EUROPEAN COMMISSION

Brussels, 30.9.2010
C(2010) 6788 final

Subject: State Aid N 407/2010 – Denmark
Danish winding-up scheme

Madam,

I. PROCEDURE

1. On 21 September 2010 Denmark notified a scheme (hereafter "the scheme") for the winding-up of financial institutions in distress. A temporary winding-up scheme was approved by the Commission in October 2008 in State aid case NN51/2008[1] under Article 107(3)(b) TFEU until October 2010.

2. In pre-notification contacts, on 26 July 2010, the Danish authorities informed the Commission that they exceptionally accept that the decision on the notified scheme be adopted in the English language.

II. DESCRIPTION

1. The objective of the scheme

3. The object of the scheme is to support value preservation in failing banks by means of a controlled winding-up on a going concern basis instead of those banks being subjected to regular bankruptcy proceedings. Controlled winding-up of failing banks aims at enhancing the stability of the financial system, reducing economic losses and promoting the public interest.

4. The relatively large number of small banks in Denmark increases the need for a generalised regime for handling failed banks, taking the specific nature of the Danish banking market into consideration.

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[1] OJ C 273, 28.10.2008, p. 2.

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5. Against this background, Denmark has proposed a regime for handling failed banks which relies on the continuation of the Financial Stability Company introduced in October 2008[2] with some adjustments, in order to ensure that expertise in handling failed banks is preserved.

2. Description of the scheme

6. Institutions eligible to participate in the scheme are credit institutions, i.e. banks and mortgage credit institutions (hereinafter banks).

7. If the Danish Financial Supervisory Authority (hereinafter the FSA) finds it necessary to fix a deadline for a distressed bank to re-establish its capital, and the bank fails to succeed and no other solution is found before the expiration of the deadline, the distressed bank can request to be wound up pursuant either to the winding-up scheme of the Danish Act on the Management of Distressed Banks[3] or to regular bankruptcy rules.

8. Where a distressed bank chooses the winding-up scheme, the Financial Stability Company (FSC) will establish a subsidiary bank (New Bank) that will acquire the assets of the distressed bank (Old Bank). The assets will be transferred at realisation value. When determining the takeover sum, the serious situation of Old Bank must be taken into account, including the need for an immediate sale. New Bank settles the preliminary takeover sum towards Old Bank by taking over unsubordinated liabilities as per the transfer date for an amount equal to the value of the assets, on a pro-rata basis.

9. The takeover sum is preliminary until the final takeover sum has been determined by two accountants appointed by the Institute of State-Authorised Public Accountants.

10. When New Bank takes over the pro-rata share of unsubordinated liabilities from Old Bank, this transfer will trigger the guarantee on deposits. As a result, the Danish Guarantee Fund for Depositors and Investors (deposit guarantee scheme) will cover deposits above the proportional share and up to a maximum of EUR 100,000. The Guarantee Fund thereafter enters as creditor with unsubordinated liabilities against Old Bank on equal terms with other claims in accordance with the normal insolvency order.

11. Shareholders and subordinated debt holders of Old Bank will maintain their claim only *vis-à-vis* Old Bank, which is a bankrupt estate.

12. New Bank takes over all employees of Old Bank and may take over other bilateral contracts pursuant to an agreement with Old Bank. Share capital and additional capital is provided by the FSC to ensure that New Bank complies with the capital requirements stipulated in the Danish Financial Business Act.

13. In addition, the FSC may provide New Bank with a liquidity facility. These loans to New Bank will bear interest on market-oriented terms, i.e. the interest must be fixed according to the risk of the bank, as determined by the market and account taken of its risk profile.

[2] Approved by the Commission under State aid case NN51/2008, OJ C 273, 28.10.2008, p. 2.
[3] Law nr. 721 of 25. juni 2010

14. The FSC will appoint the board of directors of New Bank.

15. Any loss arising in New Bank will be covered via a loss guarantee from a new Winding-up Department, which will be created as a "sub-fund" of the Danish Deposit Guarantee Fund.

16. In case of need, the State can guarantee loans taken by the Winding-up Department, which will be repaid by contributions from the member banks over time. Any such guarantee in favour of the Winding-up Department is not covered by the present decision.

III. POSITION OF DENMARK

17. The Danish authorities accept that the scheme contains State aid elements.

18. However, in the view of the Danish authorities, the scheme is compatible with Article 107(3)(b) TFEU as an aid measure intended to "to remedy a serious disturbance in the economy of a Member State".

19. Denmark commits that Old Bank must accept the takeover offer from the FSC if it is to be wound up under the scheme.

20. Denmark also commits that New Bank will not grant any loans to new or existing corporate or private customers, and that further advances on existing loans and credit lines in New Bank should only be granted in situations where necessary to preserve or increase the prospects for New Bank being repaid on its outstanding loan. New Bank will also terminate all engagements with deposit-only customers as soon as possible. Denmark commits that New Bank will set its prices and fees in the highest segment of the market (or in case of remuneration paid to clients, in the lowest segment) on the basis of the statics calculated monthly by the National Bank of Denmark.

21. Denmark also commits that New Bank will actively seek to sell off all portfolios and thereby totally dispose assets and liabilities. Any such sale of parts or the whole of New Bank will be carried out in an open, unconditional and non-discriminatory manner.

22. Denmark commits that the winding up of New Bank shall be completed within a reasonable timeframe, and that New Bank shall have its banking license revoked five years from the entry into the winding-up scheme at the latest, except under extraordinary circumstances and after consultation with and agreement of the Commission.

23. The Danish Authorities will undertake to use all possible means under Danish law to ensure that payment of remuneration to those responsible for the financial situation of Old Bank, and particular its management, will be restricted to the absolute necessary minimum under the employment contracts

24. Denmark will submit six-monthly reports, the first one six months from the date of the present decision, on the use of the scheme and on the developments concerning any Old Bank and New Bank under the scheme.

25. Once the run-off of New Bank is terminated, Denmark will submit to the Commission a final monitoring report that contains an ex-post valuation of the liquidation.

IV. ASSESSMENT

1. State aid character of the schemes

26. As set out in Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

27. The Winding-up Scheme introduced by Denmark allows for a controlled winding-up of banks under the FSC by creating a "bridge bank", i.e. New Bank, which will obtain capital and liquidity from the FSC in a time when the distressed bank was unable to find private funds on the market. That offer of capital and liquidity may give an economic advantage to New Bank as far as it continues to operate in the market, albeit in a limited way. It must therefore be regarded as potentially distorting competition and affecting trade between Member States. The advantage is selective since it only benefits the beneficiary.

28. The Commission considers that the advantage is provided through State resources. Denmark does not question that position. The Commission notes that even though the Winding-up department is financed by contributions from member banks, according to settled case-law, all the financial means by which the public sector may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector, fall under Article 107(1) TFEU provided that they constantly remain under public control, and therefore available to the competent national authorities. In particular, State resources are generally considered to be involved where funds come from contributions made compulsory by State legislation and are managed and apportioned in accordance with that legislation, even if they are administered by institutions separate from the State[4].

29. In the case at issue, it is the FSC that provides capital and liquidity to New Bank. The FSC is a State-owned public company established in October 2008 whose activities are governed by the Danish Act on Financial Stability and the Financial Business Act. The FSC stands to be covered for any losses arising in New Bank via a loss guarantee by the Winding-up department. The Commission notes that the Winding-up department is financed by banks' contributions which are mandatory and determined by law. Moreover, the measure is implemented in the context of a public interest mission defined by the State and does not have a purely commercial objective[5]. In light of the above, the Commission considers that the measure involves State resources in the meaning of Article 107(1) TFEU.

30. As a consequence, the Commission concludes that the Scheme involves aid within the meaning of Article 107(1) TFEU.

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4 See Case 173/73 *Italy* v *Commission* [1974] ECR 709, paragraph 16.

5 See Case C-345/02, *Pearle and Others* [2004] ECR I-7139, paragraphs 37 and 38, as well as Case T-136/05 *Salvat père & fils and Others* v *Commission* [2007] ECR II-4063, paragraph 164.

2. Compatibility with the internal market

Application of Article 107(3)(b)TFEU

31. Article 107(3)(b) TFEU enables the Commission to find aid compatible with the internal market if it has the effect "to remedy a serious disturbance in the economy of a Member State".

32. The Commission has acknowledged that the global financial crisis created a serious disturbance in the economy of Member States and that measures supporting banks are appropriate to remedy that disturbance. That analysis has been confirmed in various Commission communications such as the *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*[6] (hereinafter "the Banking Communication"), its *Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*[7] (hereinafter "the Recapitalisation Communication"), and its *Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules* (hereinafter "the Restructuring Communication").[8]

33. The Commission observes that financial markets have not yet fully returned to normal functioning and the aid scheme envisaged can be considered necessary to preserve the confidence of creditors in the financial system and to avoid a serious disturbance in the Danish economy. That assessment is confirmed by letters from the Danish Central Bank and from the FSA of 21 September 2010. The necessity to preserve financial stability in the Danish financial sector was also confirmed in the Commission's decision on the extension of the Danish Guarantee Scheme of 28 June 2010.[9]

34. Against that background and taking account of the objective of the proposed scheme, which is to contribute to enhancing the stability of the financial system, the Commission considers that this measure is to be examined under Article 107(3)(b) TFEU.

Conditions for compatibility under Article 107(3)(b) TFEU

35. The Banking Communication sets out the following principles applicable to schemes for the controlled winding-up of financial institutions:

    (i) It should be demonstrated that the aid enables the bank to be effectively wound up in an orderly fashion, while limiting the aid amount to the minimum necessary in view of the objective pursued.

    (ii) Appropriate burden-sharing should be ensured, in particular by excluding shareholders and possibly certain types of creditors from receiving the benefit of any aid in the context of the controlled winding-up procedure (point 46 of the Banking Communication).

    (iii) In order to avoid undue distortions of competition, the liquidation phase should be limited to the period strictly necessary for the orderly winding-up.

[6] OJ C 270, 25.10.2008, p. 8.
[7] OJ C 10, 15.1.2009, p. 2.
[8] OJ C 195, 19.08.2009, p. 9.
[9] Commission decision in case State Aid N 257/2010, not yet published.

As long as the beneficiary financial institution continues to operate it should not pursue any new activities, but merely continue the existing ones. The banking licence should be withdrawn as soon as possible (point 47 of the Banking Communication).

36. According to the notification, the value of a distressed bank is better preserved in a controlled winding-up compared to an uncontrolled insolvency of the distressed bank. First, an uncontrolled liquidation procedure, even for smaller banks, could pose a threat to financial stability in the context of the current crisis. Second, regarding potential asset disposals, under current market conditions a swift sale of assets, if possible at all, would be at an excessive discount and would not reflect the real value of assets.

37. Under the scheme, New Bank will cease its activities within a limited time frame. Currently, Denmark committed that New Bank will have its banking license revoked after five years at the latest. This commitment can be considered to be in line with point 47 of the Banking Communication, which clearly states that the liquidation phase should be limited to the period strictly necessary in view of the objective pursued. In light of the current condition of financial markets, the Commission accepts that up to five years can be considered as a reasonable time frame

38. As regards the limitation of the aid to the minimum, it can be held that the aid amount is minimised in so far as the Winding up department is supposed to be financed by member banks. Any losses encountered by the FSC would eventually be covered by the Winding-up Department of the Deposit Guarantee Fund, and thus indirectly by the whole banking sector.

39. In relation to the capital injection needed to allow New Bank to respect capital adequacy requirements, the Commission takes note that the recapitalisation will be limited to the minimum necessary to keep the bank afloat during the winding up.

40. In addition, the Commission considers positively that both the capital injection and any liquidity support granted to New Bank will be remunerated at market-oriented rates, in line with the Banking and Recapitalisation Communications.

41. The Commission recognises that the scheme could imply a higher degree of creditor protection and preservation of the economic activity of the failed bank with respect to the alternative outcome under the standard bankruptcy procedure. However, in line with point 48 of the Banking Communication, the Commission takes account of the fact that the protection of financial stability within the current financial turmoil may imply the necessity to reimburse certain creditors of the liquidated bank through aid measures. Also, it should be noted that the non-subordinated creditors are not fully protected but may lose part of their claims, depending on the value of the assets.

42. As to burden-sharing, the Commission notes that shareholders and subordinated debt holders have to bear the burden of the failure of the distressed bank to the full extent of their claims since they maintain them only vis-à-vis Old Bank, which is a bankrupt estate.

43. The Commission notes that Denmark has taken measures to minimise moral hazard, notably by the exclusion of shareholders and subordinated creditors from the aid as described above, and by removing control from Old Bank's management as New Bank's management will be chosen by the FSC. In the situation of a financial crisis, the Commission considers these measures to be sufficient.

44. Competition distortions are minimised in so far as New Bank is created only to facilitate an orderly winding-up and shall not compete on the market or expand its business but rather engage in actively disposing of its customers within a limited timeframe. In particular, New Bank shall not sign contracts with new customers or grant new loans and shall terminate customers with deposits as soon as possible.

45. The scheme also contains a built-in mechanism that aims at ensuring that no aid trickles down to the buyers if New Bank is sold (as a whole or in parts). Denmark commits to organise an open, unconditional and non-discriminatory sale process and to report to the Commission the details of such tender in the six-monthly reports to be submitted by Denmark.

46. The Commission takes note that Denmark will submit a six-monthly report on the functioning of the scheme and on the developments concerning any Old Bank and New Bank under the scheme. The first report will be submitted six months from the date of this decision.

47. The Commission also notes that Denmark commits to notify individually cases of winding up for banks with assets above EUR 3 billion. The Commission will thus examine on a case-by-case basis the compatibility of the liquidation aid, as well as any aid granted to the economic entity that may be sold during the liquidation phase, for banks having assets above that level.

48. To conclude, the Commission considers that the scheme contains the necessary safeguards to meet the conditions for compatibility under Article 107(3)(b) TFEU until 31 December 2010.

V. DECISION

The Commission concludes that the measures under the scheme are compatible with the internal market until 31 December 2010. Therefore, since it fulfils the conditions to be considered compatible with the internal market under Article 107(3)(b) TFEU the Commission has decided not to raise objections. The Commission notes that Denmark accepts exceptionally the adoption of the decision in the English language.

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Yours faithfully,
For the Commission

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