EUROPEAN COMMISSION

Brussels, 3.2.2009
C(2009) 776 final

Subject: State aid scheme N31a/2009 – Denmark
Recapitalisation of credit institutions and amendments of the guarantee scheme

Sir,

I. PROCEDURE

(1) On 23 January 2009 Denmark notified a recapitalisation scheme for credit institutions in Denmark and amendments of the guarantee scheme for banks in Denmark (hereinafter "existing guarantee scheme")[1]. The notification includes also the introduction of a state export lending, which is not dealt with in the present decision.

(2) On 28, 29 and 30 January 2009 the Danish authorities submitted additional information.

II. DESCRIPTION OF THE MEASURES

(3) The legislative proposal for the recapitalisation scheme and a proposal to amend the Law no. 1003 on financial stability (The Financial Stability Act) containing the guarantee scheme have been presented to the Danish Parliament for approval on 3 February 2009.

A) Recapitalisation of credit institutions

Objectives and beneficiaries

(4) According to the Danish authorities, the aim of the recapitalisation scheme is to stimulate the supply of credit to viable and healthy undertakings and households by increasing the capital and the solvency of credit institutions in Denmark and thus enhancing their possibility to offer finance to the real economy.

[1] Commission decision of 10 October 2008 in case NN51/2008, Guarantee scheme for banks in Denmark, OJ C 273/2008 of 28.10.2008

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(5) The recapitalisation scheme is open to all solvent credit institutions, i.e. banks and mortgage credit institutions fulfilling the solvency requirements fixed by the Danish Financial Supervisory Authority. Subsidiaries of foreign banks in Denmark are included in the scheme, as they exist in Denmark as independent legal persons.

(6) All credit institutions in Denmark that operate in conformity with the capital requirements of the Danish Financial Business Act may apply to receive from the State an injection of hybrid capital. The application shall include an explanation of the economic situation of the financial institution as well as the future perspectives and the Internal Capital Adequacy Assessment. The situation of the bank pre and post capital injection is analysed on the basis of financial ratios (leverage ratio, loan deposit ratio, cost income ratio, etc.). The assessment of the application information will be completed by a statement from an independent auditing company.

(7) With its recapitalisation scheme the Danish authorities aim at supporting only fundamentally sound banks, for which they have set up the described screening mechanism. However should Denmark nevertheless recapitalise a bank that is not fundamentally sound in the sense of the Commissions Communication on Recapitalisation of 5 December 2008, the Danish authorities commit to notify a restructuring plan to the Commission after six months and to request a remuneration that is at least the price for distress banks indicated in the Recapitalisation communication.

(8) In addition, the Danish authorities commit to send the list of the beneficiary banks at the time of the capital injection and all the relevant information to allow the Commission to take an informed view. Denmark further commits that if the Commission concludes that the beneficiary institution can not be considered as fundamentally sound, the institutions will be at least pay the price for distress banks indicated in the Recapitalisation communication and provide a restructuring plan not later than 6 months after the injection of the capital.

Temporal and material scope

(9) Until 30 June 2009, eligible credit institutions may apply to receive from the State capital injection of hybrid capital. The Danish authorities have given a commitment that any extension of the application window will be notified to the Commission.

(10) Denmark explains that the Danish economy is particularly affected by the current crisis. The turmoil in the financial markets has made growth in the Danish economy slow down faster than expected. The outlook for the export markets is less favourable than in other Member States, and private consumption is dampened by tightened credit terms, weaker development in the housing and stock markets and deteriorating consumer confidence. Housing prices continue to fall. At national level, the prices of single family and terraced houses fell by approximately 5 % in the 3rd quarter, and the prices of flats fell by approximately 10 % compared with the same period of 2007. Housing prices have declined most in Greater Copenhagen. The number of homes sold also continued to drop and reached the lowest level since 1995 when the compilation of these statistics commenced. At the same time, the number of homes for sale remains very high. The lower housing prices have influenced developments in the construction sector, where activity and employment are declining. The trade, hotels and restaurants sector is also affected by the reduced demand, and retail sales are falling. As a result, there has been a

substantial rise in the number of failing companies, and in October 2004 the monthly total reached 1994 levels. Falling housing and stock prices have reduced household wealth. First time buyers in areas that have seen substantial price drops are most vulnerable, and several homeowners have become technically insolvent. Unemployment is expected to rise in the coming year.

(11) In view of this specific situation, Denmark offers to its credit institutions having before the capital injection a Tier 1 capital of 9% or above, a maximum increase in Tier 1 capital of 3%. This should in no case exceed 12% Tier 1 capital. Credit institutions with an initial Tier 1 capital below 9% will be offered a capital injection so as to reach 12%. Credit Institutions with a Tier 1 capital of or below 6% can apply for the capital injection only after individual negotiations with the Danish Authorities.

(12) A Tier 1 ratio of about 12% should increase the bank's ability to get funding in the capital markets and be able to support lending to the real economy.

(13) The 12% Tier 1 target level is supported by a stress test conducted by the Danish National bank[2] for the 15 largest Danish banks based on three scenarios[3]. The stress tests arrives at the conclusion that in order to avoid problems for the 15 banks meeting their individually calculated capital needs, a Tier 1 ratio of 13.5% is required. The stress test model takes into account that, under the State guarantee issued in October 2008, the banks are not allowed to pay dividends for the next two years and that the government guarantee puts the banks to expense in the form of own contributions to the guarantee scheme. The negative economic shocks will exert pressure on the banks' earnings and capital adequacy. Already in the baseline scenario, several banks are likely to have problems meeting their individually calculated capital needs. Additional negative factors, which are not included in the stress test (e.g. extra payment to the winding-up company, liquidity risks, risk that the economy has not normalised by the end of 2010), could put the banks' capital adequacy under pressure.

(14) A letter from the Danish Central Bank of 27 January 2009 confirms that, in order for the Danish banking sector to be able to withstand negative economic shocks, it is vital that the banks get access to the level of Tier 1 capital envisaged in the recapitalisation scheme.

(15) The Danish authorities commit that when assessing the soundness of the banks, they will not grant the capital until it is ensured that the capital injected in the credit institutions is limited to the minimum necessary, in particular that the bank has made the maximum possible own contribution to increase its Tier 1 ratio without impeding its viability. The Danish authorities will send the Commission the necessary information to

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[2] See report Financial stability 2008, 2nd half of 12 January 2009 (http://www.nationalbanken.dk/C1256BE9004F6416/side/9D5E7E2246BE3E5FC1257535003FA1E1/$file/fin_stab_uk_2-2008_web.pdf) in particular page 47ff

[3] Scenario 1: The financial crisis leads to a deep international recession, entailing lower demand for Danish products. Central banks worldwide adopt a more expansionary monetary-policy stance, and interest rates fall where possible.
Scenario 2: The financial crisis has prompted the Danish banks to significantly reduce their lending. The Danish economy experiences a credit crunch in that creditworthy borrowers are unable to obtain bank loans. Housing prices plummet.
Scenario 3 combines scenarios 1 and 2. A deep international recession is assumed to coincide with a credit crunch in Denmark. The scenario envisages a historical decline in economic activity.

take an informed view of this assessment in the context of the ad hoc reporting indicated in point (7).

(16) The Danish authorities estimate that the recapitalisation scheme, on the basis of recent data provided by the eligible institutions, will involve approximately DKK 100 billion (around € 13.5 billion) if all eligible institutions apply for the capital injection to obtain a minimum of 12 % of Tier 1 capital.

(17) As an alternative to a full, direct capital injection by the State, the scheme includes the possibility for eligible credit institutions to raise the funds on the capital market from private investors. In this case the State will provide an underwriting guarantee. This means that the state will buy any residual capital, if private investors do not cover the full capital. The conditions of the State intervention will be the same as those under the recapitalisation scheme.

Characteristics of the recapitalisation instruments

(18) The State capital injection will consist of a hybrid capital with no final maturity date and no voting rights. In case of bankruptcy, losses will be covered first by equity, then by the hybrid capital instrument, then in turns by other forms of subordinated capital (e.g. Tier 2 capital) and by other creditors. The payment of the interest on the hybrid capital will be non cumulative.

(19) The remuneration is fixed individually for each financial institution based on an evaluation of the bank's capitalisation and risk-profile. On the basis of a number of underlying criteria, such as basis capital, capital gearing, deposit deficit, liquidity risk, earning and quality of credit, the credit institutions will be classified as objectively as possible transparent grounds in three price categories (and two subcategories).

(20) Credit institutions will be divided into three groups with an interest rate ranging from approximately 9% for group I (Credit institutions with a rating of AA- or above[4]) a middle pricing of approximately 9.55% for group II (institutions with a rating between A- and A+) and up to approximately 11.25% for group III (institutions with a rating on BBB+ or below). Accordingly, the price for the capital injection will correspond to a cumulated expected yearly return of on average approximately 10%. Credit institutions without rating will be compared to rated institutions based on a number of underlying criteria as specified in the previous paragraph.

(21) As of the fourth year after the issuance, interest rates will be fixed at the higher between the fixed interest rate and 125 % of the dividend payments to ordinary shareholders.

(22) As to the reimbursement of the capital injection, it can be reimbursed after the third year at 100% of the face value plus interests. After the fifth year, the instrument is callable at 105 % of the face value plus interests, and as of the seventh year at 110%.

(23) Denmark has no conversion rights and the reimbursement of the capital cannot be reimbursed by the beneficiaries before the beginning of the fourth year. The hybrid instrument is transferable, in case Denmark chooses to sell the hybrid capital. The rationale for not allowing exit before the minimum period of 3 years is to create the

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[4] The latest rating of each credit institution will be applied.

necessary stability for the institutions to provide a clear incentive to beneficiaries to pursue an active lending policy, which effectively addresses the credit squeeze.

Behavioural safeguards

(24) Institutions obtaining a state capital injection have to commit to promote lending to the real economy, taking into account the actual economic cycle and the perspective of running a viable, healthy and responsible business.

(25) The agreement between the state and the individual credit institution shall state that the capital injection is made with the purpose of increasing lending and preventing a credit squeeze. Beneficiaries will have to report every 6 months on the development of their actual lending and of their lending policy. These reports will be consolidated and published. The public version will include information such as the share of credit to households and companies, including industries, types of lending and size of loans as well as a qualitative explanation of the credit policy including changes in credit conditions. The Ministry of Economic and Business Affairs will every six months produce a consolidated report explaining the development in credit flows, which will be discussed with the relevant organisations and parties behind the political agreement.

(26) Danish subsidiaries of foreign credit institutions have to commit to the Danish authorities that the capital obtained is not transferred to the foreign mother company.

(27) Further conditions and restrictions on the behaviour of the beneficiary institutions are embedded in the scheme:

- a full ban on dividend payments for the financial years 2009 and 2010. Thereafter, and as long as the state capital injection is not completely repaid, beneficiaries can only pay out dividends that are covered by the yearly profit of the institution;
- a ban to issue bonus shares at a special price, or other similar schemes,
- a ban on the creation or prolongation of existing stock option programmes, and other comparables schemes, for the management of the institutions,
- a ban on repurchasing programmes of own shares until the state capital injection is recovered,
- limitations to the overall remunerations of members of the executive management, i.e. limits to variable pay components.

B) Amendment to the existing Guarantee scheme: the new guarantee scheme

Objectives and beneficiaries

(28) The objective of the amendment of the existing guarantee scheme by also covering newly issued loans with maturities of up to three years is to ensure the credit institutions continued access to medium term liquidity and by that, avoiding the banks cutting off loans and credits.

(29) The new guarantee scheme also includes mortgage institutions, which are not covered by the existing guarantee scheme. Access to the transitional State guarantee scheme is open to all credit institutions, which fulfil the minimum capital requirements.

Temporal and material scope

(30) The new guarantee scheme covers newly issued loans, including commercial papers, senior unsecured bonds, supplementary securitised capital covered bonds, and new loans covering existing debts.

(31) The duration of the new guarantee will depend on the underlying loan's maturity, but in any case will not be longer than three years.

(32) The amended Financial Stability Act foresees a window for application of the new guarantee scheme until 31 December 2010. The Danish Authorities commit to seek the Commission's approval, should it be necessary for the new guarantee scheme to continue beyond 6 months following the date of adoption of the present decision.

Remuneration for the guarantee

(33) The methodology to be followed for the calculation of the price of the new guarantee is in line with the recommendations of the Governing Council of the European Central Bank on government guarantees for bank debt of 20 October 2008, in particular point 6, 7 and 8 of the recommendations:

- For banks with CDS data, the calculation of CDS spreads should be based on (i) the median value of 5 year CDS spreads over a sample period starting on 1 January 2007 and ending on 31 August 2008, or (ii) the median value of the 5 year CDS spreads during the same sample period for the rating category of the bank concerned, whichever is the lowest.
- For banks without CDS data, or without representative CDS data, but with a credit rating, an equivalent CDS spread will be derived from the median value of 5 year CDS spreads during the same sample period for the rating category of the bank concerned, based on a representative sample of euro area large banks. The total price of the credit guarantee should also include the add-on fee of 50 basis points.
- For banks without CDS data and without a credit rating, an equivalent CDS spread should be derived from the median value of 5 year CDS spreads during the same sample period for the lowest rating category, based on a representative sample of euro area large banks. The total price of the credit guarantee should also include the add-on fee of 50 basis points and will lead to a total of 95 basis points.

(34) There is no specific limit to the amount of guarantee that a single institution can be granted. In consideration of the type of loans, their maturity and the fee, the Danish authorities estimate that the new measure will not exceed DKK 600 billion.

(35) The behavioural safeguards, as well as the monitoring and enforcement procedures embedded in the existing guarantee (i.e. no mass marketing, every six months reporting on the operation of the scheme, limitation of individual and aggregate balance sheet growth, cautious approach of participating banks) growth scheme will remain applicable.[5] In addition, the notified measures include limitations in relation to the management's salaries.

[5] Commission decision of 10 October 2008 in case NN51/2008, *Guarantee scheme for banks in Denmark, OJ C 273/2008 of 28.10.2008,* see in particular points 13 to 18, point 26 and points 52 to 54.

(36) Denmark committed that, in the event of the guarantee being called, a restructuring or liquidation plan will have to be presented within six months.

Link between the existing and the new guarantee scheme

(37) Institutions included in the existing guarantee scheme, i.e. banks that are members of the Private Beredskab, will continue to be covered by the existing guarantee scheme until its expiry date, 30 September 2010.[6] In case these institutions want to issue debt with a maturity exceeding 30 September 2010, they can apply for the new guarantee scheme. In order to avoid a double remuneration from credit institutions which have already paid a lump sum remuneration for the existing guarantee scheme for the period until 30 September 2010, the remuneration for guarantees which are given before the end date of the existing scheme (30 September 2010) under the new scheme shall be the result of the application of the remuneration charged under the new scheme (i.e. in line with the ECB recommendations) minus the remuneration which is already or will de facto be charged under the existing scheme (this is calculated on the basis of the lump sum fee for the existing scheme of up to DKK 35 billion compared to the total amount of debt covered of around DKK 3500 billion).

(38) Denmark committed that banks which participate in the new guarantee scheme will cover all their newly issued debt via the new guarantee scheme, even if the maturity is before September 2010.

(39) For the period after the 30 September 2010 all credit institutions, including the members of Det Private Beredskab, will have to pay the remuneration for the new guarantee scheme (i.e. in line with the ECB recommendations).

(40) Credit institutions which are not members of the Det Private Beredskab and which intend to apply for the new guarantee scheme will have to pay the remuneration for the new guarantee from the beginning.

(41) The Danish authorities commit to ensure that the new guarantee scheme will exclusively apply for newly issued debt with a maturity exceeding the end date of the existing scheme (30 September 2010).

C) Cash payment facility for the winding-up company

(42) The Financial Stability Act is also extending the instruments of the winding up company by including a cash payment to credit institutions in return for the take over of distressed credit institution.

(43) The objective of the cash payment is to allow the winding-up company to take a more active role in finding private buyers for distressed banks, with a view to speeding up the process of private takeovers of banks which have been transferred to the winding-up company.

(44) Denmark confirmed that the cash payment will be paid on the basis that this solution is considered as the most favourable in economic terms compared to other possible alternative solutions. In order to be able to use this instrument, the winding up company

[6] The existing scheme expires independent of the maturity of the covered debt.

shall operate in an open and transparent way, following a competitive and market-based and non discriminative process which is also open to foreign banks.

(45) The financing of this facility will be covered in accordance to the provisions of the Financial Stability Act approved by the Commission on 10 October.[7]

(46) Denmark committed that any cash payments to companies in return for the take over of a distressed credit institution will be notified to the Commission individually.

III. THE POSITION OF DENMARK

(47) The Danish authorities acknowledge that the notified measures contain State Aid elements.

(48) The Danish authorities consider the aid scheme to be compatible with the common market as it helps to "remedy a serious disturbance in the economy of a Member State" within the meaning of Article 87(3) (b) of the EC Treaty.

(49) The Danish authorities seek urgent authorisation for the recapitalisation scheme. According to the Danish authorities, the downturn cycle in the economy is implying a growing pressure on the solvency of credit institutions and, as a consequence of the current crisis, credit institutions are becoming much more risk averse leading to a credit squeeze and a credit rationing making it difficult for credit institutions to get access to capital on the global financial market. In addition there is a tendency on the market to require stronger capitalisation and a higher solvency rates. This situation may imply that the Danish credit institutions can be forced to react by reducing their lending.

(50) The Danish authorities take the view that the notified measures do not involve any undue distortions of competition or any harmful side effects for other Member States.

(51) The Danish authorities commit to report to the Commission on a 6 months basis on the recapitalisation and guarantee schemes.

IV. ASSESSMENT

State aid character of scheme

(52) 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.

(53) First, the Commission agrees with the position of Denmark that the notified measures constitute aid to the institutions concerned pursuant to Article 87 (1) EC.

(54) The notified package of measures will enable the beneficiaries to secure the necessary capital and liquidity on more favourable terms than would otherwise be possible in the

7 Commission decision of 10 October 2008 in case NN51/2008, *Guarantee scheme for banks in Denmark, OJ C 273/2008 of 28.10.2008,* point 50

light of the prevailing conditions in the financial markets. Since this confers an economic advantage on beneficiaries and strengthens their position vis-à-vis their competitors in Denmark and in other Member States, these measures distort competition and affect trade between Member States. The advantage is selective since it benefits only beneficiaries under the scheme and is provided through state resources.

(55) The Commission is convinced that in the current circumstances of financial crisis the capital injections and the guarantees of newly issued debt would not have been provided by a market economy investor on a comparable scale and on similar terms in favour of the participating banks.

Compatibility

Application of Article 87(3)(b) EC

(56) Denmark intends to provide in favour of financial institutions fresh capital and operating aid in the form of guarantees. In line with the Commission Communication of 13 October 2008 (hereinafter "Commission Communication"),[8] and the Commission Communication of 5 December (hereinafter "Recapitalisation communication")[9], given the present exceptional circumstances in the financial market, the Commission considers that it may be acceptable to examine the notified measures directly under the Treaty rules and in particular under Article 87(3)(b) EC.

(57) Article 87(3)(b) EC enables the Commission to declare aid compatible with the Common Market if it has the effect "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[10].

(58) The Commission considers that the present scheme concerns the entire Danish market. It does not dispute the analysis of the Danish authorities that the current global financial crisis has made access to liquidity more difficult for financial institutions across the board and has also eroded confidence in financial institutions' creditworthiness. If these problems are not addressed, it will result not only in difficulties for the banking sector but, owing to that sector's pivotal role in providing financing to the rest of the economy, will also have a systemic effect on the Danish economy as a whole. Hence it finds in

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8 Communication of the Commission - The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis – OJ C 270 of 25 October 2008.

9 Communication from the Commission: The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, OJ C10 of 15.1.2009.

10 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* , 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*.

line with its previous decision[11] that the scheme is apt to remedy a serious disturbance in the Danish economy.

Conditions for the application of Article 87(3)(b) of the EC Treaty

(59) In line with the Commission Communication, in order for an aid or aid scheme to be compatible under Article 87 (3) b) EC, it 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 Articles 3 (1) (g) and 4 (2) EC, which imply compliance with the following conditions:

a. *Appropriateness*: The aid has to be well targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy.

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 temporary and limited 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.[12]

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) EC which authorises State aid must ensure that such aid must be limited to that necessary to achieve its stated objective.

Assessment of the recapitalisation scheme

(60) The Commission has already observed in several cases that credit institutions may need an extra capital cushion in the present market circumstances in order to ensure a sufficient flow of credit to the entire economy, thereby preventing a further deepening of the crisis. In addition, uncertainties on the economic prospects have weakened trust in the long term solidity of financial institutions. The provision of capital to the banking sector is not intended to create a new, higher statutory capital requirements for the banking sector. The capital requirements for banks should continue to be assessed on a case by case basis, in line with the existing EU regulation, based on their individual risk profile and rigorous stress-testing. The objective of the notified recapitalisation scheme is to ensure that financial institutions are sufficiently strongly capitalised as to better withstand potential losses and give space for lending activities. This is in principle

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[11] Commission decision of 10 October 2008 in case NN51/2008, Guarantee scheme for banks in Denmark, OJ C 273/2008 of 28.10.2008

[12] 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 […]."

according to the Recapitalisation communication an appropriate means to strengthen the financial institutions and thus to restore market confidence, in the present exceptional market circumstances.

(61) As regards necessity, the Commission must examine if the measure is limited to the minimum necessary in scope and time, having regard to the current exceptional circumstances.

(62) In relation to the size of the capital injection, the Commission notes that the recapitalisation will involve a maximum budget of around DKK 100 billion and will allow beneficiary banks to reach a 12% of Tier 1 capital.

(63) Denmark submits that a 12% Tier 1 capital is necessary for the Danish credit institutions in order to ensure that the credit institutions are both able to continue lending thus avoiding a credit squeeze and at the same time cover the expected losses from the economic turnaround. This is supported by the Danish Central Bank. It indicated that as a result of the ongoing crisis, Danish banks have on average experienced a significant increase in the level of required regulatory capital. The main reason is that SMEs and private households constitute a relatively large part of Danish banks' average lending portfolio. In view of the rapid deterioration of the economic situation an urgent need for Danish banks to access new Tier 1 capital is thus expected. A simulation underlined the envisaged level of the capital injection is vital in order for the Danish Banking sector to be able to withstand negative economic shocks.

(64) The Commission understands that the level of the capital injection is related to the specific situation of the Danish banks, which are already highly capitalised.

(65) Moreover the Commission notes that the capital injection will in general not be of a size considered as disproportionate (cf. Annex 1 (iii) of the Recapitalisation communication) as about 80% of the eligible banks will not obtain capital exceeding 2% of their risk weighted assets and because of the remuneration which is above the remuneration in the Recapitalisation communication and the previously approved recapitalization schemes.

(66) Finally the Commission notes that Denmark has provided a commitment that banks have to make the maximum possible own contribution to increase their Tier 1 ratio without impeding their viability.

(67) In view of the particular conditions of the Danish banking sector, the high remuneration and the above mentioned commitment the Commission accepts that the recapitalisation is limited to the minimum necessary.

(68) The scheme aims at supporting fundamentally sound banks. The Danish authorities will assess on the basis of the information provided by the credit institutions when applying for the capital injection whether the institution can be considered as fundamentally sound in the sense of Annex 1 of the Recapitalisation Communication. The Commission notes that it is not in a position to assess the soundness of banks that might wish to participate in the scheme, but acknowledges the Danish authorities commit to send the list of the beneficiary banks at the time of the capital injection and all the relevant information to allow the Commission to take an informed view. If the Commission concludes that the beneficiary institution can not be considered as fundamentally sound, the institutions will at least pay the remuneration for distressed banks indicated in the

Recapitalisation communication and will have to commit to provide a restructuring plan.

(69) In this context the Commission notes that the scheme may also be open to credit institutions with a rating below A and which can in some cases potentially receive capital exceeding 2% of their risk weighted assets (RWA). The cumulation of such criteria could according to Annex 1 of the Recapitalisation communication indicate that a credit institution in question is not fundamentally sound. Therefore the Commission can only accept such mechanism in view of the commitment of Denmark to notify a restructuring plan to the Commission after six months and to request a remuneration that is at least as high as the remuneration for distressed banks indicated in the Recapitalisation communication, whose risk profile is in the in depth assessment of the Danish authorities viewed as not fundamentally sound credit institutions in the sense of Annex 1 of the Recapitalisation communication.

(70) In addition, the state capital injections is aimed at being temporary, given that the following incentives to exit are embedded in the scheme:

- the fixed interest rate will in average be 10 %, which under normal market conditions is a relatively high rate for fundamentally sound banks[13];
- the interest shall after the first day of the fourth year from the issue date be the higher between the fixed interest rate or 125 % of the dividend payments to ordinary shareholders;
- the reimbursement mechanism is increasingly costly to exercise for the issuer.
- the two year dividend ban

(71) Furthermore the Commission notes that the scheme elapses on 30 June 2009, hence it is only open for a period of less than six months. It can therefore be concluded that also the temporal scope is appropriate.

(72) As regards proportionality, the distortions of competition is minimised by various safeguards.

(73) Above all, the recapitalisation is linked to a price that reflects the current market conditions and results in an expected return on the investment ranging from approximately 9% to 12% for hybrid capital depending on the evaluation of the capitalisation and risk-profile of each beneficiary institution. Moreover the price is sufficiently related to the risk profile of the company. Therefore the pricing is in line with the recapitalisation communication.

(74) Moreover, the various behavioural commitments indicated above in paragraphs (24) to (27) should ensure that the beneficiaries do not make use of the capital injection for other purposes than support lending to the real economy so as to reduce the risk of

[13] Commission Decision of 12 December 2008 in case N 625/2008, *Amendment to German banks rescue scheme*, not yet published

undue distortions of competition[14]. In particular, the Commission notes that a full ban on the payment of dividend is in place for the financial years 2009 and 2010.

(75) On the basis of the above, the recapitalisation scheme can be considered compatible with the common market.

Assessment of the new guarantee scheme

(76) The objective of the new guarantee scheme is to ensure continued access to medium term liquidity to credit institutions and by that, to avoid banks cutting off loans and credits to the real economy. The Commission has already established in its case practice[15], that guarantee schemes should help to overcome these difficulties by allowing a revival of interbank lending and considers it therefore to be an appropriate means.

(77) As regards the material scope, the Commission does note that the guarantee scheme is needed because the supply of medium term liquidity has become a challenge.

(78) The Commission notes that institutions already member of the existing guarantee scheme will continue to be covered by the guarantee until 30 September 2010. However, the Danish authorities clarified that in case these institutions will apply for the new guarantee scheme, they will be charged the fee specified in paragraph (33) minus the fee they already paid for the existing guarantee scheme in the period until September 2010. Furthermore the Commission notes positively the commitment of Denmark that all banks which participate in the new guarantee scheme will cover all their newly issued debt via the new guarantee scheme, even if the maturity of the debt is before September 2010.

(79) As to the time, the duration of the new guarantee will depend on the underlying loan's maturity, but in any case will not be longer than 3 years.

(80) The window for application of the new guarantee for individual loans will be open until 31 December 2010. However, the Danish authorities have given a commitment that the above mentioned window will apply only on condition that the crisis lasts until then and that they will notify the Commission of any extension within six months of the entry into force of the measures. Thus, the temporal scope is also justified.

(81) As regards proportionality, the distortion of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market-oriented premium. It can be considered that in this way financial institutions will pay on average an adequate premium. The premium to be paid by financial institutions (see paragraph (33)) is in line with the methodology described by the European Central Bank in its

[14] Commission decision of 13 October 2008 in Case N 507/2008 *Financial Support Measures to the Banking Industry in the United Kingdom*, OJ C 290/2008 of 13.11.2008, paragraph 53.

[15] Commission decision of 13 October 2008 in Case N 507/2008 *Financial Support Measures to the Banking Industry in the United Kingdom*, OJ C 290/2008 of 13.11.2008.

recommendations of 20 October 2008. This can be considered proportionate and consistent with the recent practice of the Commission[16].

(82) Finally, the scheme includes the same behavioural constraints as the existing scheme (see paragraph (35)) and is therefore proportional. The Commission also notes the commitment that Denmark will provide a restructuring plan in case guarantee is drawn.

Assessment of the cash payment facility to the winding-up company

(83) The Commission notes that the commitment by the Danish authorities that, in accordance with the Financial Stability Act, specific arrangements with cash payment to companies in return for the take over of distressed financial institution will be notified to the Commission on a case by case basis and must therefore not be assessed at this stage.

General requirements for the compatibility of aid schemes under Article 87(3)(b)

(84) First, the Commission notes that the Danish authorities have given a commitment to report to the Commission on the support measures every six months.

(85) Secondly, the Commission notes that the notified measures are temporary and hence are shaped in accordance with the European state aid rules, being limited initially to a period of six months with a possibility of extension should the crisis persist.

V.

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[16] A similar approach is taken, for example, in Commission Decision of 27 October 2008 in case NN 512/20085 *Guarantee scheme for banks in Germany*, point 66; in the Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, point 61 and in Commission Decision of 14. November 2008 *Guarantee scheme for banks ' funding in Finland*, point 41.

DECISION

The Commission concludes that the notified amended scheme is compatible with the Common market and has accordingly decided not to raise objections against it, since it fulfils the conditions to be considered compatible with the EC Treaty.

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. Your request specifying the relevant information should be sent by registered letter or fax to:

- European Commission
  Directorate-General for Competition, State Aid Registry
  Rue de la Loi/Wetstraat, 200
  1049 Brussels, Belgium
  Fax: (32-2) 296 12 42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission