To the European Commission

Notification of State aid scheme pursuant to Article 108 (3) TFEU

Liquidity support to municipal electricity companies

The purpose of the aid scheme is to grant liquidity support to municipal electricity companies in accordance with the Temporary Crisis Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia ("**TCF**"). The notified aid measure is subsidised loan granted by municipalities or Municipality Finance Plc in accordance with section 2.3 of the TCF.

Background

In general, undertakings in Finland are affected by this crisis in multiple ways, both directly and indirectly. This may take the form of shrinking demand, interruption of existing contracts and projects, with the consequent loss of turnover, disruptions in supply chains, in particular of raw materials and pre-products, or other inputs no longer being available or not being economically affordable. The war, sanctions and countersanctions are causing disruptions in global production chains, payment flows and the availability of raw materials. According to the September 2022 Bank of Finland interim forecast[1], the energy crisis triggered by Russia's invasion of Ukraine will stifle growth towards the end of the year. Although the Finnish economy is forecast to grow by 2.2% in 2022, models are predicting that the economy will shrink in the second half of 2022 and GDP will contract by 0.3% in 2023. The final magnitude will depend on the duration and progress of the war, and on how Finland will be able to reduce its dependence on foreign trade with Russia and find new markets for exports.

As regards electricity market, one of the direct consequences of the war is that electricity is no longer imported from Russia to Finland. In 2021, around 10% of the total electricity consumption was covered by import from Russia.[2] The stagnation of energy imports from Russia inevitably increases the price of electricity in Finland and in the Nordic countries. At European level, electricity prices have risen sharply for several reasons, including higher gas and oil prices. An example illustrating the price increase in the Nordic region is provided in Figure 1.

[1] https://www.bofbulletin.fi/en/2022/articles/energy-crisis-will-shrivel-growth-in-finnish-economy/
[2] Source: Finnish Transmission System Operator Fingrid https://www.fingrid.fi/globalassets/dokumentit/fi/kantaverkko/suomen-sahkojarjestelma/electricity-imports-from-russia-to-finland.pdf

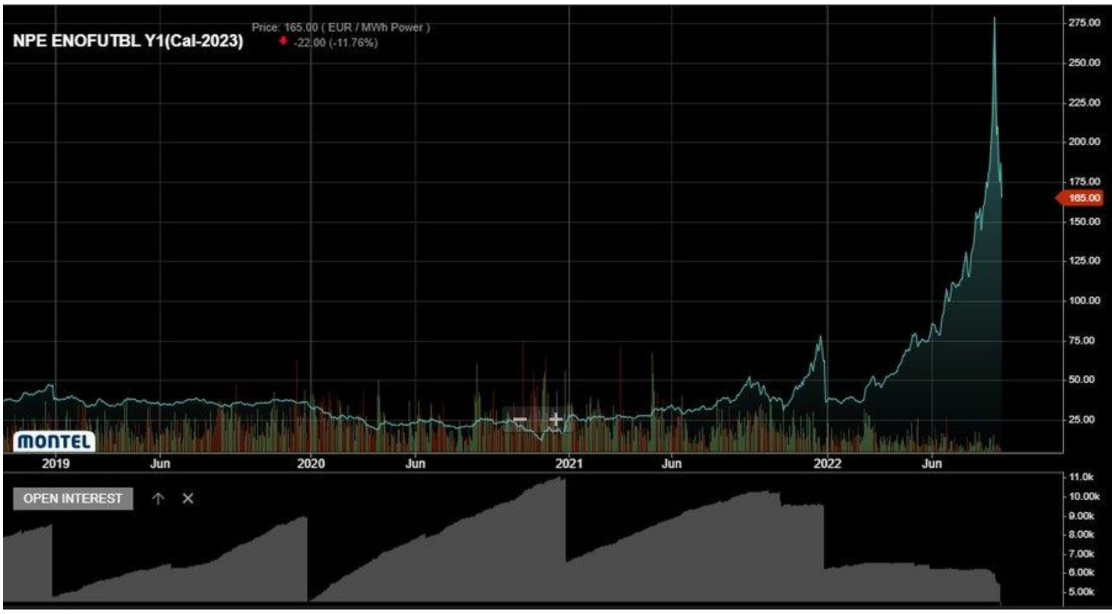

Figure 1, Development of the Nordic system price in derivative markets from 2019. The curve shows the price of electricity to be supplied in 2023. Source: Energiateollisuus ry (Finnish Energy).

While the increase in the price of energy is, in principle, profitable for some companies that produce electricity from resources the price of which has not risen at same pace, most electricity companies face or are at instant danger of facing liquidity problems because of collateral requirements for exchange trading.

According to data from the Finnish Ministry of Finance, electricity producers hedge most of their production (80%) on the electricity derivatives exchange. Hedges are typically done one to three years ahead. The hedging percentage for the closest year is typically higher and the hedging percentage for following years increases over time. With sharply increased prices in the electricity derivatives market the collateral requirements may be as much as 10–20 times higher than in normal circumstances.

Collateral requirements in derivatives markets consist of the difference between the company's derivative trading price (sale or purchase for a specified period of time) and the respective market price. There are several different components in collateral requirements, the most significant of which are daily market-to-market clearing and future risk-securing margins. The collateral amount must be deposited in practice in cash in a derivatives market account. Collateral amounts have risen up to 2–3 times the annual EBITDA for some electricity companies.

This creates a liquidity problem even if the companies are profitable and they have their power plants as real assets, for example. However, these cannot be used as collateral in electricity derivatives exchange. Upon delivery of the electricity sold, the collateral related to the sale in question is returned in its entirety. The increase in the collateral requirements is illustrated in Figure 2 which shows the total value of required initial margin on the Nordic derivatives exchange.

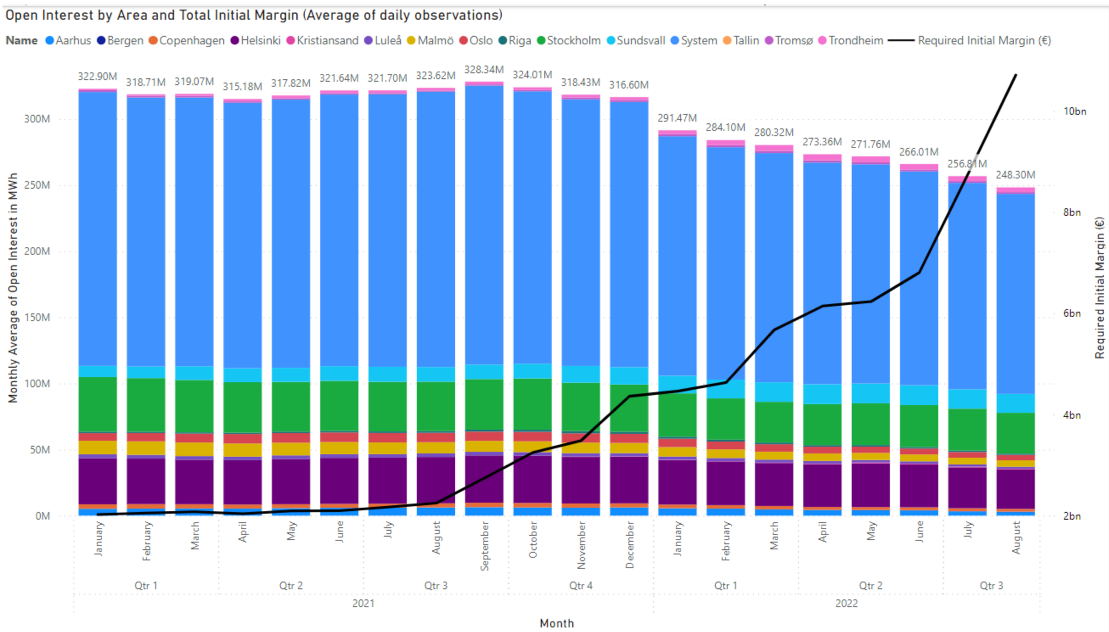

Figure 2, Price development of initial margin collaterals on the Nordic electricity derivatives exchange 2021–2022 (black curve). Source: Energiateollisuus ry (Finnish Energy). *Figure 2 contains CONFIDENTIAL information*.

Both Figures show that the prices have started to increase already in 2021 but since June 2022, the rise has been especially sharp. Due to the exceptionally high prices, even solvent and profitable companies may face liquidity problems.

Competent authorities

The purpose of the scheme is that municipalities and Municipality Finance Plc may grant subsidised loans to municipal electricity companies which face liquidity problems caused by current or future increase in collateral requirements for future delivery of electricity and which are important in securing the supply of electricity at least at the local level.

There are more than 50 municipal electricity companies in Finland which means that the major part of Finnish energy companies are majority owned by municipalities. They play a key role in securing the supply of energy in Finland. Municipalities are responsible for securing the liquidity of the electricity companies in a role of an owner and as an authority responsible for guaranteeing the supply of electricity in their area.

Municipality Finance Plc ("**MuniFin**") is a credit institution in the form of a public limited liability company, as specified in Chapter 1, Section 7 of the act on Credit Institutions (610/2014 as amended)[3]. The objective of MuniFin is to offer loans to its customers, which comprise municipalities, municipal federations and other municipality-controlled entities and non-profit entities. MuniFin is owned by Finnish municipalities, the public sector pension fund Keva and the Finnish State. The public tasks discharged by Munifin, as stipulated in Section 1 a of the Act on the MGB (see below), are non-economic in nature.

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[3] Unofficial translation of the Act: https://www.finlex.fi/fi/laki/kaannokset/2014/en20140610.pdf

MuniFin's loans to its customers are funded by bonds issued on capital markets by MuniFin. This funding is guaranteed by the Municipal Guarantee Board ("**MGB**").

The MGB is an institution under public law established by the Act on the MGB (487/1996). Its purpose is to safeguard and develop the joint funding of Finnish municipalities. According to Section 1 a of the Act on the MGB, MuniFin may use the assets guaranteed by the MGB for

1) financing municipalities, joint municipal authorities, wellbeing services counties or joint county authorities;
2) financing at preferential terms in accordance with European Union State aid rules corporations designated by state authorities and engaging in the renting or production and maintenance of housing on social grounds, or corporations controlled by them; or
3) financing at preferential terms in accordance with European Union State aid rules entities totally owned or controlled by municipalities, joint municipal authorities, wellbeing services counties or joint county authorities, or municipal or wellbeing services county enterprises, which provide public services falling within the sphere of municipal or wellbeing services county authority as provided for in legislation or carry out functions directly in service thereof or provide other services essential to citizens, if due to local or regional circumstances the provision of the last-referred services is necessary to ensure their availability or efficient provision.

This system of financing, which is part of the public sphere and internal organization of the Finnish authorities, has been approved by the Commission in State aid decision No N179/04 – Finnish municipal guarantees of 16.6.2004 (SA.16399) ("**2004 Decision**").[4] According to paragraph 21 of the 2004 Decision, MuniFin provides financing to undertakings only at preferential terms in accordance with the State aid rules and does not at market terms. Consequently, MuniFin does not compete with commercial banks in lending money to undertakings.

The Commission concluded in paragraph 24 of the 2004 Decision that the activities by MuniFin as stipulated in the notified regulations constitute public tasks and are therefore non-economic in nature. MuniFin is therefore not an undertaking within the meaning of Article 107 (1) TFEU but an intra-governmental funding agency/special credit institution as it grants financing in accordance with Section 1 a of the Act on the MGB. The guarantees granted by the MGB to MuniFin do thus not constitute State aid within the meaning of Article 107 (1) TFEU.

Description of the aid scheme

Loans would be granted in accordance with section 2.3 of the TCF. Specifically, aid under the scheme may be granted in one of the following ways:

(a) MuniFin will lend the beneficiaries directly. In this case, the municipality that owns or control the beneficiary may grant an up to

[4] https://ec.europa.eu/competition/state_aid/cases/140539/140539_1183835_26_2.pdf

100% guarantee to MuniFin on the loan provided. This guarantee will not grant any advantage to the beneficiary of the measure since the beneficiary does not receive a loan, at any case, on more favourable terms than permitted in the TCF. The guarantee forms part of a risk sharing system between MuniFin, MGB, and the municipalities which together form the joint funding system of Finnish municipalities. (‘’sub-measure 1’’);

(b) MuniFin will lend the respective municipality, which will then lend the beneficiaries by using the funds provided by MuniFin (‘’sub-measure 2’’);

(c) The municipality will lend the beneficiaries directly, using their own funds (‘’sub-measure 3’’).

The measure is administered by MuniFin, the municipalities, and the Municipal Guarantee Board (MGB). MuniFin grants loans in accordance with the principles agreed with MGB and MGB supervises that these principles and the Act on the MGB are respected. In case that MuniFin grants the aid directly (sub-measure 1) to the beneficiary, MGB subsequently approves this loan, according to Section 8 of the Act on the MGB. As regards sub-measure 2, MGB only approves MuniFin’s loan to a municipality but not further decisions by the municipality. In case that a municipality lends a beneficiary (sub-measures 2 and 3), the measure vis-à-vis the beneficiary is only administered by the municipality irrespective of whether it uses MuniFin funds or other funds.

If MuniFin grants a subsidised loan directly to an electricity company (sub-measure 1), the municipality or municipalities which own the company may grant an up to 100 % guarantee on the loan. This guarantee does not constitute State aid since, as stated in the 2004 Decision, MuniFin is not an undertaking as it grants financing in accordance with Section 1 a of the Act on the MGB. However, it is necessary to ensure that the financing granted by MuniFin to an undertaking is compatible with the State aid rules which is the purpose of this notification.

The reason for the need of this guarantee is an appropriate risk sharing between municipalities. The idea is that the municipality which owns the electricity undertaking that benefits of the loan is primarily responsible for the repayment of the loan in case of a failure of the company. MGB, and indirectly all the other municipalities, are only secondarily liable. That liability actualises only in case that the municipality in question would have financial difficulties. This prevents excessive risk-taking and the problem of free-riding easily connected to systems involving collective liability.

The guarantee granted by the municipality can cover 100% of the loan exactly for the same reasons as the guarantee granted by MGB can cover 100% of the fundraising of MuniFin as explained in the 2004 Decision. In accordance with the terminology of paragraph 14 of the 2004 Decision, the guarantee belongs to the “first level of the funding system”. When acting pursuant to Section 1 a of the Act on the MGB, MuniFin is not an undertaking competing with commercial banks. Thus, under the scheme, the guarantee is not State aid to MuniFin and it is not a separate measure to be assessed under section 2.2 of the TCF but a risk sharing measure inside the joint funding system. The aid measure to be assessed under the TCF is the loan granted by the MuniFin to electricity company, i.e., the "second level of the funding system" as defined in the 2004 Decision.

The beneficiaries of the scheme (sub-measures 1, 2, and 3) are municipal electricity companies that produce or supply electricity, engage in hedging operations, and are affected by the crisis. According to Section 129 of the Local Government Act No. 410/2015, municipal companies are entities forming part of the local authority group or being under municipal control, or the joint control of municipalities and central government. It is possible that the beneficiaries may also have minority private shareholders. Majority of the shares of beneficiaries and controlling rights are owned by a municipality or several municipalities together.

The beneficiaries will need to demonstrate that high collateral requirements on the electricity derivatives markets have created additional and unexpected liquidity needs – which need to be quantified through self-certification – and thus need to be covered with public support in order to ensure the security of supply. The measure will cover collateral payments for derivatives exchanges (such as Nasdaq OMX Commodities), spot trading (NordPool Spot), imbalance settlement (eSETT) and bilateral trading (over-the-counter trading). Aid to companies cover collateral requirements for engaging in proprietary trading is excluded under this measure. For the purpose of this aid scheme, proprietary trading is understood as such use of derivatives which is not related to selling of production of municipal electricity companies nor fulfilling their customer contracts.

The maximum amount of the loan would be

- reasonably expected liquidity needs of the electricity company for 12 months derived from need to provide financial collaterals for trading activities, or
- 15 % of the beneficiary's average total annual turnover over the last three closed accounting periods

as set out in paragraph 50(e). of the TCF.

The maturity of a loan would not be more than 3 years. The loans would be granted no later than 31.12.2022.

In accordance with paragraph 50(b). of the TCF, the loans will be granted to the beneficiaries at reduced interest rates, which are at least equal to the base rate (one-year IBOR or equivalent as published by the European Commission)[5] available on 1 February 2022 plus the credit risk margins as set-out in the table below:

Type of recipient	Margin for 1st year	Margin for a 2nd - 3rd year
SMEs	25 bps	50 bps
Large enterprises	50 bps	100 bps

[5] Base rates calculated in accordance with the Commission's Communication on the revision of the method for setting the reference and discount rates (OJ C 14, 19.1.2008, p. 6).

In any case, the minimum all-in interest rate (base rate plus the credit risk margins) is not less than 10 bps per year.

Further details of the loan scheme and confirmations concerning the compliance with the terms of the TCF are included in the Notification template for the TCF (Annex 2 of the notification).

Because the electricity prices and collateral requirements have arisen sharply and suddenly, the MGB asks the Commission to approve the aid scheme as soon as possible in order to minimize disruptions in electricity markets and production.