State Aid and Subsidy control - requirements and exemptions

14 JULY 2021

Contents

Important notice

Disclaimer

- The information contained in this document is of a general nature and is not intended to address the circumstances of any particular individual or entity.
- Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate or up to date.
- The information laid out is intended to provide a general guide and aid to discussion and any party that chooses to rely on this document (or any part of it) does so at its own risk. To the fullest extent permitted by law, Big Society Capital Limited does not assume any responsibility and does not accept any liability in respect of this document.
- No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

State Aid and subsidy control: requirements and exemptions

1 Purpose of this guide

- This handbook is an introduction to the EU's State Aid scheme for potential recipients of investment from Big Society Capital (**Investees**). It explains what State Aid is, how it relates to Big Society Capital and some of the considerations and exemptions which you need to understand before seeking funding from Big Society Capital.
- As part of the State Aid clearance obtained by Big Society Capital from the European Commission (**EC**), Big Society Capital is required to ensure that the Investees it deals with have a good understanding of their State Aid requirements and acknowledge the need to put procedures in place to deal with them.
- This handbook also sets out details of the UK's current subsidy control scheme, which replaced (subject to certain matters covered below) the EU State Aid rules in the UK, following the UK's final exit from the EU on 1 January 2021. On 30 June 2021, the UK government introduced the Subsidy Control Bill to Parliament. The updates in this handbook are an interim measure as we await the final Subsidy Control legislation.

2 The UK subsidy control scheme

Subsidy control rules in the TCA

- Following the UK's final exit from the EU on 1 January 2021, EU State Aid law in general ceased to apply in the UK. However, EU State Aid law remains relevant to Big Society Capital and Investees, for the reasons covered at section 4 of this handbook.
- Public bodies in the UK granting subsidies using state funds are now obliged to comply with the subsidy control rules in the TCA. The UK Government advises public bodies to adhere to the following five-stage process to ensure they are compliant with the relevant rules. We suggest Investees use the same process to consider whether they are giving a subsidy:

  (1) Determine whether a measure is a subsidy and what international obligations are relevant.

  (2) Evaluate whether the measure is a prohibited subsidy.

  (3) If you are in scope of the TCA, assess the subsidy against the principles (see below).

  (4) Assess the likelihood of triggering a dispute under World Trade Organisation (WTO) Agreement on Subsidies and Countervailing Measures (ACSM) rules and other Free Trade Agreements.

(5) Record the award of the subsidy (the UK Government holds a public database of awarded subsidies).

- The principles to be applied in the lawful granting of subsidies are set out in the TCA. These are that:

  i) subsidies should pursue a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns (the objective);

  ii) subsidies should be proportionate and limited to what is necessary to achieve the objective;

  iii) subsidies should be designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of subsidies being provided;

  iv) subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy;

  v) subsidies should be an appropriate policy instrument to achieve a public policy objective and that objective cannot be achieved through other less distortive means;

  vi) subsidies' positive contributions to achieving the objective should outweigh any negative effects, in particular the negative effects on trade or investment between the parties.

- As of the date of this handbook, the UK has not yet introduced a specific system of subsidy control to implement these principles (although they must nonetheless be followed in the granting of subsidies).

Minimum thresholds for the principles to apply

- It is important to note that these principles apply to subsidies of more than 325,000 Special Drawing Rights (SDR) given to a single beneficiary over three years. 325,000 SDR is currently equivalent to approximately £332,000.
- The threshold is set higher, at 750,000 SDR (approximately £771,000), for services of public economic interest. These are public services whose end users are private citizens, which the market would not normally provide or not to the extent required. They would include, for example, the running of the Post Office network.
- The sterling / SDR values of the subsidy should be calculated using the International Monetary Fund SDR convertor. We would suggest that, prior to the implementation of the specific subsidy control regime in the UK, the conversion rate is calculated at the time of the offer of the subsidy.
- Any subsidies below the relevant thresholds are out of scope of the obligation to apply the principles. Our expectation is that investments made by many Investees will fall below this de minimis limit.

Compliance with other international obligations

- In addition to applying the above principles, the UK will follow WTO subsidy rules and comply with its other international obligations regarding subsidy control.

- Investees therefore need to determine whether their subsidy carries any appreciable risk of triggering a dispute with a trade partner under the terms of the TCA, the WTO ASCM rules or the UK's other Free Trade Agreements. The WTO ACSM rules are not new commitments – the UK was subject to these rules while it remained an EU Member State.

Technical guidance on the subsidy control regime

- The UK Government has produced technical guidance on complying with the UK's international obligations on subsidy control. This includes a template to use to record consideration of the principles. Although the guide is aimed at public bodies, Investees may wish to use this guidance when considering whether they are giving a subsidy. The guidance can be found here (Guidance on the UK's international subsidy control commitments).

3 What is State Aid?

- Essentially, State Aid is an advantage (broadly defined, and so can take many forms) given by public authorities to undertakings (any entity which places goods or services on the market) which may distort competition and affect trade in the European Union.
- The Treaty on the Functioning of the European Union (**TFEU**) (previously called the European Community Treaty) is intended to promote the development of a single market within the EU, with no artificial barriers to trade or competition amongst the Member States. It was recognised that Member States may be tempted to favour their own economies by granting assistance to domestic undertakings. Therefore, the TFEU contains the following prohibition on State Aid at Article 107(1):

  "Save as otherwise provided in this Treaty, any aid granted by a Member State or through any State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market".

- State Aid may take "any form whatsoever" and there is no exhaustive list of benefits that will be State Aid. However to qualify as State Aid, there are four characteristics known as the 'four tests', all of which must be present in the assistance given. These are:

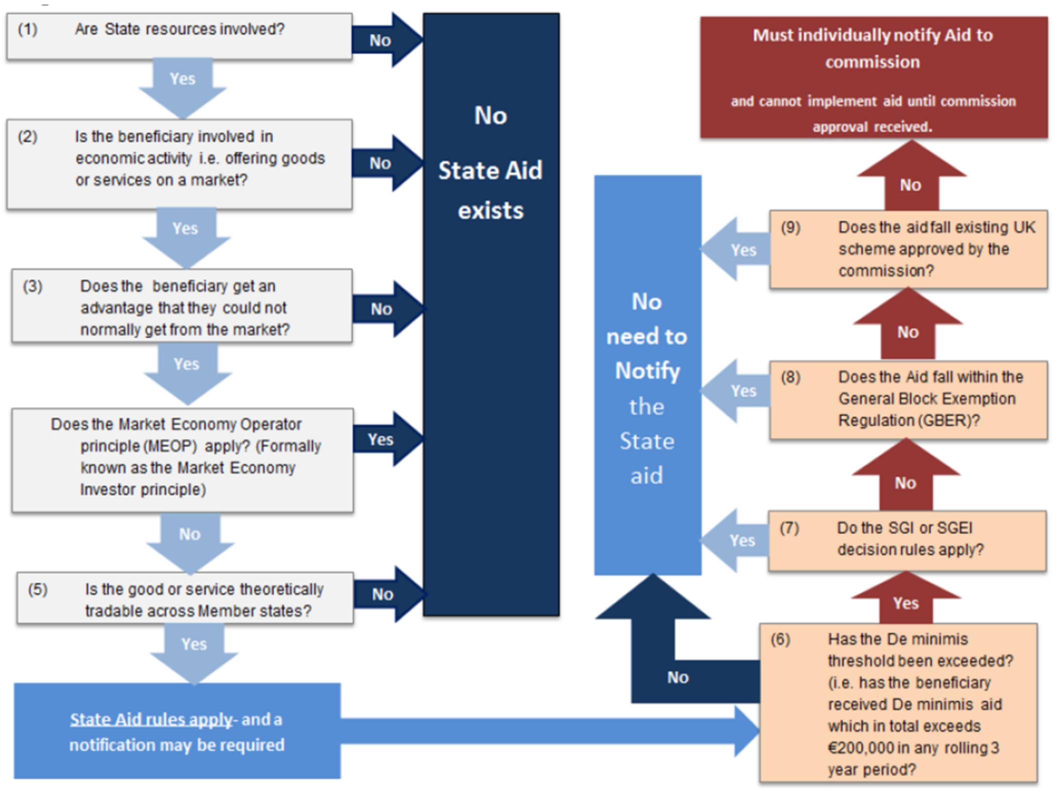
  1. The assistance is granted by the state or through state resources
     - The 'state' means any private or public body controlled by national or local government.
     - The concept of state resources applies to any advantage granted directly or indirectly from state resources
  2. It favours certain undertakings or the production of certain goods
     - As mentioned, an undertaking is defined as any entity placing goods or services on the market. As such, charities, not for profit organisations and public bodies are all classified as 'entities'.
     - The rules will not apply to measures which benefit all undertakings without distinction within a Member State. The measure must benefit certain products, types of undertaking, sectors or regions for the State Aid rules to apply. Exceptions to general rules may also be classified as favourability.
  3. It distorts or threatens to distort competition

- The threat of distorting competition does not have to be substantial, and as long as the assistance strengthens the recipient relative to its competitors, then it is likely to qualify as a threat.

4. It affects trade between Member States

- The interpretation of this element of the test is broad, and it is enough that a product or service is tradable between Member States (even if the supplier does not do this).
- If the assistance meets all four of these characteristics, it will be classified as State Aid and the compliance rules must be followed. If some of the four are not met, or there is uncertainty, seek advice.
- Some examples of what could constitute State Aid:
  - Grant aid or subsidies
  - Relief from taxes or other duties that would otherwise be payable
  - Loans granted at preferential rates or on terms other than market terms
  - Debt write-offs
  - 'Sweeteners' to attract investment into a region
  - Guarantees or indemnities on favourable terms
- State Aid must be pre-notified to and approved by the EC before it is put into effect. Failure to notify has potentially serious consequences, including a requirement to pay back aid that has been received. In order to reduce the burden on the EC, certain categories of aid which would otherwise need to be notified are exempt from the requirement to notify. There are two key regulations:
  - The De Minimis Regulation – this deals with relatively small values of aid
  - The General Block Exemption Regulation (**GBER**) – this deals with a range of aid measures that are considered to have benefits that outweigh any potential negative effects.
- Big Society Capital expects that the vast majority of investments that Investees will wish to make in the social investment market will fall within one of the exemptions explained here and will therefore not need to be pre-approved by the EC.
- There are also special rules concerning investments or loans made on purely commercial terms (see Market Economy Operator Principle at page 9) and governing payment for the provision of Services of General Economic Interest which can mean that any such investments, loans or payments are not aid (see page 14).

Figure 1- State Aid flow chart:



4 How do the EU's state aid rules apply to Big Society Capital and Investees?

- The prohibition on State Aid applies to benefits or support provided by Member State governments and by local authorities and other public sector or publicly-funded bodies. It also applies where aid is dispersed "through any state resources", so will apply where payments are made by a private sector body from state-derived funds.
- Big Society Capital is partly capitalised through monies from the English share of dormant accounts released for social spending through the Dormant Accounts Scheme (State resources). Therefore, the use of those monies requires a consideration of State Aid issues.
- There are a number of levels of investment at which the issue of State Aid requires consideration:
  - At the level of Big Society Capital itself
  - At the level of investees
  - At the level of the end user recipients of the investment
- The establishment of Big Society Capital and the provision of support/funds to Investees was notified to and cleared by the EC in 2011 and that decision was extended in 2016 (the **Decisions**). However, it is at the third level (that of State Aid potentially being given to end user recipients) that Investees will need to carry out an assessment of State Aid issues and understand the potential implications if funding gives rise to State Aid.
- The EU's State Aid rules remain relevant to Big Society Capital and Investees

following the UK's final exit from the EU, and should be borne in mind when Big Society Capital funding is involved in investments or lending. This is because:

- Under the terms of the Trade and Cooperation Agreement (TCA) between the EU and UK, State Aid decisions adopted by the EC prior to 1 January 2021 (such as the above Decisions) remain binding on and in the UK, and the EU Courts are exclusively entitled to review these decisions.
- In addition, EU State Aid rules continue to apply in certain circumstances under the Northern Ireland Protocol (namely in respect of measures that affect trade in goods and electricity between Northern Ireland and the EU). Broadly, for the State Aid rules to apply, there must be a genuine and direct link to Northern Ireland, and a real foreseeable impact on trade between Northern Ireland and the EU, as a result of the subsidy.
- Finally, we anticipate that the approach of the EC, and EU case law, will continue to remain relevant to the interpretation of both State Aid and UK subsidy control rules.

- For these reasons, the guidance and advice set out from section 5 of this handbook onwards continues to have application to – and will require some consideration by – Big Society Capital and Investees.

Making a State Aid assessment

5 Process

- Whenever you seek to invest or lend and Big Society Capital funding is involved in a proposed transaction, you should ask two questions:
  - Is there State Aid?
  - If so, is it exempt from prior notification to, and clearance by, the EC? If not, then the EC must be notified (Big Society Capital expects such situations to be very rare).
- Depending upon the outcome of the State Aid assessment, you may need to;
  - Issue a letter to the recipient informing them that the aid falls within the *de minimis* exemption
  - Notify the EC if the proposed investment falls within a GBER exemption
  - Notify the proposed investment to the EC for approval and wait for such approval before investing
- These are discussed in more detail below.

6 Market Economy Operator Principle

- In some situations, State Aid may not arise because no advantage is conferred or the investment or loan otherwise does not meet the criteria for State Aid. One example would be The Market Economy Operator Principle (MEOP), which is where an investment or loan is made by a public sector body in circumstances in which an investor or lender acting on a purely commercial basis might also have invested or loaned on similar terms. In order to apply the MEOP and for the investment to fall outside the remit of State Aid, the investment or loan must be at genuinely commercial rates, on the same terms and with the same risks and rewards that a commercial private investor or lender would invest or lend at. The most robust way of demonstrating that a public funds investment is on commercial terms would be to ensure that there is a matching investment (made on the same terms and at the same time) by a commercial entity.
- The EC accepted in its State Aid decision on Big Society Capital that there was a market failure in the social finance sector. This may mean that it is difficult to find investors or lenders willing to engage on a purely commercial basis and therefore that it is difficult to be confident that the MEOP applies. However, it may be increasingly relevant as the market matures and as commercial investors become more active alongside publicly funded or part funded activities.

7 Exemptions

- If a proposed investment or loan is State Aid (because it confers a selective advantage on the aid recipient) then you will need to consider whether an exemption applies to the requirement to notify the EC and secure clearance.

7.1 De Minimis exemption

- Under the De Minimis Regulation (Commission Regulation (EU) No 1407/2013 of 18 December 2013), aid up to a total of €200,000 to one company or organisation over a three year fiscal period is exempt from notification on the grounds that it does not distort competition or trade to an appreciable extent. Loan guarantees are also covered to the extent that the guaranteed part of the loan is not greater than €1.5m.

- Before Investees can assess whether investment qualifies under this exemption there needs to be a calculation made of the value of the State Aid which would be distributed.
  - This can be a complex calculation, which depends on the level of financial information available, the type of opportunity and the instrument proposed, amongst other issues.
  - You may require support to complete this calculation. See Appendix 1 for more detail.
  - Except in very limited circumstances (for example, where the entire value of a loan is written off), the value of the State Aid will generally not be the total amount of an investment or loan made. Rather it will be based on the difference between the market rate of return on an investment or loan and the rate of return or interest rate being charged by the Investee to the frontline organisation.
- The de minimis exemption is available if the total value of any aid granted to an organisation, over any three fiscal year period, is below €200,000. This includes both the investment from the Investee and any other state aid received by that organisation during the last three fiscal years or future periods of three years. Below this level aid is not perceived to distort the market and State Aid rules requiring notification do not apply.
- If an Investee's proposed investment falls below the de minimis limit, it is not required to notify the EC of its investment, but it must inform the recipient that the funding it is receiving is state aid that has been assessed to benefit from the de minimis exemption.
- Big Society Capital expects that a large number of loan investments considered by Investees will fall within this exemption. Further details are provided in Appendix 2.

7.2 Existing approved scheme

- If the de minimis exemption does not apply, consider whether it is possible to adapt the proposed aid to fit within the terms of one of the State Aid schemes which the EC has approved for the UK http://ec.europa.eu/competition/state_aid/register/

7.3 General Block Exemption Regulation

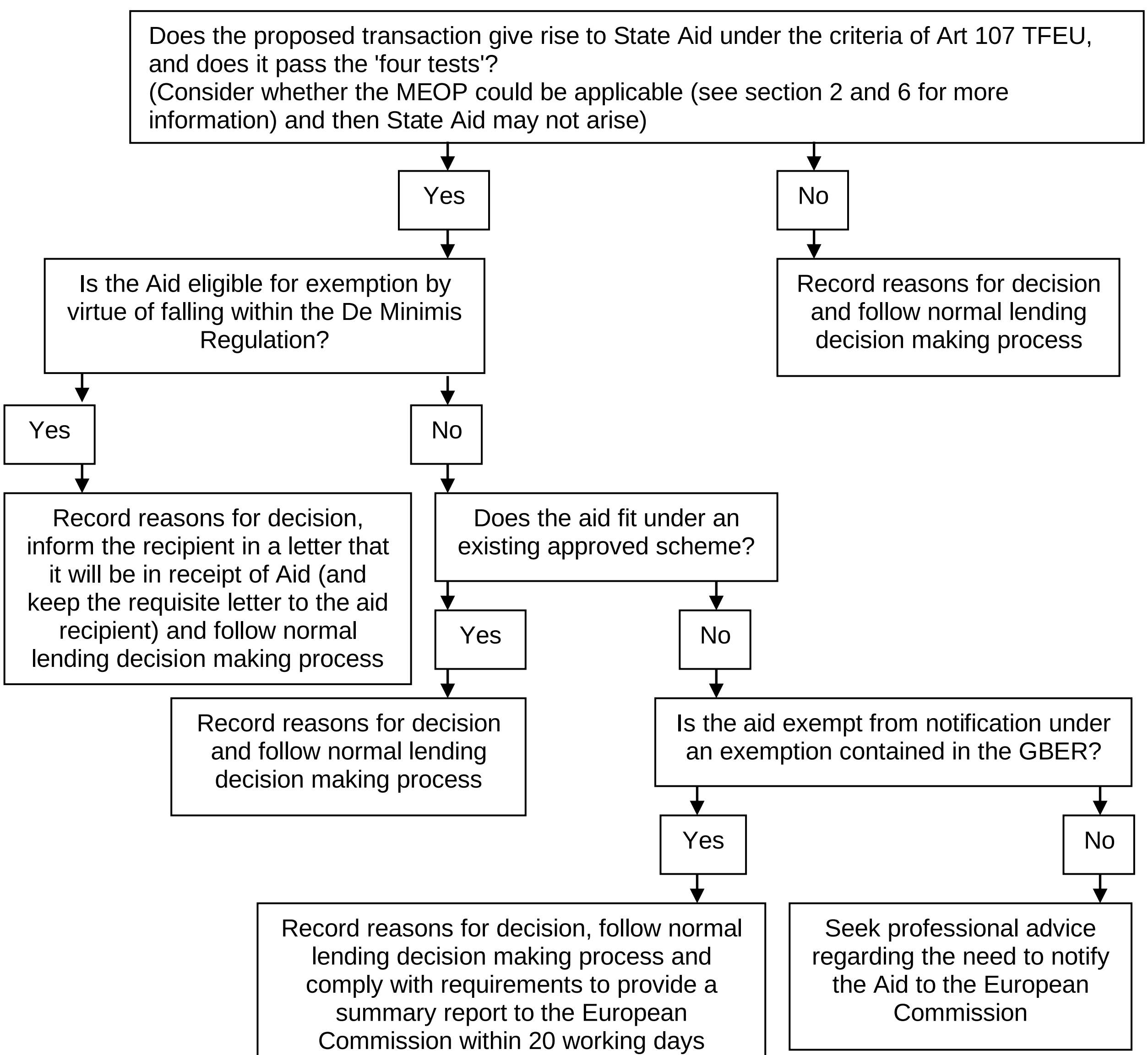
- The General Block Exemption Regulation (**GBER**) provides that certain categories of aid will be automatically compatible with the EU and sets out the criteria for exemption from the prior notification requirement in respect of different categories of aid. As noted below, a notification should nonetheless be made within 20 working days after any GBER investment or loan is made.
- Where an Investee's investment does not fall below the de minimis limit, the GBER may provide exemption from the requirement to go through the full EC approval process.
- Often GBER exemptions take the form of an increased limit for eligibility within certain categories of recipient or purpose (they are particularly relevant for assistance provided to Small and Medium Sized Enterprises (**SMEs**). Both loans and risk capital investments can fall under this exemption.
- Big Society Capital expects that many investments that cannot benefit from the de minimis exemption, will fall within one of the GBER exemptions.
- If you are investing or lending and relying on exemption under the terms of the GBER, summary information must be sent to the EC within 20 working days of

the aid having been provided. The summary should be in electronic form and in the form specified in Annex II to the GBER. More detail is shown in Appendix 3.

The decision process that Investees will need to put in place for state aid

- As part of making investment decisions, Investees will need to have a process for ensuring that opportunities comply with the State Aid rules.
- One way of doing so may be to develop a decision process similar to the one shown in Figure 3 below.
- Investees should follow the guidelines to determine the State Aid impact of each investment and, if relevant, the applicable exemption under which it falls.
- Note that a number of simplifying assumptions have been made in the diagram which may not be applicable for all situations.

Figure 3 - example decision process



Reporting and monitoring for state aid

8 Requirements

- Each of the exemptions has different reporting and monitoring considerations. Typically this relates to the information that must be recorded at the time of investment and ongoing monitoring and reporting which may be required.
- For all investments, a record should be kept of the basis on which it was concluded that there was (or was not) State Aid (for example, is it in line with the MEOP), along with the calculation of the value of any State Aid (if appropriate) together with the reasons why it was considered that exemptions apply to the State Aid. There are additional requirements to inform the recipient about the nature of the State Aid being given and to keep records of State Aid given for ten years.

De Minimis Aid

- The de minimis exemption does not need to be reported to the EC. However, care should be taken to ensure that the circumstances of the investment do not change over time, such that the de minimis limit comes under threat of being breached. A letter should be sent to the recipient of the aid informing them that it is considered that the aid falls with the de minimis exemption.

Aid exempt under a provision of the General Block Exemption Regulation

- Investments which fall under one of the GBER exemptions must be notified to the EC within 20 working days of making the investment; it is the responsibility of the Investee to ensure that this happens.
- In addition to a requirement to provide summary information to the EC within 20 working days, the GBER requires that Member States compile an annual report on the application of the Regulation and that the EC is provided with relevant information (in a specified form) within 20 working days of the aid having been granted. Big Society Capital should be informed if reliance is being placed on the GBER and further details on the reporting requirements will be provided.
- Whichever exemption an investment falls under, Investees should ensure that they are aware of the reporting and monitoring implications of these and understand what is required on a one-off and ongoing basis. Investees should seek professional advice on these obligations if necessary.

Risks and sanctions for state aid

- Investees must be conscious that there are risks associated with the potential application of the State Aid rules and ensuring that activities are carried out properly.
- Risks include:
    - State Aid may need to be repaid with interest, if the EC finds aid to have been granted unlawfully; and
    - Similarly, State Aid may need to be recovered where the circumstances of an investment change and the requirements for exemption are no longer met (e.g. if a loan becomes irrecoverable and the de minimis limit is exceeded).
- Where rules are breached, the EC has powers to order recovery of aid from recipients. In addition, aid which has been granted and which has been found to be incompatible with the EU internal market must be repaid with interest (accruing from the time of the grant of aid) by the recipient organisation. Competitors may request damages if they believe they were unduly prevented from operating in a fair and open market.
- Likewise, the EC takes a serious view of State Aid provided without its approval and aid payments can be halted while the legality of the investment is investigated.

Services of General Economic Interest

- If the investee is performing a Service of General Economic Interest (**SGEI**), it is possible that compensation for the provision of those services will not be State Aid.
- SGEIs are economic activities that are of particular importance to citizens and that would not be supplied (or would only be supplied under different conditions) if there were no public intervention. Examples may include transport networks, postal services, social services and education.
- The rules governing when compensation for SGEI will not be State Aid are restrictive. Case law of the Court of Justice of the EU sets out four cumulative conditions which, when met, mean that public service compensation does not constitute State Aid:
    - the recipient company must be subject to public service obligations and the obligations must be clearly defined;
    - the parameters for calculating the compensation must be objective, transparent and established in advance;
    - the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit;
    - where the undertaking which is to discharge public service obligations is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs of a typical well-run company.
- The four criteria set out above for SGEI not being aid are difficult to meet. Where all the criteria are not met, EU law also provides for exemption from the State Aid rules for aid of up to €500,000 per company over a three-year period where the aid is compensation for the provision of services of general economic interest.

Further advice

- Big Society Capital recommends that Investees seek independent advice on the individual circumstances of their organisation with respect to State Aid and subsidy control and consider whether they require further support, either on a one-off and ongoing basis. To support initial understanding, the following documents may provide assistance or useful background reading.
- A copy of the European Commission's decision to not raise objections to the State Aid measure to Big Society Capital :

  http://ec.europa.eu/competition/state_aid/cases/242167/242167_1287432_99_2.pdf
- Guidance produced by BEIS on the UK's subsidy control measures can be found here:

  Guidance on the UK's international subsidy control commitments - GOV.UK (www.gov.uk)
- A copy of the Regulation on de minimis aid granted to undertakings providing services of general economic interest can be found here:

  http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32012R0360:EN:NOT
- Further sources of advice include:

BEIS subsidy control team:
subsidycontrol@beis.gov.uk

State Aid Registry
European Commission
Directorate-General for Competition
For the attention of the State Aid Registry 1049 Brussels

Email: stateaidgreffe@ec.europa.eu
Telephone: +32 22961154
http://ec.europa.eu/competition/state_aid/overview/index en.html

Appendix 1: How to calculate the value of State Aid

- If a proposed investment gives rise to State Aid, the potential application of an exemption will depend upon the value of the State Aid.
- State Aid is typically expressed as a gross figure or cash grant equivalent.
    - In the case of debt, the State Aid value is usually the difference between the total amount of interest that would have been paid by a recipient had they borrowed in the open market and the total amount of interest that the Investee is planning to charge. Note that it is not (save in exceptional circumstances) the full amount of the investment being made.
    - Special rules have been developed to determine a value even where no reliable commercial market exists.
    - For de minimis aid, the exemption is only available for transparent aid, which is aid in respect of which it is possible to calculate precisely the gross grant equivalent in advance.
- It is possible that Investees will need specialist financial input and time to research and understand the regulations which are relevant to the investments that Investees want to make; particularly if they believe that exemption will only be possible under the GBER.

Determining the basis of calculation

- A number of bases of calculations are relevant. Investees must consider what type of investment instrument they are proposing to use to determine what basis to use. Big Society Capital expects the majority of investments to fall under one of the first two categories:
    - **Loan** - the difference between the Net Present Value (NPV) of the loan when calculated using a 'reference' interest rate and the NPV of the actual loan awarded by the Investee (typically limited to a looking at a three year period).
    - **Risk capital** - the total amount of the investment (typically used where investing equity or quasi-equity instruments).
    - **Guarantee** - the difference between the NPV of market rate fees and the NPV of the fees charged.
    - **Grant** - the principal value of the grant ***— this is unlikely to apply for investments made by Investees, given the intention to make sustainable investments and to stimulate a new financial market.***
- In respect of loans and guarantees, in practice this means establishing the difference between what the recipient would have paid in the market for the funds and what the Investee plans to charge, considered over either the lifetime of the investment or three years, depending on the type of instrument invested and the exemption being tested (de minimis over three fiscal years, GBER exemptions vary by category).

Useful definitions

Base rate:

- The base rate represents the lowest commercial rate for lending available, before any risk adjustment is applied by the lender, which would reflect the individual circumstances of the recipient. Base rates should be calculated in accordance with the Communication from the Commission on the revision of the method for setting the reference and discount rates (OJ C 14, 19.01.2008, p.6 at:

  http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC0119(01)&from=EN

- The rate is derived from 1-year money market rates (1-year IBOR) but is fixed by the EC.
- The current base rates are published on the EC website at http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html
- Note that this is updated regularly so should be checked for every investment made.

Margin:

- Margin is a set number of basis points that is applied to the base rate. The appropriate margin depends on the credit rating of the recipient and the collateral (if any) offered as part of the investment.
- The margin is meant to be a proxy for the uplift to the base rate that a commercial lender would have applied if it were making the proposed loan, accounting for risk and reward.
- Normally a margin of at least 100 basis points would be added to the base rate. This assumes (i) loans to undertakings with satisfactory rating and high collateral; or (ii) loans to undertakings with good rating and normal collateral.
  - For borrowers that do not have a credit history or a rating based on a balance sheet approach, such as certain special-purpose companies or start-up companies, the base rate should be increased by at least 400 basis points
  - Big Society Capital expects that most front-line recipients will have limited credit histories and no publicly available credit rating; therefore the majority of calculations will need to use a margin of ≥400 basis points.
- The following is a useful guide to establishing which margin to use:

Loan margins in basis points			
Rating category / Collateralisation	**High**	**Normal**	**Low**
Strong (AAA-A)	60	75	100
Good (BBB)	75	100	220
Satisfactory (BB)	100	220	400
Weak (B)	220	400	650
Bad/Financial difficulties (CCC and below)	400	650	1000

Reference rate:

- The reference rate is used as a proxy for the commercial interest rate that a borrower would pay were they borrowing on the open market.
- The reference rate is calculated by adding together the base rate and the margin.

Offered rate:

- The offered rate is the interest rate which is applied by the Investee on the investments made in the recipient. If a number of rates are used these will need to be included in the NPV calculation for the investment within the applicable period.

Discount rate:

- When calculating the NPV of an investment, a discount rate is used to bring the value of future periods back to today's value.
- It is usually appropriate to use the base rate increased by a fixed margin of 100 basis points as the discount rate.

Exchange rate:

- State Aid values are calculated in Euros. When calculating the value in Euros of an award given in Sterling, a set EC exchange rate should be used. This table should be used to establish the appropriate rate:

  http://ec.europa.eu/budget/inforeuro/index.cfm?fuseaction=currency historique&currency=GBP&Language=en

Carrying out the calculation:

- The following is a basic guide to the steps involved in calculating the value of State Aid. The guide is not exhaustive and different steps may be involved depending on the basis of calculation that you need to follow.

1. Determine the base rate

- Establish the right base rate by using the EC website.

2. Identify the appropriate margin to calculate the reference rate

- Consider whether a credit rating is available for the recipient, their credit history and the level of collateral being offered as part of the investment (if any).
- Establish the appropriate margin using the EC website or the table shown above.
- Add the margin to the base rate to get the reference rate.

3. Determine the discount rate (for use in NPV calculation)

- Add e.g. 100 basis points to the base rate to get the discount rate, more than 100 basis points may need to be added depending upon the credit history/rating of the end user.

4. Calculate the Net Present Value of the investment

- Model the investment over time, including repayment and interest calculation points, draw-downs and payment holidays (if applicable), discounting back (usually annually) using the discount rate.
- The investment should be modelled using both the offered rate (to show the actual cost to the recipient) and the reference rate (to show the equivalent market rate).
- Ensure that it is possible to capture the State Aid value per year, discounted, so that it is later possible to consider rolling three year periods.

5. Calculate the cash grant equivalent

- The total value of the State Aid offered (in grant equivalent terms) is the difference between the two NPVs.
- If the investment offered is in Sterling, use the appropriate exchange rate from the EC website to calculate the State Aid value in Euros.
- This is the State Aid value.

- It may be appropriate for Investees to seek legal and financial assistance to help them with this calculation.

Example calculation

Example calculation of State Aid value		
Type of instrument		debt
Value of debt	£	1,500,000
Interest rate		4%
Repayments and interest calculated		Quarterly
Periods		24
Base rate (as of 31/05/12)		1.74%
Margin (b.p.)		400
Discount rate		2.74%
Reference rate		5.74%
Discounted value of interest - offered	£	193,314
Discounted value of interest -	£	264,510
Cash grant equivalent of Aid (total loan)	£	71,196
Effective exchange rate		0.8153
Cash grant equivalent of Aid (total loan)	€	87,325

Notes:

- A loan repayment schedule has been used to assess the value of the interest, on a reducing balance basis
- Repayments represent payments of principal and interest and are equal throughout the loan
- Annual interest has been discounted annually
- Calculation does not consider intensity if relevant (e.g. proportion of costs allowable under certain GBER categories)

Appendix 2: The de minimis exemption

- The De Minimis Regulation sets a threshold figure below which Article 107 TFEU will not apply because it will be assumed that the aid will not distort competition. Crucially, below this limit, the EC need not be notified of any investments made by Investees.
- The De Minimis Regulation only applies to 'transparent' aid. Transparent aid is aid for which it is possible to calculate precisely a gross grant equivalent before the aid is granted without the need to undertake a risk assessment. Aid comprised in capital injections should not be considered as transparent de minimis aid unless the total amount of the public injection is lower than the de minimis ceiling. Aid comprised of risk capital measures should not be considered as transparent de minimis aid, unless the risk capital scheme provides capital only up to the de minimis ceiling to each target undertaking. Aid comprised of loans should be treated as transparent de minimis of the grant of aid. The market rates applicable should be the reference rates as set out in the Communication from the Commission on the revision of the method for setting the reference and discount rates. If the loan fulfils certain criteria set out in the De Minimis Regulation (broadly, the beneficiary of the loan is not subject to insolvency proceedings, the loan is secured by collateral covering at least 50% of the loan and the loan is either up to €1,000,000 for up to 5 years or up to €500,000 for up to 10 years) then the loan is assumed to be de minimis.
- Current rules stipulate that the total de minimis aid granted to any one organisation must not exceed €200,000 over any period of three fiscal years. Note that there are some sector exceptions which are not covered here (for instance road transport and fisheries).
    - This ceiling is expressed as a gross or cash grant figure and should be before any deduction of tax or other charge.
    - In the case of debt loans the cash grant equivalent is typically the difference between the market rate of interest and the rate offered, not the full amount of the investment (as explained in Appendix 1).
- It is Big Society Capital 's expectation that many of the investments made by Investees will fall below this de minimis limit, as the difference between the market and offered rates is unlikely to be above €200,000. However, it is possible that some investments may go above this limit, particularly where non-debt instruments are being used.
- For more information on exclusions see the BIS State Aid manual: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/443742/BIS-15-148-state-aid-manual.pdf

Carrying out the de minimis test

- Investees should ensure that State Aid amounts are properly calculated and decisions recorded.
- To test against the exemption, Investeesshould carry out a calculation similar to the one shown in Appendix 1, but will also need to consider what other sources of State Aid a recipient may have received over a 3 year fiscal period.
- The years to take into account for the purpose of calculating the three year fiscal period are the fiscal years as used for fiscal purposes by the undertaking in

question. The relevant period of three years should be assessed on a rolling basis so that, for each new grant of de minimis aid, the total amount of de minimis aid granted in the fiscal year concerned, as well as during the previous two fiscal years, needs to be determined

- This can be done by obtaining from each recipient, information about other de minimis aid received during the previous two fiscal years and the current fiscal year.
- Firms should usually have been informed by letter if any aid that they have been offered in the last three years fell under the De Minimis Regulation; there is a standard form of wording (detailed below).
- Investees should also look forward over a three year period to establish how the value of State Aid received will impact the calculation (for instance if the organisation is repaying a loan over a period greater than one year).

· If the total State Aid received by the recipient is lower than the limit in either three year period the de minimis exemption applies.

· If the total State Aid received by the recipient is higher than the limit in either three year period then alternative exemptions should be considered.

Processes Investees must follow

· As part of this assessment, Investees should build specific steps into their investment appraisal process, to ensure that they:

- Ask frontline organisations to declare the total value of State Aid they have received/are receiving over a three year period;
- Calculate the value of State Aid that will be provided via the Investee loan or investment;
- Total the above two amounts to ensure that the value does not exceed €200,000 over three years;
- Record the decision and retain records of State Aid given for at least ten years (this is because the limitation period for recovery of unlawfully granted aid is ten years); and
- Write to the recipient outlining explicitly that they are receiving de minimis aid and the value of the award in Euros. The letter should include the following paragraphs:

Dear,

[SCHEME TITLE (IF APPLICABLE)] STATE AIDS: DE MINIMIS AID

In order to minimise distortion of competition, the European Commission sets limits on how much assistance can be givenwithout its prior approvalto organisations operating in a competitive market. This is a De Minimis offer letter for the value of the aid(Gross Grant Equivalent)under this scheme of.

The support being provided is De minimis aid under EC Regulation 1407/2013 (De Minimis Aid Regulation) as published in the Official Journal of the European Union 24 December 2013. There is a ceiling of €200,000 [€100,000 for undertakings in the road freight transport sector] for all De minimis aid provided to any one organisation over a three fiscal year period (i.e. your current fiscal year and previous two fiscal years). **You must declare this amount if asked in the future to any other aid awarding body.**

For the purposes of the De minimis regulation, you must retain this letter for from the date on which the aid is granted and produce it on any request by the UK public authorities or the European Commission. You may need to keep this letter longer than 10 years.

Yours sincerely,

Example calculation

Example *de minimis* calculation - derived from previous calculation		
Current year interest at reference rate - discounted	£	79,337
Current year interest at offered rate - discounted	£	58,600
Value of State Aid in current year (£)	£	20,736
Value of State Aid in current year (€)	€	25,434
State Aid received by recipient in last 3 fiscal years	€	13,620
Total State Aid received in 3 year period	**€**	**39,054**
Years 1-3 interest charged at reference rate - discounted	£	195,708
Years 1-3 interest charged at offered rate - discounted	£	143,725
Value of Aid given in forward 3 year period	£	51,983
Value of Aid given in forward 3 year period	**€**	**63,759**
Conclusion (considering both three year periods)	**below de minimis**	

Additional Considerations

- Should an investment become non-recoverable, there is a risk that the portion of the loan written-off may be considered as additional State Aid (as it in effect becomes a grant). Should a default happen, Investees may need to recalculate the value of the State Aid to verify that is still within the de minimis limit. This is done on the same basis on which State Aid was initially calculated. However, non-recoverable portions may now need to be considered in full in addition to the original aid. Whether or not sums written off will be aid will depend upon the terms and conditions of the write off.
- Should the Investee find it has now breached the de minimis limit, they should return to the decision process above, to determine if another exemption applies and/or seek additional legal advice.

Appendix 3: General Block Exemption Regulation categories

- If a proposed investment is above the de minimis limit the next step is to assess whether it falls within the scope of the General Block Exemption Regulation (GBER). These exemptions outline the areas in which State Aid investment is allowable due to social, development or growth goals of the EU.
- Big Society Capital expect that investments undertaken and loans provided by Investees above the de minimis limit will be likely to fall under one of these categories, given the social aims of the funds provided by Big Society Capital . However, it is the responsibility of Investees to ensure that they undertake appropriate due diligence and follow the correct notification process, if relevant.
- Once again the State Aid valuation carried out will provide the basis for the decision.
- There are various categories of exemption in the GBER.
  - If the investment is being made under the GBER, Investees are required to confer with investees to confirm the eligibility of the recipient frontline social sector organisation
  - Aid givers are then free to invest funds without additional EC assessment, although they must notify the EC through the process as outlined by BEIS.
  - A copy of the GBER and more detail on calculation of State Aid for these categories can be found here: http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1404295693570&uri=CELEX:32014R0651
  - Note that special rules apply to the calculation of the value of State Aid in certain categories. Some costs, as a percentage of the total aid provided, are limited.
  - Where aid fulfils the conditions of an exemption under the GBER, it shall be exempt as long as the aid measure contains an express reference to the GBER.
  - The GBER only applies to aid which is transparent (which means that the amount of the aid has been quantified: for example, for aid comprised in loans, the gross grant equivalent has been calculated on the basis of the reference rate prevailing at the time of the grant).

Using the GBER

- The following are the current GBER categories as laid out by the EC. They cover areas of investment which are generally thought to contribute to growth, development goals or other social outcomes, such that State Aid investment is allowable. Numbers in brackets are references to the relevant Article in the GBER.
- For detail on the maximum allowable State Aid, please refer directly to the relevant Article in the GBER.

GBER Exemption Categories		
Sector	**Sub-sector**	**Detail**

GBER Exemption Categories		
Sector	**Sub-sector**	**Detail**
Regional Aid	Regional investment aid (14)	National regional Aid promotes the economic, social and territorial cohesion of the EU by addressing the handicaps of the disadvantaged regions. There may be some applicability for specific Investees.
	Regional operating aid (15)	
	Regional urban development aid (16)	
Aid to SMEs	Investment aid to SMEs (17)	Beyond the categories of Aid available for all enterprises, different types of Aid are specifically designed to help SMEs to overcome the specific "market failures" they face.
	Aid for consultancy in favour of SMEs (18)	
	Aid to SMEs for participation in fairs (19)	
	Aid for cooperation costs incurred by SMEs participating in European Territorial Cooperation projects	
Aid for access to finance for SMEs	Risk finance aid (21)	The GBER exempt from notification Aid for risk finance aid schemes up to certain limits. Risk finance aid may take a number of forms and may include equity or quasi-equity, loans or guarantees. This would apply to equity investments made by Investees. The GBER also exempt from notification start-up aid for small enterprises, aid to alternative trading platforms specialised in SMEs and aid for costs related to the scouting of SMEs.
	Aid for start-ups (22)	
	Aid to alternative trading platforms specialized in SMEs (23)	
	Aid for scouting costs (24)	

GBER Exemption Categories		
Sector	**Sub-sector**	**Detail**
Aid for research and development and innovation	Aid for research and development projects (25)	Beyond the more traditional categories of R&D Aid, the GBER also include a series of innovation measures to foster the competitiveness of European industry via more money spent in R&D and innovation. There may be some applicability for Investees here, looking specifically at the planned activities of their investees
	Investment aid for research infrastructures (26)	
	Aid for innovation clusters (27)	
	Innovation aid for SMEs (28)	
	Aid for process and organisational innovation (29)	
	Aid for research and development in the fishery and aquaculture sector (30)	
Training aid	Training aid (31)	The regulation authorises Aid for general training as well as for specific training. Aid shall not be granted for training which undertakings carry out to comply with national mandatory standards on training.
Aid for disadvantaged workers and for workers with disabilities	Aid for the recruitment of disadvantaged workers in the form of wage subsidies (32)	The GBER covers Aid that incentivises companies to hire disabled or otherwise disadvantaged workers.
	Aid for the employment of workers with disabilities in the form of wage subsidies (33)	
	Aid for compensating the additional costs of employing workers with disabilities (34)	
	Aid for compensating	

GBER Exemption Categories		
Sector	**Sub-sector**	**Detail**
	the costs of assistance provided to disadvantaged workers (35)	
Aid for environmental protection	Investment aid enabling undertakings to go beyond Union standards for environmental protection in the absence of Union standards (36)	The GBER facilitates national authorities granting an important number of Aid measures favouring environmental protection and tackling climate change. There may be some applicability for specific Investees or types of investment or initiatives.
	Investment aid for early adaptation to future Union standards (37)	
	Investment aid for energy efficient measures (38)	
	Investment aid for energy efficiency projects in buildings (39)	
	Investment aid for high-efficiency cogeneration (40)	
	Investment aid for the promotion of energy from renewable sources (41)	
	Operating aid for the promotion of electricity from renewable sources (42)	
	Operating aid for the promotion of energy from renewable sources in small scale installations (43)	
	Aid in the form of reductions in environmental taxes under Directive 2003/96/EC (44)	

GBER Exemption Categories		
Sector	**Sub-sector**	**Detail**
	Investment aid for remediation of contaminated sites (45)	
	Investment aid for energy efficient district heating and cooling (46)	
	Investment aid for waste recycling and utilization (47)	
	Investment aid for energy infrastructure (48)	
	Aid for environmental studies (49)	
Aid to make good the damage caused by certain natural disasters	Aid schemes to make good the damage caused by certain natural disasters (50)	The GBER facilitates the provision of Aid for repairing damage from natural disasters. This is unlikely to be applicable to Investees.
Social aid for transport for residents of remote regions	Social aid for transport for residents of remote regions (51)	Aid for air and maritime passenger transport shall be exempted from the notification requirements where it benefits final consumers resident in remote regions. This is unlikely to be applicable to SIFIs.
Aid for broadband infrastructures	Aid for broadband infrastructures (52)	Investment aid for broadband network development shall be exempted from notification, however, this is unlikely to be relevant to Investees.
Aid for culture and heritage conservation	Aid for culture and heritage conservation (53)	The GBER provides for the exemption from notification of a variety of cultural purposes and activities which are more particularly detailed in
	Aid schemes for	

GBER Exemption Categories		
Sector	**Sub-sector**	**Detail**
	audiovisual works (54)	the GBER and which may take the form of investment aid or operating aid.
Aid for sport and multifunctional recreational infrastructures	Aid for sport and multifunctional infrastructures (55)	The GBER facilitates the provision of aid for sport infrastructure and multifunctional recreational infrastructure, subject to certain condition regarding accessibility to users of that infrastructure.
Aid for local infrastructures	Investment aid for local infrastructures (56)	Financing for the construction or upgrade of local infrastructure that contributes at a local level to improving the business and consumer environment and modernising and developing the industrial base shall be exempt from notification under the GBER (subject to certain limitations).

- Big Society Capital anticipates that the two GBER provisions which will be most relevant to Investees will be:

(1) Aid to SMEs: Investment aid to SMEs – this is allowable to SMEs for investment in tangible or intangible assets relating to the setting up of a new establishment or the extension or diversification of an existing establishment.

(2) Aid for access to finance for SMEs: Risk finance aid – The new risk finance rules cover a wide range of SMEs, irrespective of whether or not they are located in assisted or non-assisted areas, and includes not only SMEs in seed/start up and expansion stages, but also SMEs at later growth stages, small midcaps (up to 499 employees) and innovative midcaps (up to 1,500 employees and with R&D and innovation costs representing 10% of total operating costs). Risk finance aid to SMEs may take the form of equity, quasi-equity investments, loans, guarantees or a mix thereof. In an amendment to the thresholds under the previous version of the GBER (in which the maximum amount of exempt aid was annual tranches of €1.5m), risk finance up to a total of €15m per SME will be exempted from the requirement to notify to the Commission.

The GBER provides that risk finance measures shall ensure profit-driven financing decisions and sets out conditions which, if satisfied, will meet this requirement. These include:

- Financial intermediaries (required for risk finance measures) shall be established according to applicable laws;

- The entity entrusted with the implementation of the measure shall provide for a due diligence process to ensure a commercially sound investment strategy for the purpose of implementing the risk finance measure; and

- A clear and realistic exit strategy should exist for each equity and quasi-equity investment.

For risk finance measures providing equity, quasi-equity or loan investments, it is also a requirement that additional finance shall be leveraged from independent private investors so as to achieve an aggregate private participation rate of:

(i) 10% for investments into SMEs before their first commercial sale;

(ii) 40% for SMEs that have been operating in any market for less than seven years following their first commercial sale; and

(iii) 60% for those SMEs that require an initial risk finance investment which, based on a business plan prepared in view of entering a new product or geographical market, is higher than 50% of their average annual turnover in the preceding 5 years or where follow-on investments in eligible SMEs are made after the seven year period from their first commercial trade (under certain circumstances).

The management of a risk capital measure or fund should be effected on a commercial basis. The management team must behave as managers in the private sector, seeking to optimise the return for their investors.