Subject: State Aid SA.43306 (2015/N) – Belgium
Amendment to the restructuring plan of Ethias – Approval of issuance of additional subordinated debt

Sir,

1. Procedure

(1) By decision of 20 May 2010 ("the Restructuring Decision"), the Commission approved restructuring aid in favour of the insurance group Ethias in the form of a capital injection of EUR 1.5 billion based on the restructuring plan and associated commitments submitted by the Belgian authorities ("the restructuring plan").

(2) On 19 July 2011, in relation to one of the commitments set out in the Restructuring Decision, the Belgian authorities requested a prolongation of the target date for the divestment of Ethias Banque SA, from 31 December 2010 to three months after the regulatory approval by the Banque Nationale de Belgique ("BNB") of the potential buyer. That prolongation was granted by the Commission by decision of 12 September 2011. On 9 November 2011, Ethias received an approval from the BNB to proceed with the sale. Ethias Banque was subsequently sold by the end of 2011.


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On 24 March 2014, the Belgian authorities notified another request to amend the restructuring plan notably in respect of the commitment to fully divest all retail life insurance reserves by 31 December 2013 and of the commitment to remunerate the public shareholders. On 12 June 2014, the Commission adopted a new decision ("Ethias amendment Decision") confirming the compatibility of the aid in favour of Ethias based on a new set of commitments set out in Annex to that decision.3

Since the Ethias amendment Decision was adopted, the Commission, the Belgian authorities and Ethias have had frequent exchanges in the form of meetings, conference calls, exchanges of electronic mails and documents.

On 1 April 2015, the Belgian authorities and Ethias informed the Commission that in the context of the EU-wide Stress Tests conducted in 2014 by the European Insurance and Occupational Pensions Authority (EIOPA), the BNB had found that Ethias will have a particularly low solvency ratio under the Solvency II prudential requirements that enter into force in 2016. In that context, the BNB had requested from Ethias to draft a financial recovery plan.

On 9 June 2015, the Belgian authorities provided the Commission with the financial recovery plan that Ethias had formally submitted to the BNB, listing the measures it intended to undertake in order to strengthen its capital position. Those measures included inter alia a restructuring of Ethias' existing subordinated debt consisting of: (i) a swap of its existing perpetual subordinated debt of EUR 250 million with a new Solvency II-compliant Tier 2 subordinated debt and (ii) an issuance of an additional amount of subordinated debt.

As recorded in point 4.2 of Annex to the Ethias amendment Decision, the Belgian Authorities and Ethias SA4 have committed that Ethias SA would "not reduce the remuneration expectations of the State through the issuance of new capital instruments at any level of the group. Any capital increase will be subject to prior notification to the Commission as an amendment of the restructuring plan and will only be implemented after approval by the Commission" ("the Commitment").

On 13 October 2015, the Belgian authorities submitted to the Commission a formal request – in line with the approach envisaged in the Commitment - to amend the restructuring plan and allow Ethias to perform a capital increase through the issuance of additional subordinated debt.

The Belgian authorities informed the Commission that they exceptionally accept that this Decision is adopted in the English language.

2. FACTS

2.1 Description of Ethias

Ethias SA and its subsidiaries ("Ethias") operate almost exclusively on the Belgian market, offering products to individuals, corporate and public sector clients. At the time of the Restructuring Decision, Ethias was the third-biggest insurer in Belgium with market shares amounting to 13% in the life segment and

4 Ethias SA: refers to Ethias SA only (without any of its subsidiaries).
15% in the non-life segment of the Belgian insurance market. During the run-up to the financial crisis Ethias recorded a significant rate of growth mainly due to its retail life insurance products. At the same time, Ethias accumulated a significant exposure to Dexia shares.

When the financial crisis erupted in 2008, Ethias faced severe solvency and liquidity issues triggered by: (1) the deterioration of the value of its investment portfolio, in particular of its stake in Dexia and (2) the withdrawal by many account holders of significant portions of their 'First' life insurance product. Moreover, Ethias still had to remunerate many policy holders at attractive minimum interest rates and faced difficulties to yield the necessary returns when the market declined. A more detailed description of Ethias' business activities as they existed when the financial crisis erupted can be found in recitals (5) to (30) of the Restructuring Decision.

In order to deal with those solvency and liquidity problems, Ethias received the capital aid measure specified in recital (1).

### 2.2 The Ethias amendment Decision

In the framework of the Ethias amendment Decision in order to preserve a fair level of burden-sharing and alleviate the Commission's concerns in particular with regard to the difficulties experienced by Ethias during the restructuring period in the implementation of its Commitment to remunerate its public shareholders, the Belgian authorities and Ethias SA undertook the following commitments.

i. First, that Ethias, unless the prudential authorities stated otherwise, would continue to pay out, during the prolonged restructuring period, remuneration to the public shareholders grouped in Vitrufin SA subject to a minimum solvency ratio being observed. That remuneration would take the form of a payment of a preferred dividend from Ethias SA towards Vitrufin equal to 10% of the latter's initial investment.

ii. Second, that Ethias would not reduce the remuneration expectations of the State by issuing new capital instruments at any level of the Ethias group.

On the basis of *inter alia* those commitments assumed by Belgium and Ethias, the Commission found that the notified changes did not put into question the burden-sharing assessment made in the Restructuring Decision.

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5 Life insurance products can be broadly categorized into “Group Life” products (including pension payment products for local authorities, reserve fund insurance for local authorities and group insurance for employees and managers) and “Individual Life” products. The various “Group Life” and “Individual Life” products are categorized according to their particular features. ‘Branch 21’ products are typically guaranteed interest rate products such as ‘First’, where the insurer assumes the risk of guaranteeing a minimum interest payment. ‘Branch 23’ products are typically linked to the performance of the stock market with capital guaranteed. ‘Branch 26’ products are aimed at institutional investors and resemble more investment than insurance products.

6 Vitrufin SA is the holding company of Ethias SA, of which the Belgian Federal Government, the Walloon Region and the Flemish Region (‘public shareholders’) own 75%-3 shares and the historic owners of Ethias grouped under Ethias Droit Commun hold the remaining 25%-3 shares.

7 Of 150% and of 100% under ‘Solvency 1’ and under ‘Solvency 2’ prudential requirements respectively.

8 Recorded in Point 4.1 of Annex to the Ethias amendment Decision.
2.3 Description of the request

(15) On 30 November 2014, the EIOPA published the results of its EU-wide stress tests aimed at assessing the overall resilience of the insurance sector under the prevailing low interest rate environment. As described in recital (5) of the present decision, those stress tests resulted in a particularly low solvency ratio for Ethias under the new prudential requirements that have been introduced with the Solvency 2 Directive and will apply as of 2016. In the Solvency 2 framework, the prudential requirements are calculated on the basis of a market-consistent valuation approach. The entry into force of Solvency 2 therefore markedly affects prudential requirements of insurance companies – like Ethias – which cope with an imbalance between high liabilities costs (primarily because of holding retail life insurance policies with guaranteed minimum interest rates) and low asset returns given the low interest rates in Europe.

(16) The solvency ratio of Ethias SA, by 31 December 2015 based on the solvency situation at 31 December-2014, when calculated according to Solvency 2 requirements stands […]. In contrast, at the same juncture Ethias had a solvency coverage ratio of more than 179% under Solvency 1. The following two events that will impact Ethias' capital position in 2015 were taken into account in the above calculation. First, Ethias had lost the appeal it had filed in a tax case against the Belgian tax authorities. As a result, Ethias has to finally recognise in its books a tax payment of EUR 367.5 million. Second, Ethias has been required by BNB to raise the provisions for future losses on its retail life portfolio to offset high guaranteed interest rates on a large portfolio of life insurance policies.

(17) In the course of 2015, Ethias undertook a number of measures to bridge the identified gap.

(18) First, Ethias undertook an operation named Switch IV, to reduce Ethias' retail life reserves by offering to its policy holders of its 'First A' product an exit premium amounting to 4 years of guaranteed interests in return for the full surrender or partial surrender of minimum EUR 100,000 of their policies. Switch IV resulted in a significant reduction of the 'First A' retail life reserves of Ethias of more than EUR 1.8 billion. Despite the upfront losses entailed by the payment of that exit premium, Ethias estimates that due to the Switch IV operation its prospective capital position under a Solvency 2 framework will improve by […].

(19) Further to the Switch IV operation, in accordance with its financial recovery plan on 9 July 2015 Ethias proposed to the holders of its existing perpetual subordinated debt of EUR 250 million to exchange it with a new one that will qualify as Tier 2 capital under the Solvency 2 framework. On 15 July 2015, the transaction was completed, with a participation rate of over 94%. The exchanged subordinated debt amounts to EUR 231.9 million, has a ten and a half year maturity (January 2026) and pays a coupon rate of 5% annually.

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* Confidential information.

10 Recorded in detail in recital (20) of the Ethias amendment Decision.

11 Calculation made on the basis of Solvency 2 figures at 31 December 2014.

12 Annex 2d to the Notification.
As an additional way to enhance its capital position, Ethias is preparing a capital increase, more specifically through the issuance of an additional amount of Tier-2 compliant subordinated debt. As Ethias aims to ultimately gather EUR 150 million eligible Tier-2 capital, the nominal value for the new issuance has been estimated in the range of EUR 150 million to EUR [150-250] million. Once issued those additional bonds will be consolidated with the bonds resulting from the exchange offer and will form one single class and set of bonds, with the same characteristics (essentially bearing a 5% annual coupon rate and a maturity in January 2026).

That capital increase will supplement other remedial measures that are already underway, such as cost cuttings, asset portfolio reshuffling as well as risks management through reinsurance contracts.

3. THE POSITION OF BELGIUM – REQUEST FOR AMENDMENTS

First, the Belgian authorities submit that Ethias has made considerable efforts over the last two years to improve its financial structure through reinforcement of risk functions and accelerated run down of the retail life business. Those efforts were however partly offset by a number of setbacks such as the public debt crisis, the loss of tax litigation and the decrease of interest rates.

They moreover note that the BNB found that under a Solvency 2 framework Ethias would have a low solvency ratio and would run excessive market risks. The BNB requested a strict plan for improving the solvency ratio and blocked any dividend payment until Ethias' solvency ratio reaches the standard of the market. Ethias has already defined a solid plan to improve its efficiency and to reduce its market risks.

The Belgian authorities consider that Ethias' structural profitability of its core business should progressively improve its solvency ratio until the BNB allows the company to pay the preferred dividend to the public shareholders. In that context, EUR 150 million of additional eligible Tier 2 bonds improve immediately the solvency ratio by [5-10] percentage points. The Belgian authorities submit that that amount represents approximately […], which is a significant step that proportionally reduces the expected delay before the payment of a dividend. In addition, they contend that the high uncertainty in the current environment justifies reinforcing immediately the capital of the company to help it adjust with the Solvency 2 framework.

Furthermore, the Belgian authorities consider that reinforcing the capital of Ethias to bring it closer to market standards should allow for a better valuation of the company, which ultimately benefits its shareholders.

The Belgian authorities confirm that the described issuance will be done at market price and the majority of the issued bonds shall not be placed with public investors. Moreover, the public shareholders shall not invest in those bonds.

Considering that Ethias' existing EUR 231.9 million subordinated debt is currently traded at approximately 85%, the nominal value of the additional subordinated debt will be issued at a price comprised in the range of [60-100]%-[60-100]% below par.
Lastly, the Belgian authorities notice that the BNB considers the operation as a necessity and a key element of the new plan.

4. **ASSESSMENT**

4.1 **Legal Basis**

Regarding the legal basis for the present decision, it should be noted that the question regarding the Commission's authorisation being required before Ethias performs a capital increase arises in the context of the implementation of the Ethias amendment Decision. In light of the commitments made by the Belgian authorities and Ethias SA, the Ethias amendment Decision allows a capital increase in Ethias only such a step has been authorised by the Commission. The present decision will thus deal with the implementation of the Ethias amendment Decision and the Commission must assess whether the capital increase in Ethias through the issuance of additional subordinated debt in Ethias SA can be permitted.

4.2. **Issuance of additional subordinated debt**

The Commission observes that in line with the Commitment, Ethias SA should not reduce the remuneration expectations of the State through the issuance of new capital instruments at any level of the group and should obtain the Commission's approval prior to implementing a capital increase at any level of Ethias group. As described in recital (13) the Belgian authorities provided that Commitment to alleviate the Commission's concerns about Ethias capacity to remunerate the State capital in the future and thus to ensure that the burden-sharing requirements of point 24 of the Restructuring Communication would be met. The Commission furthermore observes that the Commitment further achieves that burden-sharing function by restricting Ethias from performing a capital increase that would potentially reduce (through dilution of the public shareholders) the economic or legal ownership of the State in Ethias.

The Commission first notes that in line with the terms for the issuance of the additional subordinated debt, Ethias will have the legal obligation to pay out to the holders of the instrument a coupon of 5% annually. Moreover, and given that the subordinated debt is issued at a price below par, Ethias will have to pay a notional amount that is higher than the capital raised. In consequence, via that coupon payment and the loss to be incurred by the discount to par at issuance, Ethias' profits available to ordinary shareholders will be effectively reduced and so will the remuneration possibilities of the State. The remuneration that Ethias pays out to its public shareholders takes the form of dividends. The Belgian authorities have nevertheless requested that Ethias be allowed to proceed with the capital increase. The Commission thus has to assess whether that request is well-founded and whether the new issuance will not unduly affect the remuneration expectations of the State.

The Commission finds that the request of the Belgian authorities is well founded. The ground for the request to increase the capital of Ethias derives from an actual

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15 See recitals (49)-(50) in the Ethias amendment Decision.
capital shortfall identified by the BNB which has set out a formal requirement for Ethias to strengthen its solvency position. The Commission further notes that in part the capital shortfall comes in consequence of the changes to the regulatory framework to which Ethias is subject.

(32) The Commission notes positively that Ethias has initiated several far-reaching measures to address the shortfall and strengthen its capital position. For instance, the Switch IV operation, described in detail in recital (18), resulted in a significant reduction of the retail life reserves of Ethias which, given the prevailing low interest environment was (a) a source of losses (as the return on assets could not offset the interest rate guaranteed) and (b) highly capital consuming under Solvency 2. In addition, Ethias will reduce its operating costs to increase its profitability and thereby improve its capital position and its potential to remunerate the State. The issuance of new subordinated debt is therefore used to cover a limited part of the capital needs and is to be carried out only after the latter has been significantly reduced by other measures.16

(33) The Commission further notes positively that that new issuance will mainly be placed with private and not public investors and that the public shareholders shall not invest.

(34) The Commission also welcomes the fact that the capital increase is implemented through an instrument that effectively preserves the economic and legal ownership of the State in Ethias.

4.3 Replacement of Ethias existing subordinated debt

(35) With respect to the transaction described in recital (19) consisting of Ethias' offer to the holders of its existing perpetual subordinated debt of EUR 250 million to exchange that debt with a new dated Tier-2 compliant instrument, the Commission considers that as the current debt was replaced by one with a slightly smaller notional (EUR 231.9 million), that exchange does not qualify as "capital increase" within the meaning of Commitment set out in point 4.2 of the Annex to Ethias final Decision. The Commission is therefore not required to authorise that transaction. Nevertheless, the Commission finds that the exchange did not materially affect the remuneration expectations of the State as the remuneration of the exchanged instruments is comparable.17

4.4 Conclusion

(36) For the reasons set out above, the Commission has no objection to the notified increase in the capital of Ethias via the issuance of additional subordinated debt in Ethias SA.

16 Based on the recovery plan that Ethias submitted to the BNB, approximately […] of the capital gains stem from forthcoming management measures (excluding the capital gain from the Switch IV operation) while […] relates to the issuance of subordinated debt.

17 Ethias pays on the new subordinated debt a coupon of 5%. Ethias paid a 4.75% fixed coupon on the former subordinated debt. It would have become callable in December 2015 at issuer's option. If not called, the coupon would have become a quarterly floating coupon at 2.2% above the 3-month EURIBOR rate, i.e. a total rate well above 5%.
5. **CONCLUSION**

The Commission therefore has no objection that Ethias increases its capital through the above described issuance of additional subordinated debt in Ethias SA.

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Your request should be sent electronically to the following address:

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Yours faithfully  
For the Commission

Margrethe VESTAGER  
Member of the Commission

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