



EUROPEAN COMMISSION

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**Subject: State Aid NN51 /2008 – Denmark
Guarantee scheme for banks in Denmark**

Sir,

I. PROCEDURE

1. On 8 October 2008 Denmark notified a guarantee scheme for deposits and senior debt in banks in Denmark.

II. DESCRIPTION

1. The objective

2. The scheme mainly comprises two components:
 - A State Guarantee that covers depositors and creditors of all scheme member banks (for the amounts that are not covered by the Danish Deposit Guarantee Scheme)
 - A winding up company / vehicle that will be set up, owned and capitalised by the State to be available for any scheme member banks that fail.
3. The objective of the schemes is to set up a safety net for two years so that all claims against Danish banks by depositors and senior debt (unsecured unsubordinated debt) are fully covered. This will safeguard financial stability by contributing to the resumption of interbank lending. Thereby, the international market-failure where even healthy banks are having trouble getting access to liquidity should be overcome.
4. The state will establish by statute a company whose purpose is facilitating the winding-up of insolvent banks, so that the depositors and other ordinary creditors can be repaid pursuant to the guarantee in the context of an orderly winding up. In case a bank becomes insolvent, the winding-up company will provide capital to a newly-established company which will take over and wind up the insolvent bank. The winding-up company will continue its business after the expiration of the scheme.

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5. The objective of the scheme is therefore twofold:
- As a primary objective, the guarantee on deposits and senior debt will enable the Danish banks to get again access to the interbank lending market and obtain liquidity.
 - As a secondary objective, depositors and other ordinary creditors will be protected from suffering losses by their claims against insolvent banks being paid in the context of the controlled winding-up of insolvent banks (which process may include the disposal of certain assets of such banks on market terms).

2. Beneficiaries

6. The basis of this scheme is an agreement between the members of the Det Private Beredskab ("DPB" - Danish Private Contingency Association) and the State (hereinafter "The Agreement"). The scheme acts as a complementary supplement to the Danish Deposit Guarantee Scheme. The agreement will be transformed into legislation (Financial Stability Act). Participation into the scheme is voluntary. All solvent banks in the Kingdom of Denmark with a banking licence which are members of DPB are able to participate in the scheme. This includes full coverage of subsidiaries of foreign banks. Also branches of Danish banks abroad (if they are not covered by similar schemes in other Member States), as well as branches in Denmark of foreign banks (depositors only) are eligible for the scheme. Overall Denmark estimates that about 140 banks are eligible.
7. Registration for the scheme will only be possible for a short entry period of time after the announcement of the scheme in order to ensure that no banks or branches of foreign banks are established with the aim of benefitting from the scheme. It is not possible for a particular bank to withdraw from the agreement after the entry period.

3. Form and amount of the aid

8. The scheme guarantees depositors and ordinary creditors against losses to the extent that the losses are not covered by the Deposit Guarantee Scheme, other investor arrangements, or covered by other means. The guarantee does not cover covered bonds and subordinated debt.

4. Legal basis of the scheme

9. The scheme is based on the Financial Stability Act, which entered into effect on 10 October 2008.

5. Conditions for granting the aid

10. The guarantee scheme is founded on a strong financial contribution by the participating banks. The DPB will contribute up to DKK 35 billion (€ 4.6 billion equivalent to 2% of GDP). The contribution consists of three different elements: First, DPB will provide a DKK 10 billion loss guarantee to cover losses in the winding-up company. Second, DPB will pay an annual guarantee commission of DKK 7.5 billion to the State. Third, in the case the estimated losses¹ after the expiry of the guarantee scheme² exceed DKK 25

¹ Including interest on provided capital of the winding-up company.

billion (DKK 10 billion loss guarantee plus DKK 15 billion guarantee commissions), DPB will cover additional losses for the amount of maximum DKK 10 billion via an increased guarantee commission.

11. Any losses incurred by the winding-up company exceeding the DKK 35 billion will be taken over by the Danish state. Denmark estimates that in a base case scenario the scheme will need to cover expenses of at least DDK 10 billion. Thus the total costs for the banks are estimated to be DDK 25 billion.
12. DPB will decide for itself how the cost of the guarantee commission is to be apportioned between the individual banks. Each institution's contribution will be calculated in relation to its required capital according to the solvency rules, which can be assigned to activities which are covered by the guarantee. The guarantee commission is collected on a monthly basis.
13. Under the Agreement on which the scheme is based, the banking industry must complement the safety net by adopting a cautious approach and strengthening their balance sheets during the two year period. Therefore, the safety net is combined with a ban on dividend payments and share repurchases by banks as well as new stock options for management. Expiring stock option programmes shall not be renewed or extended.
14. Banks participating in the scheme may not undertake mass marketing invoking of the fact that the ordinary creditors are now insured against losses. Moreover participating banks may not undertake a significant expansion of their activities which would not have taken place in the absence of the arrangement. DPB commits itself to inform the Financial Supervisory Authority (hereinafter "FSA") if members appear to be abusing the arrangement. In this regard the FSA will monitor the banks based on a series of quantitative indicators such as growth in loans, exposure to certain sectors, concentration risk, growth in risk-adjusted loans etc.
15. If based on these indicators, a bank's behaviour deviates from the prudent approach required by the Agreement, the FSA can issue an order that will be made public. If a bank does not comply, it can be expelled from the scheme.
16. The Agreement also recognises the need to examine the adequacy of the financial regulatory system after the expiry of the scheme.

6. Duration of the scheme and bi-annual reports

17. The scheme is limited to period of two years with the possibility of a prolongation if the financial stability concerns necessitate its continuation (that means that after two years the guarantee expires independent of the maturity of the debts initially covered). Prolongation is conditional to approval by the Commission.
18. The Danish authorities undertake to present every six months reports on the operation of the scheme containing the information specified in the relevant rules on standardised

² After the expiration of the arrangement, the value in the winding-up company is calculated. On that basis possible losses of the winding-up company are calculated.

reports.³ The six months reports will also include a list of all beneficiary companies indicating for each of them the necessary data to understand the full scope of the support measures.

7. Restructuring of insolvent banks

19. Banks in difficulties (i.e. those that call on the guarantee) are committed to transfer all assets and liabilities, (except subordinate capital) to a third party or to the winding-up company owned by the state. Banks that purchase such assets and liabilities must pay a market price.

III. POSITION OF DENMARK

20. The Danish authorities accept that the guarantee scheme contain State aid elements.
21. The Danish authorities seek urgent authorisation for the rescue scheme. According to the Danish authorities the international financial crisis has affected financial markets in Denmark, frozen the money market and severely impeded the access to liquidity for many banks. The situation is regarded with great concern given the international market-failure where even healthy banks are having trouble getting access to liquidity. This threatens financial stability in Denmark and if unaddressed may cause significant disruptions to firms and households.
22. The Danish authorities further explain that the aid scheme must be warranted on grounds of “serious social difficulties” and declare that the scheme can be declared compatible with the common market to remedy a serious disturbance in the Danish economy pursuant to Article 87(3)(b) of the EC Treaty.
23. A letter sent by the Danish central bank dated 8 October 2008 confirms that the notified measures are urgently required to prevent harmful spill-over effects on the entire Danish financial system and on the economy as a whole.
24. The Danish authorities declare that the notified scheme does not involve any unduly adverse spill-over effects on other Member States or undue distortions of competition. The measures are not limited to purely Danish companies and therefore are open and non-discriminatory and do not threaten to distort competition.
25. The Danish authorities submit that all possible measures have been taken in order to ensure the Commission that the scheme will not allow the banks to expand their capacity. In this respect several safeguards have been included in the scheme (see details above II.5).
26. In particular, the Danish authorities commit that they will monitor and review the expansion of the activities of participating banks in total in order to ensure that their aggregate growth in balance sheet volume does not exceed :

³ Annex III. A and B (standardised reporting format for existing State aid) to Commission Regulation (EC) No 749/2004 of 21 April 2004 adopting provisions for the implementation of council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 140, 30.4.2004, p. 1).

- the annual rate of growth of Danish nominal GDP in the preceding year, or
- the average historical growth of the balance sheets in the Danish banking sector during the period [1987-2007], or
- the average growth rate of the balance sheet volumes in the banking sector in the EU in the preceding six months,

whichever is the higher.

If the activities of the participating banks in total exceed the above thresholds, the Danish Financial Supervisory Authority will examine whether the conditions for participating in the scheme are fulfilled in accordance with § 13 in the Financial Stability Act. If the thresholds are exceeded the Danish authorities will take as a matter of urgency the necessary measures to adjust the guarantee scheme in order to re-establish the discipline, unless there is evidence that the thresholds are exceeded for reasons unrelated to the guarantee scheme.

27. The Danish authorities commit to seek the Commission's approval, should the need be for the measures to continue beyond the set two years period. Furthermore the Danish authorities commit to report to the Commission on a 6 months basis on the scheme.
28. The Danish authorities commit to notify individual cases of winding up of insolvent banks by the winding-up company, unless the assets of the bank are fully liquidated and the bank is of insignificant size (< € 3 billion balance sheet)

IV. ASSESSMENT

29. The Commission observes that the scheme is made up of several components. The Commission understands first that the main focus of the scheme is to stimulate the provision of liquidity by providing a guarantee covering all senior debt as described above in point (8). However, the Commission understands second that the scheme also foresees the controlled winding up of insolvent banks.

1. State aid character of scheme

30. As set out in Article 87(1) EC, 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 common market.

a. The guarantee on debt

31. The guarantee on the existing as well as the new issued debt allows the participating banks first, to get again access to the interbank lending market and obtain liquidity, and second, to obtain the required liquidity at advantageous conditions, which are similar to that of the Danish state. This gives an economic advantage to the beneficiaries and strengthens the position of these beneficiaries compared to that of their competitors in Denmark and other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. The advantage is selective since

it only benefits the beneficiaries of the scheme and is provided through State resource. It distorts or threatens to distort competition and has an effect on trade.

32. The Commission is of the view that the guarantee would not have been provided by a market economy investor. First, no private investor would have granted such a guarantee on all senior debt of the participating banks in the current circumstances of financial crisis. Second, this finding is not altered by the significant participation of the banks themselves. To this end, the Commission recalls that, to fall outside Article 87(1) EC, a public intervention must not only be made in parallel with other private interventions, but the interventions needs to be proportionate to each party's interests, and must be provided under the same conditions⁴ and industrial rationale.⁵ Against this background the Commission notes that the banking industry contribution is capped to € 35 billion DKK, while the Danish State is exposed to unlimited liability above this figure and it is only the unlimited exposure of the State that confers sufficient credibility on the guarantee to provide the reassurance required for the guarantee to achieve its intended effect of restoring the banks' access to liquidity. Moreover, while the banking associations obtain a direct benefit from the guarantee, the State does not. It merely does so indirectly by avoiding spill over effects to the entire economy, a consideration that is irrelevant to a private investor.
33. The measures therefore constitute State aid within the meaning of Article 87(1) of the EC Treaty.

b. The winding-up of insolvent banks

34. As regards the winding-up of insolvent banks, the state will establish a company by statute with the purpose of facilitating the winding-up of insolvent banks. The winding-up company is a vehicle which the state establishes in order to minimise the losses stemming from the above guarantee to depositors and other ordinary creditors.
35. It is clear that the guarantee has the above described effect that depositors and other ordinary creditors do not suffer losses during the winding up phase on their claims against insolvent banks. However, for reasons of completeness it should be noted that the provision of the guarantee in the context of the winding up of a bank also provides an advantage to the depositors and creditors. Given that these depositors and creditors act Europe wide, this also has an effect on trade and thus distorts competition in the sense of Article 87 (1) EC. However, the Commission reiterates that this effect is essentially the other side of the coin of the guarantee and it will therefore be considered as an integral part of the guarantee to the banks, in particular within the compatibility assessment.
36. It can however not be excluded that in the liquidation process of an insolvent bank additional resources (above those necessary to cover the claims of the ordinary creditors) are provided to the company. Such a situation may arise if a bank is not totally liquidated, but some of its assets are sold, for which purpose aid might be granted to assist the sale. Given that Denmark provided a commitment (see above point 28) to notify all cases where the assets of the bank are not fully liquidated and the bank is not of insignificant size (< € 3 billion balance sheet) the Commission sees no reason to assess this possibility further at this stage: any aid granted on such a sale, e.g. by way of a negative sales price,

⁴ Communication on public undertakings in the manufacturing sector, OJ 1993 C 307, page 3.

⁵ Commission Decision in Case C25/2002 *Carsid*, OJ 2005 L 47, page 28, at points 67 to 70.

falls outside the scope of this Decision and would be assessed in the context of the relevant notification.

37. In case of the sale of a bank of insignificant size, although this will not entail an individual notification, the Commission understands that Denmark will ensure that also in such cases no aid is granted to the buyers of (a part of) the bank or to the sold entities, and that the sales process would be open and non-discriminatory and that the sale would take place on market terms.⁶

2. Compatibility of the scheme

a. The guarantee on debt

Application of Article 87(3)(b) EC

38. Denmark intends to provide operating aid under a scheme which is granted to assist banks that have problems accessing liquidity. Given the present circumstances in the financial market, the Commission considers that it may be acceptable to examine this measure directly under the Treaty rules and in particular under Article 87(3)(b) EC.
39. 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."⁷
40. The Commission considers that the present scheme concerns the entire Danish banking industry. In fact, the Commission does not dispute the analysis of Denmark that there is a clear international market-failure where even healthy banks are having trouble getting access to liquidity, which shall be overcome by the scheme. The Commission also considers that this shortage of liquidity will not only result in difficulties for the banking sector but due to its pivotal role in providing funds to other sectors is having a systemic effect for other industry sectors and thus the entire Danish economy. The Commission does not dispute that the present scheme is suitable to overcome the inaccessibility for liquidity to Danish banks. Hence it finds that the scheme is apt to remedy a serious disturbance in the Danish economy.

⁶ Cf. the Commission's rules on privatisation, Commission, 23rd Competition Report, 1993, page 270. In addition, this implies that no conditions are attached to the sale and that no guarantees should be granted by Denmark in respect of the sold (parts of) the bank. The winding up company should aim at maximising the sales price, without the grant of further aid, either in the form of capital or through conditions favouring the undertaking disposed of (See Commission decision of 27 February 2008 in case C 46/2007 - *Privatisation of Automobile Craiova*, not yet published).

⁷ Cf. in principle case Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Confirmed in Commission Decision in case C 47/1996, *Crédit Lyonnais*, OJ 1998 L 221/28, point 10.1, Commission Decision in Case C28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, page 1, points 153 *et seq* and Commission Decision in Case C50/2006 *BAWAG*, not yet published, points 166. See Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, OJ C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, *Rescue aid to WestLB*, OJ C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

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

41. Although there is no established practice as to the conditions for compatibility of aid granted under Article 87 (3) b) EC, it must be stressed that in order for such aid to be compatible, any aid or aid scheme must comply with general criteria for compatibility under Article 87 (3) EC, viewed in the light of the general objectives of the Treaty and in particular Article 4 (2) EC, which imply compliance with the following conditions:
- 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.
 - 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.⁸
 - c. *Proportionality*: The distortions of competition must be properly balanced against the positive effects of the measures. Hence the distortions must be limited to the minimum necessary to reach the 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) EC which authorises State aid must ensure that such aid must be limited to that necessary to achieve its stated objective, limiting to a minimum consequential distortions of competition.

Assessment of the conditions for compatibility under Article 87 (3) (b)

42. First, as regards appropriateness, as stated above the objective of the schemes is to set up a safety net so that all claims against Danish banks by depositors and senior debt (unsecured unsubordinated debt) are fully covered. This is a reaction to the international market-failure where even healthy banks are having trouble getting access to liquidity shall be overcome. This is due to the fact that banks have lost confidence in lending money to each other given that the risk of failure is too high. This risk is avoided by the present guarantee mechanism. Consequently the scheme should allow for a revival of the interbank lending in Denmark.
43. Moreover, the scheme is targeted at the appropriate beneficiaries as the eligibility of participating firms is limited to in principle solvent companies. Already insolvent companies are excluded. This follows *a contrario* from the fact that in case a bank becomes insolvent, companies must be unwound. Indeed, the sole provision of a

⁸ 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 [...]."

guarantee on debt in order to get additional liquidity is not appropriate as these companies need not only additional liquidity but need to be unwound in a controlled fashion. As noted above, the calling of the guarantee would also provide a benefit to depositors and creditors, but this is an inherent feature of the guarantee and does not alter the Commission's assessment, the restoration of depositor and creditor confidence being essential to the underlying objectives of the measure.

44. Furthermore, entry and withdrawal from the scheme are possible for only a short period of time after the announcement of the scheme so as to make sure that only already existing companies may participate.⁹
45. In sum, the Commission considers that design of the present scheme is appropriate to remedy a serious disturbance of the Danish economy.
46. Second, as regards necessity, the guarantee mechanism, whereby a safety net is established to cover all claims against Danish banks by depositors and senior debt are fully covered, is limited to the minimum necessary in scope and time.
47. As regards scope, the Commission does not dispute the position of Denmark that several measures are needed to restore confidence of lenders. In this respect it seems not sufficient to reduce the guarantee to retail deposits as this would only avoid bank runs but not restore confidence of the institutional lenders. Moreover, the Commission notes positively that subordinated debt is not guaranteed.
48. As regards time the Commission does not dispute that two years are the minimum necessary for such scheme to safeguard financial stability by contributing to facilitate the resumption of interbank lending. Six months might be sufficient in an individual case where a follow up is envisaged (such as rescue aid) but not where the measure is aiming at establishing financial stability in the whole Danish banking sector.
49. Third, as regards proportionality, the distortions of competition seem minimised by various safeguards.
50. Above all, the aid amount is minimised through a private banks contribution in the guarantee mechanism. The maximum financial contribution of the participating banks is DKK 35 billion (e. g. 2 % of GDP in Denmark) and the minimum is de jure DKK 15 billion. However it must be noted that Denmark estimates in a base case, a minimum of DKK 10 billion should be needed to cover all estimated expenses. In this case the banks would still need to pay the annual fee and thus DKK 25 billion. That would imply that the scheme would be self financing even beyond the base case scenario.
51. Moreover, it can be estimated that in this way the banks pay on average an adequate premium. Considering that the banks will pay in a base case a minimum contribution of DKK 25 billion, this translates in view of the overall debt covered, which is estimated to be around DKK 3,500 billion into an average annual premium of each bank of almost 0.4 % per annum. This is in line with the simple evaluation for SMEs with strong payment capacity for being aid free under the guarantee notice¹⁰.

⁹ A similar principle is imposed by point 12 of the rescue and restructuring guidelines
¹⁰ OJ C 155/10 of 20.6.2008.

52. Finally, the scheme includes several strong behavioural constraints which help to ensure that the participating banks do not expand their activities under the scheme and thus do not receive more support than necessary for re-establishing their long term viability.¹¹ This concerns a limitation of the expansion of activities on an individual and an aggregate level of all participating banks against clear benchmarks (see above point 25). To this end the Danish FSA will monitor the banks based on a series of quantitative indicators such as growth in loans, exposure to certain sectors, concentration risk, growth in risk-adjusted loans etc.
53. In addition the behavioural commitments also aim at fostering long term viability of the participating banks, so that the participating banks will at the end of the scheme be able to obtain loans on their own financial strength again.¹² For example, the participating banks must display a cautious approach and strengthening their balance sheets during the granting period. The scheme is combined with a ban on dividend payments and share repurchases by banks as well as new stock options for management.
54. Fourth, as regards coherence with other principle of the rescue and restructuring guidelines Treaty the Commission notes that many of the overriding principles such as fostering viability, aid being limited to the minimum and safeguards compensating distortions of competition are also included in the scheme. Moreover, Denmark committed to report on the functioning of the scheme on a bi-annual basis.

b. The winding-up of insolvent banks

55. The Commission explained above that a controlled winding-up of (parts of) a bank may contain additional elements of state aid on top of the debt guarantee. The compatibility of such aid will in cases where the assets of the bank are not fully liquidated and the bank is not of insignificant size (< € 3 billion balance sheet), be assessed on an individual basis (see above point 36). However, in other case it can be considered as compatible liquidation aid if it complies with the following considerations, which the Commission understands to be inherent to the scheme.
56. Any aid given in a controlled winding-up procedure, where the bank itself is disappearing must in principle be considered as liquidation aid. Considering that the bank's assets and liabilities will be sold to other market participants (rather than being transferred to a succeeding entity), the liquidation aid would not be covered by the Guidelines, but the basic principles of the Guidelines should however apply *mutatis mutandis*.
57. In particular, in view of the minimum necessary principle this would imply that first a private sector solution is considered, before committing any additional state resources which is indeed required for in the agreement between the State and DPB. In addition, it the Commission understand that Denmark aims at seeking the least expensive solution should be sought. This implies that winding-up of a bank will be pursued if economically more advantageous than selling the bank. Moreover, it is clear that if the bank continues to operate, it will not pursue any new activities, but merely phase out the ongoing operations.

¹¹ A similar principle is imposed by point 44 of the rescue and restructuring guidelines.

¹² A similar principle is imposed by point 37 of the rescue and restructuring guidelines.

V. DECISION

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

Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission