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Subject: State aid SA.39793 (2016/N) – Malta - The Malta Development Bank

Dear Sir,

The Commission wishes to inform the Maltese authorities that having examined the information notified on the matter referred to above, it has decided not to raise objections to the measure for the reasons set out below.

1. PROCEDURE

(1) On 4 July 2016 the Maltese authorities notified, pursuant to Article 108(3) of the Treaty on the Functioning of the European Union[1] ("TFEU"), the measures to set-up the Malta Development Bank ("MDB" or "the Bank"), asking for those measures to be assessed on the basis of the Article 107(3)(c) TFEU.

(2) A number of electronic mail exchanges took place between the Commission and the Maltese authorities in which additional information was requested and submitted between 7 July 2016 and 1 August 2016.

[1] OJ C 115, 9.5.2008, p. 47.

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2. DESCRIPTION OF THE MEASURES

2.1. The objective of the measures

(3) The main objective of the measures is to establish the MDB, a new public development bank and to define its remit of intervention.

(4) The MDB aims at addressing market failures and has a twofold objective: (i) to improve access to finance for Maltese small and medium-sized enterprises ("SMEs"), particularly the smaller firms, those in innovative areas, and those in their early firm lifecycle; and (ii) to provide adequate funding for infrastructure projects of a public nature, particularly those having long-term maturity and lacking of any direct financial returns. According to the Maltese Authorities, the market in Malta tends to fail in those particular instances[2] as a result of various factors characterizing the Maltese economy including its small size and typical firm micro-size (which are mainly family businesses), the lack of alternatives to bank financing (often based on a collateralized model) and the under-capitalisation of local firms. The creation of the MDB within the proposed remit is considered by the Maltese authorities to be the best approach to improve the supply of investment finance in the areas affected by market failures. It is also expected to play an important role in catalysing long term finance and supporting economic development in Malta.

2.2. The infrastructure financing market in Malta

(5) With the notification[3], the Maltese authorities have provided a description of the infrastructure financing market in Malta. According to the analysis presented by the Maltese authorities, most infrastructure projects in Malta have traditionally been supported with funds from the national budget and from the EU (in particularly the EU Cohesion Fund and the European Regional Development Fund ("ERDF")).

(6) Malta has also resorted extensively to European Investment Bank ("EIB") facilities for the financing of public driven infrastructure mainly in the areas of energy, water and sewerage infrastructure, telecommunications, urban development and transport.

(7) Efforts have lately been undertaken to boost public-private partnership initiatives and increase the role of the private sector in the financing of infrastructure projects.

(8) Domestic banks have been quite active in extending infrastructure loans mainly for telecommunication, energy and transport infrastructure as well as to road construction contractors and urban developers. Such facilities represent traditional financing products ranging from long term capital funding to short term funding related to working capital. However, local banks have tended to shy

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[2] The Maltese authorities have submitted with the Notification, a *'Market Study on the Potential Existence of Market Failures in Malta'* prepared by Ernst and Young in July 2015 to support the existence of market failures in Malta.

[3] Annex II to the Notification.

away from non-traditional funding products such as securitisations or syndicated loans.

(9) Other private sector means to raise infrastructure funding through public offers of private equity or through tapping private financing from abroad have been relatively subdued and limited to a few projects.

(10) In conclusion, according to the Maltese authorities, most infrastructure financing in Malta has traditionally been provided by the Maltese Government and the EU and to a lesser extent by the domestic commercial banks. Foreign commercial banks, the local capital market and international investors play a minor role in this sector.

2.3. Legal basis

(11) The legal base of the measures are:

(a) The Malta Development Bank Draft Act dated 4 July 2016 ("MDB Act"); and

(b) Subsidiary Legislation concerning the 'Supervisory Board Regulations' of the MDB, which is annexed to the MDB Act.

2.4. Granting authority

(12) The aid granting authority is the Ministry of European Affairs and Implementation of the Electoral Manifesto.

2.5. The measures

(13) The aid measures take the form of: (i) an initial share capital to be subscribed by the government; (ii) government guarantees to be provided on the assets and liabilities of the MDB; and (iii) an exemption from tax on the assets, property, income, operations and transactions of the Bank ("tax measure") altogether ("the measures") .

2.6. Duration and review clause

(14) The legal base does not determine a concrete duration for the MDB. However, the Maltese authorities seeks the Commission's approval for the MDB's activities and aid measures for a three-year period, starting from 1 September 2016 and ending on 31 August 2019. Any prolongation should be notified to the Commission sufficiently in time and approved before the expiry of the authorisation in this decision on 31 August 2019.

2.7. The Budget

(15) The total maximum funding that may be provided by Malta to the MDB on non-commercial terms for the first three years of its operation is around EUR 255 million[4], in the form of capital, guarantees and tax measure as follows:

Share capital

(16) The initial authorised share capital of the MDB will be EUR 200 million. The government may subscribe up to 100% of the authorised and issued capital.

(17) The indicative split between the subscribed and paid-up capital for the first three years of MDB's operation is shown in Table 1.

Table 1: Equity of MDB[5]

Equity (100% Government):	Year 1	Year 2	Year 3
▪ *Authorised*	*200*	*200*	*200*
+ *Subscribed*	*60*	*80*	*100*
+ *Paid Up*	*30*	*40*	*60*

(18) The MDB Act provides the possibility for Malta to contribute up to 30% of the authorised and paid-up capital (i.e. approximately up to EUR 18 million by Year 3) in the form of moveable and/or immoveable property[6]. However, Malta envisages providing the initial capital to MDB in the form of cash only.

(19) The Maltese authorities have committed that any additional capital injection, by the Government or by any other injector, will be subject to prior approval by the Commission[7].

Guarantees for funding purposes

(20) The MDB will also benefit from an unconditional, irrevocable and at first demand government guarantee for funding purposes.

(21) In particular, according to Article 5(1)(a) of the MDB Act, the government guarantee shall cover all obligations of the MDB in respect of:

(i) the aggregate of loans extended to the MDB;

(ii) debt securities issued by the MDB;

(iii) forward transactions or options entered into by the MDB;

4 In the budget of the measures, the aid amount corresponding to the share capital refers to the authorised amount as provided for in Article 10(1) of the MDB Act.

5 NB: The amounts shown in the Table are not cumulative.

6 Article 10(2) of the MDB Act.

7 Article 17(2) of the MDB Act.

(iv) other credits extended to the MDB; and

(v) credits extended by licensed credit and financial institutions or other publicly-owned entities to third parties to the extent that the said transactions, options or credits are expressly guaranteed by the MDB.

(22) It is expected that for the first three years of MDB's operation, the exposure of the government arising from such guarantees will be limited to 20% of the MDB funding obligations during the same period. The maximum amount of government guaranteed exposure during the same period has been estimated to approximately EUR 49 million[8].

Guarantees on assets

(23) Where the MDB intends to operate on aided terms through loans, facilities and guarantees, the government may provide an asset guarantee[9] instead of the capital that would be needed by the MDB to grant those loans, facilities and guarantees. Such an arrangement allows the MDB to avoid any obligation to hold a level of capital equivalent to its exposure pursuant to such loans, facilities and guarantees.

(24) Malta estimated for the first three year period of MDB's operation an amount of approximately EUR 80 million[10] as the maximum exposure for the government arising from those asset guarantees. Malta has calculated in approximation an amount of EUR 5.3 million as the amount of aid arising from those guarantees, equivalent to the amount of capital that the MDB would have to hold to grant the budgeted loans, facilities and guarantees if they were not backed by the government guarantees.[11] The result of this calculation has been taken into account in the overall EUR 255 million budget for the MDB referred to in recital (15). If the government guarantees are triggered the equivalent-capital amount that the MDB should have held to grant those loans, facilities and guarantees has to be counted in the total budget of the MDB.

(25) Malta has committed not to provide asset guarantees for those activities for which the MDB will not operate on aided terms.

Tax measure

(26) The MDB will also benefit from an exemption from tax on its assets, property, income and its operations and transactions. The Maltese authorities expect the

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8 Which is equivalent to 20% of the total projected borrowing of EUR 245 million of the MDB by year 3 of its operation.

9 Which shall be unconditional, irrevocable and at first demand.

10 Approximately 30% of the total financing (EUR) to be provided by the MDB by year 3 of its operation.

11 By way of example, if the MDB has provided a guarantee at a rate of 100% covering a EUR 29.30 million infrastructure loan portfolio, the maximum amount that the MDB may be liable pursuant to this guarantee is EUR 29.30 million (100% *EUR 29.30 million). In order to cover for the EUR 29.30 million, the MDB would (in absence of a State guarantee) have had to hold EUR 2.34 million of capital (EUR 29.30 million * 8% depending on the risk weighting and capital requirements). As it is currently not required to do so, the EUR 2.34 million would be the equivalent aid in form of capital for this loan portfolio.

effect of the aid from this this tax measure to be marginal during the early years of MDB's establishment given the nature and scale of its operations[12].

2.8. The set-up of the MDB, its legal status and purpose

(27) According to Article 4 of the MDB Act, the MDB's corporate purpose is that of supporting entrepreneurship and socio-economic development in Malta by:

(a) providing promotional investment and financing, financial and advisory services; and

(b) Issuing securities or otherwise raising funds or capital in support of those services.

(28) The MDB shall, in general, act as a wholesale intermediary in coordination with and via commercial banks, private investors and other private financial intermediaries. A relatively small fraction[13] of its activities will be performed directly with the final beneficiary, meaning in turn that the MDB will for the overwhelming part of its activities provide financing indirectly to the final beneficiary.

(29) With regard to the financial intermediaries that will be selected to act as MDB's partners, the Maltese authorities have committed that the selection process of those intermediaries will be organised in an open, non-discriminatory and transparent manner.

(30) With regard to the aided activities of the MDB, the Maltese authorities have committed that the financial intermediaries will not benefit themselves from such measures. The full pass through of the advantage by the intermediaries to the final beneficiaries will be incorporated in the contractual arrangements between the MDB and the financial intermediaries and will be duly monitored to ensure compliance.

(31) It is important to outline that even if MDB will intervene at "non-aided terms" those interventions cannot be considered to be "commercial terms", as the MDB will not engage in financing entities or projects which can obtain funds in the normal market. The MDB will not be competing with other banks.

(32) According to the Maltese authorities, the Minister responsible for the Bank will be the Minister responsible for European Affairs and Implementation of the Electoral Manifesto ("the Minister"). The Minister will ensure that the MDB complies with the Laws of Malta, the MDB's bye-laws and other regulations.

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12 The value of the tax measure is not expected to exceed EUR 10 thousand in the first three years of the MDB's operation. That amount has being included in the budget for the MDB referred to in recital (15).

13 Direct financing shall not exceed 25% of the overall lending of the Bank (Article 8(1) of the MDB Act).

(33) From an institutional point of view the MDB will take the form of a body corporate with a distinct legal personality. It will be entirely State-capitalised, State-owned and State-supervised.

(34) The MDB is not permitted to take retail deposits from the public. It is not envisaged that the MDB will be taking any deposits from institutional investors albeit there might be the possibility of some short/medium term borrowing from the interbank market.

(35) The MDB's corporate bodies are comprised of a Board of Directors, a Chairperson and a Chief Executive Officer.

(36) The Minister shall appoint a Supervisory Board to oversee the policy pursued by the management of the Bank, the implementation of this policy and the general affairs of the Bank. The Supervisory Board will consist of six members, one of which will be an officer from the MFSA, one from the Central Bank of Malta, one from the Ministry of Finance, one from the Ministry responsible for the Bank[14] and two independent members with regulatory and/or banking experience. The Supervisory Board shall have no executive powers whatsoever over the Bank, its officers, management and employees.

2.9. Funding and profitability of the MDB

(37) Apart from its initial funding which will be provided by the government in the form of capital, part of the MDB's financial resources will be borrowed from external creditors such as the ERDF and the EIB (with or without the backing of a government guarantee) through the issuance of bonds and bilateral loans and to a much lesser extent, by short term credits. The MDB will also use funds provided through the repayment of loans or guarantees made or returned to the MDB.

(38) Although profitability is only a secondary objective, the MDB is expected to be profitable and financially self-sustainable without having to rely on government subsidies or transfers for the funding of its operations[15].

2.10. Remit, activities and conduct of business

(39) The MDB will intervene through the following instruments: loans, investments and guarantees. The MDB Act[16] also provides the power to the MDB to underwrite or participate in the underwriting of securities issued by companies, or enterprises for purposes strictly within the remit of the Bank.

(40) The present decision does not assess the compatibility of the aid at the level of the final beneficiary. Malta will have to verify that there is a legal basis that would allow the Commission to conclude on the compatibility of that aid and

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[14] That is the Ministry for European Affairs and Implementation of the Electoral Manifesto.

[15] *'A Blueprint for Malta Development Bank'*, p.24 annexed to the Notification.

[16] Article 18 (d) of the MDB Act.

ensure notification of such aid, unless it is exempted from the obligation to notify.

(41) In carrying out its activities, the MDB will give particular consideration to:

(a) the needs of SMEs, through State aid measures that are compatible under the General Block Exemption Regulation (GBER)[17] or through finance measures in line with the *de minimis* Regulation[18]; and

(b) large infrastructure projects.

(42) The Maltese authorities have submitted an estimation of the MDB balance sheet according to which the type of activities under (a) would represent around 75% of the MDB's total activities.

(43) Within that broad remit, the MDB will carry out both aided and non-aided (but not commercial) activities as follows:

(44) First, the MDB will implement State aid measures which were approved by a Commission decision, as well as future measures to be notified and approved by the Commission, in line with applicable State aid rules, with respect to potential aid at the level of the final beneficiary. The market failure for those measures would have already been demonstrated at the time the respective Commission decision was taken or will have to be proven for future measures in the notification.

(45) Second, the MDB will implement State aid measures that are compatible under the GBER. Such measures will comply with all the requirements of the GBER. The market failure for those block-exempted measures is presumed.

(46) Third, the MDB will implement measures in line with the *de minimis* Regulation.

(47) Fourth, the remit of the MDB will also cover specific activities providing financing to SMEs on market economic operator ("MEO") terms. To ensure that the MEO financing addresses SMEs access to finance market failures, the MDB's MEO financing activities will target SMEs eligible under the GBER except the conditions relating to aid intensities or aid amounts. As an example the MDB can provide loans and guarantees on MEO terms to SMEs that fall within any categories defined within the GBER (such as Articles 17 or 23 of the GBER). The total amount of the MDB's MEO financing activities for SMEs will not exceed EUR 90 million during the first three years of MDB's operation.

(48) Fifth, the remit of the MDB will also include financing to infrastructure projects on "MEO" terms. The MDB's MEO financing activities will target infrastructure projects eligible under the GBER except the conditions relating to aid intensities or aid amounts. To ensure that the MEO financing addresses market failures in

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[17] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Article 107 and 108 of the treaty, OJ L 187, 26.06.2014, p. 1-78.

[18] 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.

infrastructure project finance, Malta commits that for each project financed by the MDB on non-aided (MEO)-terms, the participation of private investors would be at least 50% on *pari passu* terms with the MDB. Therefore, the funding provided at MEO terms by the MDB will in principle be additional to significant private funding. The total amount of the MDB's MEO financing activities for infrastructure projects will not exceed EUR 29.3 million during the first three years of the Bank's operation.

(49) The MDB will apply, on all MEO activities, no-crowding-out measures[19] to ensure that only the SMEs and infrastructure projects which can prove they could not obtain sufficient market funding can receive funding from the MDB.

(50) Sixth, the remit of the MDB allows participation in EU Financial Instruments, such as COSME and Horizon 2020 funds. Those EU Financial Instruments are included in the remit as they also target market failures[20] and pursue objectives set by the Commission. In those situations, the MDB will act as a vehicle to channel and manage EU funds, or as a co-investor. The MDB will also be able to act as a co-guarantor using its own resources to cover liabilities.

(51) Seventh, the MDB will provide financial and project advisory services, predominantly to SMEs and start-ups and more rarely to entities undertaking infrastructure projects. In the case of aided activities the MDB will provide such advisory services in accordance with the *de minimis* Regulation. In the case of MEO measures, such services will be provided on market terms. The MDB will provide those services only where the market is unable or unwilling to accommodate them. The Maltese authorities have indicated that those types of activities will represent a marginal proportion of the MDB's total activities.

(52) The MDB will keep the scope of its remit under regular review and in the event that private investment has been sufficiently leveraged in a particular area, so that there is no further need for the MDB to intervene, it will not introduce any further measures in relation to those areas.

(53) The Maltese authorities have committed to notify and obtain prior Commission's approval before they introduce any new activity that falls outside the parameters of the MDB remit and in any case within three years from the present decision to review the entirety of the remit under a new notification.

2.11. Operating principles

(54) According to Article 14 of the MDB Act, the Bank will be guided by sound banking principles in its operation, including paying due regard to prospects for the repayment of the loans and suitable compensation for risk.

(55) The MDB shall approve projects only if they are viable in nature. Moreover, companies in difficulties will not be eligible for support from the MDB.

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[19] See section 2.12 to this decision.

[20] See recital (97).

2.12. MEO activities and no-crowding-out measures

(56) To ensure avoidance of distortion of competition the MDB will intervene on MEO terms only when market funding is not sufficient or not available or only available on substantially unfavourable terms.

(57) In particular, the MDB will apply the following no-crowding-out measures for its MEO activities catered for SMEs:

(a) The MDB will require the MDB investees[21] to demonstrate that they undertook to obtain the required financing from the market but were unable to secure part or whole of the required financing. Such 'investees' must provide the MDB with documentary evidence that at least two market operators did not provide them with the required financing or quoted interest charges and other terms, which were significantly out of line from prevailing market rates for comparable operations.

(b) If market operators were prepared to provide only part of the required funding, the pricing of any supplementary financing by MDB to meet the funding gap must not be more favourable than the pricing of the most onerous market operator that was prepared to provide (insufficient) funding.

(c) In the event that it is not feasible for the MDB to match the interest charges quoted by the most onerous market operator because the latter was significantly out of line with prevailing market rates for comparable operations, the rate applied by the MDB will be equivalent to the weighted average of the rate quoted by other market operators.

(d) If market operators are not willing to provide any financing, the MDB will calculate a hypothetical market rate equivalent to the implied market rate, taking into account the average base rate of the banks plus an adequate risk margin that ensures that its pricing is at MEO terms.

(e) The MDB will ensure market conformity for the various instruments, including by observing the Reference Rate Communication for loans and the Guarantee Notice for guarantees.

(58) With respect to the MDB's intervention in infrastructure projects at MEO terms the MDB's financing policy will rely on the principle of additionality ("top-up" investment approach) by avoiding crowding out and working to 'crowd in'. The MDB will seek to always finance projects alongside private co-investors according to the following principles:

(a) The MDB will intervene either directly or indirectly via financial intermediaries to incentivise private finance providers to provide more financing to infrastructure projects.

(b) The MDB will strictly adhere to its remit and will seek to complement private funding of at least 50% at *pari passu* terms in a given infrastructure project before it intervenes in this project as a lender of last resort. This implies that in order to close a funding gap for infrastructure: i) the MDB

[21] i.e. an SME in case of direct funding by the MDB or a financial intermediary in case of indirect funding.

will require financial intermediaries to demonstrate that they undertook to obtain the required financing from the market but were unable to secure more than 50% of the required total financing. Such financial intermediaries must provide the MDB with documentary evidence that at least two market operators did not provide them with the required remaining 50% of the total financing; (ii) The MDB can only contribute financing at the same terms and conditions as a private participation of at least 50% of the total financing. Alternatively, the MDB can finance infrastructure on aided terms under the GBER or under an approved Commission decision.

(59) In addition, the MDB will set up a monitoring procedure which will serve the purpose of ensuring better oversight of infrastructure projects processed and approved. Through this monitoring procedure, a record will be maintained on the following information for each project financed on market terms: the beneficiaries, the size of the projects, the terms of financing, the private participation ratio, the proof of a funding gap in the private market and the necessity for the MDB's intervention. The demonstration that insufficient finance was available for a fully privately financed operation will include *inter alia* evidence supplied by market participants that are active in financing infrastructure projects (as described in recital (58)), the respective sector and market.

3. POSITION OF THE MALTESE AUTHORITIES

(60) Malta states that the scope of its notification is limited to the capital injection, the provision of the government guarantees and the tax measure together with the remit of activities and therefore the resulting aid to the MDB. It does not encompass potential aid to projects/beneficiaries and/or co-investors that will be subject to an independent notification.

(61) Malta considers that the capital injection into the MDB, the provision of the government guarantees as well as the tax measure constitute State aid to the MDB. However, it submits that the proposed measures are compatible under Article 107(3)(c) TFEU, since they are aimed at a well-defined objective of common interest, they are necessary, appropriate and proportionate and have an incentive effect.

(62) For all the interventions of the MDB in infrastructure projects Malta will submit by the end of the three year period (2016-2019) a monitoring report. In particular, through a monitoring procedure to be set up by the MDB, a record will be maintained on the following information for each project financed on market terms: the beneficiaries, the size of the projects, the terms of financing, the private participation ratio, the proof of a funding gap in the private market and the necessity for the MDB's intervention. This information will be included in the monitoring report. This report will also include an assessment of the affectation on intra-EU trade due to the aid measures. The visibility outside Malta of each infrastructure project financed by the MDB, and thus its potential impact on trade between Member States and locally will also be analysed.

(63) Accordingly, Malta is seeking the Commission’s approval for the aid measures outlined above and for the remit of MDB.

4. ASSESSMENT OF THE PRESENCE OF STATE AID

4.1. Legality

(64) By notifying the proposed measures before implementation, the Maltese authorities have fulfilled their obligation under Article 108(3) TFEU.

4.2. Presence of State aid under Article 107(1) TFEU

(65) By virtue of Article 107(1) TFEU *"any aid granted by a Member State or through 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 internal market."*

(66) The Commission will therefore assess in the following recitals whether the measures fulfil the following criteria laid down in Article 107(1) TFEU, namely whether: (i) the measures are granted by a Member State or through State resources; (ii) the measures confer an advantage to certain undertakings or the production of certain goods; (iii) those measures are selective; and (iv) the measures distort or threaten to distort competition and have the potential to affect trade between Member States.

(67) The present decision assesses only the presence of aid to the MDB itself. Whether the MDB's interventions provide State aid to the final recipients, financial institutions and co-investors is not within the scope of this decision. Such aid will be subject to a separate notification and separate decision(s) of the Commission.

(68) As the funding of approximately EUR 255 million, in the form of capital and guarantees will be provided directly by the Maltese government to the MDB, the Commission concludes that this measure stems from State resources.

(69) As regards the tax measure, the tax revenue foregone by the State also constitutes a loss of State resources. Therefore, the condition of State resources is fulfilled also for that measure.

(70) With respect to EU Financial Instruments, resources coming from the European Union should be considered as State resources if national authorities have discretion for the use of those resources (in particular the selection of beneficiaries)[22]. By contrast, if such resources are awarded directly by the European Union or supranational financial institutions, with no discretion on the part of the national authorities, they do not constitute State resources (e.g. funding awarded in direct management under the Horizon 2020 framework programme or the COSME programme). The EIB Group (EIB and European Investment Fund) may also invest in EU Financial Instruments, depending on the parameters of the respective programme. However, own resources awarded by the EIB Group do not as such constitute State resources.

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[22] See, for instance, concerning structural funds, Commission Decision of 22 November 2006 on State aid N 157/06, United Kingdom South Yorkshire Digital Region Broadband Project, recitals 21 and 29 on a measure partly financed by the European Regional Development Fund (ERDF), OJ C 80, 13.4.2007, p. 2.

(71) To verify whether an undertaking has benefited from an economic advantage, the Commission applies the MEO test. The State's intervention is considered to confer an economic advantage within the meaning of Article 107(1) TFEU if it would not have been provided by a private undertaking under the same market conditions.

(72) As regards the funding provided to the MDB by the Maltese government, the Commission notes this will be done on non-commercial terms, i.e. the MDB is not required to generate market-level returns. Moreover, the guarantees are provided without remuneration (guarantee fee) or if there is one it is below market level. Therefore, a private undertaking would not have invested along those terms. As a result, the Maltese government is not acting as a market economy operator. Therefore, the funding provided to the MDB constitutes an advantage for the MDB.

(73) As regards the tax measure, the Commission cannot exclude that such an arrangement confers an economic advantage to the MDB which will exercise economic activities. Specifically, the measure enables the MDB to potentially enlarge its reserves and to thus reinforce its capital position, whereas other undertakings operating under normal market circumstances would be taxed. Therefore, the tax measure provided to the MDB constitutes an advantage for the MDB.

(74) The Commission notes that both measures are selective in nature as the non-commercial funding and the tax measure are provided only to the MDB and therefore confer an advantage only to the MDB.

(75) The measures must be likely to distort competition and affect trade between Member States. As the MDB will provide financing for SMEs and infrastructure projects it could enter into competition with other financial institutions in the market. Financial services are global markets and by their nature affect trade between Member States. Therefore those conditions are fulfilled.

Conclusion

(76) On that basis, the Commission considers that the measures consisting of an initial funding of up to EUR 255 million to the MDB involve State aid within the meaning of Article 107(1) TFEU to the MDB.

5. ASSESSMENT OF THE COMPATIBILITY OF THE MEASURE

5.1. Scope and legal basis for assessing the compatibility: Assessment under Article 107(3)(c) TFEU

(77) As mentioned in recital (60), the notification relates to the creation of the MDB and its funding in the form of capital and guarantees and the tax measure extended to it, which constitute State aid within the meaning of Article 107(1) TFEU. Therefore, the Commission has assessed the State aid compatibility of those measures only. The existence and compatibility of investments at the level of co-investors and at the level of final beneficiaries are outside the scope of this decision.

(78) Article 107(3)(c) TFEU provides that *"aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not*

adversely affect trading conditions to an extent contrary to the common interest" may be considered compatible with the internal market. The Commission has assessed the measures directly under Article 107(3)(c) TFEU following the common assessment principles and its case practise. In particular, it has analysed whether the measures contribute to a well-defined objective of common interest; are necessary; are appropriate; have an incentive effect; are proportionate; avoid undue negative effects on competition and trade between Member States and are transparent.

5.2. Contribution to a well-defined objective of common interest

(79) The measures must aim at a well-defined objective of common interest.

(80) The Commission must assess whether the creation and funding of the MDB (including the tax measure extended to it) meet a clearly defined objective of common interest, which stands as a pre-condition for compliance with Article 107(3)(c) TFEU. Furthermore, the Commission has to examine whether the notified measures are suitable to attain that objective.

(81) The objective of the measures is twofold: on one hand to facilitate SMEs' access to finance and on the other hand to support the financing of infrastructure projects for the benefit of Malta.

(82) As recognised by the Guidelines on State aid to promote risk finance investments[23], access to finance for SMEs may be an objective of common interest underpinning the Europe 2020 Strategy[24]. Therefore, the general objective of the MDB related to easing SMEs' access to finance fits with that common objective and is therefore considered to pursue the common objective of providing access to finance to SMEs affected by a market failure.

(83) The Commission has also examined the types of financing the MDB will provide, and whether they pursue a well-defined objective of common interest, as set out below.

(84) For the MDB's financing activities at aided terms under the GBER, if all conditions laid down therein are fulfilled, they are presumed to pursue common interest objectives.

(85) For activities falling under the *de minimis* Regulation, by their nature they will be limited in amount. In additon, they will be targeted to the development remit of the MDB.

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[23] Communication from the Commission, Guidelines on State aid to promote risk finance investments, OJ C 19, 22.1.2014, p. 4.

[24] In particular, the Communication from the Commission, Europe 2020, A strategy for smart, sustainable and inclusive growth, (COM(2010) 2020 final, 3.3.2010) sets out a strategy framework for a fresh approach to industrial policy that should put the Union economy on a dynamic growth path strengthening Union competitiveness. It underlines the importance of improving access to finance for businesses, especially for SMEs.

(86) In addition for any aid schemes that are approved by the Commission, and implemented by the MDB, it is ensured that the MDB pursues the common interest objectives.

(87) For MEO activities undertaken by the MDB, they will be constrained within the eligibility criteria and certain other limits of the GBER. On that basis, the Commission considers that those MEO activities also pursue common interest objectives.

(88) With respect to the EU Financial Instruments, according to Article 140(2)(f) of Regulation (EU) No. 966/2012[25] ("the Financial Regulation"), they shall be established on the basis of an *ex ante* evaluation. Specifically with respect to COSME and Horizon 2020, their objectives are to enable access to finance for SMEs and innovative companies respectively, which is in line with the identified common interest.

(89) The Commission notes that the general objective of the MDB related to supporting the financing of infrastructure projects will be implemented by the MDB within the scope of the activities described in recitals (84)-(87). That limitation therefore ensures that the MDB will focus on pursuing the common objective of addressing market failures in the financing of infrastructure projects in Malta.

(90) In light of those elements, and in particular the fact that the MDB will conduct activities that all contribute to a well-defined objective of common interest for Malta, the Commission finds that the measures target a well-defined objective of common interest.

5.3. Necessity

(91) State aid must be targeted to generate a material improvement that the market cannot deliver itself by remedying a market failure.

(92) As described in section 2.10, the remit of the MDB will focus on addressing market failures related to SME access to finance and to infrastructure projects benefitting Malta's economy. The MDB will undertake financing activities in line with the GBER, the *de minimis Regulation*, relevant State aid guidelines and rules, including notification where required. Therefore in line with recent decisional practise[26], the Commission assumes the existence of market failures for such activities.

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[25] Regulation (EU, EURATOM) No 966/2012 on the financial rules applicable to the general budget of the Union, OJ L 298, 26.10.2012, p. 1.

[26] See cases SA. 36061 (2014/N) – United Kingdom –The British Business Bank – OJ C 460, 19.12.2014, p.5, SA. 37824 (2014/N) – Portugal – IFD - Instituição Financeira de Desenvolvimento portuguesa – OJ C 5/3, 9.1.2015, p. 5 and SA. 36904 (2014/N) – Latvia –MLB development segment and creation of the Latvian Single Development Institution – OJ C 25, 22.1.2016, p. 1

(93) First, the MDB may provide financing in compliance with State aid schemes approved by the Commission. When approving individually those schemes, the Commission verifies whether they address the market failures identified in the relevant State aid legal base. Therefore, there is no need to re-notify the remit of the MDB when new aid schemes are added to it, since those schemes will have been approved by the Commission and the relevant market failures will have been established in the related Commission decision. As mentioned above, the Maltese authorities have committed to notify the relevant measures to the Commission, where it is required under State aid law.

(94) Second, the MDB may provide financing on the basis of State aid measures that are compatible under the GBER. Recital 40 of the GBER recognises that *"SMEs play a decisive role in job creation and, more generally, act as a factor of social stability and economic development. However, their development may be hampered by market failures, leading to these SMEs suffering from the following typical handicaps. SMEs often have difficulties in obtaining capital or loans, given the risk-averse nature of certain financial markets and the limited collateral that they may be able to offer. Their limited resources may also restrict their access to information, notably regarding new technology and potential markets. To facilitate the development of the economic activities of SMEs, this Regulation should therefore exempt certain categories of aid when they are granted in favour of SMEs. (...)"* Therefore, the GBER sets the legal presumption that market failures are addressed by providing access to finance measures which are set out in the GBER and which fulfil all its respective conditions, without the need for further market failure evidence in that regard.

(95) The same presumption exists for other areas covered by the GBER (such as broadband infrastructures, culture and heritage conservation, environmental protection, etc.) when the respective GBER conditions are complied with.

(96) Third, the MDB may provide financing under the *de minimis* Regulation. Because of the limited amount received per undertaking and the absence of effects on competition of such interventions, the Commission considers that the activities conducted under the *de minimis* Regulation do not alter its assessment of the necessity of the measure to the MDB.

(97) Fourth, the MDB may provide financing under the EU Financial Instruments, such as COSME and Horizon 2020. According to Article 140(2)(a) of the Financial Regulation, Financial Instruments set up from the EU budget have to comply with the condition of *"addressing market failures or sub-optimal investment situations, which have proven to be financially viable but do not give rise to sufficient funding from market sources"*. Consequently, the EU Financial Instruments are considered to address market failures by their design, irrespective whether they provide investments at commercial or sub-commercial terms.

(98) Fifth, the MDB may provide financing on MEO terms to SMEs and infrastructure projects, on the occasions when the beneficiaries do not receive aid. However, the MDB will limit its MEO financing within the eligibility conditions set by the GBER. Consequently, these MEO activities will target exclusively undertakings and infrastructure projects which are eligible under the respective articles in the GBER to receive aid instruments specific therein. In consequence, the undertakings and projects will be able to receive MEO investments in the instrument form and at conditions specified therein, except for the specific rules

on aid intensities and aid amounts. Such MEO activities will also comply with all the common provisions of the GBER, except for aid intensities and aid amounts. Furthermore, MEO activities will also comply with Article 5 of the GBER on transparency[27]. As mentioned in recital (94), activities in compliance with the GBER are presumed to address market failures. Therefore, the limitation of MEO activities to undertakings and infrastructure projects in principle eligible under the GBER except for the aid amounts aims to ensure that those MEO activities will address market failures in the funding market.

(99) In particular, with respect to MEO access to finance measures, the MDB will not provide financing to all SMEs, but only those ones that do not find alternative source of funding on the market, or not in the amount necessary. Therefore, the objective of the measure is to provide access to finance to more SMEs than absent the intervention of the MDB, since it will not replace any private investment in those SMEs.

(100) Finally, with respect to MEO infrastructure project finance measures, the MDB will invest in projects on a *pari passu* basis to a significant extent with private co-investors, which ensures the crowding-in of private investors and limits any potential distortions of competition. The Commission also notes that according to the analysis provided by the Maltese authorities (see section 2.2) the funding gap in Malta seems to be underpinned by the limited willingness of traditional investors, be they utilities or project lending from banking institutions.

(101) In light of the above, the Commission concludes that the measures are necessary because the MDB as an entity, as well as all its financing activities, aim at addressing market failures in Malta.

5.4. Appropriateness

(102) The State aid measures must be an appropriate policy instrument to address the objective of common interest. In that regard, the Commission has assessed whether the creation of the MDB is an adequate response to addressing market failures in the Maltese economy and in particular in the SME’s and infrastructure project financing market.

(103) First, as mentioned in section 2.1, the Maltese authorities propose to establish the MDB with the explicit purpose to facilitate SME's access to finance and to improve financing of infrastructure projects benefiting Malta.

(104) Second, the Commission considers that the limitation of the MDB's activities to always respecting State aid rules, including notification and suspension obligations, is an appropriate way of ensuring that the MDB is a development institution required to address market failures and therefore limit potential distortions of competition.

[27] By way of example, the MDB will be permitted to provide grants, loans and guarantees (in compliance with the Guarantee Notice) to firms that fall within any category of SMEs within the GBER. However, the MDB will not be permitted to provide equity investments, mezzanine finance loans or subordinated loans to firms, unless such investments meet the requirements of Articles 21 or 22 of the GBER.

(105) Third, with respect to the MEO activities, the Commission notes the commitments provided by Malta to focus the MDB's intervention on closing the funding gap while not crowding out competition.

(106) Therefore, the Commission concludes that the measures are appropriate.

5.5. Incentive effect

(107) A State aid measure must have an incentive effect, i.e. it must change the behaviour of an undertaking in such a way that it engages in additional activity which it would not carry out without the aid or would carry out in a restricted or different manner. In that regard, the Commission has examined whether the creation of the MDB and the financing provided to it provide an incentive effect so as to improve SME's access to finance in Malta and the supply of financing for infrastructure projects benefiting Malta.

(108) With respect to the MDB's financing activities carried out on the basis of the aid schemes approved by the Commission, the Commission considers that they have an incentive effect, since it is one of the mandatory elements of the compatibility assessment. Without an incentive effect, the Commission would not have authorised such aid schemes.

(109) With respect to the MDB's financing activities carried out on the basis of block-exempted activities under the GBER, all conditions laid down therein will have to be fulfilled, including as regards the necessary presence of an incentive effect.

(110) With respect to funding provided below the threshold set under the *de minimis* Regulation, the Commission considers that the limited amount of such funding per undertaking and the absence of effect on competition ensure that the implementation of *de minimis* activities by the MDB does not alter its assessment of the incentive effect of the measure.

(111) With respect to the MDB's financing activities on MEO terms, firstly, the MDB will provide funding in areas where a market failure is presumed to exist. Therefore, the MDB will contribute to close the funding gap that exists in the markets where it will be active. Second, the MDB will apply no-crowding-out measures to ensure that only the entities and projects which can prove they could not obtain sufficient market funding can receive funding from the MDB. Therefore, the funding provided by the MDB will be additional to private finance. Third, the MDB will mostly invest indirectly, via other financial intermediaries, and relies on a principle of additionality ("top up" investment approach) and is thus focused on limited interventions to complement the funding provided by private investors. Therefore, the Commission concludes that the MDB's interventions on MEO terms will increase the funding available to SMEs and infrastructural projects in areas where a market failure exists.

(112) With respect to the MDB's financing activities funded from the EU Financial Instruments (such as ESIF, COSME and Horizon 2020), the Commission finds that there is an incentive effect for the following reasons. First, such instruments also aim to address market failures or suboptimal investment situations. Second, according to Article 140(2)(b), (d) and (e) of the Financial Regulation, the principle of additionality, leverage effect and alignment of interest apply to them. In consequence, those instruments *"shall not be aimed at replacing those of a*

Member State, private funding or another Union intervention", that *"the Union contribution to a financial instrument shall aim at mobilising a global investment exceeding the size of the Union contribution (...)"*, and that *"when implementing financial instruments, the Commission shall ensure that there is a common interest in achieving the policy objectives defined for such an instrument, possibly fostered by provisions such as co-investment, risk-sharing requirements or financial incentives (...)"*. Finally, according to Article 140(2)(c) of the Financial Regulation, *"Financial Instruments shall comply with (...) non-distortion of competition in the internal market and consistency with the State aid principles"*. Therefore, the Commission concludes that the MDB's interventions funded from the EU Financial Instruments will also increase the funding available to SMEs.

(113) In light of these elements, and in particular the fact that all activities conducted by the MDB will constitute activities that have an incentive effect, the Commission concludes that the measures have an incentive effect.

5.6. Proportionality

(114) The State aid measures must be limited to the minimum necessary to induce the additional investments or activity by the undertakings concerned, i.e. whether it would not be possible to reach the same outcome with a lesser amount of aid.

(115) The Commission notes that the funding and the tax measure benefiting the MDB will be passed on to beneficiaries and projects that are affected by market failures in accessing the necessary finance. The geographic scope of the MDB's activities will be restricted to Malta.

(116) With respect to the MDB's financing activities carried out on the basis of the aid schemes approved by the Commission, aid is considered to be proportionate, since proportionality is one of the elements of the compatibility assessment. Without proportionality, the Commission would not have approved such aid schemes.

(117) With respect to the MDB's financing activities carried out on the basis of the GBER, if all conditions laid down therein are fulfilled, aid is presumed to be proportionate.

(118) With respect to funding provided below the threshold set under the *de minimis* Regulation, the Commission considers that the limited amount of such funding per undertaking, and the absence of effect on competition ensure that the implementation of *de minimis* activities by the MDB does not alter its assessment of the proportionality of the measure.

(119) With respect to the MDB's financing activities funded from the EU Financial Instruments (such as ESIF, COSME, Horizon 2020), the Commission notes that the principle of proportionality also applies to them. According to Article 140(1) of the Financial Regulation, "*financial instruments shall be used in accordance with the principles of sound financial management, transparency, proportionality, non-discrimination, equal treatment and subsidiarity* (…). Moreover, the principle of "leverage effect" applies to EU Financial Instruments by virtue of Article 140(2)(d) of the Financial Regulation, which ensures that they also aim to attract co-financing, including from private investors.

(120) With respect to the MDB's financing activities on MEO terms, the Commission notes that there is no legal requirement to demonstrate that market conform interventions are proportionate, which is a requirement specific to aid measures. Nevertheless, the Commission notes that according to the Maltese authorities, such measures will be constrained within the eligibility criteria and certain other limits of the GBER. Moreover, as regards infrastructure projects, the MDB's intervention is governed by an additionality principle ("top up" investment approach). The MDB aims not to be the sole investor in a project but will invest along other, private investors who will have contributed at least 50% of the amount required for the funding of the project.

(121) The MDB will in principle provide financing in an indirect manner, i.e. providing funding to entities via financial intermediaries. The involvement of operators already present on the market ensures that the direct intervention of the MDB is limited.

(122) In light of those elements, and in particular the fact that all activities conducted by the MDB will conduct activities that are proportionate, the Commission concludes that the measures are proportionate.

5.7. Avoidance of undue negative effects

(123) The measures imply no or very limited risk of crowding out for a number of reasons, as set out below.

(124) First, the MDB will conduct its activities in line with State aid rules, which by itself ensures that potential negative effects are limited to the minimum.

(125) Second, a significant share of the MDB's activities will be implemented indirectly, through private commercial banks and other financial intermediaries. As described in recital (29), the Maltese authorities have undertaken to implement the necessary procedures and mechanisms to ensure that private finance providers participating in the selection process will be treated in a non-discriminatory manner. Moreover, that model of intervention encourages crowding-in, rather than crowding out of private finance providers, since private finance providers that otherwise would be reluctant to provide the financing on their own due to perceived risks, will be more likely to co-invest with a public finance provider where the risks are shared between them.

(126) With regard to the MDB's future financing activities on MEO terms addressed to SMEs as described in section 2.12, they will be subjected to no-crowding-out measures, whereby the MDB intervenes only when market funding is not sufficient or not available. This will be ensured by a set of mandatory steps that the MDB will follow before investing in an entity. In detail, those steps are:

(a) First, the investee will have to demonstrate that he tried to obtain the required financing from the market but were unable to secure part or whole of the required financing. Such investee must provide the MDB with documentary evidence that at least two market operators did not provide them with the required financing, or quoted interest charges and other terms which were significantly out of line from prevailing market rates for comparable operations. Therefore, that step ensures that the first solution for the provision of finance is looking for and securing private financing available on the market. Consequently, the MDB will not crowd out private investors already in the market because they always have a priority to invest compared to the MDB. On the contrary, the Commission finds that that mechanism will ensure the "crowding-in" of private investors.

(b) Second, if the investee has obtained some private investments, the MDB will always use no advantage pricing by requiring the MDB to match its pricing to the most onerous comparable commercial investor or if it is not feasible to do so, to take a weighted average of the rate of the other investors. That mechanism effectively ensures that the MDB will always be a price-taker, never setting the price below the available commercial market rates. Consequently, the MDB will not be able to take market share from the private investors in Malta by pricing below the market.

(c) Third, if the investee has not obtained any funding, the MDB will have to calculate the market price for the financing it provides, in order to make sure its pricing is at MEO terms. That mechanism ensures that even in the absence of available private investment, the MDB will price its investments at a hypothetical market price and not below.

(127) Therefore, the Commission finds that the no-crowding-out measures which will apply for all MEO activities of the MDB will ensure that the financing provided will not distort the market.

(128) Moreover, with regard to infrastructure projects financing at MEO terms, as described in Section 2.12, the MDB will be guided (apart from a 'lender of last resort' approach) by the additionality principle and will complement private investments at MEO terms to the extent necessary to make the project happen.

(129) The Commission also welcomes that Malta has undertaken to submit by the end of 2019, for MDB interventions in infrastructure projects, a monitoring report, which will also include an assessment of how the aid measures affect intra-EU trade. The visibility outside Malta of each infrastructure project financed by the MDB, and thus its potential impact on trade between Member States and locally will be analysed in this report.

(130) Malta was not able to identify *ex ante* a list of infrastructure projects for which it has identified a market failure. However, because a regular review (after three years) has been planned and a monitoring mechanism will be put in place by the MDB to verify that for each infrastructure project that MDB finances at MEO terms there is indeed a funding gap in the private market, the Commission considers that there are limited risks of crowding out competition in those particular areas of the MDB's intervention where a market failure currently exists.

(131) In light of those elements, the Commission concludes that the creation of the MDB will not lead to undue distortions of competition.

5.8. Conclusion on compatibility

(132) Having assessed these positive and negative effects of the measure, the Commission considers that the positive effects offset the negative ones of the above mentioned elements.

(133) In conclusion, the Commission considers the measures to the MDB to be compatible with the internal market on the basis of Article 107(3)(c)TFEU for the three year period starting from 1 September 2016 to 31 August 2019. Continuation of the MDB's activity beyond that period requires formal notification and approval by the Commission.

6. CONCLUSION ON THE ASSESSMENT

(134) The Commission concludes that the notified measures constitute State aid within the meaning of Article 107(1) TFEU, the aid benefits the MDB itself, and that the measures fulfil the conditions of Article 107(3)(c) TFEU and are therefore compatible with the internal market.

(135) The compatibility of the aid measures to the MDB by the present decision is limited to the notified amount of up to EUR 255 million of aid. Any amount of aid exceeding that limit requires a formal notification and approval by the Commission.

(136) The activities of the MDB are limited to the remit of well-defined market failures, as outlined in this decision. Any additional activities beyond that remit require formal notification and approval by the Commission.

(137) The Commission reminds the Maltese authorities that the Commission's approval by this decision is granted for the three-year period starting from 1 September 2016 to 31 August 2019. Continuation of the MDB's activity beyond that period requires formal notification and approval by the Commission.

7. DECISION

(138) On the basis of the foregoing assessment, the Commission concludes that the proposed measures providing an initial funding of up to EUR 255 million in the form of capital injection (EUR 200 million), government guarantees and tax measures (up to EUR 55 million for the latter two measures) are compatible with the internal market on the basis of Article 107(3)(c) TFEU.

(139) The Commission reminds the Maltese authorities that all plans to modify the measures, in particular with respect to further funding beyond the one defined in the present decision, the remit and duration of the MDB, must be notified to the Commission.

(140) This approval does not extend to any potential aid to undertakings, financial institutions and/or co-investors resulting from the MDB's financing activities.

(141) In any case, the present approval is granted until 31 August 2019. Any extension of the measures beyond that period requires formal notification and approval from the Commission.

(142) This aid decision is without prejudice to any infringement action related to bank licensing and bank supervision and in particular to Directive 2013/36/EU and Regulation (EU) No 575/2013.

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http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent electronically to the following address:

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Yours faithfully,

For the Commission

Margrethe VESTAGER
Member of the Commission