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In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […]		PUBLIC VERSION This document is made available for information purposes only.

Subject: State Aid SA .57708 (2020/N) – Luxembourg
COVID 19: Reinsurance of short-term credit and surety risks

Excellency,

1. PROCEDURE

(1) On 17 June 2020, the Luxembourgish authorities informed the Commission about the intention of the Luxembourg State to set up a reinsurance programme for short-term credit and surety risks of private insurers established in Luxembourg, provided in return for their commitment to maintain the existing credit limits covered by credit and surety insurance.

(2) By electronic notification of 23 June 2020, Luxembourg notified a measure in the form of a quota-share reinsurance programme for short-term credit and surety risks linked with the COVID-19 outbreak ("the measure") pursuant to Article 108(3) of the Treaty on the Functioning of the European Union[1] ("TFEU").

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

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(3) Luxembourg exceptionally agrees to waive its rights deriving from Article 342 TFEU, in conjunction with Article 3 of Regulation 1/1958[2], and to have this Decision adopted and notified in English.

2. DESCRIPTION OF THE MEASURE

(4) Luxembourg considers that the COVID-19 outbreak significantly affects the real economy. The measure forms part of an overall package of measures and aims to ensure that sufficient liquidity remains available in the market, to counter the damage inflicted upon undertakings impacted by the outbreak and to preserve the continuity of economic activity during and after the outbreak.

(5) According to the Luxembourgish authorities, the impact of the COVID-19 outbreak in Luxembourg is very likely to be unprecedented. As a result of the pandemic, amplified by the recent containment policies, the global and Luxembourgish economy are projected to contract sharply. The extreme contraction in the economic activity and trade due to the COVID-19 outbreak will generate significant liquidity gaps for a large number of non-financial corporations in the coming months. Liquidity being a key risk driver in creditworthiness assessment, the Luxembourgish authorities suspect a possible squeeze in credit limits covered by credit insurance companies, even for borrowers with acceptable solvency.

(6) In that respect, the Luxembourgish authorities wish to introduce a reinsurance programme destined to complement a broader package of measures that aims at avoiding a systemic crisis in the Luxembourgish economy. The programme would ensure that trade credit and surety insurance continues to be available in the Luxembourgish economy within the pre-crisis limits to the largest possible extent. A properly functioning trade credit and surety insurance market has the positive side-benefit to avoid that the company buying from a policyholder of an export credit insurance is asked to pay for deliveries or services in advance (or instantly upon delivery), which would create an additional liquidity need for those companies, already under liquidity stress due to the COVID-19 outbreak.

(7) The measure is based on Article 107(3)(b) TFEU to remedy a serious disturbance in the economy. According to the Luxembourgish authorities, the measure is designed in analogy to the principles set out in the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak ("the Temporary Framework")[3].

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[2] Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.

[3] Communication from the Commission - Temporary framework for State aid measures to support the economy in the current COVID-19 outbreak, OJ C 91I, 20.3.2020, p. 1–9, as amended on 3 April 2020 (OJ C 112I, 4.4.2020, p. 1–9), as amended on 8 May 2020 (OJ C 164, 13.5.2020, p. 3–15) and as amended on 29 June 2020 (not yet published).

2.1. The nature and form of measure

(8) The measure is conceived as a stop loss mechanism in the form of a quota-share reinsurance[4] of short-term credit and surety risks.

2.2. National legal basis

(9) The legal basis for the measure is Article 9(1) point 2 of the Luxembourgish Law of 4 December 2019 governing the Office du Ducroire Luxembourg (hereinafter "ODL") and a reinsurance agreement to be signed between ODL, on behalf and for the account of the State, and the participating private credit insurers.

2.3. Administration of the measure

(10) The Luxembourgish Export Credit Agency ODL will administer the measure on behalf and for the account of the Luxembourgish State.

(11) The measure will be implemented by way of bilateral reinsurance agreements to be signed between ODL, on behalf and for account of the Luxembourgish State, and the participating private trade credit insurers.

2.4. Budget and duration of the measure

(12) The maximum budget for the measure is EUR 145.17 million, representing the maximum loss for the Luxembourgish State under the measure.

(13) Support under the measure may be granted as from the date of the approval of the measure by the Commission until 31 December 2020.

(14) The measure will concern exclusively risks underwritten between 1 January 2020 and 31 December 2020. The measure only covers losses that materialise after 27 March 2020. The losses that occur after 31 December 2020 are covered by the measure if both the reinsurance contract between ODL and the insurer was signed and the underlying trade or transaction and invoicing took place before 31 December 2020 and if the claim is submitted before claims notifications deadline stated in the insurance contract and in any case before 30 March 2025[5].

2.5. Beneficiaries

(15) The final beneficiaries of the measure are private trade credit insurers active in Luxembourg.

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4 Quota-share reinsurance is a pro-rata reinsurance contract in which the insurer and reinsurer share premiums and losses according to a pre-agreed percentage up to a predetermined maximum coverage.

5 By 31 March 2025 all accounts are to be settled under the bilateral reinsurance agreements between ODL, on behalf and for account of the Luxembourgish State, and the participating private trade credit insurers.

2.6. Relevant context for the measure

(16) Trade credit and surety insurance are risk management products offered to all types of companies wishing to protect their accounts receivable from losses due to credit risks. In the absence of such products, sellers of goods or services may ask buyers for advance payments. It would also have an indirect impact on the liquidity requirements of buyers up to a point where business activities may cease if liquidity were to be unavailable or too costly. This again would hurt suppliers. Hence, any reductions in credit or surety limits of insurance coverage or sudden withdrawal of such coverage, would further weaken the resilience of the economy in the face of the COVID-19 pandemic.

(17) An important function of the trade credit and surety products that insurers offer to the policy holders (the sellers of goods or providers of services) lies in the capacity of the insurers to constantly monitor the creditworthiness of buyers and immediately alert the policyholder of a deterioration of this creditworthiness. In the event of a creditworthiness downgrade of a buyer, the credit and surety insurer can thus immediately reduce the limit assigned to that buyer, up to the point that the buyer could be asked for advance payment. Trade credit and surety insurance contracts typically require policyholders to retain a minimum share of the amount of receivables on their own risk, providing them thereby incentives to screen the riskiness of the buyers. In Luxembourg, this minimum share is between 5%-15%.

(18) At the end of 2019, the total amount of outstanding credit limits of the main private trade credit insurers serving the Luxembourgish market was EUR 25 billion for policyholders domiciled in Luxembourg[6]. This amount represents the maximum amount of limits possible within the contracts between the main private trade credit insurers and the policyholders currently in place. The Luxembourgish authorities do not possess figures on the amount of utilised credit limits but estimate that it was between 10% and 60% of the actual credit limits at the end of 2019. However, the actual use of those limits as estimated at the end of 2019 may vary considerably (i.e. between 0% and 100%) by debtor.

(19) Under the present circumstances, given the abrupt deterioration of economic activity and the fear of an overall deterioration of credit worthiness, trade credit insurers may immediately reduce credit limits by resorting to mass actions (automated reductions of credit limits without regard to individual debtors' risks) or linear measures at portfolio level or at sector level. This would further reduce economic activity by aggravating the liquidity position of companies.

[6] The main private trade credit insurers active in Luxembourg are operating out of Belgium and serve both the Belgian and Luxembourgish market.

2.7. Sectoral and regional scope of the measure

(20) The measure is open to all private credit insurers legally authorised to operate in Luxembourg[7], with no restrictions on sectors or size.

(21) The measure relates to trade credit and surety risk insurance held by policyholders[8] domiciled in Luxembourg i.e. both companies incorporated in Luxembourg and those incorporated outside Luxembourg but acting through a Luxembourgish subsidiary or branch, which are insured with a credit insurer with an active presence in Luxembourg (either as an insurance company or through a subsidiary or a branch established in Luxembourg). Companies established abroad that are co-insured companies under the policies are however excluded.

(22) The measure will apply to risks located in Luxembourg (domestic risks) and worldwide (export risks), with the exception of countries under sanctions.

[7] Insurers that would qualify as undertakings in difficulty on 31 December 2019 as defined by Article 2(18) of the General Block Exemption Regulation.

[8] Debtors that would qualify as undertakings in difficulty on 31 December 2019 as defined by Article 2(18) of the General Block Exemption Regulation, Article 2(14) of the Agricultural Block Exemption Regulation and Article 3(5) of the Fishery Block Exemption Regulation are excluded from the measure. In addition, a debtor for which the credit limit had been withdrawn on 01 January 2020 is considered a debtor in difficulty and therefore is excluded from the measure.

2.8. Basic elements of the measure

Underlying instruments

(23) The measure covers insurance of domestic and export trade portfolios of credits and sureties between companies (B2B)[9] with a credit period of less than two years and, for the most part, with a risk period of less than two years. The maximum percentage of insurance cover is 95% and the minimum claims waiting period is 90 days in most cases and in any case not less than 60 days. Insurance is offered only for political and commercial risks[10] that are acceptable and justified in the light of the underlying sound economic risks assessment. If a business relationship already exists, there must be a positive trading/payment experience for the policyholders and the buyers. The participating insurers are charging market premiums for the insurance of the underlying trade credits and sureties.

Reinsurance programme

(24) The objective of the measure is to maintain credit limits by short-term credit and surety insurers in the Luxembourgish economy to the fullest possible extent, and indirectly to avoid liquidity crunch and to counter the effects of the serious disturbance caused by the COVID-19 pandemic.

(25) In order to achieve that objective, the measure foresees Luxembourg receiving a commitment from the private credit insurers participating in the measure to refrain until 31 December 2020 from any mass actions or linear measures (at portfolio or sector level) that would drastically reduce the credit limits there were used in the 12 months prior to 1 March 2020.

(26) In the global financial crisis, credit insurers reduced the credit limits on average by 25%. Luxembourgish authorities expect that the COVID-19 outbreak could trigger further limit reductions and that, in the absence of the measure, those limits could be reduced by even more than 25%. By setting up the measure, Luxembourg intends to minimise this effect and estimates the insurers not to reduce the credit limits by more than 15%.

(27) In order to minimise the reduction of existing credit limits, the Luxembourgish authorities implement the following principles that participating private insurers must follow in the setting of credit limits:

(a) The participating credit insurers will not carry out any mass actions or linear measures at portfolio level or at sector level. The risks in relation to all debtors (buyers) will be assessed on a case-by-case basis;

9 To the extent that the underlying short-term export-credits and sureties concern agricultural products within the meaning of Annex 1 to the WTO Agreement on Agriculture, then as regards such products, the measure must comply with any relevant requirements of paragraph 15 of the WTO Ministerial Decision on Export Competition of 19 December 2015 (WT/MIN(15)/45 — WT/L/980) on maximum repayment term and self-financing.

10 See point 9 of the Short-term export-credit Communication for the definition of commercial and political risks.

(b) For the case-by-case assessment, the participating credit insurers will make every effort to determine the credit limits on the basis of the most recent relevant information regarding the financial situation of the buyer and the country in which the buyer operates, of the information reports, the external ratings, the payment experience with the buyer and the prospects of the buyer. In doing so, the participating credit insurers undertake to reduce or withdraw their credit limits only if:

i) the buyer's solvency deteriorates and no government support is foreseeable, leading to a high risk of non-payment;

ii) the insurers receive notifications of non-payments, where a non-payment is defined as failure to meet the due payment date within 30 days;

iii) the policyholder has not, or has only partially, used the credit limit over the previous 12 months and the credit limit is limited to the portion used; and

iv) the political risk associated with the country in which the buyer is established is assessed as being so high that it may lead to non-payments; political risk in this respect includes, among other things, wars, foreign exchange scarcity, a government-imposed debt moratorium, etc.

(28) The Luxembourgish authorities set up a reporting mechanism to monitor the compliance of the participating credit insurers with the principles laid out in recitals (25) and (27). The reporting mechanism is identical to the one under the Belgian re-insurance scheme (SA.57188). The Luxembourgish authorities may consult and exchange with the Belgian authorities. The reporting mechanism concerns, among other things:

(a) Monthly reporting on the evolution of the existing credit limits, at an appropriate aggregation level;

(b) If requested by the ODL, the participating credit insurer must briefly explain the basis on which it has taken the decision to reduce or withdraw their credit limits, so as to demonstrate that it is not an arbitrary decision. However, the participating credit insurer remains fully autonomous in its decision.

(29) Under the measure, ODL provides a quota-share reinsurance of the portfolio of insurance claim exposures of those private trade credit insurers that have signed the reinsurance agreement with ODL as described in recital (11). The measure therefore does not cover particularly risky transactions but rather mirrors the full range of exposures of the industry.

(30) The reinsurance mechanism is defined in relation to gross losses expressed as percentage of the annual gross premium volume ("the loss ratio"). It is drawn up around an estimated loss ratio of 0% to 1000% and works in three stages:[11]

(a) In the first stage of the loss ratio from 0 to 100%, there is an equal distribution of losses between the participating insurers and ODL: each participates in the losses with 50%.

(b) In the second stage of the loss ratio of 100 to 300%, the participating insurers participate with 20% and ODL with 80% in the losses for the tranche above 100%.

(c) In the third stage of the loss ratio of 300 to 1000%, the participating insurers participate with 10% and ODL with 90% in the losses for the tranche above 300%.

(d) The percentage of premium that the participating insurers cede to ODL is equal to the percentage of total losses ceded according to the three stages under (a) to (c) divided by the total losses. For example, at a loss ratio of 400%, the participating insurers cede 75% of the total losses according to the three stages under (a) to (c) and, thus, they cede 75% of the premium.

(e) If the loss ratio is higher than 1000%, ODL does not cover any losses for the tranche above 1000%. All losses above a 1000% loss ratio remain fully with the participating insurers. At this stage the participating insurers cede 84% of the total premium to ODL. The participating insurers do not cede any premiums beyond this point to ODL.

(31) The measure also provides for a mechanism by which the participating insurers can cover their operating costs. The private credit insurers cover their operating costs by retaining 35% of the premium amount ceded to ODL and out of the premiums allocated to themselves.

(32) Any recoveries will be allocated according to the effective exposure ratio of the participating credit insurers on one side and ODL on the other side.

(33) The annual gross premium volume denotes the total premium volume collected by the Luxembourgish private trade credit insurers in a given year. The annual gross premium volume for 2019 has been estimated by the Luxembourgish authorities at EUR […]. This amount is used as basis for the calculation of the loss ratio and as basis for the sharing of premiums. To give an illustrative example of the functioning of the reinsurance programme, in the worst case scenario at the maximum loss rate of 1000% (annual gross premium volume x 10: equivalent to EUR […] losses), the share of insurance premiums, losses and costs between ODL and the participating trade credit insurers are thus as follows:

[11] The participating insurers already have reinsurance contracts concluded with other private reinsurers with respect to same trade credit and surety limits covered under this measure. The reinsurance programme with ODL will replace any other existing reinsurance programme and will be applied before any other existing reinsurance programme, up to the limits described under the measure. Any private reinsurance would only cover the risks not covered under the measure and not retained by the policyholder.

(a) ODL will receive EUR […] in premiums, cover losses of EUR […] and compensate the participating trade credit insurers for operating costs of EUR […]. This represents net costs of EUR 145.17 million to the Luxembourgish State.

(b) The insurers will have retained EUR […] in premiums, cover losses of EUR […] and incurred net operating costs of EUR […]. This represents net costs of EUR […] to the credit insurers.

(34) The maximum loss coverage of the State of EUR 145.17 million EUR represents 0.58% of the total outstanding credit limits of EUR 25 billion. The losses at the level of the maximum loss coverage imply an increase in losses by over […] times more compared to the historical average as described in recital (43).

(35) The reinsurance mechanism implies that ODL and the participating trade credit insurers face the same loss ratio on their respective share of losses and premiums as the overall sector loss ratio.

(36) The maximum risk per debtor (buyer) for an insurer is EUR 50 million. This amount can be exceeded by means of a special acceptance by the Luxembourg State.

(37) The premiums and losses will be transferred by the participating credit insurers to ODL each month on a provisional basis at an assignment rate of 50%. The first settlement with an estimation of the actual loss ratio, which allows the determination of a more precise assignment percentage in line with the distribution of losses and premiums as described in recital (30), will take place in the first quarter of 2021. The insurer will have the possibility of a "cash call" for losses on a single debtor as from EUR 10 million (at 100%), i.e. the insurer may in such a case request a payment from ODL before paying the indemnification to the policyholder.

2.9. Monitoring and reporting

(38) Luxembourg will publish information on the reinsurance programme, specifying all applicable conditions, on the official website of ODL. At the latest on 31 July 2021, it will provide an annual report to the Commission on the use of the programme outlining how the measure was implemented and in particular provide figures on the actual payments and usage of the reinsurance mechanism for reasons of transparency.

3. POSITION OF THE MEMBER STATE

(39) Luxembourg considers that the proposed measure should be deemed compatible aid within the meaning of Article 107(3)(b) TFEU, which states that aid may be deemed compatible with the internal market if its objective is "*to remedy a serious disturbance in the economy of a Member State*".

(40) The importance of trade is crucial to the Luxembourgish economy and it is therefore essential that the necessary measures be taken to help Luxembourgish companies overcome the serious consequences of the COVID-19 crisis.

(41) Short-term credit and surety insurers are an essential link in providing working capital to companies, and banks often require for their lending that the trade receivables on the assets side of the balance sheet of the borrower are covered by a credit insurer. Together, these insurers notably provide EUR 25 billion of credit limits to policyholders domiciled in Luxembourg. Credit and surety insurance plays accordingly a key role in the economic development and in the business life in Luxembourg.

(42) Due to the economic disruption caused by the COVID-19 crisis, a lot of payment difficulties are expected, for which the insurers will have to pay compensations. Insurers would normally have to drastically reduce outstanding credit limits to comply with the Solvency II[12] rules applicable to the insurance sector, which would have a huge negative impact on trade flows. In order to avoid such drastic credit limit reduction by credit and surety insurers and to support the Luxembourgish economy, Luxembourg decided to set up the reinsurance programme during the COVID-19 crisis.

(43) The crucial parameter in the reinsurance programme is the loss ratio, i.e. the gross loss divided by the gross premiums earned. Under normal circumstances, credit insurers aim for a loss ratio of 45 to 55%. The historical average over the past 10 years in the Belgian and Luxembourgish market is around the […] loss ratio. These loss ratios do show some volatility depending on the economic cycle, the size of the insurer and the nature of the risks (e.g. domestic credit insurance or distant export). The financial crisis of 2008-2009 resulted in the highest loss ratios in the last 20 years. In 2008, the market's loss ratio (based on year of risk underwriting) was around 100%. For the three main Luxembourgish private insurers, the loss ratios in that year ranged from 37% to 100%. At time, the credit insurers made significant reductions on the credit limits they still wanted to insure, often even on a linear or portfolio basis without taking much account of the creditworthiness of each individual buyer. Luxembourg now seeks to avoid that scenario.

(44) Luxembourg considers it difficult to estimate the exact effect of the COVID-19 crisis, but expects it to be unprecedented. It is expected that many invoices will not be paid in the coming months due to the liquidity problems of many companies and a scenario of 200% to 300% loss ratio is quite realistic. It could also be much higher if a few very large companies decide to cease paying. With a maximum limit of EUR 50 million per debtor per insurer, the loss ratio could escalate quickly if one takes into account the fact that the premium volume of credit insurers for Luxembourgish policyholders is estimated at EUR […] in 2019. In light of the above, the Luxembourgish authorities have drawn up the reinsurance programme around a loss ratio of 0% to 1000%.

[12] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)(OJ L 335, 17.12.2009, p. 1).

(45) According to the Luxembourgish authorities, the part of the reinsurance programme which concerns short-term export-credit risks falls under the scope of the Short-term export-credit Communication[13]. On 28 March 2020, in accordance with point 18(a) of the Short-term export-credit Communication, the Commission decided to consider all commercial and political risks associated with exports to the countries listed in the annex to the Short-term export-credit Communication as temporarily non-marketable until 31 December 2020. This was made in line with the Temporary Framework, as the Commission considered that the rapid contraction of private credit insurance capacity for exports in general meant that an insufficient availability of private insurance for those countries was to be expected in a very short term. Member States should therefore be allowed to intervene to cover all economically justifiable risks regarding exports to all countries in the world until 31 December 2020. In that regard, this part of the reinsurance programme would in principle not need to be notified to the Commission. Nevertheless, Luxembourg has decided to notify this part of the reinsurance programme for reasons of legal certainty.

(46) To the extent that it concerns reinsurance of temporarily not marketable short-term export-credit risks in the sense of the Short-term export-credit Communication, the Luxembourgish authorities consider the measure to be compliant with the conditions for providing cover for temporarily non-marketable risks of Section 4.3. of that Communication. The quality of cover will remain consistent with market standards and sound underwriting principles will be applied in the assessment of risks. The maximum coverage for commercial and political risks will always be 95% and the minimum waiting period will generally be 90 days. The quota share pricing as described under the measure will adequately minimise the crowding out of private credit reinsurers and enable the phasing out of State intervention. The Luxembourgish authorities commit to comply with the required principles of transparency and reporting on the measure. In the alternative, should the Commission find that the measure does not fulfil all conditions of Section 4.3. of the Short-term export-credit Communication, Luxembourg invokes point 31 of that Communication and argues that the measure in any case achieves the objectives of the Section 4.3., in particular considering the exceptional circumstances of the current COVID-19 outbreak.

(47) Luxembourg argues that the measure is appropriate, necessary and proportionate and may be declared compatible with the internal market pursuant to Article 107(3)(b) TFEU

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[13] Communication from the Commission to the Member States on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to short-term export-credit insurance (OJ C 392, 19.12.2012, p. 1) as amended (OJ C 101 I, 28.3.2020, p. 1).

4. ASSESSMENT

4.1. Lawfulness of the measure

(48) By notifying the measure before putting it into effect, the Luxembourgish authorities have respected their obligations under Article 108(3) TFEU.

4.2. Existence of State aid

(49) For a measure to be categorised as aid within the meaning of Article 107(1) TFEU, all the conditions set out in that provision must be fulfilled. First, the measure must be imputable to the State and financed through State resources. Second, it must confer an advantage on its recipients. Third, that advantage must be selective in nature. Fourth, the measure must distort or threaten to distort competition and affect trade between Member States.

(50) The measure is imputable to the State, since it is granted by the Luxembourgish Export Credit Agency ODL on the basis of the legislative act mentioned in recital (9). ODL acts on behalf of the Luxembourg State in application of its missions under the Luxembourgish Law of 4 December 2019 governing the Office du Ducroire Luxembourg. It is financed through State resources, as ODL acts for the account of the State and is financed by public funds. As stipulated by the Law of 2019, for the purpose of promoting trade or investments, ODL acts on behalf of the Luxembourg State implementing measures and mission entrusted to it by the State. Premiums and compensations for activities carried out on behalf of the State are being paid to ODL, the account of which is consolidated with the budget of the State.

(51) The measure confers an advantage on the participating trade credit and surety insurers as direct beneficiaries but entails design features to ensure that the advantage is as much as possible passed on to the wider economy. The measure removes risks from the portfolios of the participating insurers, in exchange of their commitment not to reduce the existing credit limits subject to limited exceptions as described in recitals (25) to (27).

(52) The measure also confers an indirect economic benefit for the policyholders and their debtors (buyers). Trading sellers will be able to continue using trade credit and surety insurance without a reduction of the credit limits commensurate with the macroeconomic effects of the COVID-19 outbreak. This in turn will avoid that buyers are faced with a demand for advanced payment adding to their existing liquidity crunch. In that way the measure also provides positive secondary effects to the wider economy.

(53) The advantage granted by the measure is selective, since it is awarded only to certain undertakings, in particular participating trade credit and surety insurers.

(54) The measure is liable to distort competition, since it strengthens the competitive position of the participating trade credit and surety insurers. It also affects trade between Member States, since those beneficiaries are active in sectors in which intra-Union trade exists.

(55) In view of the above, the Commission concludes that the measure constitutes aid within the meaning of Article 107(1) TFEU. The Luxembourgish authorities do not contest that conclusion.

(56) As regards the part of the measure which concerns short-term export-credit risks, the Commission currently considers all countries listed in the Annex to the Short-term export-credit Communication to be temporarily non-marketable risk countries until 31 December 2020. Consequently, there is no obligation for Member States to notify reinsurance of short-term export-credit risks until the end of this year. The Luxembourgish authorities nonetheless decided to notify the measure pursuant to point 31 of the Short-term export credit Communication.

4.3. Compatibility

(57) Since the measure involves aid within the meaning of Article 107(1) TFEU, it is necessary to consider whether that measure can be declared compatible with the internal market.

(58) Pursuant to Article 107(3)(b) TFEU the Commission may declare compatible with the internal market aid "to remedy a serious disturbance in the economy of a Member State".

(59) By adopting the Temporary Framework, the Commission acknowledged that "the COVID-19 outbreak affects all Member States and that the containment measures taken by Member States impact undertakings". The Commission concluded that "State aid is justified and can be declared compatible with the internal market on the basis of Article 107(3)(b) TFEU, for a limited period, to remedy the liquidity shortage faced by undertakings and ensure that the disruptions caused by the COVID-19 outbreak do not undermine their viability, especially of SMEs".

(60) The measure aims at facilitating trade between companies at a time when the normal functioning of markets, including the trade credit and surety insurance market, is severely disturbed by the COVID-19 outbreak, and that outbreak is affecting the wider economy.

(61) While the Commission has provided guidance in the Temporary Framework as to when aid under Article 107(3)(b) TFEU can be declared compatible with the internal market in light of the current shock to the economy, the Temporary Framework is not directly applicable to the measure proposed by Luxembourg, as it does not cover reinsurance of trade credit and surety insurances.

(62) Therefore, the measure proposed by Luxembourg has to be assessed based on general criteria for compatibility under Article 107(3)(b) TFEU. However, the Temporary Framework can provide general guidance and its principles can be applied in analogy as far as appropriate.

(63) The measure applies to overall portfolios of both domestic and export-related transactions within the same reinsurance mechanism. The Commission therefore has to assess the overall measure under Article 107(3)(b) TFEU.

(64) As far as short-term export-credit risks are concerned, the measure also has to be assessed in light of principles for reinsurance of temporarily non-marketable risks of the Short-term export-credit insurance Communication. As it is reflected in the Temporary Framework, in the current context of the COVID-19 outbreak, the Commission considers that all commercial and political risks associated with exports to the countries listed in the Annex to the Short-term export-credit Communication are temporarily non-marketable until 31 December 2020.

(65) As for any derogation from the prohibition on State aid enshrined in Article 107(1) TFEU, the compatibility exception pursuant to Article 107(3)(b) TFEU provision must be interpreted and applied restrictively. Such a strict application requires taking into account, in particular, the nature and the objective seriousness of the disturbance of the economy of the Member State concerned, on the one hand, and the appropriateness, necessity and proportionality of the aid to address it, on the other. It also requires taking into account the possibly systemic importance and position of the beneficiaries and the sector concerned and any safeguards proposed to avoid undue negative effects on competition and trade between Member States.

(66) For the avoidance of doubt, the Commission notes that the Banking Communication of 2013 (the "Banking Communication")[14] is not applicable to the measure, as the beneficiaries of the proposed measure are not credit institutions. The Commission considers further that it is also not appropriate to apply the principles of the Banking Communication by analogy to the current situation[15], because the measure is not intended to address concerns related to financial stability or existing liquidity or solvency needs of the trade credit insurers. This is because the insurers could simply avoid assuming any further risks that may over-burden their capital position by withdrawing existing limits going forward. By incentivising participating trade credit and surety insurers to uphold limits also in the future, the measure addresses the direct consequences of the COVID-19 outbreak in the real economy. As a result, applying the Banking Communication to the measure would not be appropriate.

4.3.1. Appropriateness

(67) In order to be appropriate, the aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the Luxembourgish economy. This would not be the case if the disturbance disappeared in the absence of the measure or if the measure is not appropriate to remedy the disturbance.

(68) The measure aims at maintaining credit limits by short-term credit and surety insurers and indirectly preventing liquidity shortages to companies at a time when the normal functioning of credit markets is severely disturbed by the COVID-19 outbreak. The ensuing economic shock is unprecedented and affects demand and supply at the same time. The Commission recognises that this outbreak is

[14] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (OJ, C 216 of 30 July 2013, p. 1).

[15] See point (26) of the Banking Communication.

affecting the wider economy and leading to severe disturbances of the real economy of Member States. The measure is one of a series of measures conceived at national level by the Luxembourgish authorities to remedy this serious disturbance in their economy. The importance of the measure to maintain credit limits during the COVID-19 outbreak is widely accepted by economic commentators and the measure is of a scale, which can be reasonably anticipated to produce effects across the entire Luxembourgish economy.

(69) In addition, the measure is also unique as regards the direct beneficiaries and the specificities of the trade credit sector. Trade credit and surety insurers can usually manage their risk effectively by adjusting insurance limits for a given purchaser for future trades as an immediate reaction to sudden credit risk changes as well as to their own capacity to bear risk going forward. Any measure that should have the intended effect needs to take this peculiarity into account, namely that the beneficiaries would not require support, unless they should be convinced to refrain from using their normal risk adjustment techniques for the sake of a wider policy consideration. Avoiding the drastic reduction of credit limits is specifically the wider policy consideration in question here.

(70) The measure will be effective for the Luxembourg economy, as it will be applied by the largest three trade credit and surety insurers active in Luxembourg, which account for a combined market share of approximately 90%. In addition, the measure is open to any other insurer authorised to operate in Luxembourg, which may be offering trade credit and surety insurance, even if not as its core business.

(71) The Commission considers that the measure will thus allow the policyholders (suppliers) to be able to continue relying on the credit limits as insurance coverage. This will in turn prevent suddenly increasing liquidity needs for the buyer that would have likely occurred in the absence of the reinsurance programme, as suppliers would have been forced to demand advance payments.

(72) Furthermore, the Commission accepts that the serious disturbance in the Luxembourgish economy due to the effects of the COVID-19 outbreak could multiply, if existing trade credit insurance limits were to adapt to the risk, which emerged due to the COVID-19 outbreak. The impact on liquidity needs for purchasers that would be required to provide advance payments as well as the potential losses spreading on to suppliers would be significant, sudden and widespread across the whole economy.

(73) The Commission notes that in order to benefit from the proposed measure, trade credit insurers have committed themselves to maintain current limits, subject to certain exceptions (see recitals (25) to (27)) and to monitoring by the Luxembourgish State (see recital (28)). The Commission therefore considers that the measure has the intended effect to avoid large-scale reductions of the current trade credit limits, avoiding thereby the negative effects described in recital (44), which would lead to a significant deterioration of the economic situation in Luxembourg.

(74) In light of the above, the Commission considers that the measure proposed by Luxembourg is appropriate, because it addresses the current malfunctioning of the credit and surety insurance markets with its associated imminent and serious risks of a significant further damage to the real economy of Luxembourg.

4.3.2. *Necessity*

(75) In order to meet the compatibility criterion of necessity, the aid measure must in its amount and form be necessary to achieve its objective. That implies that it must be of the minimum amount necessary to reach this objective.

(76) First, it is important to note the extreme and fully unexpected situation of the private credit and surety insurers. It is true that the prediction of creditworthiness of purchasers is the core competency of the insurance providers and is conducted based on complex models, involving numerous parameters. However, the current and unprecedented situation with the sudden widespread economic shock that affects demand and supply at the same time, the sudden increase in the demand for liquidity in the real economy and associated concerns on future creditworthiness of companies, was not predictable only a few months ago.

(77) Second, it should be considered that the normal risk remediation technique the trade credit and surety insurers would take in absence of the measure - namely the significant de-risking going forward via reducing limits - is what the measure intends to avoid by implementing guidelines as described in recital (27) to which the participating trade credit and surety insurers must adhere when considering limit reductions. The Commission understands that this measure was conditional to obtaining the acceptance of the guidelines by the insurers.

(78) Third, insurers in difficulty on 31 December 2019 are excluded from participating in the measure and risks related to debtors for which the credit limit had been withdrawn on 1 January 2020 are also excluded. The Commission therefore considers that the measure is limited to the minimum necessary in that it only addresses companies affected by the COVID-19 outbreak.

(79) Fourth, the measure is limited in time and applies only to risks underwritten between 1 January 2020 and 31 December 2020, as in the trade credit insurance business the credit limits are typically being determined for one year period. As it excludes losses occurred before 27 March 2020, it is limited to events that occurred after the COVID-19 outbreak.

(80) Finally, the estimated maximum budget of the measure of EUR 145.17 million represents 0.58% of the total outstanding credit limits of EUR 25 billion and 1% of the estimated upper limit of utilised credit limits of EUR 15 billion (60% of total outstanding credit limits, see recital (18). As described in recitals (34) and (43), the estimated maximum budget of the measure represents the estimated maximum losses under the measure and implies an increase of losses by over […] times more than the historic average. In light of the current uncertainties, it cannot be excluded that such a significant increase of losses may be expected in light of the unprecedented economic impact of the COVID-19 outbreak. Therefore, the Commission considers a threshold of this magnitude as justified.

(81) It should also be taken into account that the measure is in any case contingent upon actual losses in the real economy and will only be utilised in an exceptional situation. In the current unprecedented situation, any estimates of future economic activity are fraught with a high degree of uncertainty beyond the limits of traditional financial modelling. At this stage of the COVID-19 crisis, robust data that would allow for a precise quantification of default probabilities in the real economy does not exist. With this in mind, the Commission considers that the

maximum amount of losses estimated to be covered by ODL of EUR 145.17 million is calibrated to address the factual and unprecedented uncertainties in which insurers are operating which requires a coverage also of less likely scenarios. The amount therefore appears justified to reach the intended result, namely to stabilise the trade credit insurance activity and to avoid negative effects leading to widespread reduction or cancellation of trade credit and surety insurance limits of the real economy.

(82) Based on the above, it can be concluded that the measure is limited to the minimum amount and form necessary to achieve the objective pursued. No less distortive instrument is available that would be as effective.

4.3.3. Proportionality

(83) The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives.

(84) First, the measure is designed in a way to keep market forces working under the safety net provided. By sharing losses and premia, it is excluded that the participating private trade credit and surety insurers conduct an adverse selection and transfer only bad risks to the reinsurer.

(85) This model of sharing risks and return also ensures that the vital function of credit risk assessment provided by the industry is upheld. By retaining a significant amount of risk, the insurers still have an incentive to provide an individualised credit risk assessment of purchasers – a function that is also vital for policyholders who also participate in potential losses. It therefore appears that the chosen model is well justified as a methodology that effectively limits State intervention while still providing the envisaged result that would not be achievable as an outcome of pure market forces alone.

(86) As already considered in recital (61) above, the Temporary Framework – although not directly applicable – serves as a reference point to identify relevant principles to assess the proportionality of the measure.

(87) In particular, the measure provides that insurers will surrender from 50% to 84% of the premiums to the reinsurer depending on the effective loss ratio and participate with the same ratio in bearing of losses as described in recital (30). The maximum loss coverage is thus below the 90% threshold provided for in point 25(f)(i) of the Temporary Framework. The transfer of up to 84% of the premiums to the reinsurer also allows to exclude any overcompensation of the insurers.

(88) In terms of premiums paid to the reinsurer, in the worst case scenario of a loss ratio of 1000%, the total net remuneration is expected to amount to approximately EUR […] (reinsurance premium of EUR […] ceded to the reinsurer less operating cost of insurers of EUR […]), as explained in the recital (33)(a). In the scenario of a loss ratio below 100%, the reinsurer still receives EUR […] (reinsurance premium of EUR […] ceded to the reinsurer less operating cost of insurers of EUR […]). The State receives thus premiums in the range of […] of the estimated maximum losses under the measure (EUR 145.17 million). This is significantly above the minimum premiums as defined in point 25(a) of the Temporary

Framework for a one-year protection, which the Commission has accepted as ensuring the proportionality of aid and which can serve as a benchmark for the present assessment because the measure has in practice a similar effect as a guarantee.

(89) In terms of losses retained by the participating credit and surety insurers, in the worst case scenario of a loss ratio of 1000%, insurers will retain up to EUR […] of losses, to be compared with EUR […] retained premium and EUR […] incurred costs, resulting in a total operational loss of EUR […], as explained in recital (33)(b). This loss amount is high compared to the expected gross premium volume of Luxembourgish insurers for 2019 of EUR […], given that the historical average loss ratio of credit insurers amounts to […] of premium. Therefore, the participation of the insurers covers an important part of likely losses.

(90) In addition, the measure provides for a fixed commission of 35% of the premiums to compensate the insurers' costs and it reflects the historical and average percentage for the relevant insurance market. The fixed percentage incentivises credit insurers to maintain their premium levels because this commission compensates for their actual nominal costs only at current premium levels. In the event of a sharp reduction in their premium income, the cost ratio (cost/premiums) will rise rapidly since the costs are fixed in the short run.

(91) Based on the points above, the Commission considers that the measure proposed by Luxembourg ensures a participation of participating trade credit and surety insurers that is at least as strict as the one foreseen in the Temporary Framework. The distortions of competition are therefore considered to be limited to the minimum necessary to reach the measure's objectives.

4.3.4. Limits to the distortion of competition

(92) The measure must also be designed in an appropriate manner to minimise undue distortions of competition.

(93) First, in order to benefit from the proposed measure, insurers have to commit not to unnecessarily suspend, reduce or cancel the existing credit limits under strict conditions (no mass actions or linear measures at portfolio level or at sector level; case by case assessment; use of most recent information to determine credit limits).

(94) Second, the measure is open to all trade credit and surety insurers with activities in Luxembourg. This will safeguard competition between these providers and therefore provide an additional lever to ensure that benefits are channelled through to the real economy to the largest extent possible.

(95) Third, participating credit and surety insurers are also retaining a significant part of the losses under the measure. That design ensures that the insurer’s decision making process incorporates economic considerations and is not detached from a market logic. This ensures an overall risk-monitoring by the insurers, and is in line with the intention of section 3.2 of the Temporary Framework.

(96) Based on the above, the Commission considers that the measure as proposed by Luxembourg minimises the distortion of competition.

4.3.5. Conclusion on compatibility

(97) Based on the above considerations, the Commission concludes that the measure is compatible under Article 107(3)(b) TFEU.

4.3.6. Short-term export-credit Communication

(98) Following the amendment to the Short-term export-credit Communication of 28 March 2020, the Commission considers all countries as non-marketable or as temporarily non-marketable risk countries until 31 December 2020.

(99) On that basis, in as far as the measure covers export-credit insurance with a risk period of less than two years, the Commission will assess if the measure fulfils the requirements of Section 4.3 of the Short-term export-credit Communication, which defines the conditions for providing cover for temporarily non-marketable risks.

(100) The Commission notes that the quality of cover will be consistent with market standards, as it will remain the one offered by the private insurers in normal conditions. The maximum coverage will always be 95% for commercial risks and political risks and the minimum waiting period will be 90 days in most cases. In the cases in which this will be less, but at minimum 60 days, this will remain consistent with market standards, as this will be the standard practice of the private insurer in question for these cases. Only economically sound political and commercial risks will be covered by the measure (see recital (46)).

(101) In order to minimise the crowding out of private credit reinsurers, the Short-term export-credit Communication requires risk-carrying in the export-credit reinsurance to be remunerated by an adequate premium. According to point 24 of the Communication, pricing of a quota-share reinsurance cover will in principle be adequate if the reinsurance premium charged is at least 30% higher than the premium for the (original) cover provided by a private credit insurer. The purpose of this requirement is to minimise the crowding out of private credit reinsurers and to ensure phasing out of State intervention by incentivising the insurers using the cover to eventually return to private reinsurers once the market conditions allow that.

(102) In the present case, in light of an unprecedented crisis, Luxembourg seeks to prevent suspension or reduction in credit limits in the private trade credit and surety markets. The participating trade and surety credit insurers already have in place contracts with private reinsurers. However, given the expected massive losses, the Commission notes Luxembourg's submission that private reinsurers would either withdraw from such reinsurance or push for such conditions that would incentivise the insurers to reduce the risks they underwrite. It is precisely those effects that could result in systemic crisis to the economy and that the measure seeks to prevent. The measure is therefore designed to keep the credit and surety insurance available in the Luxembourgish economy within the pre-crisis limits to the largest possible extent.

(103) The cover is accessible to all commercial insurers in Luxembourg in an open, transparent and non-discriminatory manner. The measure essentially allows the market to remain as it was for all private insurers, with respect to all short-term credits and for all Luxembourgish policy holders. In that regard, the reinsurance is being offered on a large scale to portfolios consisting of all types of risks, including a significant number of creditworthy buyers with clean claims record and good financial ratings. The remuneration resulting from the risk and premium sharing is therefore justified and adequate in light of objective of the measure to preserve the existing credit and surety insurance limits available for a limited period of time to the real economy in Luxembourg (see recital (30)).

(104) Luxembourg has committed to publish information on the measure, specifying all applicable conditions, on the official website of ODL. It will provide an annual report on the use of the measure (see recital (38)).

(105) On the basis of the above and in view of the principle set out in point 31 of the Short-term export-credit Communication, the Commission considers that the measure fulfils the requirements of the Short-term export-credit Communication.

5. CONCLUSION

The Commission has accordingly decided not to raise objections to the aid on the grounds that it is compatible with the internal market pursuant to Article 107(3)(b) TFEU and, as far as the reinsurance of temporarily-non marketable short-term export-credit risks is concerned, the Commission also concludes that the measure complies with the Short-term export-credit Communication.

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Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu]

Yours faithfully,

For the Commission

Margrethe VESTAGER
Executive Vice-President

CERTIFIED COPY
For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION