Subject: State Aid NN2/2009 – Finland
State measure involving arrangements with Kaupthing Bank h.f, Finnish Branch

Sir,

I. PROCEDURE

1. On the 29 of October 2008 Finland notified a guarantee against any legal risks of banks and the special purpose vehicle and the depositors participating in the arrangement with Kaupthing Bank h.f, Finnish Branch. Additional information was provided in the course of November and December.

II. DESCRIPTION

1. The measure and its objective

2. The measure consists of a guarantee against any legal risks of participants in the arrangement with Kaupthing Bank h.f. (hereafter the "Measure"). Under this private sector arrangement the participants - the three commercial banks involved and a special purpose vehicle – basically took over credit claims and other assets of Kaupthing Bank h.f. and will settle all the deposit claims in Finland. The state guarantee covers the legal risks in this arrangement, i.e. economic losses suffered from any recovery claim or any other equivalent insolvency claim made against the participating banks, the special purpose vehicle and the depositors.

3. The immediate objective of the measure is to support a private sector solution for allowing the depositors in the Finnish branch of Kaupthing Bank h.f. to receive their money in full (i.e. more than foreseen according to the Finnish deposit guarantee scheme). This immediate objective has to be seen against the broader objective of preserving the confidence of depositors in Finnish banks.

2. Events leading to the measure

4. After Icelandic Kaupthing Bank h.f. (hereafter "Kaupthing") ran into financial difficulties in the course of September 2008, the Financial Supervisory Authority of Iceland assumed on 9 October the powers of the shareholders of the Bank, dismissed the Board of the
Directors in its entirety and appointed a Resolution Committee\(^1\) for the Kaupthing.\(^2\) On the same day the Financial Supervision Authority of Finland (hereafter "RATA") suspended the operations of the Finnish Branch of Kaupthing (hereafter the "Branch").

5. According to a report dated 9 October 2008 provided by the Branch there were unavailable deposits\(^3\) in the Branch in the aggregate amount of EUR 113 million from more than 10,000 depositors.\(^4\) The book value of Branch's credit portfolio is approximately [EUR 50-250 million] and, in addition, the value of the cash reserves has been reported to be approximately [EUR 5-25 million]. In addition, the Branch has other securities and receivables. However, the Branch's assets and debt are part of Kaupthing's balance sheet, and there is no separate legal entity in Finland that could be isolated from Kaupthing.

6. An administrator was appointed by the Finnish Deposit Guarantee fund to observe the situation of the Branch. His duties covered identification of the funds and liability status of the Branch and to make a proposal for the solution of the situation. The administrator discussed the matter with the Resolution Committee, the Branch, the Finnish and the Icelandic authorities and with the main Finnish banks - Nordea Bank Finland plc, OP-Pohjola Group Central Cooperative and Sampo Bank plc.

7. On 15 October 2008 Nordea Bank Finland plc, OP-Pohjola Group Central Cooperative and Sampo Bank plc (hereafter the "Banks") made a fixed-term commitment to finance the deposits of all Branch depositors to the full extent including interest. This private sector initiative has to be seen against the backdrop of the current banking crisis, where deposit funding is one of the few remaining private sector funding sources for banks.


10. On 24 November 2008 the District Court of Reykjavik granted a moratorium order on Kaupthing, until 13 February 2009.\(^5\)

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\(^1\) The Resolution Committee takes on all matters related to the Bank, including oversight of all treatment of its assets, as well as the handling of other business. It abides by the decisions taken by the Financial Supervisory Authority of Iceland on the basis of Article 100a of the Act on Financial Undertakings (Iceland) and operates in consultation with the Financial Supervisory Authority of Iceland.

\(^2\) "Decision of the Financial Supervisory Authority on the appointment of a Resolution Committee for Kaupthing bank hf" Reference: 2008100055.

\(^3\) The unavailable deposits, which are repayable funds due and payable but not paid by the Branch to the Finnish depositors, are defined in accordance with section 10 and 105 of Finnish Act on Credit Institutions (9.2.2007/121).

\(^4\) [...] * Confidential information. Where possible, figures have been replaced by ranges in brackets.

\(^5\) The purpose of the moratorium is to obtain protection for the Bank's assets for a certain period of time. During this time the reorganization and winding-up of the credit institution will be prepared, in order to be able to maximize recovery, and provide for an equitable distribution of value among all creditors. Please note that the moratorium is not a bankruptcy proceeding according to the Icelandic law (Chapter XII A of Act No. 161/2002 on Financial Undertakings). The fact of the moratorium of Kaupthing is relevant as s in the "Decision of the Finnish Financial Supervisory Authority on approval in relation to the Finnish Branch of Kaupthing Bank h.f. and its assets in the Republic of Finland" it is stated that the arrangement and the Measure attached to it, are made on the basis of the assumption that Kaupthing (or the Branch) are not liquidated or set into bankruptcy or into the equivalent procedure before the targeted arrangement has been fully achieved.
3. The private sector solution and the state measure

11. During the course of October 2008, a largely private sector agreement was reached for the payment of deposits\(^6\) of the Branch. It involved setting up a special purpose company (hereafter the "SPV"), which was financially responsible for the deposit stock payment to the depositors. The credit claims and other assets of the Branch were pledged to the SPV. To ensure that the SPV can settle all the deposit claims, it was funded by the Banks.

12. The Banks lent funds to the SPV and they financed it in proportion […]: Nordea Bank Finland plc [30-50%], OP-Pohjola Group Central Cooperative [30-50%] and Sampo Bank plc [10-30%].

13. The SPV lent funds to the Branch and obtained as collateral for this loan […]. The funds lent by the SPV were paid to a blocked account opened by the Branch. After the funds were transferred into the blocked account, the Resolution Committee with the approval of the RATA paid out the funds to the Finnish depositors in total EUR 113 million, on 31 October 2008. The deposits were paid in full (including interest). Consequently, Finnish depositors are not entitled to claim anything from the Icelandic or Finnish deposit guarantee schemes in respect of the paid out deposits.

14. Kaupthing (on behalf of the Branch) and the SPV entered into a credit facility agreement in the form of a short-term loan from the SPV to the Branch, which becomes due on a monthly basis. Kaupthing has pledged […] as the collateral of the loan. The payments resulting from the pledged […] will accrue on a separate pledged blocked account, from which the SPV is entitled to withdraw funds. In the case of the realisation of […], the obtained funds will be transferred to the SPV. The Resolution Committee will supervise the realisation of the pledged assets and will authorize the Branch's management to execute the realisation of the pledged assets, subject, however, to the supervision by the RATA and consent by the SPV. The security will be realised within three months.

15. While in this arrangement the commercial and credit risks are carried by the Banks, the Finnish Authorities provide a guarantee for any legal risks of these Banks in the arrangement.

16. Finland will make available a state guarantee to indemnify the Banks, the SPV and the Finnish depositors against all loss suffered by any of them from any recovery claim or any other equivalent insolvency claim relating to the contemplated arrangements.

17. Regardless of the fact that the arrangement has been approved by the Icelandic authorities and is deemed to fully conform to the legal provisions in force in Iceland, the assets of Kaupthing might become subject to claims of the other depositors of Kaupthing\(^8\) consisting of a right of recourse or similar claims, which, if successful in court, could have financial consequences for the Banks, for the SPV or the depositors.

18. The Finnish authorities have not set an upper limit of the indemnity, since it is impossible to estimate the amount of possible claims.

19. The guarantee is governed by Finnish legislative acts on government lending and government guarantees and it may be granted without charging retention payments and without financial collateral. In the case, the guarantee is triggered, the Government will adopt more specific terms and conditions.

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\(^6\) It means a full compensation to Finnish depositors for the unavailable deposits of the Branch.

\(^7\) […]

\(^8\) Such claims could potentially be made by depositors from other MS or Iceland since Kaupthing is in administration and the deposits of Kaupthing in several European countries are not paid out.
III. POSITION OF FINLAND

20. The Finnish authorities accept that the indemnity contains State aid elements.

21. The Finnish authorities seek urgent authorisation for the measure. According to the Finnish authorities the measure results from unusual circumstances in the financial market and especially from the situation of the Icelandic banks.

22. The Finnish Authorities welcome the private sector solution for the payment of deposits of the Branch in Finland, as contributes to avoiding any unnecessary uncertainty about the security of bank deposits and to increase confidence by the depositors in the Finnish banking market. Taking into account that Kaupthing operated in Finland through a branch the deposits would have been partly guaranteed by the Icelandic deposit guarantee scheme, partly by the Finnish scheme and partly left uncovered. Therefore the guarantee scheme process would have contained more uncertainty for the Finnish depositors.

23. The Finnish authorities state that the Banks would carry the commercial and credit risks in the arrangement, while Finland would carry the legal risks by accepting to indemnify the Banks, the SPV and Finnish depositors for all losses suffered by any of them from any recovery claim or any other equivalent insolvency claim relating to the arrangement. The Finnish Authorities define the legal risks as separate from the business risk relating to the loan given by the SPV. The legal risks are supposed to take into account that the Kaupthing is in administration and that the situation of depositors in several European countries remains unsolved. This means that irrespective of the fact that the Finnish arrangement has been planned in co-operation with the Icelandic FME and the Resolution Committee, there may in the future be creditors which consider they have suffered damage as a result of the arrangement.

24. The Finnish Authorities have not limited the amounts they may be called to pay out as a result of the guarantee, and state that it is not possible to make an estimate on the amount of a potential recovery claim (if any).

25. The Finnish authorities claim that the measure is compatible with the common market because it is necessary to remedy a serious disturbance in the Finnish economy pursuant to Article 87(3)(b) of the EC Treaty, in view of the currently ongoing financial crisis.

IV. ASSESSMENT

1. Existence of state aid

26. The Commission first assesses whether the measures constitute state aid within the meaning of Article 87 (1) EC Treaty. According to this provision state aid is 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, in so far as it affects trade between Member States.

9 Concretely, the Icelandic Deposit Guarantee Fund would have about [EUR 50-100 million] to cover (up to a level of coverage of EUR 20 800 per depositor), the Finnish Deposit Guarantee Fund about [EUR 1-15 million] (up to the level of coverage of EUR 25 000 per depositor in force at the time) and the rest of the amount would have been left uncovered.
27. The Commission notes first the largely private sector nature of the solution being found for the stated objective, namely to refund the depositors in Kaupthing and to preserve the trust of depositors in Finnish banks. It also notes that the participating banks have taken on themselves responsibility for the overall stability of the Finnish market for deposits, a responsibility, which normally falls onto the state. The Commission welcomes such action by the private sector insofar as it minimises state aid.

28. It also notes, though, that the private sector solution would not have been agreed to without the state guarantee to the participating banks, the SPV and the depositors in Kaupthing. The Commission considers that the state commitment to indemnify any legal risks of banks, the SPV and depositors participating in the arrangement with Kaupthing constitutes state aid pursuant to Article 87 (1) EC Treaty. It also notes that the measure indirectly benefits Kaupthing itself.

29. Firstly, the Measure will be financed from State resources, if the guarantee is ever to be called.

30. Secondly, given that the three Banks and Kaupthing are active in the financial sector, which is open to intense international competition, any advantage from state resources given to them has the potential to affect intra-Community trade and to distort competition.

31. Thirdly, it has to be examined whether the State indemnity leads to a selective advantage for it to constitute State aid. There are three direct beneficiaries from the guarantee: i) Kaupthing retail depositors; ii) the Banks iii) the SPV and one indirect one, iv) Kaupthing.

32. The principal beneficiaries of this measure are the retail depositors of the Branch. Without the guarantee the private solution would not have been applied and the deposit guarantee scheme would have to be triggered. As Kaupthing operated as a branch in Finland the deposits would have been partly guaranteed by the Icelandic scheme and partly by the Finnish scheme and partly left uncovered. In this case the deposit holders would have suffered from the uncertainty and would not have had access to their money for a longer time taken into account the general deposit guarantee scheme process and the Icelandic situation in particular. Therefore the deposit holders have received an advantage. But as the simple fact of depositing funds does not constitute a commercial activity within the meaning of the state aid rules, the depositors should not be considered as undertakings for the purposes of the assessment of the measure, and as a result they fall outside the scope of the State aid rules. Thus, the Commission considers that the guarantee did not lead to a State aid for retail depositors.

33. The second group of beneficiaries are the involved Banks as the Measure limits their exposure to risk. Although the Banks are exposed to some credit risk, this does not alter the fact that the Measure confers a selective advantage on them.

34. Although the maximum loss can be up to [EUR 10-200], which is the paid out sum of the deposits minus the cash reserves, a loss will only arise to the extent that the realisation of pledged credit portfolio generates less than the liability towards the depositors. This is

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10 See e.g. the judgment of the ECJ of 10 January 2006 i case C-222/04, “Cassa di Risparmio di Firenze”, points 107-108
unlikely to be the case as the portfolio has a book value of [EUR 50-250 million] and an estimated market value around [EUR 10-200 million]. Therefore the estimated loss for the Banks would be approximately [EUR 1-30 million].

35. Furthermore, the situation without the private solution should be assessed. Without the arrangement the deposit guarantee scheme would have applied, meaning that the Icelandic Deposit Guarantee Fund would have about [EUR 50-100 million] to cover (up to a level of coverage of EUR 20 800 per depositor), the Finnish Deposit Guarantee Fund about [EUR 1-15 million] (up to the level of coverage of EUR 25 000 per depositor in force at the time) and the rest of the amount would have been left uncovered. The deposit guarantee scheme would not have been as straightforward as the private arrangement, and would therefore have been a less effective means to restore the public confidence of the depositors on the Finnish market. Since a lack of confidence in the Finnish banking market could have had a negative influence on the day-to-day business of the Banks, the Measure, which helps to restore public confidence, is in the interest of the Banks. If depositors withdrew their funds from these Banks to buy safe financial assets, such as government bonds, would have required the Banks to slightly increase the interest rates paid on their deposits to attract back those funds. Given the large size of the funds deposited by those banks, even a modest increase would result in significant costs for the banks.

36. In addition, the Banks are also the main contributors to the Finnish Deposit Guarantee Fund, and in the absence of the private arrangement, the Banks would face higher contribution payments to the Deposit Guarantee Fund in the future. The banks therefore have an interest in assuming the commercial risk, the likely loss being relatively small, and accepting such a loss avoids other adverse consequences.

37. In view of the above, the Measure provides an advantage to the Banks.

38. The third possible beneficiary is the SPV formed by the Banks. It was established only for the limited purpose of being a vehicle through which the funds provided by the Banks are channelled to the Branch to pay out the Finnish depositors; the SPV takes part in the realization process of the credit portfolio of Kaupthing. Beyond the above mentioned actions the SPV does not have any further financial activities and will be closed after the operations have been finished, meaning that the SPV is not an undertaking. As mentioned above any losses will be covered by the Banks and any surplus will be transferred to Kaupthing. Therefore the Measure does not contain any State Aid to the SPV.

39. In addition, the very purpose of the whole measure is to allow a private sector solution to allow Kaupthing to honour the claims against its depositors, which it incurred previously. As a result, Kaupthing is also an indirect beneficiary of the measure.

40. The Commission therefore comes to the conclusion that the measure provides a selective advantage to the Banks and that it consequently constitutes State aid in the sense of Article 87 (1) EC Treaty.

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11 Even if the realisation process is more successful than expected, the Banks will not have any net profit from the arrangement. […]  
12 Had the limit been EUR 50 000 at that time in Finland, it is estimated that the responsibilities of the Finnish Deposit Guarantee Fund would have been roughly [EUR 1-10 million] higher.  
13 The shares of the above mentioned banks of the ex ante financing of the Finnish Deposit Guarantee Fund are the following: OP-Pohjola- Group […], Nordea Bank Finland […], Sampo Bank […].
2. Compatibility of the aid with the common market

Application of Article 87(3)(b) EC

41. Finland intends to provide the indemnity to the participants in the arrangement against economical loss suffered from any recovery claim or any other equivalent insolvency claim. Given the present circumstances in the financial market, the Commission considers that it is appropriate to examine this measure directly under the Treaty rules and in particular under Article 87 (3) (b) EC.

42. Article 87 (3) (b) EC enables the Commission to declare aid compatible with the Common Market if it is "to remedy a serious disturbance in the economy of a Member State". The Commission recalls that the Court of First Instance has stressed that Article 87 (3) (b) EC needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State. 14

43. The Commission considers that present measure helps to implement a private arrangement to restore the confidence in the Finnish banking sector and thus in the Finnish economy. The public confidence is, beside adequate liquidity, one of the essential conditions for the functioning of the banking sector. Hence, if the issue of lack of confidence is not addressed, it will result not only in difficulties for the banking sector alone, but due to the financial sector's pivotal role in providing financing to the rest of the economy, will also have a systemic and harmful spillover effect on the Finnish economy as a whole. Therefore the Commission finds that the Measure aims at remedying a serious disturbance in Finnish economy.

Conditions for compatibility under Article 87 (3) (b)

44. In line with the Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", in order for an aid or aid scheme to be compatible under Article 87(3)(b) of the EC Treaty, it must comply with general criteria for compatibility under Article 87(3) of the EC Treaty, viewed in the light of the general objectives of the Treaty and in particular Articles 3(1)(g) and 4(2), which imply compliance with the following conditions15:

a. Appropriateness: The aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the disturbance would also disappear in the absence of the measure or if the measure is not appropriate to remedy the disturbance.

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b. **Necessity**: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g., a guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.\(^\text{16}\)

c. **Proportionality**: The positive effects of the measures must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measures' objectives. This follows from Article 3 (1) g EC and Article 4 (1) and (2) EC, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87 (1) EC prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87(3)(b) of the EC Treaty which authorises State aid must ensure that such aid must be limited to what is necessary to achieve its stated objective.

**Application of the criteria to the Measure**

45. As regards appropriateness, the objective of the present measure is to assure the implementation of the private arrangement, which aims to pay out the depositors in Kaupthing and preserve the public confidence of the depositors in the Finnish banking market and to avoid any further uncertainty about the security of the bank deposits in the current financial crisis. As the banks fulfill a central role in financial intermediation, the private arrangement and the Measure attached to it, aim to avoid any spillover effect of the current financial crisis to the real economy. Therefore the Commission considers the Measure as appropriate.

46. But most importantly, the Measure serves to maintain confidence in the Finnish financial system. Given the current turmoil in the banking sector, the uncertainty about the security of the bank deposits may have caused knock-on problems for other Finnish banks and could have led to a run on otherwise stable banks. These could have had spillover effects on other Member States and their banking sector.

47. As regards necessity, the Measure should be limited to the minimum necessary in scope and time to restore confidence.

48. As regards scope, the Commission considers that it is positive that there will be no State resources needed for the payments of the deposits in Finland as they are funded by the three private Banks. The Measure only covers risk, caused by possible recovery claims or any other equivalent insolvency claim relating to the arrangement. The fact that the arrangement is planned in co-operation with the Finnish Authorities, the Financial Supervisory Authority of Iceland and the Resolution Committee means that the risk for the recovery claims has been kept as low as possible. Nevertheless, the Measure is essential to the arrangement as no market economy investor would otherwise have been ready to assume such risks; whereas the Banks can assess the credit risk of the

\(^{16}\) Cf. Case 730/79, *Philip Morris* [1980] ECR 2671. This line of authority has recently been reaffirmed by the Court of Justice in Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive* of 15 April 2008, where the Court held that, “As is clear from Case 730/79 […], aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market […].”
transaction, the wider risks potentially arising from the insolvency of Kaupthing are less readily quantified. Besides the arrangement does not alter the existing deposit protection principles in force in Finland and Finnish depositors are not entitled to claim after they were paid out in full in Finland. Therefore the Commission does not dispute the appropriateness of the indemnity being unlimited in amount and accepts that the paid out sum of 113 million serves only as an approximate benchmark for the possible recovery claims.

49. As regards the temporal scope, the entire private arrangement follows a very strict timetable and is expected to be ended at the end of January 2009. Concerning the Measure, the indemnity can be called upon beyond the end of the arrangement.

50. As regards proportionality, the distortion of the competition has been limited. Firstly, the main beneficiaries are the Finnish retail depositors of the Branch. The Measure indirectly prevents the Finnish depositors from losing part of their savings and avoids the uncertainty of the application of the deposit guarantee scheme. Furthermore, as all the main Finnish Banks are involved in the arrangement, the potential distortions between banks in Finland are kept as low as possible. Indeed, the Commission notes that the Banks did not have any obligation to participate in the private sector solution and participating does not set them at a competitive advantage vis-à-vis other banks.

51. On the basis above, the Measure can be considered compatible with the Common Market.

V. DECISION

52. The Commission has accordingly decided not to raise objections against the notified measure, since it fulfils the conditions to be considered compatible with the EC Treaty.

53. If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site. http://ec.europa.eu/community_law/state_aids/index.htm.

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Yours faithfully,

For the Commission

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