. In turn, the safe harbour premiums described under section 3.3 of the Guarantee Notice require that the annual premiums should at least be between 40 to 55 basis points for similarly rated SMEs. It is easy to see that the credit risk margins implied by this treatment under the Guarantee Notice would be much lower than those spelt out in the Reference Rate Communication, once the necessary adjustments to the former are made, i.e. netting out administrative and capital remuneration costs.[83] The guarantee premiums do not take into account any level of collateralization, and the guarantee premiums' dependence on the credit quality step of the borrower is much more granular when comparing to the corresponding features in the Reference Rate Communication. Similarly, the Guarantee Notice and the Reference Rate Communication have different levels of granularity for the credit risk steps.

The examples above highlight three areas in which the Reference Rate Communication and the Guarantee Notice differ in the way they treat credit risk margins.[84] First, the margins themselves are not comparable. Second, the Guarantee Notice does not incorporate any consideration for collateral levels. Third, while the safe harbour rates are only applicable for SMEs, the reference rates are applicable more broadly.

Beyond the safe harbour premiums, the Reference Rate Communication also does not contain any guidelines or sufficient conditions to allow Member States to calculate their

[82] For the purposes of this sub-section, credit risk margin or loan margin refers to the guarantee premium (for guarantees) and what a borrower pays over the so-called base rate, or the funding cost (for loans). Unlike the discussions in earlier Sections, the term incorporates all of the administrative, capital remuneration and other relevant costs associated with guarantees and loans, which are assumed to be also the same for simplicity.

[83] As an interesting side note, the credit risk margins and loan margins applicable to unrated firms appear more comparable. More specifically, an unrated firm or a startup is associated with a loan margin of at least 400 basis points in the Reference Rate Communication, while the Guarantee Notice only associates a safe-harbour premium of 380 basis points.

[84] In comparison, OECD's *Export Credit Arrangement* does incorporate a single credit risk element for the calculation of export credit subsidies and guarantees. More specifically, Article 21 of the Arrangement foresees the identification of a common element, or the so-called "Minimum Premium Rate", which is to be applicable for both market conform interest rate and guarantee premium calculations.

own reference rates, which would be comparable to sections 3.2 and 3.4 of the Guarantee Notice.

Issue #4. Aid to the lender

The independent experts identify the different ways in which the Guarantee Notice and the rest of the relevant State aid framework exclude aid to the lender as another potential incoherence. In particular, there is no requirement or guideline on how aid to the lender should be assessed and, to the extent possible, ruled out. More specifically, section 2.3 of the Guarantee Notice only describes cases in which guarantees may provide aid to the lender and draws attention to the "*fact that such aid might, in principle, constitute operating aid*". Beyond these high-level descriptions, it does not provide any guidelines on how such aid may be ruled out or minimised and any applicable conditions. This approach contrasts quite remarkably with GBER, where, under Article 21 paragraph 13(b) as applicable to risk finance aid, the financial intermediaries should be "*selected through an open, transparent, and non-discriminatory call*".

Against this background, the following provides a summary of the assessment of the coherence of Guarantee Notice:

- The Notice on the Notion of Aid envisages that pricing information obtained from comparable market transactions, i.e. market benchmarks, should only be used in the absence of direct pricing information on that very transaction[85]. Furthermore, the Notion of Aid also envisages a preference for market benchmarks over market proxies, such as those generated by a pricing methodology[86]. Lastly, the Notice on the Notion of Aid also requires the use of the interest rate of the non-guaranteed loan to be comparable to the total cost of the guaranteed loan. These preference structures are not fully taken into account in the Guarantee Notice.

- The approaches of the Guarantee Notice and the Reference Rate Communication are not consistent with one another in terms of the fixed credit margin tables. In particular, the indirect credit margins that are implied by the safe harbour premiums are not comparable to those fixed by the Reference Rate Communication. Moreover, the Guarantee Notice remains applicable only for SMEs and does not incorporate any consideration for collateral levels.

- The Guarantee Notice does not provide guidance on how to rule out indirect advantages to lenders. Thus, it is not fully aligned with the ex ante examination that is called for by the Notice on the Notion of Aid[87]. This omission also contrasts with the GBER as applicable to risk finance aid, where it is required that financial intermediaries are "selected through an open, transparent, and non-discriminatory call"[88].

85 See point 111 of the Notice on the Notion of Aid.
86 See point 113 of the Notice on the Notion of Aid.
87 See point 116 of the Notice on the Notion of Aid.
88 See GBER Article 21 paragraph 13(b).

4.3 EU added value - How did the Guarantee Notice make a difference and to whom?

The evidence gathered in the evaluation, particularly the expert consultation and the external study, suggests that the Guarantee Notice has a clear EU added value compared to a situation without any guidance. In particular, the Guarantee Notice has provided a framework within which the Commission can approve guarantee methodologies developed by Member States and which provides directly applicable safe harbour premiums. It has thereby increased predictability and legal certainty in the context of the approval of guarantee methodologies and the corresponding measures. Lastly, the application of the Guarantee Notice has also ensured a level playing field between Member States.

4.4 Relevance of the Guarantee Notice

As explained in section 3.3.2, Member States continue to notify guarantee methodologies based on the Guarantee Notice. The stock of the approved methodologies therefore continues to increase. These continued notifications by Member States to obtained approved guarantee methodologies shows that the Guarantee Notice remains relevant. In addition, respondents to the expert consultation have emphasized the Guarantee Notice's role in guiding stakeholders and noted the enduring relevance of its concepts, addressing the needs of Member States and other stakeholders over time with regard to financing companies. The fact that guarantees do not imply immediate fiscal costs are also driving Member States' use of the Guarantee Notice for public guarantees, which is in evidence from the significant number of on-going discussions with Member States for new methodologies that are yet to be adopted.[89] More broadly, the Guarantee Notice remains relevant as the calculation of a market conform premium and the measurement of the aid element are quite distinct for guarantees than for other support measures, such as loan subsidies and grants. Nevertheless, due to the changing market conditions and regulatory environment since 2008, the evaluation has shown that the Guarantee Notice has several shortcomings, notably the fixed nature of the safe harbour premiums and a capital remuneration for self-financing methodologies that is not in line with current regulatory levels.

5 WHAT ARE THE CONCLUSIONS AND THE LESSONS LEARNT?

5.1 Conclusions

The present evaluation aims to assess whether the Guarantee Notice remains 'fit for purpose', to identify its shortcomings and to verify whether there is any scope for improvements or simplifications.

The findings provided in section 3.3 demonstrate that Member States have made extensive use of the methods offered by the Guarantee Notice to provide public guarantees. The widespread and increasing use of both the risk-based methodologies and safe harbour premiums suggests that Member States value the guidance offered by the Guarantee Notice. These also confirm that the Guarantee Notice continues to fulfil an important role as secondary legislation under which Member States can provide aid in the

[89] As of 1 September 2025, there are on-going pre-notification and notification discussions with 7 Member States for new methodologies.

form of guarantees. In addition, this framework, within which the Commission can approve guarantee methodologies developed by Member States in line with the guidance provided by the Guarantee Notice, results in a level playing-field.

However, the evaluation has also shown some shortcomings with regards to the effectiveness, efficiency, and the coherence of the Guarantee Notice with other State aid legislation.

With regards to effectiveness, the results summarised in section 4.1.1.1 clearly demonstrate that the existing methodologies do not yield an accurate estimation of market conform guarantee premiums in many cases. This is especially the case for existing risk-based methodologies, which produce premiums that are consistently lower than the relevant benchmarks across different risk categories, maturities, and time horizons. The existing safe harbour premiums, however, produce guarantee premiums that are higher than the relevant benchmarks only for lower risk BBB-rated borrowers.

Also linked to effectiveness is the question of whether the guidance provided under the Guarantee Notice helps prevent potential unwanted effects and competition distortions. The empirical results presented in section 4.1.1.2 suggest that public guarantees do provide some form of additionality, ruling out the possibility that they lead to *full* crowding out of private risk taking. However, there is some evidence from reviewed empirical studies using COVID-19 guarantee measure data in section 4.1.1.4 that lenders might have substituted higher risk non-guaranteed loans with publicly guaranteed loans, suggesting that there may be some crowding out for that category of borrowers. More generally, although the empirical evidence in section 4.1.1.3 suggests that public guarantees do result in lower interest rates than what would otherwise be possible, these lower interest rates are not sufficient to fully rule out aid to lenders. Nevertheless, these potential benefits are also not large enough to generate statistically significant financial gains or competitive advantages for lenders. This also mitigates the risk of the qualification of the (indirect) aid to lenders, as extraordinary public financial support, under the BRRD/SRMR.

Regarding efficiency, the voluntary stakeholder interviews demonstrate that the implementation of the Guarantee Notice is considered to be complex, calling for a significant amount of resource allocations from Member States, especially in the design and setting up stages of guarantee methodologies. In addition, lengthy pre-notification, notification and adoption stages result in uncertainty and costly allocations or re-allocations of resources. The quantitative analysis suggests that larger measures are associated with lower administrative costs as a share of guaranteed amounts, implying significant economies of scale and potentially higher unit costs for smaller measures and/or Member States. In addition, although safe harbour measures and, to a lesser extent, single premium schemes, do have lower (unit) administrative costs, the results are not statistically significant.

Regarding external coherence, a key message is that the ranking established in the Notice on the Notion of Aid on the types of market information to be used in the estimation of the market conform premiums is not fully incorporated in the Guarantee Notice. In addition, the independent experts identify several inconsistencies between the Guarantee Notice and the Reference Rate Communication, most notably on the credit margins, eligibility conditions and consideration for collateral levels. Lastly, the Guarantee Notice does not provide guidance on how to rule out indirect advantages to lenders, unlike specific conditions and criteria provided in the Notice on the Notion of Aid as well as in GBER.

5.2 Lessons learnt

The following issues describe the key lessons learnt that emerged from the evaluation. Note that some of these issues are not directly addressed by the Study but rather are based on discussions with Member States in the context of specific cases (see discussion section 3.4).

Lesson #1. Existing safe harbour premiums may be too high for higher risk borrowers

Safe harbour methodologies could be less preferable for Member States, as noted in section 3.4, since the targeted beneficiaries, i.e. SMEs and start-ups, typically have higher default risks. Since the fixed safe harbour premiums for those beneficiaries are higher than the benchmark premiums, it should not come as a surprise that many Member States opt for developing risk-based methodologies for those beneficiaries, even if this results in extra costs and complexity.

Lesson #2. Accuracy of risk-based methodologies may be undermined due to inappropriate parameters or incorrect specifications

The evaluation demonstrates that the accuracy of risk-based methodologies may be undermined if the parameters used are not aligned with market reality. The following are three key areas where misalignments may be originating from:

a) The accuracy of the premiums calculated under any risk-based methodology could be undermined due to the substantial variability in administrative costs. As described in section 4.1.2.2, the reported annual administrative costs as a share of the guaranteed amounts range from a low of 0.10% (for measures involving only risk monitoring and management tasks) to a high of 1.3% (for measures that also involve the more costly risk assessment tasks), with an average of 0.74%. It is possible that some of this variability is due to differences in not only the tasks performed but also the specific characteristics of the underlying loans and the targeted beneficiaries

b) As noted in section3.4, a more granular approach for determining the amount of capital that needs to be set aside and the expected earnings on that capital may help align the Guarantee Notice with the new regulatory environment. In particular, Article 122 of the CRR sets the standardised-approach risk weights for corporate exposures, ranging from 20% (for AAA-rated borrowers) to 150% (for borrowers with a rating of B+ and below). These imply that a minimum capital requirement of 10.5% as a percentage of risk-weighted assets translates into capital charges of 2.1% and 15.8% as a percentage of the notional loan amounts for borrowers with a rating of AAA and B, respectively.[90] These considerations

[90] A similar case can also be made for expected earnings on capital. While footnote 17 of the Guarantee Notice suggests the use of 400 basis points as the "normal risk premium for equity", the return on equity for significant institutions averaged at a much higher 9.5% for end-2024 and an average of

demonstrate that the single example provided in Footnote 17 of the Guarantee Notice is not only outdated, but could also result in an accurate representation of the amount of capital market participants have to put aside, resulting in a lower premiums, especially for higher risk categories.

c) Also as noted in section 3.4, there is very little economic justification for a 4% risk premium, at least in the current market conditions, which is cited as an example in the Notice. Fitch Ratings reports that the 20 largest European banks are expected to maintain a return on equity of around 12% in 2025, while S&P Global Ratings provides a slightly more conservative estimate of 9%. On average, the return on equity for European banks has been around 6% over the past 10 years and has rarely dropped to 4% or lower. Another source of misalignment could be the fact that the current Guarantee Notice does not require that higher risk is compensated by higher return.

The inaccuracies may also be explained by the fact that certain parameters are not taken into account at all in the calculation of the premiums. The following are key areas for such incomplete specifications:

a) As noted in section 4.1.1.1, the existing methodologies typically do not distinguish risk levels based on the maturity of the underlying loan or the guarantee itself. This contrasts with the observation that investors typically ask for additional margins on certain types of financial instruments, including loans, to account for inflation, interest rate and liquidity risks associated with longer term assets.

b) Some of the existing methodologies do not incorporate any elements to account for changing market conditions. While private guarantees and similar instruments in the market do have fixed prices, which are paid on regular intervals (e.g. annually or monthly) for the entire duration of the loan, those prices usually take into account information on expected or potential market developments at the date on which the price is agreed. In contrast, the results summarised in section 4.1.1.1 highlight that existing methodologies typically exhibit a much lower sensitivity to market dynamics than the relevant benchmarks and that, in some cases, the premiums are set at a fixed level for the entire duration of the measure.

c) The Guarantee Notice does not take into account counterparty credit risk, which is linked to the possibility that the public guarantor may not be able to honour its guarantee obligations. The independence experts note that the consideration for counterparty credit risk is a key component of the pricing of guarantees and similar financial products, such as CDS and similar credit derivatives. In particular, the pricing of those financial transactions is typically inversely linked to the default risks associated with the insurance provider.

Lesson #3. There may be potential aid to lenders

The empirical evidence in section 4.1.1.3 suggests that public guarantees do result in lower interest rates than what would otherwise be possible, these lower interest rates are

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6.4% between 2016 and 2024[90]. For less significant institutions, the return on equity was lower, at 6.9% at end-2024 and an average of 5.2% between 2020 and 2024 (the longest set of period for which data was available).

not sufficient to fully rule out aid to lenders. As discussed in section 3.4, the Commission's services were able to address some of the identified shortcomings in some of the recent approved methodologies, by incorporating the effective interest rate (EIR) safeguard.[91] However, the Commission's experience in these decisions highlight a number of issues, ranging from the significant variability in administrative costs (section 4.1.2.2) and the sensitivity of the calculated floor to estimations errors (section 3.4).

Lesson #4. The current framework is undermined by limited information sharing, lack of standardisation and poor quality reporting

Interviews conducted by the independent experts, which are summarised in section 4.1.2.1, highlight that Member States lack a robust framework for knowledge and information sharing. While the existing safe harbour methodologies could be seen as an example, the evaluation reveals a number of areas that may undermine a full standardisation and the relevant efficiency gains, including the extent to which lenders may be willing to share their assessments with the public guarantor, and variability in the correspondence of internal ratings systems of lenders (or guarantors) with those used by international credit rating agencies. Moreover, Member States face significant administrative costs in the initial phases of the approval process, including the design and setup of the guarantee measure or methodology, as described in section 4.1.2.1. The discussion at the beginning of section 4.1.2 also makes it clear that there is only very limited information available from the reports presented to the Commission services under section 6 of the Guarantee Notice. Lastly, as the evidence in section 4.1.2.2 shows, there are significant economies of scale, which result in disproportionate costs borne by smaller Member States. All of these elements point at a lack of adequate information sharing, not only between the Commission and the Member States but also between Member States. It is also clear that the current reporting framework is at best only partially achieving its intended aim of monitoring the developments in the financial markets and the evolution of State guarantees over time.

Lesson #5. Implementation and interpretation issues still persist

The discussions with Member States mentioned in section 3.4 highlight the following implementation and interpretation issues:

a) As described in detail in section 2.4, and under points (d) and (e) of section 3.4 of the Guarantee Notice, a market conform scheme should be and remain "self-financing". However, as described in section 3.4, this condition is often interpreted as being the only requirement for achieving market conformity. However, point (f) of section 3.4 of the Guarantee Notice makes it clear that the guarantee premiums must cover not only the expected losses that the guarantor would bear through the triggering of the guarantees, but also the expected returns

[91] Such an approach has already been deployed in some recent decisions, comprising of the 2021 Portuguese guarantee methodology (SA.61340), the 2022 Greek guarantee methodology (SA.102741), the 2022 Croatian guarantee methodology (SA.64359), and the 2022 Italian guarantee methodology (SA.100837).

on regulatory capital as well as the relevant administrative costs borne by the guarantor.

b) As noted in section 3.4, several Member States have implemented guarantee measures at a portfolio level or have introduced a cap on the guarantees granted at portfolio level. However, the Guarantee Notice offers little guidance on how such measures should be assessed.

c) As is clear from section 4.1.1.1, the independent experts have observed that the public guarantees often have maturities that go beyond the maturity of an existing bond market for certain credit risks. In financial markets sub-investment grade bonds with a maturity above 15 years are highly exceptional. Yet, some Member States guarantee investment loans beyond that duration.

d) As noted in section 3.4, although the Guarantee Notice claims it is applicable to guarantees linked to any specific financial transaction, i.e. going beyond a typical loan or debt transaction, there are no applicable conditions or criteria for certain types of transactions. For example, performance guarantees or guarantees on securitised loans incorporate specific elements that are not clearly addressed by the Guarantee Notice, such as if and how the rating of the beneficiary matter.

ANNEX I. PROCEDURAL INFORMATION

– *Lead DG*:

Commission Directorate-General for Competition (DG Competition)

Decide Reference: PLAN/2022/918

– *Organisation and timing*:

An inter-service steering group (ISSG) was set up which gathered representatives from the Commission's Secretariat-General, the Legal Service and the Directorates-General FISMA, GROW, RTD, DEFIS and ESTAT. The first meeting was held on 24 May 2022 and focused on the purpose, scope and tentative timeline of the evaluation, as well as the call for evidence, public consultation strategy, questionnaire for the public consultation, and request for information to Member States and targeted questionnaire.

The evaluation was then initiated with a call for evidence on 29 August 2022. Further details on the steps of the evaluation and their timing can be found in the table below.

Overall timeline:

- Start date: Q3-2022
- Planned completion date: Q4 2025

Detailed timeline:

Date	Description
24 May 2022	1st ISSG meeting
29 August 2022	Call for evidence
29 August – 19 December 2022	Public consultation
29 August – 19 December 2022	Targeted consultation (additional request for information as part of the targeted consultation submitted to Member States on 5 September 2022)
28 February 2023	Factual summary report of replies and contributions to the public consultation published
20 October 2023	Award of the contract on the Study on the Review of the Guarantee Notice
22 November 2024	Submission of the final Study
24 June 2025	ISSG meeting on the draft Staff Working Document

– *Evidence used together with sources and any issues regarding its quality*:

The evaluation is based on the feedback received to the call for evidence which was followed by a public consultation aimed at gathering high-level feedback from the general public. Further evidence used stems from a targeted consultation which comprised (i) a request for information where Member States were asked to provide consolidated data on State guarantees and (ii) a targeted questionnaire directed at stakeholders with direct involvement or expertise in State guarantees and credit risk. For more details and the limitations of certain sources, please see Annex II.

– *Use of external expertise*:

  An external study has been conducted by the contractor between November 2023 and December 2024. It focused on the Guarantee Notice's effectiveness, efficiency, and coherence and the identification of characteristics and methodologies of existing guarantee measures. Further, benchmark methodologies on guarantee pricing were developed. For more details, please see Annex II.

ANNEX II. METHODOLOGY AND ANALYTICAL MODELS USED

The current Evaluation was based on a wide range of data sources and inputs.

The Evaluation involved both internal analyses by the Commission services and an expert study prepared by experts conducting the external study.

Moreover, the Commission services also used the results of the public consultation and the targeted stakeholder consultation, as well as already existing, publicly available studies (some of them can be found in section 3.1.2.1 of the External Study) and other information collected by the Commission services. The Evaluation also benefitted from the relevant insights and observations resulting from the Commission services' application experience and the Commission services' own case practice.

1 CONSULTATION ACTIVITIES

1.1 Public consultation

The open public consultation on the evaluation of the Guarantee Notice took place between 29 August 2022 to 19 December 2022 on the Commission's Better Regulation Portal. The objective of the public consultation was to obtain the views of citizens, public authorities and other relevant stakeholders on the effectiveness, efficiency, coherence, relevance and EU added value of the currently applicable Guarantee Notice. The public consultation took the form of an online survey, with a mix of closed and open questions. Participants were able to reply in any of the EU's official languages. The public consultation was also promoted through Twitter (now X), DG Competition's State aid Newsletter and DG Competition's website. The statistics computed in this summary are based only on contributions to the public consultation submitted through the online questionnaire.

The synopsis of the answers of respondents to the public consultation is available in Annex V.

1.1.1 Targeted consultation

The targeted consultation was aimed at stakeholders directly involved in or affected by the provision of State guarantees or with relevant expertise in the field of credit risk. Like the public consultation, the targeted consultation took place from 29 August 2022 to 19 December 2022 on DG Competition's website. Contributions were particularly sought from Member State authorities, supranational authorities and institutions (including national governments, managing and implementing authorities of various State guarantee schemes and also of individual guarantees), guarantee institutions and financial intermediaries, financial industry associations, market participants in the credit and credit derivative markets, non-financial companies (including SMEs), business associations and the research community. The objective of the targeted consultation was to gather evidence for the evaluation of the Guarantee Notice and, in particular, whether the proxies it describes were aligned with market benchmarks. More broadly, the targeted consultation aimed to gather evidence and views on the effectiveness, efficiency, relevance, coherence and EU added value of the Guarantee Notice.

At the same time of the public consultation, the Commission launched a targeted request for information on 5 September 2022 (the 'REQ'), addressed to Member States directly impacted by the Guarantee Notice. A conference to clarify the request for information with representants from all Member States took place on 20 October 2022. Given that it is the Member States that grant the guarantees and apply the Guarantee Notice, their responses are of particular relevance to the Evaluation.

The synopsis of the answers is available in Annex V.

1.2 Expert study[92]

The Commission services commissioned an external study with the specific aims to assess the effectiveness, efficiency, and coherence of the Guarantee Notice over the evaluation period.

The Study was conducted by independent experts of Prometeia and Learlab and its academic partners and is published together with this SWD. It was carried out in the course of 2024. The Study is 'backward-looking', focusing on the period 2010 to 2023. To the extent that it uses its insights in the report, the Commission takes ownership of the Study, agreeing with the corresponding methodology and analysis.

The Study evaluates the impact of the 2008 Guarantee Notice through a detailed examination of its characteristics, existing pricing methodologies, and the development of new benchmarking approaches. The study is organized in three key areas: (i) Analysis of Guarantee Methodologies, (ii) Benchmarking Methodologies, and (iii) Impact Assessment.

For the study, the independent experts have created four databases, which were provided to the Commission services as separate deliverables.

- Sample A is a sizeable database that includes information on 283 public guarantee measures that are based on the Guarantee Notice, and that were implemented between 2010 and 2022. To compile the Sample A dataset, the independent experts combined several data sources, including the REQ, the DG Competition's State Aid Register, national laws implementing guarantee measures, information contained in the Commission's Decisions, websites of Guaranteeing Institutions and completed it with contacts with the Granting and Administering Authorities. According to the independent experts, the construction of Sample A was time-consuming due to problems of poor data quality in the replies sent by Member States to the REQ and the continuous need to update it with information arriving at later stages of the Study.

- Sample B1 is based on a subset of measures from Sample A, selected through a sampling approach to ensure the representativeness of all Member States and sectors. However, its aim is to provide the necessary details for the calculation of guarantee premiums under each sampled guarantee measure. It is based on the same information sources as Sample A and was faced with similar challenges.

- Sample B2 provides the necessary details for the calculation of guarantee premiums for each market benchmark developed by the independent experts. To that end, sample B2 is constructed in a similar manner as sample B1 but covers only hypothetical calculation methodologies that are identified as market

[92] This description reuses parts of the Study performed by Prometeia and its partners. The Study is available online on https://competition-policy.ec.europa.eu/state-aid/publications_en.

benchmarks. The sample is not based on any of the sources identified above, but is rather based on market indicators, such as credit default swap (CDS) spreads and credit spreads for comparable financial instruments, and other publicly available data sources that are used for the calculation of each of the market conform benchmarks.

- Sample C includes data used in the empirical estimations referred to in section4, covering the period from 2010 to 2022. The data sources include SAFE, data obtained from FCG and Orbis, firm-level data obtained from guarantee granting authorities in Croatia, Lithuania, and Latvia, Bureau van Dijk's Orbis database, OECD's Structural Analysis (STAN) database, EU-KLEMS database, EBA's stress test and transparency exercises, ECB's Bank Lending Survey (BLS) and World Bank's Global Financial Development Database (GFDD).

1.3 Other data sources

To complete the information on the results obtained in the REQ, the Commission requested Member States to provide the obligatory reporting detailed in Section 6 of the Guarantee Notice. Other sources used by the experts conducting the external study include S&P Capital IQ, the European Commission State aid case register website, websites of the relevant authorities and the European Association of Guarantee Institutions.

2 KNOWN LIMITATIONS AND MITIGATING MEASURES OF THE EVALUATION

During the initial stages of the study, several limitations were identified that could potentially impact the validity and reliability of the results. However, through a thorough analysis and implementation of mitigating measures, these limitations were effectively addressed to ensure the overall quality and accuracy of the evaluation.

2.1 Limitations in data quality

Although the sample of guarantees provided by public institutions is considered representative, given that it is based on the REQ survey, the samples used do not provide a complete picture of public guarantees in the EU. The REQ responses contained many out-of-scope measures, such as export guarantee schemes or Temporary Framework measures, which were excluded from the analysis.

Furthermore, in some cases, the dataset lacked comprehensive information on key elements, such as pricing methodologies and costs. To overcome this circumstance, the missing data was completed using alternative sources, including national laws and direct contact with the Member State authorities.

2.2 Limitations in the study: Benchmark methodologies

A known limitation of the benchmark methodologies development is the simplification used when determining the recovery value. Specifically, the current approach only considers defaults at maturity, rather than at any stage before maturity. This simplification has significant implications for the pricing of guarantees, resulting in lower credit spreads and therefore lower guarantee premiums. However, to address this limitation, an extension to the methodology has been proposed in the annexes of the study. This revised approach considers defaults at any stage before maturity, providing a more realistic view of guarantee valuation.

In the benchmark definitions, a simplification has been applied to determine the market price of guarantees. Specifically, it has been assumed that public institutions granting guarantees have zero default risk[93]. This approach is consistent with other financial institutions' regulations, which often simplify default risk for public institutions when calculating capital consumption. If the credit risk of public institutions as guarantors were considered, it would likely lead to a reduction in the price of guarantees.

Another simplification applied in the study is the absence of default correlation between borrowers. Considering default correlation between borrowers would introduce significant complexity into the methodologies and result in less stable benchmarks. However, it is reasonable to expect some positive correlation between defaults among borrowers in the same country or sector, and in particular during economic crisis periods, which could lead to higher potential losses and result on increased guarantee prices.

In addition to these limitations, the calibration of certain parameters may be complicated or unavailable at the minimum required granularity level. In some cases, these parameters may need to be approximated, such as the real-world probability of default term structures, appropriate capital remuneration, and information on lenders' credit pricing.

2.3 Limitations in the study: assessment of effectiveness, efficiency and coherence

One critical source of information for conducting the efficiency analysis was the mandatory reporting outlined in Section 6 of the Guarantee Notice submitted by Member States. However, the information provided in these reports exhibited a low level of standardization, resulting in inconsistencies and gaps in the data. This lack of uniformity made it challenging to compare the data submitted by different Member States, hindering a comprehensive analysis. To overcome these limitations, the Contractor conducted interviews with the authorities of the Member States to supplement the available data and gather additional information. This approach was necessary to ensure a more accurate and comparable analysis.

In evaluating the effectiveness of the Guarantee Notice, the Contractor based its analysis in data derived from the ORBIS database, which provided detailed information for Italy. Additionally, some Member States, including Croatia, Latvia, and Lithuania, were able and willing to offer more detailed data. While the samples were sufficiently large, extrapolating the results to all EU Member States may not be completely accurate due to the unique characteristics and specificities of each country. As a result, it is necessary to be cautious when generalizing the findings to the broader EU context, considering the potential for country-specific nuances to be overlooked.

To address potential methodological limitations on the evaluation of the effectiveness of the Guarantee Notice, the Contractor employed an approach to control for potential endogeneity issues stemming from omitted variables in the estimation: the initial analysis was re-run with the inclusion of firm and time fixed effects. This served to control for any unobserved factors that may be specific to individual firms or time periods, thereby

[93] The default risk of the public institutions has been taken into consideration in the study only in the effective interest rate risk methodology.

strengthening the validity of the results. Additionally, to mitigate concerns about reverse causality, the Contractor employed a dynamic approach controlling for the previous situation of the companies. This allowed for a more nuanced understanding of the relationship between the Guarantee Notice and the outcome variables, helping to isolate the causal effect of the programmes. By accounting for the pre-existing conditions of the companies, the Contractor was able to more accurately attribute the impact of the Guarantee Notice to the program itself, rather than to other factors.

3 METHOD OF THE EVALUATION

An evaluation needs an appropriate point of comparison to be able to assess the change that the EU action has brought over time. In general, the main baseline (or counterfactual) is a situation in the absence of EU intervention.

In the current situation, the EU intervention is the 2008 Guarantee Notice setting out the Commission's approach to State aid granted in the form of guarantees.

The evaluation questions and criteria are presented in Annex III below.

ANNEX III. EVALUATION MATRIX

Effectiveness

- To what extent has the Guarantee Notice contributed to determining market-compliant guarantee premiums?
    - Whether public guarantees have succeeded in creating additional access to finance for final beneficiaries?
    - To what extent are guarantees passed through to beneficiaries via the conditions of the loan?
- Is there a relationship between public guarantee measures using the Guarantee Notice and banking market concentration?
- Which types of firms are more likely to receive guarantees and what effects the guarantees produce?
- Have the Guarantee Notice's provisions facilitated access to finance for smaller beneficiaries, and has this had a positive impact on their competitiveness compared to their sector peers?
- How effective were the guarantee measures using the Guarantee Notice in limiting distortions of competition between financial intermediaries and distortions of prices in credit markets?
    - Do banks benefit from public guarantees and to what extent it may have distorted competition in lending markets?
- Is there a link between pricing methodologies and effectiveness of the Notice?

Efficiency

- Has the Guarantee Notice contributed to determining market-compliant guarantee premiums, to what extent have the requirements of the Guarantee Notice been proportionate to the cost of implementing guarantee schemes?
- To what extent have the requirements of the Guarantee Notice been proportionate to the cost of implementing guarantee schemes?
- Did the simplified solutions for measures targeted at small and medium-sized enterprises achieve the right balance between simplicity and accuracy?
- How did the applied pricing systems work, compared to optimal pricing systems for state guarantees?
- Did Member States implement guarantee schemes in line with the Guarantee Notice?
- Did the Member States face difficulties when interpreting the Guarantee Notice? Have the rules been clear?

Relevance

- How has the Guarantee Notice's relevance evolved over time, particularly in light of changes in macroeconomic conditions, financial stability, and regulatory developments since 2008? What implications do these changes have for its continued effectiveness?

Coherence

- To what extent does the Guarantee Notice provide a coherent framework for determining market-compliant guarantee premiums, and how consistent is it with other EU legislation, such as the Reference Rate Communication, in terms of ensuring a level playing field and preventing indirect advantages to lenders?

EU added value

- Has the Guarantee Notice provided added value in terms of facilitating the approval of guarantee methodologies, ensuring a level playing field between Member States, and promoting the use of public guarantees?
- Is the intervention still relevant?

ANNEX IV. OVERVIEW OF BENEFITS AND COSTS

Table 1. Overview of costs and benefits identified in the evaluation									
		Citizens/Consumers National administrations		**Businesses**		**EU Administrations**		**Broader Economy**	
		Quantitative	Comment	Quantitative	Comment	Quantitative	Comment	Quantitative	Comment
It is not possible to quantify the costs and benefits listed in this table other than those that are quantified									
Direct Costs	**(all one-off for any given aid measure)**	Direct cost of developing methodologies (estimated at EUR 1.93 million[94] for all EU Member States during the evaluation period).	The National Authorities cost of developing methodologies since 2008. As one of the requirements in the Guarantee Notice is that the schemes remain self-financed, the cost of using the guarantee in case it is triggered by defaults is not	Administrative costs included in GN (in sample B1 of the study it, as detailed in section 4.1.2.2, ranges between 0.1% and 1.1% of the guaranteed amount) in line with market practice. Premiums (including costs paid) on the guarantees (depending on the methodology used), in line with market practice[95]	The aided beneficiaries (Businesses) have to cover the administrative costs and the guarantee premiums based on their credit profile and the methodology used, in line with market practise.	Costs of assessing and approving methodologies (estimated at EUR 1 million[96] for the Commission during the evaluation period)	National authorities may need to notify the individual guarantees or guarantee schemes to ensure their compliance. The Commission's services carry out the assessment of the measures based on the Guarantee Notice.		

94 The cost estimation considers a similar amount of time dedicated by public administration of Member States to the amount of time dedicated by the Commission (but taking into consideration also the cases that don't contain aid) and similar cost per hour.

95 It has to be noted that both of these cost types are not exclusive to public guarantees based on the Guarantee Notice. Also guarantees provided by the private market bear costs.

96 The cost is estimated based on the 152 State aid cases considered in the study, an average case dedication of 24 hours and a cost per hour of 35.6 euro.

			considered as direct costs since this should be covered by the premiums on the guarantees paid by the companies.						
Indirect Costs	**(one-off with recurrent effects)**	Costs for external consultants (not quantifiable[97])	National Authorities may need help from special advisors on the application of the Guarantee Notice. More details can be obtained in the external study	Potential crowding-out of banks from certain sectors. Potential indirect aid to financial institutions. (not quantifiable)	State guarantees if not well designed may result in crowding-out financial institutions from participating in certain activities. It may also result in a no pass-on of the benefits to final consumers resulting in aid to financial. institutions This is limited by State aid control.			Competition distortions (not quantifiable;)	By supporting certain beneficiaries but not others, State aid has the power to produce competition distortions, which are, however, minimised by the State aid control. See sections 4.1.1.3 and 4.1.1.4 for more details

97 As indicated in section 4.1.2 Efficiency, it is not possible to make adequate quantifications due to the lack of access to or availability of relevant and representative financial information on the costs.

					See section 4.1.1.2 for more details				
Direct benefits	**(one-off with recurrent effects)**			Reduction in financing costs and ensuring access to financing. (not quantifiable)	Companies get cheaper loans and improved access to loans through the public guarantees. More information on section 4.1.1.2				
Indirect benefits	**(one-off with recurrent effects)**	Legal certainty Less bureaucracy (not quantifiable[98])	Simplified methodologies provide legal certainty, reduce bureaucracy and reduce the time needed to be prepared. (In the absence of the Guarantee Notice, a case-by-case decision would be required to ensure legal			Reduction of administrative costs of reviewing methodologies. (not quantifiable)	Safe harbour is a very effective tool to reduce bureaucracy and to facilitate the implementation of measures ensuring legal certainty. Single premiums exclude the need for company ratings. See more details	Financial system stability Standardisation of methodologies across Member states (not quantifiable)	State guarantees provide comfort to financial institutions providing loans and enhance their credit profile due to credit exposure reduction. The Guarantee Notice ensures a level playing field for all EU members as regards the

[98] As detailed in section 2.1, Member States reported the improvements of the Guarantee Notice in legal certainty and reduction of bureaucracy terms but there is no quantification provided.

			certainty) See section 2.1 of the study for more details				in section 4.1.2.1		calculation of guarantees. See more details in section 4.3

TABLE 2: S***implification and burden reduction (savings already <u>achieved)</u>***						
	Citizens/Consumers/Workers **National administrations**		**Businesses**		**Administrations**	
	Quantitative	Comment	Quantitative	Comment	Quantitative	Comment
Direct compliance cost savings (for example adjustment cost savings, administrative cost savings, savings from regulatory charges)						
Type: one-off with recurrent effects	Administrative costs (not quantifiable)[99]	Administrative costs for the Governments have been reduced thanks to the introduction of a dedicated set of rules to simplify the provision of individual public guarantees (e.g. safe harbours) and guarantee schemes. Safe harbour premium for SMEs have offered a simpler evaluation approach to determine the level of the guarantee premiums. Methodologies approved have ensured that	Administrative costs (not quantifiable)	Having a more standardised approach from the government also has reduced the administrative costs to get the guarantees for the enterprises More details can be obtained in the external study	Administrative costs (not quantifiable)	Administrative costs have been reduced thanks to the introduction of a dedicated set of rules for guarantees. More details can be obtained in the external study

[99] See footnote 95.

		guarantee premiums charged on non-aided State guarantees are market conform. See more details in sections 4.1.2.1 and 4.3				

PART II: II <u>Potential</u> simplification and burden reduction (savings) *Further potential simplification and savings **that could be achieved** with a view to make the initiative more effective and efficient without prejudice to its policy objectives[100].*						
	Citizens/Consumers/Workers **National administrations**		**Businesses**		**Administrations**	
	Quantitative	Comment	Quantitative	Comment	Quantitative	Comment
Direct and indirect compliance cost savings (for example adjustment cost savings, administrative cost savings, savings from regulatory charges)						
Type: recurrent	Administrative costs	Administrative costs could be further reduced by simplifying reporting obligations by Member States, which would	Administrative costs	Administrative burden for small mid-caps could be reduced by further unifying and standardizing the requirements for this kind of companies opting for guarantees.	Administrative costs	Administrative costs could be further reduced by simplifying reporting obligations by Member States, i.e. the submission of periodic reports on key metrics of guarantees (e.g. amounts, remuneration), in terms of scope and frequency (“Section VI reports”)

[100] This assessment is without prejudice to a possible future Impact Assessment.

		indirectly also reduce reporting efforts and costs of financial intermediaries providing Member States with the relevant data for their annual reports to be submitted to the Commission				

ANNEX V. SYNOPSIS REPORT

The Commission gathered stakeholder opinions on the effectiveness, efficiency, relevance, coherence, and EU added value of the Guarantee Notice through a call for evidence, as well as a public and a targeted consultation.

1 CALL FOR EVIDENCE

1.1 Overview of respondents of the call for evidence

The call for evidence consultation ran from 29 August to 19 December 2022. In total there were 11 respondents. Feedback could be provided in all 24 official EU languages. There were no specific questions but instead, general feedback could be provided on the call for evidence.

Responses were received from different stakeholders including public authorities (4), EU citizens (4), companies/businesses (2) and other (1). All respondents were stakeholders from the EU, except for one stakeholder from Norway. EU respondents came from six different Member States: Germany (3 respondents), Slovakia and Spain (each 2 respondents), as well as France, the Netherlands, and Portugal (1 respondent each). Given the very low rate of participation, the fact that several answers were unrelated to the consultation, and the general lack of convincing arguments or explanations, the feedback received via the call for evidence was not perceived as sufficiently reliable or representative and thus, could not be considered in the SWD.

1.2 Summary of key messages

Two respondents mentioned the importance of the Guarantee Notice as a guidance tool whilst pointing out that an update was welcome. One respondent supported a continuation of a simple and constant safe harbour premium matrix.

Several respondents mentioned potential areas for improvements. These included an extension of the safe harbour premiums to a broader range of companies, the increase of the 80% threshold implying (in connection with other conditions) that there is no aid, and the need for clear rules on guarantees in the context of municipal services. Further, it was proposed that the Guarantee Notice should allow the use of OECD Arrangement terms.

Amongst points of criticism of the current Guarantee Notice, one respondent found that the assessment of whether a company was in financial difficulty was too rigid and binary. Another respondent generally found that the Notice would lead to a discriminatory treatment of smaller companies compared to larger ones. Another respondent generally criticized the provision of guarantees to the aviation sector in the past.

2 PUBLIC CONSULTATION

2.1 Overview of respondents of the public consultation

The public consultation ran from 29 August to 19 December 2022. Replies could be provided in all 24 official EU languages. The public consultation contained 15 high-level questions, grouped by the five evaluation criteria under consideration, namely the effectiveness, efficiency, relevance, coherence and EU added value of the Guarantee Notice.

Responses received were from a variety of stakeholders representing public authorities (2), business associations (2), EU citizens (1) and others (1). All respondents were stakeholders from the EU, covering four EU Member States: Belgium (3 respondents), Finland, Greece and Italy.

Overall, the feedback from the public consultation in most areas did not lead to clear, convincing results and was considered not sufficiently representative given the low participation rate. Therefore, the evaluation findings only rely on feedback that was also supported by other sources used in the evaluation.

2.2 Summary of key messages

Effectiveness

Four respondents found the Guarantee Notice helpful in facilitating State guarantees, with one highlighting safe harbour premiums for SMEs and another noting its usefulness without approved EU methodologies. Two respondents said the Notice supported market-conform guarantees, while one criticized the high premiums for SMEs. Only one respondent felt that the Notice enabled pricing guarantees below market terms, while three disagreed, citing high premiums as a barrier.

Respondents identified the Notice's most successful long-term impacts as ensuring that benefits reach ultimate beneficiaries, limiting competition distortions among financial intermediaries, and stabilizing credit market pricing. One respondent, however, felt it was “rather not successful” in helping creditworthy SMEs secure necessary loans or credit.

Efficiency

Two respondents found the Guarantee Notice easy to understand, and three stated the Notice supports a common standard for granting public guarantees. One respondent disagreed with both points. Two respondents felt there was insufficient public information concerning the Commission’s policy, while others were neutral or had no opinion. Respondents highlighted that the Guarantee Notice is highly technical and challenging for financial intermediaries and beneficiaries, recommending informal guidance for its practical application.

Respondents noted the Guarantee Notice helped reduce administrative and operating costs for public authorities, lenders, and beneficiaries. However, one respondent found it “rather not helpful” for lenders and beneficiaries. Respondents agreed that public authorities have used the Notice’s methods effectively, that it ensured predictable provision of guarantees and supported efficient State expenditure. One respondent disagreed, attributing efficiency to internal rules rather than the Notice.

Three respondents suggested clarifying aspects of State guarantees, particularly the comparison with market-priced non-guaranteed loans, which often lack a benchmark. One respondent claimed the Commission recently applied the Market Economy Operator Principle more strictly than outlined in section 3.2. Another respondent reported that State guarantees under the Notice imposed a disproportionate administrative burden, requiring special expertise in certain cases.

Relevance

Three respondents considered that the Guarantee Notice remains relevant in helping Member States provide financing to undertakings in the form of guarantees. Respondents consider that the financial crisis episodes, periods of low interest rate environment and changes in the regulatory framework for financial intermediaries are important for the relevance of the Guarantee Notice. More concretely, the level of safe harbour premiums for SMEs is considered too high in periods of low interest rates. The criticism on the accuracy of safe harbour premiums was also raised by other sources in the evaluation and addressed in sections 4 and 5 of the SWD.

Coherence

Three respondents considered that the Guarantee Notice is internally coherent, i.e. different sections of the Notice are consistent with one another. The others were neutral or had no opinion. As regards the coherence with other EU policies and legislation, the respondents broadly reported coherence with the Reference Rate Communication, the General Block Exemption Regulation and the De Minimis Regulation. One respondent mentioned incoherence with the Commission Notice on the Notion of State aid, without specifying the main reasons. Overall, the feedback on coherence was considered not representative and inconclusive, so the evaluation relied on the expert consultation and the more elaborated analysis in the external study.

EU Added Value

Four respondents agreed that the Guarantee Notice has provided an added value in comparison to a situation without such guidance. One of those respondents referred to the clear guidance on calculating the aid element in State guarantees. This feedback aligns with that from the expert consultation and the findings of the external study and was taken into account in the evaluation findings under section 4.3 above.

Other aspects

Three respondents provided additional feedback. One respondent mentioned difficulties regarding the application of Section 3.3 of the Guarantee Notice to SMEs without credit history or having their rating based on a balance sheet, but for which financial intermediaries apply other rating systems.

One respondent claimed incoherence with Article 213 of the EU Regulation No 575/2013, specifying that credit protection contracts must not contain any clauses that would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure. According to the respondent, the Guarantee Notice does not comply with this requirement, without however providing further details.

One respondent claimed that municipalities have been applying wrongly the Guarantee Notice to undertakings of a non-economic nature or to activities which are not subject to competition on the market, and that led sometimes to cancellations of transactions or to providing financing at higher costs.

3 EXPERT CONSULTATION

The expert consultation ran from 29 August to 19 December 2022. Replies could be provided in all 24 official EU languages. The expert consultation contained 31 high-level and more detailed questions, grouped by the five evaluation criteria under consideration, namely the effectiveness, efficiency, relevance, coherence, and EU added value of the Guarantee Notice.

The expert consultation was targeted at selected stakeholders with specific expertise and experience in the provision of State guarantees, but open to the general public. Responses were received from ten public authorities from the following nine EU Member States: Bulgaria, Germany, the Netherlands, Finland (2), Sweden, Estonia, Greece, Lithuania, and Italy.

In parallel to the expert consultation, a separate information request was sent to the managing and implementing authorities of State guarantees of Member States which aimed at gathering consolidated data on State guarantees. The information received constituted an important input for the external study conducted as part of the evaluation. An overview of how the qualitative and quantitative data received has been analysed and used for the study can be found in Tables A2 and A3 of the study. Apart from that, the feedback received was only conclusive in a few aspects, such as confirming that the Guarantee Notice has broadly achieved its objectives, remained relevant for the financing of undertakings, and has provided EU added value compared to a situation without the Notice.

3.1 Synopsis of the key messages

Effectiveness

Nine respondents stated that the Guarantee Notice was working well and facilitated the granting of guarantees, whilst one respondent had no opinion. Seven respondents also agreed in that the Notice facilitated the granting of market conform guarantees, whilst two respondents had no opinion. Six respondents viewed the Notice as facilitating aided guarantees whilst three respondents had opposing views, though without substantiating their answer.

Respondents found the Guarantee Notice helpful (4) or rather helpful (5) to ensure that beneficiaries would not receive an advantage in the context of a guaranteed loan. One respondent added that particularly the safe harbour premiums for SMEs were useful in this respect. When it comes to avoiding aid to the intermediary, most respondents (9) found the Notice to be helpful or rather helpful. One respondent found that it was rather unhelpful though, due to the lack of practical guidance on how an advantage to the lender should be avoided and thus, urged to include specific conditions in the Guarantee Notice.

Most respondents answered that the Notice has achieved its objectives regarding e.g. legal certainty, market-conform guarantee premiums, easy-to-apply safe harbour rates for SMEs or the calculation of the aid element. Two respondents however found that it has been rather unsuccessful in achieving its objectives to increasing legal certainty and transparency of market-conform guarantee premiums and increasing the predictability of the Commission's assessment and ensuring equal treatment of market participants.

Concerning the successful provision of guidance by the Guarantee Notice on market-conformity, most respondents found that it has been rather successful or successful in laying out horizontal guidance on ruling out the presence of aid (6) and providing safe harbour rates for SMEs (8). One respondent added that the Notice was easy to understand in this respect. Two respondents mentioned that it has been rather unsuccessful concerning guidance to determine market-conform premiums for individual guarantees and regarding the determination of premiums that make schemes self-financing and that are aid-free without providing any further explanations.

Most respondents found that the transparency and predictability of the Commission's assessment as regards State guarantees has been successful or rather successful. Two respondents added that the criteria for the Commission's assessment were clear. One of them proposed that examples could be given in footnotes in case of a revision.

There was positive feedback received regarding the Notice's role in providing easy to apply rules for guarantees to SMEs with only one respondent finding it rather not successful concerning conditions for single premiums, guarantee methodologies, and providing guidance on market conform prices, without providing further explanations.

There was also overall positive feedback on the long-term impacts of the Guarantee Notice such as ensuring that creditworthy SMEs were able to get bank loans or other forms of credit.

When asked about other benchmarks used to determine market conform guarantee premiums that are not included in the Guarantee Notice, two respondents mentioned CDS rates. One respondent also mentioned the OECD Arrangement for Export Credits as benchmark and pricing method.

Efficiency

When asked whether the Guarantee Notice was easy to use, three respondents disagreed, whereas five agreed out of which two added that the Notice was easy to understand. Respondents also had split views on whether the Guarantee Notice was formulated in a way which is likely to lead to a common standard for granting public guarantees across the EU and on whether there was sufficient publicly available information to ensure a good understanding of the Commission's policy in this field (with four respondents agreeing with these statements and three respondents disagreeing). Other respondents were neutral or had no opinion in this regard.

Most respondents were of the opinion that the Guarantee Notice helped or rather helped public authorities (6), lenders (5), and beneficiary companies (3) to keep down the administrative and operating costs related to the granting of State guarantees down. Only one respondent respectively disagreed concerning costs for public authorities and beneficiaries, however without providing a justification. On the question of whether the Notice had been effective in limiting the amount of administrative costs for access to finance for SMEs, most respondents had no opinion (5) or stayed neutral (3), whilst 2 respondents found the Notice effective with regard to certain aspects such as the provision of safe harbour-rates.

As additional remark, one respondent added that the Guarantee Notice facilitates the launch of guarantee schemes without aid elements thanks to the conditions in the Notice. Another respondent found safe harbour premiums helpful in this respect. One respondent stated with regard to costs for public authorities, that the simplicity to provide guarantees on market-conditions or determine whether the guarantee includes State aid or not, helped to lower the administrative and operating costs.

Eight respondents positively replied to the question whether certain aspects or concepts related to the provision of State guarantees made the application of the Guarantee Notice difficult or sub-optimal and could therefore have been further clarified or been defined more precisely. Amongst the examples given were the suggestion to establish more exemptions from the 80% threshold as one of the conditions for implying no aid of a measure. Further, one respondent found that the Commission applied the Market Economy Operator Principle test more strictly than set out in the Notice. Another one expressed the view that further guidance on State aid rules on specific guarantees for development cooperation would be warranted, as well as clearer guidance on section 3.2.

Most respondents (5) answered that the provision of State guarantees under the Guarantee Notice has not created any disproportionate administrative burden, whereas three respondents came to the opposite conclusion. One of the latter respondents mentioned that in some special circumstances special expertise was needed to assess how to apply the Guarantee Notice. Another respondent explained that public authorities were forced to acquire specific competences to ensure that lenders do not benefit from State guarantees.

Relevance

All respondents (9) except for one supported the view that the Guarantee Notice has been and remains relevant in addressing the needs of Member States and other stakeholders over time with regard to financing undertakings. One of them pointed out that the Notice was important, because it provided guidance to Member States and other stakeholders. A second one highlighted that the concepts introduced by the Notice remained relevant to a very large degree, whilst adding that safe harbour premiums may have changed due to the long period of time since they were estimated and introduced and that guidance on the conditions necessary for the passing of the advantage from the lender to the borrowers could be an improvement.

In terms of developments and events for the relevance of the Guarantee Notice over time, many respondents found that the financial crisis has been important (3) or rather important (4). Respondents also found the description of the types of guarantees and the types of financial obligations covered by the Guarantee Notice and the horizontal conditions for guarantees to rule out the presence of State aid (point 3.2 (a)-(c)) relevant or rather relevant (6).

Some respondents had proposals for the Guarantee Notice to stay relevant regardless of future macro-economic developments. One of them suggested regular adjustments of the safe harbour premiums to make them more market-oriented. Another respondent suggested a more regular review of the points affected by other regulatory frameworks.

Coherence

Four respondents found the Guarantee Notice internally coherent, whilst three found it rather coherent and three others remained neutral. With regard to external coherence, one respondent found the Guarantee Notice not coherent with the Reference Rate Communication and rather not coherent with the Notice on the Notion of State aid. Another one found the Notice to be rather incoherent with the General Block Exemption Regulation. Most other respondents however found the Notice coherent or rather coherent with the Reference Rate Communication (3), the General Block Exemption Regulation (5), the De minimis Regulation (5), and the Notice on the Notion of State aid (5).

EU Added value

All ten respondents stated that the Notice has provided an added value in comparison to a situation without such guidance. One respondent added that without the Guarantee Notice market-conform guarantee premiums would likely be determined very differently across the EU. Another respondent expressed a similar view by commenting that the design of State guarantees would show greater differences.

ANNEX VI. CASE PRACTICE PRIOR TO 2000 AND COMPARISON OF GUARANTEE NOTICE OF 2000 AND 2008

In 1989, the Commission addressed two letters on State guarantees to the Member States. In the first letter[101] it pointed out that the Commission regarded all guarantees given by a State as falling within the scope of Article 87(1) of the EC Treaty[102] at the time. According to the first letter, the Commission had to be, therefore, notified of any plans to give or alter such guarantees in sufficient time to enable it to submit its comments. In the second letter[103] the Commission made it clear that it intended to examine the establishment of State guarantee schemes, and that individual guarantees given under an approved scheme would not need to be notified.

In 1993, the Commission adopted a communication[104] which, besides other topics, addressed the subject of guarantees as well.

By 2000, the Commission gained sufficient experience suggesting that the Commission's policy in the area of guarantees had to be reviewed and dealt with in a separate communication. Therefore, in 2000 the Guarantee Notice of 2000[105] was adopted which replaced the two Commission letters of 1989 and paragraph 38 of the Commission communication of 1993.

Guarantee Notice of 2000 and 2008 compared

The Guarantee Notice of 2000 required Member States to notify guarantee measures to the Commission in advance pursuant to Council Regulation (EC) No 659/1999.

In the case of an individual State guarantee, the aid element should be assessed by reference to the details of the guarantee and loan (or other financial obligation). The relevant factors include the (i) duration and (ii) amount of the guarantee and loan, (iii) the risk of default by the borrower, (iv) the price paid by the borrower for the guarantee, (v) the nature of any security given, (vi) how and when the State could be called upon to pay a debt and (vii) the means (e.g. declaration of bankruptcy) to be used by the State to recover amounts owed by the borrower once the guarantee has been invoked.

The Guarantee Notice of 2000 also set conditions for exemption from the notification requirement. The Commission considered that any State aid fulfilling the following conditions was compatible with the competition rules and thus exempt:

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[101] Commission letter to the Member States, SG(89) D/4328 of 5 April 1989.

[102] Treaty establishing the European Community Official Journal C 340 , 10/11/1997 P. 0173 - Consolidated version

[103] Commission letter to the Member States, SG(89) D/12772 of 12 October 1989.

[104] Commission Communication to the Member States on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, 13.11.1993, p. 3).

[105] Commission notice on the application of Articles 87 and 88 of the EC Treaty to state aid in the form of guarantees, OJ C 71 of 11.03.2000.

Individual guarantee	Guarantee scheme
The borrower is not in financial difficulty.	The borrower is not in financial difficulty.
The borrower would, in principle, be able to obtain a loan on market conditions from the financial markets without any intervention by the State.	The borrower would, in principle, be able to obtain a loan on market conditions from the financial markets without any intervention by the State.
The guarantee is linked to a specific financial transaction.	The guarantee is linked to a specific financial transaction.
The guarantee gives rise to payment of a premium on the market price.	A realistic assessment of the risk has been carried out.
-	The guarantee is subject to a review of overall financing at least once a year.
-	The premiums cover both the normal risks associated with granting guarantees and the administrative costs of the scheme and allow a normal return on the initial capital.

The Guarantee Notice of 2000 also stated that failure to comply with the above conditions does not mean that such a guarantee or guarantee scheme is automatically regarded as State aid.

Member States were also required to present an annual report to the Commission giving the total amount of state guarantees outstanding, the total amount paid in the preceding year by the State to borrowers and the premiums paid for state guarantees in the same year. Thereby, the Commission aimed to monitor the State guarantee granted by Member States.

Based on case practice, the Guarantee Notice of 2008 updated the Commission's approach on State guarantees and gave more detailed guidance about the principles used for the assessment while retaining the content of the Guarantee Notice of 2000. In particular, it defined more concretely the types of guarantees to which it applied, the need for individual assessment of the risks related to each guarantee in the case of schemes and introduced the safe harbour premium for SMEs.