

European Commission
Directorate General for Competition
State Aid Registry

March 27, 2008

SECOND DRAFT REVISED COMMISSION NOTICE ON THE APPLICATION OF ARTICLES 87 AND 88 OF THE EC TREATY TO STATE AID IN THE FORM OF GUARANTEES (HT.920)

Dear Sir/Madam

The International Capital Market Association (**ICMA**) is pleased to comment on the second draft revised Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (the **Draft Notice**).

ICMA is the self-regulatory organisation and trade association representing constituents and practitioners in the international capital market worldwide. ICMA's members are located in 49 countries across the globe, including all the world's main financial centres, and currently number some 400 firms in total.

Our comments are based on extensive consultations with our member firms and their legal counsel.

We attach our comments as **Annex** to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,



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ANNEX

Background and general comments

We would like to thank the Commission for giving the market participants another opportunity to comment on the Draft Notice.

As in our previous submission¹, we focus on state guarantees which support borrowers` obligations under debt securities ("bonds").

From this perspective, the Draft Notice is a welcome and significant improvement against the June draft due to exclusion of bonds from the "80% rule" and removal of the former paragraph 2.3.2 regarding state aid to lender.

We would like to take this opportunity to make some specific comments on the Draft Notice and to recall certain wider policy implications of the current state guarantee regime.

Specific comments on the Draft Notice

We have the following specific comments on the Draft Notice, listed in order of priority. Most of them are merely requests for clarification. We believe that the legal certainty and increased confidence stemming from such clarifications would be of considerable benefit, especially at this time when confidence (or lack thereof) is a significant issue in the securities markets.

When discussing impact on lenders (2.3.2), the Draft Notice approximates the position of "*financial institutions involved in the issuance of the bonds*" to the position of lenders. This is not entirely correct. As explained in more detail in our previous submission, such institutions usually on-sell the bonds to the ultimate investors on the day the bonds are issued. The investors are the lenders who benefit from the guarantee and who should be referred to in this paragraph. It is not the financial institutions which will be no longer involved in the relationship or exposed to the borrower after the bonds are issued. This is a very important point which should be clarified. On a more technical note, we are concerned that inclusion of this point under the "Aid to the lender" heading is not entirely systematically correct and might lead to improper interpretation.

The Draft Notice retains the "fixed maximum amount requirement" (3.2(b)). As explained in our previous submission, we fully accept the principle but question how strictly it should be interpreted. By way of an example, the guaranteed bonds will often bear floating interest rate which will be adjusted from time to time in line with market conditions. The exposures under hedging arrangements which usually accompany the bonds will also fluctuate as explained in the response by ISDA to the June draft. We believe that as long as the guarantee is linked to a fixed principal amount of the borrowing (and therefore capable of being calculated or estimated), the fact that the interest or other related payments cannot be fixed in advance should not automatically deprive the guarantee of the benefits of paragraph 3.2 of the Draft Notice. It would be very helpful if this could be clarified, if only to avoid unnecessary applications to the Commission.

Sections 3 and 4 of the Draft Notice are said to be designed for "*guarantees linked to a specific financial transaction such as a loan*" (1.3, first para.). We take this to mean that statutory and similar general guarantees are excluded from the scope of the Draft Notice but it would be helpful to clarify this. As we have noted in our previous submission, it is not clear how some of the requirements of the Draft Notice would apply to such guarantees. We accept, however, that the Commission may wish to state its precise policy on statutory and similar guarantees separately.

Member States are invited by the Draft Notice to "*adjust their existing guarantee measures to the stipulations of the [Draft Notice]*" within a certain deadline (7). We take this to mean adjusting

¹ http://www.icmagroup.org/market_practice/Advocacy/other_projects/other_projects_-_related.Par.0021.ParDownLoadFile.tmp/ICMA%20comments%20on%20Commission%20draft%20notice%20re%20state%20guarantees.pdf

existing guarantee schemes for future guarantees to be granted after the deadline, not adjusting the terms of any existing individual (direct or indirect) guarantees which will have been provided on the basis of the current regime. Such a requirement would in our view run contrary to the principles of predictability, legal certainty and unacceptability of retroactive application of legal obligations and would be very difficult to enforce in practice. It would be very helpful to clarify this point.

On a rather technical note, the exemption from the “80% rule” (**3.2.(c)**), refers to “*bonds*” and not to “*bonds and similar instruments*” as the existing Notice 2000/C/71/07 does in paragraph 4.2(c). We believe that this is an unintentional change but are concerned that some market participants might interpret it otherwise. As you will know, a “bond” is not a legal term but a term used in market jargon to describe debt securities (other such terms include, for example, “notes” and various domestic expressions). We believe that any such misunderstandings could be avoided by reverting to “*bonds and similar instruments*” or simply “*debt securities*”, a term used by the various EU securities directives with which market participants will be familiar. In relation to the “80% rule”, we also refer to the response by ISDA to the June draft which rightly noted the anomaly which would arise from applying the “80% rule” to an accompanying hedging arrangement but not to the underlying bond.

Wider implications of the state guarantee regime

In our previous submission, we outlined certain wider policy implications of the current state guarantee regime. These have not been reflected in the Draft Notice. However, we continue to believe that:

- There is a serious misalignment between the risks which private operators are asked to bear and the means available to them to mitigate those risks. This becomes particularly acute where the Member State concerned is not willing to co-operate with the lenders and seek the Commission clearance. In addition to the risks to the lenders, however responsible and diligent, this also creates not insignificant risks from the investor protection and market stability perspectives. At a time when liquidity constraints are seriously affecting the operation of financial markets globally, the elimination so far as possible of legal uncertainties affecting such markets assumes commensurately greater importance.
- This being so, we believe the Commission ought to protect diligent and responsible lenders and transfer the risks of non-compliance with the EC state aid regime to the primary obligors under its rules and the sole formal interlocutors of the Commission in this area, i.e., the Member States. The misallocation would be best rectified if lenders who took (through, in case of bonds, the financial institutions arranging the issue) all reasonable steps to ensure compliance of the transaction with the EC state aid regime were protected (i.e. if the guarantee remained enforceable by the lenders) even if the guarantee was or subsequently became illegal state aid. We have no preference for how precisely such a principle should be formulated.

We would encourage the Commission to continue to consider these implications and the possible ways to address them but accept that they should not necessarily delay finalisation of the Draft Notice. We would be pleased to discuss them in more detail at your convenience.