EUROPEAN COMMISSION

Brussels, 29.10.2008
C(2008) 6538

**Re: State aid N 533/2008 – Support measures for the banking industry in Sweden**

## 1. PROCEDURE

1. Sweden submitted a notification on 27 October 2008.

## 2. DESCRIPTION OF THE AID

### 2.1. General

2. In response to the ongoing exceptional turbulence in world financial markets, Sweden intends to bring forward a package of measures under the umbrella of the "Lagen om statligt stöd till kreditinstitut" designed to restore stability to the financial system and to remedy a serious disturbance to the Swedish economy. These measures have as their objective restoring confidence and encouraging healthy inter-bank lending, through the provision of liquidity, the provision of a state guarantee to new debt issuance and other measures that may prove necessary.

3. The central element of this package is a bill that will give the government broad powers to grant various forms of urgent aid to financial institutions. Among the measures it intends to take in response to the present financial crisis is the institution of a guarantee scheme in order to support the medium term financing needs of banks and mortgage institutions. In addition the Swedish Riksbank has confirmed that it will treat the guaranteed debt instruments as government bonds within its lending facility.

4. Sweden has proposed other measures, such as the setting up of a recapitalisation fund as part of a program to resolve potential future solvency problems in Swedish financial institutions. However, these measures have not yet been made concrete and therefore were not notified.

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## 2.2. The beneficiaries

5. Eligible institutions will be banks and mortgage institutions incorporated and operating in Sweden (including Swedish subsidiaries of foreign institutions) that are solvent. Only institutions with at least 6% Tier 1 capital and at least 9% combined Tier 1 and Tier 2 capital will be considered sufficiently capitalised to be eligible.

## 2.3. Description of the measures

6. Sweden will make available a state guarantee to new short and medium term debt issuance. Under this scheme, institutions will have the option to enter into an agreement with the state which in turn would guarantee the institutions' new issuance of debt instruments in exchange for a fee.
7. Instruments covered by the guarantee are bonds, certificates of deposits and other non-subordinated debt instruments which have a maturity longer than 90 days but less than five years. The scheme includes covered bonds. It excludes complex and structured financial products or instruments that qualify as either Tier 1 or Tier 2 capital. The scheme is not subject to any currency restrictions.
8. Instruments guaranteed under this scheme may be issued until 30 April 2009. The Swedish authorities have committed that they will notify any extension to the Commission. They currently consider that the scheme could be extended up to 31 December 2009.
9. The State will initially guarantee up to SEK 1,500 billion of debt instruments. For each financial institution the maximum available amount is limited to a maximum of either

   a) the sum of that institution's debt instruments maturing after 1 September 2008 but before the 30th April 2009 and which have maturities longer than 90 days or

   b) 20% of that institution's deposits as of 1 September 2008.
10. The scheme is to be administered by the Swedish National Debt Office.
11. Sweden devised a structure for a fee for the debt which is based on the "Recommendations on government guarantees on bank debt" of the European Central Bank (ECB) of 20 October 2008. Essentially the fee payable for the guarantee is based on market benchmarks and will in most cases comprise of two elements. The first element will be a measure of institution-specific risk and the second one a fixed add-on of usually 50 basis points.[1] On this basis the fee shall be:

    a) For credit guarantees on bank debt with maturities of less than or equal to 1 year

    - equal to 0.5 % on an annual basis (the first criterion is not applied).

    b) For Credit guarantees with longer maturity than 1 year:

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[1] This was in principle established by the UK, see Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet pulished, at point 15.

- For banks with CDS data, the price should equal the median 5 year CDS spread over the period 1 January 2007 to 31 August 2008 (the first criterion), plus 0.5 % on an annual basis (the second criterion).
- For banks without CDS data, or representative CDS data, but with a credit rating, an equivalent CDS spread should be derived from the median value of 5 year CDS spreads during the above mentioned period for the rating category of the banks concerned, based on a representative sample of euro area large banks (the second criterion remains unchanged).
- 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 over the same period for the lowest rating category (the second criterion remains unchanged).
- For guarantees for covered bonds the second criterion, the add-on fee will be set to 0.25 % on an annual basis (the first criterion remains unchanged).

12. The pricing will be constant until the 30th April 2009, but could be revised if the guarantee period is prolonged, to reflect changes in market conditions.

13. Sweden will also impose certain conditions on institutions availing of the state guarantee, aimed at eliminating or minimising any spill over effects which may distort competition.

14. At an aggregate-level the Swedish authorities undertake to monitor and review the expansion of the activities of the banks that are participating in the guarantee scheme in order to ensure that their aggregate growth in balance sheet volume does not exceed:

    - the annual rate of growth of Swedish nominal GDP in the preceding year,
    - the average historical growth of balance sheets in the Swedish 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 (Sweden estimates this limit to be 10.8 %).

15. The Swedish Financial Supervisory Authority will be responsible for monitoring the growth of balance sheet volume in participating banks and, after having consulted the Swedish National Debt Office, report back to the government on a regular basis. If the activities of the participating banks in total exceed the above thresholds, the Swedish Government will examine the reasons for such growth. Unless there is evidence that the thresholds are exceeded for reasons unrelated to the guarantee scheme, the Swedish government will as a matter of urgency take measures to adjust the guarantee scheme in order to re-establish the discipline.

16. The Swedish authorities clarify that if the balance sheet volume for participating banks or other financial institutions grew due to a collapse in a securities market, for example the market for commercial paper or corporate bonds, they would not consider this as related to the existence of the guarantee scheme.

17. In addition the following constraints will be included in the bylaw for participating banks:

    - Restrictions on mass marketing of the guarantee, except when required by law or other regulations, for example rules relating to offering documents,

- A commitment not to undertake a significant expansion of activities which would not have taken place in absence of the guarantee scheme, and
- Restrictions with respect to wage increases, bonus payments, increases in board remuneration and bank executives´ severance packages during the guarantee period.

18. As part of the measures to remedy the financial crisis, the Riksbank has widened the scope of accepted collateral and thus increased the banks' access to overnight lending.
19. In connection with the plans for the guarantee scheme, the Riksbank has confirmed that it will treat guaranteed debt instruments as government bonds within its lending facility. The guarantee is to be structured in a way which will qualify the guaranteed instruments a zero risk weighting, using the Standardized Approach, for capital adequacy purposes. This widening in the definition of collateral will continue until 30 April 2009.

## III POSITION OF THE SWEDEN

20. Sweden accepts that the notified measures constitute state aid within the meaning of Article 87(1) of the EC Treaty.
21. Sweden seeks urgent authorisation for the measures. According to the Swedish authorities, fears regarding the creditworthiness of counterparties have led to an extreme and dangerous flight to quality across the global financial system. Public sector intervention is necessary to restore market confidence. The notified state aid measures are, together with the other parts of the package, necessary and proportionate to restore financial stability in Sweden. Given the severe stress in global financial markets and in the Swedish financial system, it is in their view imperative that the measures are implemented rapidly.
22. The Swedish authorities claim that the measures are compatible with the common market because they are necessary to remedy a serious disturbance in the Swedish economy pursuant to Article 87(3)(b) of the EC Treaty.
23. A letter from the Central Bank dated 24 October 2008 confirms that the notified measures are urgently required to prevent harmful spill-over effects on the entire Swedish financial system and on the economy as a whole.
24. The Swedish authorities submit that their guarantee needs to include covered bonds[2] because the experience in Denmark, where they were excluded, has shown that in their view this market would dry up without the guarantee. As over 80% of Swedish housing loans are packaged in the form of covered bonds, it is an essential feature of the Swedish financial system. In particular, a well functioning mortgage bonds market, which consists to a large extent of fixed rate loans with a maturity of five years, is crucial to the whole financial industry in Sweden. Any exclusion of covered bonds with a duration lasting up to five years would severely distort the mortgage loan market. To limit distortions from this longer guarantee period, Sweden

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[2] Covered Bonds are issued not just against the balance sheet of a bank but also against collateral, in particular mortgages.

commits to limit the guarantee on debt with a maturity of between three and five years to covered bonds only and to a maximum amount of SEK 500 billion

25. Moreover, the Swedish authorities argue that their guarantee fee is in line with the "Recommendations on government guarantees on bank debt" of the European Central Bank of 20 October 2008. This is also true for covered bonds which can be considered as collateralised, and therefore for which under point 5 a lower add-on should be acceptable. Indeed Sweden contends that the premium will still be sufficiently high to discourage of the use of the guarantee for covered bonds as soon as some confidence in the market is reestablished.

26. The Swedish authorities commit to seek the Commission's approval, should it be necessary for the measures, both the guarantee scheme and the Riksbank's widened definition of collateral, to continue beyond 30 April 2009.

27. In addition, the Swedish authorities commit to file individual restructuring/liquidation plans, within 6 months, for banks that default on their liabilities and which cause the guarantee to be called upon.

## 3. ASSESSMENT

### 3.1. State aid character of the measures

28. As set out in Article 87(1) of the EC Treaty, 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.

29. First, the Commission agrees with the position of Sweden that the guarantee scheme constitutes aid to the institutions concerned pursuant to Article 87 (1) EC.

30. The guarantee on the new issued debt allows the beneficiaries to refinance at advantageous conditions. This gives an economic advantage to the beneficiaries and strengthens the position of these beneficiaries compared to that of their competitors in Sweden 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 resources.

31. In particular, the Commission is convinced that in the current circumstances of financial crisis no private investor would have granted such a significant guarantee on senior debt of the participating banks.[3]

32. Moreover, as regards the provision of liquidity provided by the Riksbank, the Swedish Central Bank, the Commission considers that its lending activity is in principle within the remit of a central bank's role as a monetary authority, and would normally be characterised as general measures and therefore not constitute state aid.

33. However, the Commission notes that the guarantee scheme will allow some beneficiaries to obtain high quality collateral which might be used to obtain liquidity

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[3] Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 32. Commission decision of 21 October 2008 in case C 10/2008 *IKB,* not yet published, at point 74.

from the Riksbank. It is this guarantee that makes such bank debt into the type of high quality collateral that the Riksbank requires. While this might be irrelevant from the point of view of the Central Bank, the collateral is only eligible because of the guarantee and may therefore be considered as contaminated by the aid to the collateral and not totally free of aid.

## 3.2. Compatibility of the Financial Support Measures

### *3.2.1. Application of Article 87(3)(b) EC*

34. Sweden intends to provide operating aid under a scheme which is granted to assist banks and building societies. Given the present circumstances in the financial market, the Commission considers that it is appropriate to examine this measure directly under the Treaty rules and in particular under Article 87(3)(b) of the EC Treaty.

35. Article 87(3)(b) of the EC Treaty 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) of the EC Treaty needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State.[4]

36. The Commission considers that the present scheme concerns the entire Swedish banking industry. The current global financial crisis has made access to liquidity more difficult for financial institutions across the board and has also eroded confidence in the creditworthiness of counterparties. In these circumstances, even fundamentally sound financial institutions are facing the prospect of going out of business. The Commission considers that if the issues of lack of liquidity and lack of confidence are not addressed, it will result not only in difficulties for the banking sector but, due to that sector's pivotal role in providing financing to the rest of the economy, will also have a systemic effect on the Swedish economy as a whole. The Commission does not dispute that the present scheme is designed to address the problems of the lack of liquidity and lack of confidence that are currently striking Swedish banks. Therefore it finds that the scheme aims at remedying a serious disturbance in Sweden's economy.

### *3.2.2. Conditions for compatibility under Article 87(3)(b) of the EC Treaty*

37. In line with the Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", in order for an aid or aid scheme to be compatible under Article 87(3)(b) of the EC Treaty, it must comply with general criteria for compatibility under Article 87(3) of the EC Treaty, viewed in the light of the general

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4 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.

objectives of the Treaty and in particular Articles 3(1)(g) and 4(2), which imply compliance with the following conditions[5]:

a. *Appropriateness*: The aid has to be well targeted to in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy. This would not be the case 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 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.[6]

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

*3.2.3. Application of the criteria to the guarantee scheme*

38. The objective of the guarantee scheme is to provide a safety net to investors in newly issued debt of participating institutions, so that they can have sufficient access to liquidity. This is a reaction to the international market-failure where even healthy banks are having trouble getting access to liquidity. The Commission considers that such guarantee schemes should help to overcome this market failure, by establishing the conditions for the revival of the interbank lending market and regards it therefore as an appropriate means.[7]

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[5] Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 41.

[6] 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 […]."

[7] See Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 42, Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet published, at point 56, and Commission decision of 13 October 2008 in case NN 48/2008 *Guarantee scheme for banks in Ireland*, not yet published, at point 59.

39. Moreover, the scheme is targeted at the appropriate beneficiaries as the eligibility of participating firms is limited in principle to solvent companies (see above point 5).

40. Second, as regards necessity, the guarantee mechanism, whereby a safety net is established to cover all newly issued debt against financial institutions in Sweden, is limited to the minimum necessary in scope and time.

41. As regards scope, the Commission does not dispute that the guarantee scheme is needed to restore confidence of lenders.[8] A guarantee on retail deposits would not be sufficient as it would only avoid bank runs but not restore confidence of institutional lenders. Moreover, the Commission notes positively that Sweden is in principle limiting the guarantee to the form of financing that is currently experiencing the greatest difficulties, namely short to medium term interbank lending. Firstly, subordinated debt is not guaranteed. Secondly, existing debt is not covered but only newly issued debt and only such debt that is short and medium term. Thirdly, Sweden has also limited the scope of the guarantee scheme so that the institutions have only a window of six months to issue the new debt that will benefit from the guarantee.

42. The Commission does not consider it problematic that the scheme also comprises covered bonds[9], because the fact that a premium is charged will ensure that such bonds will only be included against a significant and deterrent surcharge and thus only if absolutely necessary. Sweden justifies the necessity to include by reference to the Danish experience, where in their view the exclusion of covered bonds from the guarantee led to a loss of confidence and to the drying up of the market.

43. Moreover, the guarantee shall in principle apply to the newly issued debt for up to three years, and in the exceptional case of covered bonds for up to 5 years. In general, the Commission is of the view that the duration of a guarantee should be as short as possible. In this regard, the Commission notes positively an additional safeguard in the present scheme in so far as it has a limited issuance period of six months.. The temporal scope is thus in principle justified.

44. The Commission notes however that covered bonds shall be covered for a period for up to 5 years. However in this context it accepts the Swedish submission that covered bonds should normally not even need a guarantee given that they are already sufficiently collateralised, but, in the context of the current market failure, any debt that is not covered by the guarantee risks being shunned by excessively risk averse investors. Second, Sweden has sufficiently explained that covered bonds are an integral part of their financial system which can not be excluded from the system without creating major distortions. Thus, given that the guarantee systems are aimed at stabilisation and not at creating additional distortions, an exceptional coverage of long term covered bonds up to 5 years can be sufficiently justified. Moreover, the Commission notes that Sweden has limited the scope not only to covered bonds but capped this type of acceptable debt at 1/3 of the overall amount covered. Given this

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[8] See the above mentioned Commission Decisions in cases NN 51/2008 (at point 47) and NN 507/08 (at point 59).

[9] A different system was the basis of the Danish scheme (Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published) where the guarantee would if applicable to covered bonds have included them automatically. A similar approach is taken in Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, not yet published.

context, and within this limitation the exception can for now be accepted, but will certainly be reviewed after six months.

45. Third, as regards proportionality, the distortions of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market orientated premium. It can be estimated that in this way the banks pay on average an adequate premium. The banks will pay in a base case a premium of 50bps plus the median of the 5-year CDS spread over the 20 months period ending on 31 August 2008 for each institution. This can be considered proportionate and consistent with the recent practice of the Commission.[10] In addition, the Commission notes that this is also in line with the recommendations of the ECB, which also aim at the establishment of an appropriate framework for premiums on guarantees issued in the Euro zone.

46. Also the fact that for covered bonds the add-on is lowered is in line with the ECB as it allows for a lower add on in cases where the guaranteed debt is collateralised. The reduction of 50 % in the add-on fee seems at this stage reasonable.

47. Given that these recommendations are themselves building upon the Commissions decision in particular in case N 507/2008, the ECB criteria should be applied in parallel with the behavioural constraints that were established in this decision.

48. Indeed, 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 aggregate level of all participating banks against clear benchmarks (see above points 14 and 17) as well as strong individual behavioural commitments. Indeed, the limitation of the guarantee for each participating bank to either its existing debt that is due for refinancing after 1 September 2008 but before the 30th April 2009 or 20% of its existing deposit base is already an important step in this regard.

49. Furthermore, the Commission acknowledges that Sweden has committed to provide a restructuring or liquidation plan, within 6 months, for any institution that causes the guarantee be drawn.[12] In relation to the Riksbank's extension of eligible collateral for its liquidity facilities, the Commission has already previously observed that to the extent that the measure might be considered aid it is compatible with the Common market[13].

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[10] A similar approach is taken in Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, not yet published. Point 66. ==and in the Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet published, point 61.

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

[12] Such plans are the cornerstone of the Community Guidelines on State aid for Rescuing and Restructuring Firms in Difficulty, see OJ 2004 C 244, p. 2,

[13] Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet published, point 64-67.

50. Finally, the Commission would like to reiterate that the window to avail of financial support measures is limited by the Swedish law to a period ending on 30 April 2009. Should Sweden wish to extend the application of this scheme, it needs to notify this to the Commission as new state aid under Article 88(3) of the EC Treaty.

51. On the basis of the above, the guarantee scheme can be considered compatible with the Common market.

## V. DECISION

The Commission finds that the notified measures are compatible with the Common market and has accordingly decided not to raise objections.

The Swedish authorities indicated that the notification does not contain any confidential information. The Commission will therefore disclose this letter to third parties by publishing its full text in the working language on the Internet site http://ec.europa.eu/community_law/state_aids/index.htm.

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Yours faithfully,

For the Commission

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