EUROPEAN COMMISSION

Brussels, 17.08.2009
C(2009)6441 final

Subject: State Aid N415/2009 and NN 46/2009 – Denmark
Prolongation and amendment of the recapitalisation scheme and prolongation of the guarantee scheme

Sir,

I. PROCEDURE

1. On 10 July 2009 Denmark notified a request to prolong and amend its recapitalisation and guarantee scheme for banks. The original measure, notified on 23 January 2009, was approved on 3 February 2009 in State aid case N31a/2009[1]. In addition, an amendment to the recapitalisation scheme was implemented in Danish Law since 3 February 2009 without prior notification. The amendment has been registered as State aid case NN46/2009.

2. The request for prolongation does not relate to the liquidity support measures authorised by the Commission on 10 October 2009 in State aid case NN51/2008 for banks that are members of the Danish Private Contingency Association (Det Private Beredeskab)[2]. Furthermore, the link between the guarantee scheme and the liquidity support measures authorised on 10 October 2008 remains the same as that authorised in the Commission's decision of 3 February 2009[3].

II. DESCRIPTION

1. Description of the measures

3. In response to the exceptional turbulence in global financial markets, Denmark put in place a recapitalisation and guarantee scheme designed to restore stability of the financial system and to remedy a serious disturbance in the economy of Denmark.

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1 Commission decision C (2009) 776 final, in OJ C 50, 3.2.2009, p. 3.
2 Commission decision C (2008) 6034, in OJ C 273, 28.10.2008, p. 2.
3 See Commission decision C (2009) 776 final, in OJ 50 3.2.2009, p.3, paragraphs 37 to 41.

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4. Institutions eligible to participate in the recapitalisation and guarantee scheme are credit institutions (i.e. banks and mortgage credit institutions), fulfilling the solvency requirements fixed by the Danish Financial Supervisory Authority (hereinafter the FSA).

a) Recapitalisation scheme

5. The recapitalisation scheme allows eligible institutions which applied before 30 June 2009 to obtain a capital injection in the form of hybrid capital notes with no final maturity date and no voting rights. The objective of such capital injections is to offer a maximum increase in Tier 1 capital of 3% to eligible credit institutions which had a Tier 1 capital of 9% or above before the capital injection. Credit institutions with an initial capital below 9% can be offered a capital injection so as to reach 12%. Credit institutions with a Tier 1 capital of 6% or below can apply for a capital injection only after individual negotiations with the Danish authorities. The Danish authorities have committed to ensure that, when assessing the soundness of the banks, they will not grant capital until it is ensured that the capital injected in the credit institution 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 remuneration is fixed individually for each financial institution based on an evaluation of the bank's capitalisation and risk-profile and ranges from 9% to 12%. According to Danish authorities, the recapitalisation scheme is available for institutions which are viable in the long run.

6. The Danish authorities stated that following the application period which closed on 30 June 2009 they had to examine applications submitted by 50 banks. Examination of those applications by the Danish Ministry of Finance and the FSA was a lengthier process than initially expected and necessitates an extension of the recapitalisation scheme to 20 December 2009. By this date all capital injections duly requested by banks and approved by Danish authorities should be paid out. Such an extension does not mean, however, that the deadline for applying for the scheme is extended: the application window has been closed since 30 June 2009 and no bank can apply under the scheme after this date.

7. In addition to the extension of duration of the recapitalisation scheme, the Commission was also informed of an amendment made to the scheme in order to offer issuing banks the possibility to ask the Danish State for a conversion of hybrid capital notes issued into ordinary shares within a five-year period after the issue date (see below under heading 3). Apart from those changes, all other conditions of the scheme, including remuneration, behavioural constraints and reporting to the Commission, remain applicable.

b) Guarantee scheme

8. Under the guarantee scheme, eligible institutions can apply for a State guarantee to cover newly issued loans, including commercial papers, senior unsecured bonds, supplementary securitised capital covered bonds, and new loans covering existing debts. The duration of the guarantee depends on the underlying loan's maturity, but in any case is not longer than three years. The fee for the guarantee is based on the recommendations of the European Central Bank[4].

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[4] Recommendations on Government Guarantees on Bank Debt of the European Central Bank of 20 October 2008.

9. Pursuant to the on-going difficulties encountered by Danish credit institutions which raise short- and medium-term funding, the Danish authorities intend to extend the duration of the guarantee scheme for another six-month period, until 2 February 2010 (included). Except its duration, all other conditions of the scheme (including remuneration, behavioural constraints, and reporting requirements) remain identical to those previously authorised by the Commission.

2. Operation of the recapitalisation and guarantee scheme up to June 2009

10. Pursuant to point 41 of the Banking Communication[5] and point 40 of the Commission Communication on Recapitalisation[6], Denmark has submitted a report on the use of the recapitalisation and guarantee scheme.

11. As regards recapitalisation, Danish authorities received 50 applications amounting to 63 billion DKK, which is within the limits of the maximum budget of the scheme (100 billion DKK). Following investigations carried out by the FSA, it was possible to finalise 11 agreements before the date of the report, amounting to 35 billion DKK. Before capital injections, two applicants out of those 11 banks had a Tier 1 capital ratio below 9% and 9 had a Tier 1 capital ratio above 9%. After capital injections, the Tier 1 capital ratio of the recapitalised banks is slightly below 12% for one bank only, which is nevertheless considered as sufficiently capitalised with respect to its particular risk profile. All other beneficiaries have a Tier 1 capital ratio superior to 12% after the capital injection.

12. In accordance with recapitalisation agreements, banks which benefit from capital injections should not tighten their lending policy more than would be necessary under normal economic conditions. A positive indication of the effect of the recapitalisation scheme is that total financial institution lending to companies and households has been broadly stable around the level reached in November 2008. Furthermore, the Danish bank lending survey published on 10 July 2009 shows that Danish credit institutions have not tightened their lending policy towards companies in Q1 and Q2 2009 and expectations are stable for Q3 2009.

13. Regarding the guarantee scheme, on 14 July 2009 three banks had applied for a State guarantee on debt issued for a total amount of 21.1 billion DKK:

    - The first beneficiary has received a guarantee amounting to 100 billion DKK (13.4 billion EUR). Of this amount, the bank has issued bonds denominated in USD, EUR, and SEK for a total amount of 4.1 billion EUR. All issuances have a maturity of close to three years. As a member of the Det Private Beredskab, a discount on the premium would apply until 30 September 2010.

    - The second beneficiary has received a guarantee amounting to 7.5 billion DKK (1 billion EUR). Of this amount, the bank has issued one series of EUR denominated bonds amounting to 0.5 billion EUR. The bonds have

5 Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis, OJ C 270, 25.10.2008, p. 8.

6 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, 15.1.2009, p. 2.

been issued with a three year maturity. As a member of the Det Private Beredskab, a discount on the premium would apply until 30 September 2010.

- The third beneficiary has received a guarantee amounting to 50 billion DKK (6.7 billion EUR). The bank has not yet issued any bonds covered by the guarantee but announced that it is planning to issue such guaranteed bonds in Q3 2009. As a member of the Det Private Beredskab, a discount on the premium would apply until 30 September 2010.

14. Although the direct effect of the guarantee scheme is not measurable, a short analysis by the Danish central bank shows some easing in the banks' ability to raise funding in the money market. However, Danish banks still encounter difficulties in raising medium-term funding, which the Danish authorities offer as a justification for their request to extend the duration of the guarantee scheme.

15. This report on the use of the recapitalisation and guarantee scheme confirms that the measures are effective in order to remedy a serious disturbance in the Danish economy. Danish credit institutions participated in the scheme and, as a result, could maintain their activities, thus preventing any potential aggravation of the financial crisis.

16. It is noticeable, though, that notwithstanding the thorough analysis on the viability of the scheme's beneficiaries carried out by Danish authorities, the 11 recapitalised credit institutions have received a total amount of capital injection superior to 2% of their risk weighted assets. Furthermore, after capital injections, the Tier 1 capital ratio of recapitalised institutions is, in most cases, higher than 12%. In view of criteria generally used by the Commission, these elements can constitute presumptions that beneficiaries are distressed[7]. As a consequence, the Danish authorities have committed to provide the Commission with all necessary information that justify the level of recapitalisation and will enable the Commission, in accordance with its Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules[8], to conclude whether some beneficiary credit institutions are indeed distressed and, therefore, have to provide a restructuring plan within six months after the recapitalisation. Therefore, the present decision on the prolongation of the scheme does not prejudge any possible future measures that the Commission may take in the context of the ongoing monitoring of the scheme.

3. Description of the amendment to the recapitalisation scheme (NN46/2009)

17. In order to enhance the quality of capital issued by Danish banks under the scheme, Danish authorities have introduced the possibility for issuers to convert hybrid capital notes issued under the recapitalisation scheme into ordinary shares (Issuer's Conversion Option). The issuance of hybrid capital notes, as notified to the Commission on 23 January 2009, did not fully meet markets' and rating agencies'

[7] See Annex of the 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, 15.1.2009

[8] See Communication of the Commission on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rule, of 23 July 2009, not yet published in the OJEU.

expectations in terms of quality of capital issued, especially for banks that are recorded on a regulated market (i.e. capital issued under the scheme did not meet rating agencies' standards for core Tier 1 capital). Therefore, the Issuer's Conversion Option, which was not part of the original notification of the scheme and is not covered by the Commission's decision of 3 February 2009, was introduced by the Danish State in order to ensure that beneficiaries can maximise the use of capital injection for external rating purposes. The Issuer's Conversion Option improves the quality of issuers' capital while minimising changes to the capital instruments in the form that they were authorised by the Commission. Thus, this option potentially improves the lending and funding conditions of the beneficiary credit institutions in accordance with the overall objective of the Danish recapitalisation scheme.

18. The Issuer's Conversion Option can be exercised at the issuer's initiative under the following conditions:

- The option is available for all banks licensed in Denmark and whose shares are admitted for trading in a regulated market;

- The option can be exercised when the credit institution's total hybrid Tier 1 capital exceeds 35% of its total Tier 1 capital;

- Hybrid notes to be converted are limited to 20% of the original governmental capital injection and may be repeated if the credit institution's total hybrid Tier 1 capital should again exceed 35% of total Tier 1 capital.

19. The conversion price is calculated as the volume-weighted average of share price over the three working days before the conversion minus a 5% discount. If there is a public announcement of price-sensitive information at the time when the conversion is publicly announced, the conversion price is calculated as the volume-weighted average of share price over the three working days before and the three working days after the announcement.

20. The conversion option is remunerated by an annual fee of 20 to 60 bps added to the fixed coupon of the note.

III. POSITION OF DENMARK

21. In line with the original decision, the Danish authorities accept that the prolonged recapitalisation and guarantee scheme contains State aid elements.

22. The Danish authorities note that the banks' access to market funding is still severely affected by the international financial crisis and that it is thus necessary to prolong the guarantee scheme. Difficulties in banks' access to market funding have already caused repercussions for households' and firms' ability to refinance their own debts. In order to avoid strengthening the negative feedback loop between the real economy and the financial sector, it is imperative that the scheme be prolonged, as endorsed by the Danish central bank.

23. As regard the recapitalisation scheme, the Danish authorities have committed to inform the Commission *ex ante* of each recapitalisation under the scheme and to provide the Commission with all relevant information necessary to allow it to take an informed view on whether the beneficiary institution in question can be

considered fundamentally sound or unsound. Moreover, in the event that a bank receives a second capital injection under the scheme, the Danish authorities commit to notify this measure individually to the Commission.

24. Furthermore, if a capital injection increases a beneficiary institution's Tier 1 capital ratio above 12%, the Danish authorities have committed to provide the Commission with additional detailed information justifying the level of capital and the amount of capital injection.

25. Regarding the amendment to the recapitalisation scheme, the Danish authorities are of the opinion that it does not constitute State aid within the meaning of Article 87(1) EC, since it does not give any additional economic advantage to the beneficiary institution.

26. However, should the Commission consider the Issuer's Conversion Option as State aid within the meaning of Article 87(1) EC, the Danish authorities claim alternatively that the aid is compatible with the common market under Article 87(3)(b) EC as it is designed to remedy a serious disturbance of the Danish economy.

IV. ASSESSMENT

1. State aid character of the prolonged scheme

27. 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, save as otherwise provided.

28. The Commission agrees with the position of Denmark that the prolonged scheme for eligible institutions constitutes aid to the institutions concerned pursuant to Article 87(1) EC.

29. As for the Issuer's Conversion Option, this amendment provides an additional advantage to beneficiaries since it allows them to increase their core Tier 1 capital, instead of hybrid Tier 1, which is better perceived by rating agencies. Since this possible increase confers an economic advantage on beneficiaries and strengthens their position vis-à-vis their competitors in Denmark and in other Member States, the measure distorts competition and affects trade between Member States. The advantage is selective, since it benefits only banks which issue new capital notes containing a conversion option. Finally, the Issuer's Conversion Option is likely to affect State resources since if it is exercised by the beneficiaries the risk of capital loss taken by the State is higher when holding equity shares than when holding hybrid capital notes. Therefore, unlike the Danish authorities, the Commission considers that the amendment to the Scheme constitutes State aid within the meaning of Article 87(1) EC.

2. Legality of the amendment to the recapitalisation scheme

30. The Commission observed that the Danish authorities had already put the notified amendment into effect in breach of Article 88(3) of the Treaty. In consequence, the

aid is unlawful in the meaning of the definition stated in the Chapter I, Article I, point (f) of the Procedural Regulation[9].

3. Compatibility of the measures

a) Prolongation of the scheme

31. In its decision C (2009) 776 final of 3 February 2009, the Commission concluded that the adoption by the Danish State of a recapitalisation and guarantee scheme was compatible with the common market under Article 87(3)(b) EC because it was apt to remedy a serious disturbance of the Danish economy. To this end the Commission had assessed the appropriateness, necessity and proportionality of the measure.

32. Regarding the recapitalisation scheme, the Commission acknowledges that the prolongation of the measure is aimed to address the fact that the due diligence necessary to process the many applications for capital injection received by Danish authorities from eligible institutions has taken longer than initially expected. Moreover, the above-mentioned monitoring report confirms that recapitalisations carried out so far were effective to remedy a serious disturbance of the Danish economy. Danish credit institutions which participated in the recapitalisation scheme could maintain their activities and continue to provide capital to the real economy.

33. However, the Commission also notes that capital injections carried out so far put the Tier 1 capital ratio of beneficiary institutions at a level significantly higher than is generally expected from markets and supervisory authorities for fundamentally sound banks. Furthermore, the amount of newly injected capital is higher than 2% of beneficiary institutions' risk weighted assets.

34. The Commission understands that the level of capital injection is related to the specific situation of the Danish banking industry, which is very heterogeneous, comprised of a large number of small non-diversified institutions. Furthermore, the Danish banking industry has no access to the Tier 2 capital market since the liquidation of Roskilde Bank and is characterised by a number of mortgage institutions operating under high solvency standards. These features, which have previously been assessed by the Commission in its decision C(2009) 776 final[10], explain the high level of Tier 1 capital needs for Danish banks and are confirmed by studies and the stress scenario undertaken by the Danish central bank[11].

35. Nevertheless, the Commission welcomes the Danish authorities' commitment to inform the Commission *ex ante* of each recapitalisation under the scheme and to provide the Commission with all relevant information necessary to allow it to take an informed view on whether the beneficiary institution in question can be considered fundamentally sound or unsound. In cases where the Commission concludes that the beneficiary institution cannot be considered as fundamentally sound, the Danish authorities commit that the institution will at least pay the price for distressed banks indicated in the Commission Communication on Recapitalisation and provide a restructuring plan no later than six months after the

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9 Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27.03.1999, p.1.

10 See Commission decision C (2009) 776 final, in OJ 50 3.2.2009, p.3, paragraphs 63 to 67.

11 See, for instance, Danmarks Nationalbank, *Financial Stability* (1st half 2009).

capital injection. Finally, in the event that a bank receives a second capital injection under the scheme, the Danish authorities commit to notify this measure individually to the Commission.

36. Furthermore, if a capital injection increases a beneficiary institution's Tier 1 capital ratio above 12%, the Danish authorities have committed to provide the Commission with additional detailed information justifying the level of capital and the amount of capital injection. In cases where the Commission considers that the amount of capital injection is not justified by the particular situation and/or risk profile of the beneficiary institution, the latter will at least pay the price for distressed banks indicated in the Commission Communication on Recapitalisation and provide a restructuring plan no later than six months after the capital injection.

37. Furthermore, the prolongation of the recapitalisation scheme does not preclude any further investigation from the Commission on the long-term viability of institutions which have already benefitted from capital injections under the scheme.

38. In view of the particular conditions of the Danish banking sector, the high remuneration and the above-mentioned commitments, the Commission accepts that the recapitalisation is limited to the minimum necessary. Other conditions of the recapitalisation scheme remain unchanged, except the amendment mentioned below, which is subject to a specific compatibility assessment. As a consequence, and considering also the report on the operation of the scheme provided by Danish authorities, the Commission is of the view that the prolongation of the recapitalisation scheme is appropriate, necessary and proportionate.

39. Regarding the guarantee scheme, the Commission considers that the exceptional circumstances at the origin of the notified measure still persist and therefore recognises the need for the prolongation of the scheme for another six-month period. Moreover, the Commission also notes that the prolongation will keep unchanged all conditions attached to the guarantee scheme (i.e. remuneration, behavioural constraints and reporting requirements), except its duration.

40. In view of the above, the notified prolongation of the guarantee scheme does not alter the Commission's previous assessment of the scheme in its decision of 3 February 2009. Consequently, the guarantee scheme remains compatible with the common market until 2 February 2010.

b) Assessment of the amendment to the recapitalisation scheme

41. By means of the amendment, the recapitalisation scheme allows issuing banks to convert hybrid capital notes with no final maturity and no voting rights issued under the scheme, into ordinary shares. This option can be exercised within five years following the issue date. Compared to the hybrid capital notes previously issued under the scheme, notes containing the conversion option will reinforce the capital base of the issuer since they will be recorded in core Tier 1 capital instead of hybrid Tier 1 capital. Furthermore, the Commission notes that the conversion option is available for five years after the issue date and could be exercised in order to avoid the step-ups attached to the remuneration of the notes (e.g., after four years, the remuneration is the highest between the fixed coupon and 125% of the dividend payment to ordinary shares) and to the repayment of the notes (e.g., after five years,

the principal to be paid by the issuer in case of repayment increases to 105% of the face value plus interests). Indeed, these step-ups in remuneration and repayment could be an incentive for banks to convert notes into ordinary shares and thus avoid having to pay increased remuneration and redemption prices on hybrid notes. The conversion option would thus allow credit institutions to avoid the exit path that was built into the remuneration and repayment conditions authorised under the scheme.

42. However, the Commission also notes that the advantage offered to banks in terms of capital of higher quality is compensated for by several features:

   - First, conversion is only possible if the issuing bank has reached a 35% threshold for hybrid instruments within the Tier 1 capital and it can only take place by tranches of 20% of the amount of the initial capital injection. These conditions limit the scope of conversion and amount of hybrid notes to be converted.

   - Second, the conversion price contains a 5% discount, which limits the possibility for beneficiary institutions to use the conversion option as a way to avoid the step-up in the redemption price of hybrid notes.

   - Third, an additional fee of 20 to 60 bps is to be paid annually on the convertible notes on top of the remuneration previously set, in accordance with ECB recommendations, in the range of remuneration set up for ordinary shares. A priori, the high level of remuneration to be paid by beneficiary institutions on convertible notes can be considered appropriate. However, since one cannot anticipate at this stage which institutions will benefit from the conversion option, the Commission will verify the appropriateness of the overall level of remuneration of convertible hybrid notes, on a case-by-case basis, as part of the Commission's review of information provided by Danish authorities as set out in paragraph 35 above.

43. In view of the above the Commission considers that these limitations provide a sufficient safeguard and that undue distortions of competition are avoided. The Commission can therefore agree to the amendment.

44. The Commission therefore concludes that the prolongation of the Danish amended recapitalisation and guarantee scheme can be considered compatible with the common market.

V. DECISION

The Commission concludes that the prolonged and amended measure constitutes a State aid scheme within the meaning of Article 87(1) of the EC Treaty. Since this aid measure fulfils the conditions under Article 87(3)(b) of the EC Treaty, this aid measure is compatible with the common market. The Commission has accordingly decided not to raise objections to the amendment and the prolongation of the scheme until 20 December 2009 as regards the recapitalisation and 2 February 2010 as regards the guarantee.

The Commission notes that Denmark accepts that the decision be adopted in the English language.

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Yours faithfully,
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