

Case No: 70521  
Event No: 661864  
Dec. No: 145/13/COL

## EFTA SURVEILLANCE AUTHORITY DECISION

of 10 April 2013

on alleged state aid to Landsbankinn  
through the forgoing of an expected return on public funds

(Iceland)

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD to the Agreement on the European Economic Area,<sup>1</sup> in particular to Article 61(1) thereof,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice,<sup>2</sup> in particular to Article 24 thereof,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement<sup>3</sup>, in particular to Article 1(3) of Part I and Article 4(2) of Part II thereof,

WHEREAS:

### I. FACTS

#### 1. Procedure

- (1) On 16 September 2011, the EFTA Surveillance Authority (the “Authority”) received a letter (Event No. 609415) from the Icelandic law firm LOGOS Legal Services (Helga Melkorka Óttarsdóttir hdl.), acting on behalf of the Icelandic commercial bank, Arion Bank<sup>4</sup>, submitting a complaint against Iceland regarding alleged state aid granted to Landsbankinn hf. (“Landsbankinn”).
- (2) By letter of 19 October 2011 (Event No. 612035), the Authority invited the Icelandic authorities to submit their comments and requested them to provide all relevant information for assessment of the complaint under Article 61 EEA.

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<sup>1</sup> The “EEA Agreement”.

<sup>2</sup> The “Surveillance and Court Agreement”.

<sup>3</sup> “Protocol 3”.

<sup>4</sup> While it was initially requested that the identity of the complainant should not be disclosed, Logos announced in an email of 9.10.2011 (Event No. 612259) that its client had decided not to request confidentiality treatment.

- (3) By letter of the Ministry of Finance of 7 December 2011 (Event No. 617725), the Icelandic authorities responded to the above request.
- (4) At the request of the complainant, a meeting was held in Brussels on 22 November 2011. Following this meeting, the complainant sent by letter of 17 February 2012 (Event No. 625429) further information regarding the complaint.
- (5) By letter of 24 February 2012 (Event No. 625806), the Authority forwarded the supplementary information from the complainant to the Icelandic authorities and invited them to comment.
- (6) By letter of the Ministry of Finance of 12 April 2012 (Event No. 630891), the Icelandic authorities provided further information.

## **2. The Complaint**

- (7) The allegations made by the complainant relate to measures taken by Landsbankinn in May 2011 in the context of implementation by the bank of household debt restructuring measures, following a declaration of intent concluded on 15 January 2011 by the Icelandic Government, financial undertakings and pension funds on voluntary measures to address household debt problems, including the so-called 110% debt alignment.
- (8) The complainant alleges that certain debt forgiveness measures offered by Landsbankinn to its household customers which go beyond the measures agreed upon as a part of the 110% debt alignment solution involve illegal state aid. While initially highlighting three different measures, the complainant in subsequent submissions wished to amend the complaint and limit the subject matter of the complaint to only one set of measures. The measure complained of is the decision by Landsbankinn to refund 20% of all interests paid by prompt household customers during the period 31 December 2008 to 30 April 2011.<sup>5</sup>
- (9) The complaint could also be understood to mean that the measure complained of demonstrates that Landsbankinn has been granted illegal state aid through the bank's preferential financial relations with the State. This is so, since the Icelandic State owns the majority of the shares in the bank through the State holding company, the Icelandic State Financial Investments (ISFI), which appoints majority of the board members in Landsbankinn. The complainant claims that the cost of the measures undertaken by Landsbankinn was likely to be around 25-30 billion ISK or not far from Landsbankinn's after-tax profit in 2010, which amounted to 27.2 billion ISK.
- (10) According to the complainant, a privately owned bank would never take a decision to distribute this amount of money to its clients to serve the purpose of marketing and good will with its clients. The complainant considers that the Icelandic government might lack a requirement of adequate return on capital invested in Landsbankinn, thus enabling Landsbankinn to take the measures at issue. By not seeking ordinary returns from the operations of Landsbankinn, the Icelandic State was effectively granting the bank a subsidy.
- (11) The complainant claims that in relation to the implementation of the measures, Landsbankinn initiated a marketing campaign where the bank stated amongst other things that the measures

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<sup>5</sup> The other two measures initially complained of concern lowering of debts, i.e. lowering of the principal or accumulated and non-paid interest. The first of the measures concerns lowering mortgage debt and affects roughly 3 500 customers. The second one concerns lowering of other debt and affects roughly 1 600 customers.

demonstrated that the bank was respecting its social responsibility as a financial institutions. The complainant considers that such statements by Landsbankinn indicate that the bank was under pressure from public authorities to act in line with their political objectives.

### 3. Background

- (12) The collapse of Iceland's banking system in the autumn of 2008 resulted in major economic turbulence, including a sharp depreciation of the Icelandic króna, a hike in inflation and falling real estate prices. Given the widespread indexation in Iceland's financial market, this had severe implications for household debt, which grew significantly and in many cases to levels above the market value of the collateral and beyond the payment capacity of borrowers. For the same reasons, the share of non-performing loans in financial institutions' portfolios rose to unmanageable levels.
- (13) Already from 2009, banks and other financial institutions had offered certain solutions for households in payment difficulties. Nevertheless, the problems mounted and in the autumn of 2010, the Government initiated a special inquiry into the payment and debt problems of households, concluding in a memorandum of understanding in December 2010<sup>6</sup>. Among the measures recommended to benefit over-indebted households was an alignment of mortgages to property value and debt service capacity. In cases where existing mortgages were significantly higher than the value of the mortgaged property, lenders agreed to work towards solutions according to which the debtor would be offered the option to have the mortgage reduced to 110% of the value of the property (the so-called 110% mortgage alignment procedure). The aim of the measure was to accelerate the inevitable adjustment of existing mortgages to asset values and debt service capacity of debtors. This would in turn serve to reduce the share of non-performing loans and improve the quality of the loan portfolios of the respective financial institutions.
- (14) On 15 January 2011, a declaration of intent was concluded between lenders on the mortgage loan market concerning the measures recommended in the Government's memorandum on debt relief when the encumbrances are in excess of 110 % mortgaging of the debtor's property.<sup>7</sup>
- (15) By its nature, the declaration of intent is a general, non-binding document and does not prevent the signatories from offering customers other or different solutions than the '110% solution', as is explicitly recognised in Article 5(2) of the declaration: "*Collaboration of the parties to the Agreement is limited to its provisions. The Agreement shall not prevent creditors from offering additional payment difficulty remedies to their customers in addition to the solutions provided for in the Agreement or to otherwise compete based on applicable terms and conditions.*" The declaration was examined by the Icelandic Competition Authority which did had no objection, given in particular the provision referred to above that allows competition to take place amongst the signatories.

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<sup>6</sup> The memorandum is available at <http://eng.forsaetisraduneyti.is/news-and-articles/nr/4500>.

<sup>7</sup> In addition to the Government, the following are signatories of the declaration: the Housing Financing Fund (HFF), the Icelandic Financial Services Association (SFF), the Icelandic Pension Funds Association (LL) and the financial undertaking Dróma hf. The declaration is available (in Icelandic) at <http://www.atvinnuvegaraduneyti.is/media/frettir/Samkomulag.pdf>. While the banks through their interest organisation (the SFF) were partly involved in the preparation, the declaration on the 110% mortgage alignment procedure is frequently referred to as the 'Government's 110 % solution', as it is a general arrangement and in order to distinguish it from measures that the individual banks had been taking earlier.

#### **4. Description of the measures**

- (16) It is clear that Landsbankinn is the grantor and not the beneficiary of the measure to refund 20% of interest payments. The beneficiaries are households and private individuals. However, as already mentioned, the complainant also alleges that this measure demonstrates that Landsbankinn benefits from state aid through preferential financial relations with its majority owner, the Icelandic State, as it permits the bank to offer its clients a generous rebate of interest inconsistent with commercial banking practices and the interest of shareholders. It thereby forgoes a normal rate of return on its investment in the bank. For the assessment of this allegation, it is therefore necessary to review the basic underlying facts of the measure.
- (17) On 26 May 2011, Landsbankinn announced that it had decided to offer to its household clients three different debt relief measures. These measures came in addition to measures previously offered by the bank, as a part of its effort to restructure household debt. Two of the measures concern reduction of household debt, firstly as an amendment of the 110% mortgage alignment procedure, and secondly, a reduction of other outstanding debt of household clients in excess of their payment capacity. These two measures are outside the scope of the complaint addressed in this decision.
- (18) Thirdly, the bank announced that individuals and household clients who had honoured their obligations towards the bank during the period 31 December 2008 to 30 April 2011 without having defaulted on them for a period longer than 3 months, were entitled to a repayment of 20% of all interest paid during this period, up to a maximum amount of 1 million ISK. According to Landsbankinn, this measure was seen as a means to improve the bank's loan portfolio and further ease the burden of payment by customers.
- (19) The refund was implemented as a reduction of the outstanding obligations of clients towards Landsbankinn in the following order: (i) unsecured debt; (ii) secured debt, be it by guarantee, mortgage or other security; and (iii) overdrafts. Only in cases where all loans were paid up was the refund paid on the clients' bank accounts.
- (20) According to Landsbankinn, the background to the measure was that during the first months of 2011 it became clear to the bank that the 110 % solution was in many instances insufficient to solve the problems encountered in practice. Many customers who had strived to honour their obligations, withdrawing for that purpose supplementary pension savings or borrowing from family members, fell outside the scheme or received little or no resolution to their problems despite quite evidently heading for payment difficulties. Customers who had consistently honoured their payment obligations towards the bank argued they were not treated fairly in comparison with clients that did not meet their payment obligations. They held that the latter group had been rewarded by the bank for their behaviour as they had been offered different forms of write-offs and debt reliefs.
- (21) In the early months of 2011, the bank was witnessing increased pace on overdue in the individual loan portfolio despite the recent reduction of 40 billion ISK of total balance following the Supreme Court ruling on foreign exchange linked loans. It was considered vital by the bank and for its customer relations that there should be no further spread of this sentiment that customers would consider themselves to be better off by not meeting their payment obligations. The measure thus aimed at limiting credit risk and enhancing customer loyalty, and ultimately improving the loan portfolio of the bank.
- (22) In the course of May 2011, preparatory work took place within the bank to come up with proposals to address the situation. On 26 May 2011, the board approved the proposals made.

The number of customers eligible for the refund of interest was in the order of 54 000 and the total refund amounted to approximately 4.4 billion ISK. Over the last years, it has, according to Landsbankinn, become a considerable temptation for many individuals and households in Iceland to default on their debts. The measure was designed to combat this tendency and reward loyal customers for not defaulting on their debts, and thus to create motivation on their side to continue being prompt payers. At the same time it was designed to create motivation on the part of defaulting payers to become prompt payers. According to Landsbankinn, the notes accompanying the proposals on the measure to the Board of Directors indicate the goal of the proposal to enhance customer willingness to honour their payment obligations.<sup>8</sup>

## **5. The alleged beneficiary, Landsbankinn hf.**

- (23) In the financial meltdown in October 2008 the Icelandic authorities, on the basis of emergency legislation, set up three new banks to take over most of the domestic operations of the troubled banks which were submitted to public administration. The new banks were founded as public limited liability banks with 100% state ownership. Subsequently, the State ceded its majority interests in two of the banks, Íslandsbanki and Arion Bank, to the creditors of their predecessors. As for the third bank, Landsbankinn, the State also ceded shareholding to the creditors of the bank's predecessor, Landsbanki Íslands, but the State continues to be the majority shareholder (81.333 %). Landskil ehf. owned by the creditors of Landsbanki Íslands, holds a minority interest of 18.667%, and appoints one member of the board of directors of Landsbankinn. In all three banks the ownership is thus divided between the creditors of the old banks and the State, but in different proportions.
- (24) NBI hf. (now named Landsbankinn hf.), the successor of Landsbanki Íslands hf, is currently Iceland's biggest bank. Landsbankinn is a universal bank offering a comprehensive range of financial services to individuals, households, corporations and professional investors in Iceland.
- (25) Upon foundation on 9 October 2008, the government appointed the three new banks' interim boards of directors, consisting of five board members and five alternate members. The interim boards of directors consisted largely of public servants. The interim boards were soon replaced by permanent boards of directors. In the case of Landsbankinn, the interim board was replaced at a shareholder's meeting on 8 November 2008, with a new board of directors. At a shareholders' meeting held on 18 February 2010, a new board of directors was elected, where the ISFI (cf. section 6.1 below), which started operation on 1 January 2010, appointed four of the members.

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<sup>8</sup> The explanatory document prepared by the services of the bank for the meeting of 23 May 2011 of the Board of Directors includes the following clarifications of the measure:

- *Key emphasis is placed on efficiency, fairness and automation based on sound business arguments, on which the improved solutions and actions, should they be approved, are based.*
- *These proposals suggest measures to effectively deal with the debt problems of individuals and households. The objective is to reduce the number of customers experiencing payment difficulties which can be resolved and which it is our aim to resolve. Customer reticence and slow processing has until now presented great difficulty. By offering new and more efficient solutions the unavoidable settlement of these issues will take place more quickly. Customers who, hopelessly entangled in a mesh of various payment difficulty solutions, have not found a reason to honour their obligations will hopefully see a way out of the jungle and regain the willingness to serve their debt.*
- *Furthermore, the proposals include provisions to reward customers who made timely payment. Promptness will become a tangible asset and repayments will for the most part be used to partially pay off obligations with Landsbanki, first non-secured debt that involves the most risk.*

## 6. Arrangement on state ownership of banks

- (26) The sudden and huge involvement of the State in the banking sector posed the question as to what should be the guiding principles for the State's participation<sup>9</sup>. Having consulted foreign financial experts and studied examples and recommendations from abroad, the conclusion of the Icelandic authorities was, firstly, to set up an independent state body, the Icelandic State Financial Investments, to be entrusted with overseeing the State's interests in the banks. Secondly, it developed and announced the position of the State as owner in the banks in an instrument called the 'State Ownership Policy', as further outlined below.<sup>6.1</sup>

### 6.1 The Icelandic State Financial Investments

- (27) On 18 August 2009, the Icelandic Parliament adopted Act No. 88/2009 on the Icelandic State Financial Investments (the ISFI)<sup>10</sup>. According to Article 1 of the Act, the ISFI is a separate state institution reporting to the Minister of Finance. The main responsibility of the ISFI is to administer the state's holdings in financial undertakings in accordance with currently applicable law, good administrative and business practice, and the State Ownership Policy (cf. point 6.2 below). It shall also provide financial undertakings with funds on the State's behalf, based on budget allocations.
- (28) In its activities, the ISFI shall emphasise the reconstruction and development of a robust domestic financial market and promote efficient and healthy competition in that market. It shall ensure transparency in all decision-making related to the State's participation in financial services, as well as effective information disclosure to the general public. Article 5 sets out in more detail provisions on competition concerns, stating *inter alia* that the ISFI must, in its activities and its management of state holdings, make every effort to encourage and reinforce competition in the financial market, by *inter alia* promoting robust and effective competition between financial undertakings owned by the State.
- (29) The management of ISFI shall be in the hands of a three-person Board of Directors, who shall fulfil eligibility criteria set out in Article 6.<sup>11</sup> The Minister of Finance shall appoint the chairman and the vice-chairman. The role of the Board is to establish ISFI's priorities and oversee its activities and operations.<sup>12</sup> The Board of Directors of ISFI was appointed in September 2009, and the institution started operations in January 2010.
- (30) The tasks of ISFI are set out in more detail in Article 4 of the Act, which states *inter alia* that the ISFI shall supervise the implementation of the State's ownership policy, exercise the Treasury's voting rights at shareholders' meetings of financial undertakings, conclude

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<sup>9</sup> Since privatisation in the Icelandic banking sector around the turn of the century, banks were mostly privately owned. There was therefore no need for a policy on public ownership in the financial sector.

<sup>10</sup> An English translation of the Act is available at: [http://bankasysla.is/files/Icelandic%-20State%20Financial%20Investments%20Act\\_An\\_greinagerðar\\_340421187.pdf](http://bankasysla.is/files/Icelandic%-20State%20Financial%20Investments%20Act_An_greinagerðar_340421187.pdf)

<sup>11</sup> Among the eligibility requirements set out in Article 6 are that the Board of Directors and Director General must have suitable educational qualifications and expertise in banking and financial matters. Care shall be taken when the Board is appointed to ensure sufficient diversity in the experience and qualifications of directors, and that they have a sound knowledge of good corporate governance.

<sup>12</sup> Major decisions shall be referred in writing to the Board for approval or rejection. Should the Minister decide, in exceptional circumstances, to issue instructions to ISFI's Board of Directors on specific issues, the Board may express its opinion of these instructions to the Minister before complying with them. The relevant parliamentary Trade Committee shall be given an account of the Minister's instructions and the Board's position on them as soon as possible.

agreements with the boards of the financial undertakings concerned with regard to, for example, equity contributions and the specific and general objectives of their operations.

- (31) According to Article 7 of the Act, the Board of Directors of ISFI shall appoint a special three-member Selection Committee to nominate, on behalf of the state, members to the boards of banks or companies under its supervision.<sup>13</sup>
- (32) According to the explanatory notes to the bill of law for the ISFI<sup>14</sup>, it is seen as fundamental for the state to be a credible owner of the financial undertakings and that its function is elevated above any suspicion of political interference in the day-to-day decision-making process of those undertakings. It is therefore considered vital that the conduct of the State corresponds to that of an informed owner providing the appropriate policy direction for the undertakings and that the ownership role is diligently and professionally managed.
- (33) According to the same source, the Icelandic Government's policy with regard to state ownership takes account of the OECD Guidelines on Corporate Governance of State-Owned Enterprises and of the experience in different OECD member states, in particular Norway's policy in this regard. On this basis, the ISFI is to be operated on professional grounds, with the aim of promoting a credible and solid financial sector in Iceland, and thereby promoting normal and efficient competition in that market. Among the main tasks of the ISFI is, through agreements with the financial undertakings where the State has holdings, to define their operational objectives as well as a benchmark for the return on equity which the state as shareholder expects to see.
- (34) The ISFI arrangement is seen as temporary, as the institution shall have completed its duties no later than 5 years after its foundation.

## 6.2 State Ownership Policy

- (35) On 2 September 2009, the Icelandic Government announced that it had agreed on a state ownership policy for financial undertakings.<sup>15</sup> As mentioned above, it is the role of the ISFI to implement this policy.
- (36) The policy covers four main areas: (i) the state's objectives in its ownership of financial undertakings; (ii) the organisation of the ownership function within the state; (iii) the principles laid down by the state as owner; and (iv) the requirements and criteria in the management of financial undertakings which the state owns a stake in.
- (37) As concerns the objectives of the state ownership, the following is underlined: *The restructuring of the financial system will be a challenging task. In order to guarantee its success, it is important that the state should come across as the informed and strategy-*

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<sup>13</sup> ISFI shall formally request the Selection Committee to nominate candidates for board membership prior to the election of the Board of Directors of the relative bank or financial undertaking. The Board of Directors of ISFI sets the rules of procedure for the committee, defining the criteria to be applied for the assessment of the qualifications, education and experience of individuals being considered for membership of the boards of banks or undertakings. These rules shall be made public on the website of the ISFI. The Board of Directors of ISFI formally requests nominations from the Selection Committee for the appointment of members to the board of directors of the relevant bank or undertaking. The Selection Committee selects two to three candidates for every seat that becomes available. Individuals shall be given an opportunity to apply to participate on the boards of banks and undertakings by sending their curriculum vitae to the committee.

<sup>14</sup> The bill of law is available (in Icelandic) at <http://www.althingi.is/altext/137/s/0166.html>.

<sup>15</sup> An English translation of the State Ownership Policy 2009 is available at [http://bankasysla.is/files/-STATE%20OWNERSHIP%20POLICY%2020100811\\_1803806065.pdf](http://bankasysla.is/files/-STATE%20OWNERSHIP%20POLICY%2020100811_1803806065.pdf)

*making owner of these undertakings and exercise its ownership function with due diligence. The state needs to be a credible owner of the financial undertakings and its function has to be above any suspicion of political interference in the day-to-day decision-making process of the undertakings.*

- (38) The policy has three objectives: (i) to facilitate the construction of a healthy and efficient financial system which serves the interests of the Icelandic society; (ii) to foster confidence and credibility in the Icelandic financial market; and (iii) to ensure that the state receives proper and adequate returns on the significant investments made by the state in the financial undertakings.

### **6.3 The State's required return on investment**

- (39) Among ISFI's tasks is to conclude agreements with the boards of the financial undertakings with regard to, for example, equity contributions and the specific and general objectives of their operations. In that context the ISFI sets whatever conditions it deems necessary for equity capital contributions, in particular on the expected return on its investment. Summaries of such agreements shall be made public 12 months after their conclusion.
- (40) In December 2010, the ISFI concluded an agreement with the board of NBI hf. (now Landsbankinn hf.) on general and specific objectives for the bank's operations.<sup>16</sup> Among the focal issues covered in the agreement is a profitability requirement for the bank.<sup>17</sup> According to Article 4.2 of the agreement, Landsbankinn shall have as its objective that profitability from regular long-term operations enable the bank to attract capital under normal market conditions. The aim shall be for the shares in the bank to be an attractive investment option. Profitability requirements for the long term take account *inter alia* of long-term market yields on capital. As a minimum, the profitability target for regular operations shall be 7% above the risk-free rate based on a capital adequacy (CAD) ratio of 12 %. Where the CAD-ratio requirement is set at 16%, the profitability target shall, as a minimum, be 5.25% above the risk-free interest rate.
- (41) ISFI's annual reports set out in more detail its general considerations on the basis of which it establishes the State's required return on equity. The profitability requirements for Landsbankinn are consistent with those considerations as well as the requirements which the ISFI has defined for the other commercial banks where the State has equity interests, Arion Bank and Íslandsbanki, and implemented in corresponding agreements with those banks. According to ISFI's annual report for 2011, the minimum requirement for return on equity, based on a long-term nominal interest rate of 7.7% and a CAD-ratio of 12%, is 14.7%. This requirement is compared to the target yields of Norwegian and UK banks, which are partially government owned, concluding that the yield requirement made to Icelandic banks corresponds to those made to financial undertakings in Iceland's neighbouring countries.
- (42) Landsbankinn reported a pre-tax return on equity of 20.8% in 2010, 8.1% in 2011 and 14.0% in 2012. Landsbankinn has so far not paid out dividends. The same applies to the other commercial banks partially state-owned, Arion Bank and Íslandsbanki.

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<sup>16</sup> The agreement is available (in Icelandic) at [http://www.bankasysla.is/files/Samningur-%20um%20almenn%20og%20sértæk%20markmið%20i%20rekstri%20NBI%20hf\\_1082616028.pdf](http://www.bankasysla.is/files/Samningur-%20um%20almenn%20og%20sértæk%20markmið%20i%20rekstri%20NBI%20hf_1082616028.pdf)

<sup>17</sup> Among other matters covered in the agreement are: operational goals, healthy operations, corporate and household financial restructuring, disclosure of information to shareholders, business plan, annual financial statements and annual meeting, quarterly reporting, information meetings with shareholders and monitoring the implementation of the agreement.



## **7. Position of the Icelandic authorities**

- (43) The Icelandic authorities submit that the measures taken by Landsbankinn are not attributable to the State. The decisions by the bank were taken by its board and management without any influence from the Icelandic authorities and without consultation with the bank's shareholders. The bank's measures were based on market considerations. Moreover, the whole set-up for the State's participation in financial undertakings and its ownership role is governed by the principle that there should be no interference by the State. In this context, the Icelandic authorities point to extensive information which has been made available to the Authority on earlier occasions concerning the management of the State's holdings in financial undertakings.
- (44) The Icelandic authorities explain that they forwarded a copy of the Authority's request for information regarding the complaint to Landsbankinn and asked the bank to submit information and comments relevant to the complaint. Landsbankinn's replies to the responsible ministry are enclosed with the Icelandic authorities' responses to the Authority, stating that apart from the general view of the Icelandic authorities referred to above, they consider that the matters raised by the complaint are sufficiently documented by Landsbankinn in its reply to the Icelandic authorities.
- (45) Landsbankinn claims that the complainant's allegation, on the cost of Landsbankinn's measure being in the region 25-30 billion ISK, are wrong. The cost was in the order of 4.4 billion ISK or similar to the costs of corresponding measures later provided by the complainant.
- (46) The measures were developed and adopted within the bank. The measures were discussed at board meetings in the course of May 2011. At no time has any pressure been applied by the State to adopt these measures, as insinuated by the complainant. The decisions by the bank were taken by its board and management without any influence from the Icelandic authorities and without consultation with the bank's shareholders.
- (47) Landsskil ehf., which holds 18.667% of the bank's shares, did not object to the measures taken. On the contrary, the member of the board of directors nominated by Landsskil ehf. fully supported the adoption of the measures.
- (48) Landsbankinn points out that the bank's operations are subject without reservation to private law on limited liability companies, namely the Act on Public Limited Companies No. 2/1995. According to Article 76 of that Act, Landsbankinn cannot make arrangements that favour the interests of a specific shareholder at the expense of other shareholders.
- (49) It is claimed that Landsbankinn's measures subject to the complaint were based on commercial logic and considerations, in the same way as is presumed to have been the case regarding similar measures adopted by Arion Bank. In the circumstances prevailing in Iceland at the time when the measure was taken, improving loan portfolios was a high priority and an indispensable part of regular banking operations.
- (50) Landsbankinn submits that there is no foregoing of an expected return on public funds in the present case. It is clear that:
- the State's professional and independent body, managing the State's holdings in the financial sector, the ISFI, is under an obligation to ensure profitability of the State's investment, thus to require a market-based return on the investment;
  - a return requirement has formally been laid down to Landsbankinn;

- the return requirement is based on transparent and objectively justified parameters;
- the cost of the disputed measures did not result in Landsbankinn not meeting the required return; and
- Landsbankinn has followed a similar dividend policy as its direct competitors.

(51) The measures adopted only apply to individuals who are customers with Landsbankinn. These persons are thus the beneficiaries.

## II. ASSESSMENT

### 1. The presence of state aid

#### 1.1 State aid within the meaning of Article 61(1) of the EEA Agreement

(52) Article 61(1) of the EEA Agreement provides that:

*“Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States 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 Contracting Parties, be incompatible with the functioning of this Agreement.”*

(53) It follows from Article 61(1) EEA that in order for a measure to amount to state aid the following conditions must all be met:

- i. The measure must be granted through *state resources*;
- ii. It must favour certain undertakings or the production of certain goods, that is the measure must confer an *economic advantage* on an undertaking;
- iii. It must be *selective*; and
- iv. It must be capable of *distorting competition* and *affecting trade* between the Contracting Parties.

(54) The Authority notes that, as pointed out by Landsbankinn and the Icelandic authorities, the beneficiaries of the 20% refund of interest payment are individuals and households, i.e. not undertakings. Therefore, the refund does not entail any state aid.

(55) However, the complainant’s allegations could also be understood to mean that the bank was able to adopt this measure, i.e. the 20% refund of interest payment due to its preferential financial relations with the Icelandic State, the State being the majority shareholder in Landsbankinn. This would imply, among other things, that the State was not requiring market-based returns on its investment in the bank and that the measure does not reflect commercial behaviour.

(56) It is appropriate to recall the support measures given by the Icelandic Government in relation to the establishment of Landsbankinn in October 2008 on the basis of the domestic operations of Landsbanki Íslands and the agreement in December 2009 with the creditors of the latter bank to acquire minority shareholding in the new bank. The measures were in the form of equity investment by the Icelandic State in Landsbankinn, where the State was initially the sole owner, and after the agreement with the creditors retained 81.333% of shares in the bank.

By Decision 290/12/COL of 11 July 2012, the Authority concluded that these measures involved state aid which however was found to be compatible as restructuring aid on the basis of Article 61(3)(b) of the EEA Agreement, as aid to remedy a serious disturbance in Iceland's economy. As will be further reviewed below, the approval was based on a restructuring plan for Landsbankinn, which in the Authority's view demonstrated the restoration of the long-term viability of the bank. The aid was considered to be limited to the minimum necessary and sufficient measures were being taken to limit distortions of competition. The matter raised by the complainant in this case invites the question whether the measure taken by Landsbankinn in May 2011 provides reasons to call into question the Authority's previous conclusions regarding the restructuring measures in 2008 and 2009 in favour of Landsbankinn.

### *1.1.1 Presence of state resource and imputability to the state*

- (57) In order to constitute state aid within the meaning of Article 61(1) EEA, the measure at issue must be granted by the state or through state resources. This also implies that the measure must be attributable or imputable to the state.<sup>18</sup> Public undertakings or undertaking organised under private law as limited liability undertakings where the state is the majority shareholder and can exercise a dominant influence, as in the case of Landsbankinn, are capable of granting state aid.<sup>19</sup> However, such undertakings often have a degree of autonomy in relation to decision-making which means that, in cases where the remaining elements of Article 61(1) of the EEA Agreement are satisfied, it must be determined whether the public undertaking is acting on behalf of the state in relation to the measure at issue.
- (58) Through Article 125, the EEA Agreement establishes the principle of neutrality with regard to the system of property ownership. According to Article 59, public undertakings are subject to the rules on competition and state aid in the same way as private undertakings. This means among other things that the state aid provisions of the agreement shall neither favour nor penalise public undertakings.
- (59) The so-called Transparency Directive<sup>20</sup> seeks to establish transparency in the financial relations between public authorities and public undertakings. The rules of the directive are essential in ensuring fair and effective application of state aid rules. According to the directive, 'public undertaking' means any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it. A dominant influence on the part of the public authorities shall be presumed when these authorities, directly or indirectly in relation to an undertaking: (i) hold the major part of the undertaking's subscribed capital; or (ii) control the majority of the votes attaching to shares issued by the undertakings; or (iii) can appoint more than half of the members of the undertaking's administrative, managerial or

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<sup>18</sup> Joined Cases 67, 68 and 70/85 *Van der Kooy BV and others v. Commission* [1988] ECR 219; Case 308/88 *Italy v. Commission* [1991] ECR I-1433, paragraph 11; Case C-305/89 *Italy v. Commission (Alfa Romeo)* [1991] ECR-1603; and Case T-385/94 *Air France v. Commission* [1996] ECR II-2109.

<sup>19</sup> In Case 78/76 *Steinike & Weinlig* the Court of Justice confirmed that the state aid rules apply equally to aid granted by public or private bodies designated or established by the state to administer aid. Thus, the prohibition in Article 61(1) EEA 'covers all aid granted by a member state or through state resources without it being necessary to make a distinction whether the aid is granted directly by the state or by public or private bodies established or operated by it to administer the aid'.

<sup>20</sup> Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (OJ L 318, 17.11.2006, p.17). The directive is referred to in point 1a of Annex XV to the EEA Agreement.

supervisory body. Given that the Icelandic State holds, through the ISFI, 81.333% of shares in Landsbankinn, controls the majority of voting rights and appoints 4 out of 5 members of the board of directors, Landsbankinn meets the definition of a public undertaking according to the directive. According to Article 3 of the directive, the transparency of the financial relations between public authorities and public undertakings required by the directive covers *inter alia* the forgoing of an expected return on public funds.

- (60) Public or publicly owned undertakings will be considered to be under the control of the state and therefore capable of granting state aid when the state actually exercises a dominant influence over that undertaking. This is a question of the assessment of the facts and circumstances of the case, and the factors indicating dominant influence vary from one case to the other.
- (61) However, the Court of Justice has stated that "*[e]ven if the State is in a position to control a public undertaking and to exercise a dominant influence over its operations, actual exercise of that control in a particular case cannot be automatically presumed.*"<sup>21</sup>
- (62) Whether measures of a public undertaking are imputable to the State may be inferred from a set of indicators arising from the circumstances of the case and the context in which the measure was taken, such as whether the body in question was able to take the contested decision without taking account of requirements of the public authority. Other indicators might also in certain circumstances be relevant, including the undertaking's "*[...] integration into the structures of the public administration, the nature of its activities and the exercise of the latter on the market in normal conditions of competition with private operators, the legal status of the undertaking (in the sense of its being subject to public law or ordinary company law), the intensity of the supervision exercised by the public authorities over the management of the undertaking, or any other indicator showing, in the particular case, an involvement by the public authorities in the adoption of a measure or the unlikelihood of their not being involved, having regard also to the compass of the measure, its content or the conditions which it contains.*"<sup>22</sup>
- (63) In the circumstances of the present case, it is appropriate to review, firstly, the arrangement on public ownership of holdings in financial undertakings prevailing at the time when the contested measure was adopted and, secondly, the available information on the involvement of public authorities in deciding on the contested measure.

#### The arrangement on public ownership in financial undertakings

- (64) As has been explained by the Icelandic authorities, the sudden and major increase of the State's participation in the financial sector resulting from the demise of Iceland's three major commercial banks in October 2008 presented a major challenge for the arrangement and organisation of the ownership function and how to ensure fair competition undistorted by the sudden and major state intervention. Leaving aside the first weeks in the banks' operation when they were under the management of interim boards of directors<sup>23</sup>, the response of the

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<sup>21</sup> Case C-482/99 *France v. Commission (Stardust Marine)* [2002] ECR I-4397, paragraph 55.

<sup>22</sup> Case C-482/99, paragraph 56.

<sup>23</sup> It shall be noted that according to the EFTA Surveillance Authority's Decision 292/12/COL of 11.7.2012 regarding state aid granted in the winding up of certain investment funds connected to New Glitnir, New Landsbankinn and New Kaupping, the Authority concluded that the decisions of the three banks to purchase assets from the investment funds managed by their subsidiary companies were imputable to the Icelandic State and that the three banks did not act in accordance with the market economy investor principle by investing in securities of investment funds managed by their subsidiaries. The investments in this case were

Icelandic authorities, based on experience in OECD and neighbouring countries, was to take the necessary steps to ensure that the banks would be run professionally in accordance with good administrative and business practice and insulated from political interference<sup>24</sup>. It should be ensured, among other things, that the State receives proper and adequate returns on the significant investments made by the State in the financial undertakings. This was done by the establishment of an independent body entrusted with overseeing the State's interests in the banks, the Icelandic State Financial Investments (the ISFI) and by laying down the policy of the State as owner in the banks in an instrument, called 'State Ownership Policy'.

(65) For the purposes of the present decision, it suffices to recall the main themes of the steps taken by the Icelandic authorities in this regard, as outlined in more detail in section I.6 above:

- The ISFI is set up by Act No. 88/2009 and is a separate state institution reporting to the Minister of Finance. Its main responsibility is to administer state holdings in financial undertakings in accordance with applicable law, good administrative and business practices and the State Ownership Policy.
- The management of the ISFI is in the hands of an independent board of directors chosen on the basis of the eligibility criteria set out in Article 6 of the Act.
- The ISFI shall amongst other things seek to ensure "transparency in all decision-making related to the state's participation in financial activities".
- Its main role is to manage the state's holding in financial undertakings, and in that context to stipulate the general and specific operational goals of the state-owned financial undertakings through separate agreements with each of them, define the return on equity expected by the state as well as setting general goals concerning the restructuring of the financial sector.
- As for Landsbankinn in particular, the ISFI and Landsbankinn concluded their agreement in December 2010. It sets out specific and general objectives of the operation of Landsbankinn. The objective of the agreement is to ensure that the ISFI fulfils its obligations under the State Ownership Policy. Nothing in the agreement indicates that the ISFI is involved in the day-to-day management of Landsbankinn's affairs. On the contrary, the agreement merely places an obligation on Landsbankinn to communicate certain information to ISFI.
- The ISFI is required to respect and encourage undistorted competition and make every effort to encourage and reinforce competition in the financial market, also between financial undertakings owned by the State.
- In order to ensure additional distance between a bank where the State holds equity interests and the State, the Act also provides for a special Selection Committee charged with examining candidatures for and nominating members to the boards of banks coming within the remit of the ISFI.

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decided upon on 23 and 27.10.2008 by the interim boards of directors of the respective banks. Decision 292/12/COL is available at <http://www.eftasurv.int/media/decisions/292-12-COL.pdf>.

<sup>24</sup> Cf. explanatory notes to the bill of law on the ISFI and the State Ownership policy outlined in section I.6 above.

- Landsbankinn is a public limited liability company set up and operating in accordance with the Act on Public Limited Companies No. 2/1995 and Act No. 161/2002 on Financial Institutions. This means that Landsbankinn is subject to private law as classified under the Icelandic legal system. Therefore, Landsbankinn cannot be considered an integrated part of the public administration, obeying hierarchical administrative rules and thus lacking commercial autonomy.

- (66) Thus, the State's ownership, not just in Landsbankinn, but in all financial undertakings in which the State has a holding, is administered by a professional and independent body operating at arm's length from the Ministry of Finance. The ISFI is by law required to monitor that the State has an appropriate return on the capital invested and that competition is not distorted. ISFI has no legal authority to waive these requirements. Should it do so, the ISFI would be in breach of its duties. It is recalled that the law on the ISFI was adopted in August 2009, at a time when the state was still the sole owner of all the three new commercial banks. The state ceded majority ownership in two of the three banks later that year, and the creditors of Landsbanki Íslands become minority shareholders in the new Landsbankinn. Nevertheless, the law on the ISFI and the State Ownership Policy have remained unchanged.
- (67) With reference to the above considerations, the Authority concludes that the ownership arrangement prevailing at the time when the contested measure to refund 20% of interest payment was adopted was in general such as to ensure the bank a sufficient degree of autonomy to preclude its measures being imputable to the state.

Adoption of the contested measure consisting in the refund of 20% of interest payments

- (68) It has been underlined by the Icelandic authorities that the bank adopted the measure on its own initiative. The decisions were taken by the bank's board of directors and management without any interference or influence from the Icelandic authorities and without consultation with the bank's shareholders.<sup>25</sup>
- (69) According to Landsbankinn, the measures were developed and adopted within the bank, following discussions at board meetings in the course of May 2011. Landsbankinn has submitted internal documents<sup>26</sup> which in the Authority's view support that claim. It must be acknowledged that it can be hard for competitors of a public undertaking to provide proof of public involvement in the day-to-day decision making of that undertaking. However, on the basis of the submission made by the complainant and the information provided by the Icelandic authorities and Landsbankinn, the Authority does not find a reason to question the statement of the Icelandic authorities that the measure was adopted by the bank without any involvement of the authorities.

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<sup>25</sup> The complainant has amongst other things drawn attention to a statement of the CEO of the ISFI regarding the contested measure, according to which it is confirmed that the ISFI was informed of the measure the night before it was adopted. At the same time, however, the CEO stated that the bank's board of directors was authorised to take decisions such as this one and that shareholders therefore had no special entitlement to be involved in the decision. "We have no reason to doubt the assessment of the board of directors, management or specialists at the bank that it was a beneficial move from Landsbankinn, and thus for its shareholders, in the long term." Interview with Elin Jónsdóttir, CEO of the ISFI by the news agency *Visir.is* on 12.6.2011.

<sup>26</sup> Document dated 23.5.2011 on alignments in relation to payment difficulties of Landsbankinn's individual and household clients (in Icelandic: *Úrbætur og aðlaganir á skuldavandaúræðum fyrir einstaklinga og heimili í viðskiptum við Landsbankann*).

(70) With reference to the above considerations, it would already appear clear that the contested measure of Landsbankinn is not imputable to the State, and therefore does not involve state aid. However, for the sake of completeness and given the complainant's allegation that the refund of interest does not correspond to the conduct of a privately owned bank, the Authority will also consider the following questions: (i) Does the contested measure reflect commercial behaviour and business logic?; (ii) Does the measure complained of affect the rate of return that the State receives on its investments in the bank?; and (iii) Was the restructuring aid which Landsbankinn received in 2008 and 2009 limited to the minimum necessary or was it excessive?

(i) Does the measure reflect commercial conduct on the part of Landsbankinn?

(71) It is appropriate to review the nature and scale of the contested measure. The measure entailed that customers that had honoured their obligations towards the banks during the period 31 December 2008 to 30 April 2011 without default for a period longer than 3 months, were entitled to a repayment of 20% of all interest paid during this period up to a maximum amount of 1 million ISK.

(72) The complainant has submitted the estimation that the cost of Landsbankinn's refund of interest decision amounts to 25-30 billion ISK. It shall be noted, however, that Landsbankinn declines this estimation as unfounded. According to Landsbankinn, the actual total cost of the refund measure was in the order of 4.4 billion ISK.

(73) According to Landsbankinn, its measures were based on commercial considerations and logic, where the ultimate goal was to improve the bank's loan portfolio and reduce risk. In the circumstances prevailing in Iceland at the time when the measure was taken, improving loan portfolios was a high priority and an indispensable part of regular banking operations. Each bank has sought and continues to seek to restructure household loan portfolios as effectively as it possibly can, and it does so in its own manner. Such measures were recognised and recommended by the supervisory authorities, the ISFI, the IMF and others, and have been practiced by all financial undertakings.

(74) Landsbankinn has drawn attention to the fact that the complainant, Arion Bank, provided its clients with a similar refund of interest. However, according to the complainant, those measures were on a much smaller scale than the ones offered by Landsbankinn, and the underlying reason was the interest refund previously offered by Landsbankinn. The total cost of Arion Bank's measures was in the order of 2.5 billion ISK.<sup>27</sup>

(75) The Authority has also noted that on 21 February 2013, Íslandsbanki announced publicly that it had decided to grant its customers an interest refund, according to which approximately 20 thousand of Íslandsbanki's customers would receive a refund of 30% of the interest payments made on mortgages and general debt over the course of 2012. The bank's cost of the measure

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<sup>27</sup> According to information provided by Arion Bank to the Authority on 17.2.2012, the bank states that it had recently offered to its customers rebates on their prompt loans with the bank, but on a much smaller scale than Landsbankinn. The measures entailed rebates of two installments of prompt loans of customers, provided that all twelve installments in the previous year were duly paid. The measure was mainly relevant to household mortgages. The average payment to customers under this measure was ISK 125 000. The rebate is also in the form of 30% interest refund on overdraft credit loans of interest paid in the previous year. The average payment to customers under this measure was ISK 13 000. According to Arion Bank, the measures were first and foremost implemented to answer the claims of the bank's customers. After Landsbankinn introduced its measures there was extensive pressure on Arion Bank to introduce similar measure.

amounts to 2.5 billion ISK and on average each customer will receive ISK 120 000, subject to a maximum repayment of ISK 500 000.<sup>28</sup>

- (76) Landsbankinn has underlined that numerous measures had been adopted by the banks to improve their loan portfolio and help those who are unable to meet their obligations following the financial crisis. However, in Landsbankinn's view, little had been done to ease the burden of those who have managed to honour their obligations towards the banks. Customers who honoured their payment obligations towards the bank during the financial crisis had in many instances taken additional loans, used their supplementary pension funds or received assistance from family members. Given the fact that Landsbankinn sensed amongst its prompt customers the sentiment of unfairness and a declining willingness to honour their obligations, it was decided to repay them 20% of the interest paid during the period 31 December 2008 to 30 April 2011. This was done to ensure that they would continue to honour their obligations as well as to encourage customers in default to become prompt customers. The measure was thus seen as a means to improve the loan portfolio of Landsbankinn and further ease the burden of payment by customers, as a substantial part of refunded interest was used to lower other debts of customers in the order as explained above.
- (77) The Authority notes that the business logic of the contested measures as explained by Landsbankinn appears to be exceptional for a bank which is to be operated on commercial principles. At the same time, however, it acknowledges that as a result of the financial crisis, payment difficulties of in particular indebted households were also exceptional and grave when the measures were adopted. The Authority furthermore notes the diversity of debt forgiveness and alignment measures adopted by Icelandic financial institutions and the encouragement given for debt restructuring measures by the relevant Icelandic authorities as well as by the IMF. In this context, Landsbankinn's 20% rebate of interest payments of prompt household clients can be viewed as an investment in long-term customer loyalty. Finally, the Authority notes that Landsbankinn's main competitors, Arion Bank and Íslandsbanki, have both adopted measures that are not dissimilar in nature. In those circumstances, it is not for the Authority to replace the evaluation of Landsbankinn of its measures with that of its own. With reference to the above considerations, the Authority does not find a reason to question the commercial nature of Landsbankinn's measure.

#### *1.1.2 Does the measure confer an economic advantage to an undertaking?*

- (78) The two latter questions mentioned above in paragraph 70 relate to whether the measure confers an advantage on Landsbankinn implying that the bank is thus being favoured according to Article 61(1) EEA.
- (ii) The State's requirement on return on its investment in Landsbankinn
- (79) The complainant has claimed that the scale of Landsbankinn's interest refund measure must show that the State is not actively seeking an adequate return on its shareholding in Landsbankinn and thus that its conduct as the main investor in the bank does not correspond to that of a market economy investor.

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<sup>28</sup> Íslandsbanki's announcement in this measure is available at <http://www.islandsbanki.is/english/about-islandsbanki/news/news-item/2013/02/21/Customers-receive-interest-refund-from-Islandsbanki/>. The refunds will be deposited into 30-day notice savings accounts. Customers are free to withdraw their refund from the account with a 30 day notice. Íslandsbanki wants to encourage its customers to establish savings for the future, although the best savings sometimes include paying down debt that carries higher interest rates.



- (80) As explained in Chapter I.6 above, the ISFI shall manage the State's holdings in financial undertakings in accordance with good administrative and business practice and the State Ownership Policy. Among the main objectives of that policy is to ensure that the State receives proper and adequate returns on the significant investments made by the State in the financial undertakings. In other words, the State's policy as concerns return on capital is laid down in normative texts and applies to all the banks in which the State holds interests. Those banks should take their decisions professionally and with a view to ensure adequate profitability. Those principles are unaffected by the banks' policies on corporate social responsibility.<sup>29</sup>
- (81) The Authority has reviewed the work of the ISFI, in particular as it appears in the annual reports on its operation. On this basis the Authority considers it clear that also in practice, the ISFI has attached importance to the profitability requirement emanating from the State Ownership Policy and the specific agreements with each bank on their general and specific objectives of operation. In this regard, reference can be made to the report of ISFI's activities in 2010, where *inter alia* the following is mentioned:

*Despite the fact that the Icelandic State's investment in the restoration of the three banks is considerably lower than initially anticipated, it nevertheless constitutes a substantial sum. The amount which the State has allocated to the restoration of the banks is 40 % of the State's expected income in 2010, and, [...]. It therefore matters a great deal to the taxpayer to know that this money is being used efficiently and yields the best possible dividends, considering the scope and the nature of the operations the State is investing in.*

- (82) The general considerations on the basis of which the ISFI establishes the required return on equity transpires from its 2011 annual report, stating *inter alia* that in the long run the requirement for return on equity is 14.7% based on a long term nominal interest rate of 7.70% and a CAD-ratio of 12%.<sup>30</sup>
- (83) As concerns Landsbankinn in particular, on the basis of Article 4 in the Act on the ISFI, an agreement was concluded in December 2010 between the ISFI and Landsbanki, setting out *inter alia* the requirements as to the profitability of Landsbankinn, stating the following:

*Landsbanki shall have as its objective that profitability from regular long-term operations*

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<sup>29</sup> The complainant has indicated that Landsbankinn's policy on corporate social responsibility demonstrates that the bank is acting under the influence of public authorities. However, all three banks have announced their policies on corporate social responsibility. Having reviewed Landsbankinn's policy in this regard, the Authority cannot see that it contravenes the profitability requirement set out in the State Ownership Policy or in ISFI's agreement with the board of Landsbankinn.

<sup>30</sup> The report refers among other things to that the Norwegian Bank DnB NOR which is partially owned by the Norwegian Government has a target yield of 13% in the long run. The required rate of return is somewhat lower than in Iceland as interest rates are generally lower in Norway than Iceland. UK Financial Investments, a holding company managing the shares of the British Government in financial undertakings, makes a requirement of 15% rate of return for the Royal Bank of Scotland. In the view of the ISFI, the yield requirement made to Icelandic banks therefore corresponds to those made to financial undertakings in Iceland's neighbouring countries. The ISFI considers further the yield on relevant bonds in the Icelandic market and concludes that with reference to the market yields in the previous year (i.e. 2010), the yield of financial undertakings with a 12% capital ratio and 7% risk premium would be 13.5%. However, given that the Financial Supervisory Authority (the FME) makes a requirement of 16% capital ratio, financial undertakings must show a return on equity of 11.7%. It is also noted that based on the accounting profit, all of the Icelandic commercial bank, which have a capital ratio of 19 – 26%, reach this requirement.

*enable the Bank to attract capital under normal market conditions. The aim shall be for the shares in the Bank to be an attractive investment option. ...*

*Profitability demands for the long term are based on long term market yields on capital and performance pre-tax and prior to other new public levies on financial undertakings. At a minimum, the profitability target for regular operations shall be 7% above the risk-free rate based on a 12 % equity ratio. Where the equity ratio demand is set at 16%, the profitability target shall be 5.25 % above the risk-free rate at a minimum.*

(84) Since its foundation in 2008, the financial performance of Landsbankinn has varied somewhat from one year to the other. The bank's profitability has also been affected by irregular items, initially mainly in the form of valuation gains from assets transferred from its predecessor, and more recently due to losses linked to judgments of the Supreme Court of Iceland finding loans to be illegally linked to the value of foreign currencies. Nevertheless, the bank's overall profitability has remained positive since its foundation, and the bank's return on equity from core operations excluding irregular items has grown from 5.7% in 2009, to 9.3% in 2010 and 14.5% in 2011.<sup>31</sup> Given the positive profitability and the fact that Landsbankinn has so far not paid out dividends<sup>32</sup>, the bank's capital ratio has been rising, from 14.9% at the end of 2009 to 19.5% at the end of 2010, 21.4% at the end of 2011 and 25.1% at the end of 2012. Landsbankinn reported a pre-tax return on equity of 20.8% in 2010, 8.1% in 2011 and 14.0% in 2012. This indication of the bank's financial performance in recent years must be viewed in the light of the bank's high and rising capital ratio.<sup>33</sup> Thus, a return on equity of 14% where the CAD-ratio is 23%, would correspond to a return on equity of approximately 20%, assuming that the CAD ratio was 16%. In view of this, Landsbankinn's financial performance must be considered to have in general developed favourably in recent years.

(85) With reference to the above facts and considerations, the Authority concludes that it cannot be established that in relation to the measure complained of the State has waived any requirement as to an appropriate return on the capital invested in Landsbankinn.

(iii) Was the restructuring aid to Landsbankinn limited to the minimum necessary?

(86) It shall be recalled that on its foundation in 2008 and its final capitalisation in 2009, involving also the creditors of Landsbanki Íslands as minority shareholders, Landsbankinn received state aid. This aid was approved by the Authority as restructuring aid on 11 July 2012, in Decision 290/12/COL. Among the requirement for approval of restructuring aid to banks on the basis of Article 61(3)(b) of the EEA Agreement and the Authority's temporary guidelines

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<sup>31</sup> See Chapter 4 of the annual report on the activities of the ISFI in 2012, available at [http://bankasysla.is/files/Skyrsla%20Bankasyslu%202012\\_1762135646.pdf](http://bankasysla.is/files/Skyrsla%20Bankasyslu%202012_1762135646.pdf).

<sup>32</sup> The same applies to Arion Bank and Íslandsbanki. Among the supervisory sign-off conditions imposed by the FME in 2009 when granting operating licenses to the new banks was a restriction on payment of dividends. The conditions applied for three years. Landsbankinn is furthermore restrained as concerns payment of dividends to its shareholders due to certain provisions in senior bonds issued by the bank as a payment for acquiring the domestic operations of Landsbanki Íslands. According to this provision, if the bank makes a dividend payment then it shall redeem the bonds on a pro rata basis in an amount equal to such dividend payment. It shall be recalled, however, that in June 2012, Landsbankinn made an optional and partial prepayment of principal of each of the bonds in an amount equivalent to ISK 71 200 million. Future dividend payments up to this limit would therefore not require early repayment of the bonds. See point 24 of the notes to Landsbankinn Consolidated Financial Statements for the year 2012.

<sup>33</sup> For any bank, the return on equity depends on its capital structure. For any fixed amount of annual profits, the higher the CAD ratio, the lower will become the return on equity.

on restructuring aid in the financial sector is that there should be sufficient own contribution by the beneficiary and the aid should be limited to the minimum necessary. It is therefore appropriate to examine whether this was the case regarding restructuring aid to Landsbankinn or whether the measure examined in this decision may demonstrate that the aid was excessive.

- (87) In Decision 290/12/COL, the Authority took account *inter alia* of the fact that the weak capitalisation of Landsbanki Íslands was one of the factors that led to its downfall, of the demanding operating conditions of the new Landsbankinn and of the severe tests performed as part of the bank's restructuring plan. At the end of 2010, the bank had achieved a CAD-ratio of 19.5% or well above the FME requirement of 16%. According to the restructuring plan, this ratio was forecast to rise further, and under the stress case scenario, the ratio would also be above the FME requirement. The Authority concluded that it was prudent and comforting that the bank was provided with a capital buffer to deal with unexpected adversities.<sup>34</sup> It shall also be mentioned that after the Authority adopted the above decision, the FME concluded in the fourth quarter of 2012 the so-called SREP process with regard to Landsbankinn, leading to the result that the regulatory requirement on the bank's CAD ratio was raised from 16% to 19.5%.<sup>35</sup>
- (88) It shall also be kept in mind that the question as to whether or not the aid was limited to the minimum necessary must be examined at the time when it was decided upon in 2008 and 2009, at a time when considerable uncertainty prevailed in Iceland and in the global financial sector.
- (89) Furthermore, it is particularly important to keep in mind the form in which aid to Landsbankinn was granted. Unlike the reconstruction of Iceland's two other major commercial banks, where aid was granted also in the form of subordinated loans and other credit facilities, aid to Landsbankinn was only in the form of equity investments, where the State acquired majority ownership of the bank.<sup>36</sup> As for this form of aid, the answer to the question whether or not it was limited to the minimum necessary depends essentially on whether or not the State makes adequate arrangements to require normal market return on its investment. This question has already been answered positively above.

## 2. Conclusion

- (90) The preceding analysis has established that (i) the contested measure does not benefit undertakings; (ii) the measure was not imputable to the State; (iii) there are insufficient grounds to question the commercial nature of Landsbankinn's measure; (iv) in relation to the measure, the State has not waived any expected return on its investments in the bank; and (v) the measure does not alter the Authority's previous conclusion in Decision 290/12/COL that the aid granted for the restructuring of Landsbankinn in 2008 and 2009 was limited to the minimum necessary. Given these conclusions and the fact that the conditions of Article 61(1) EEA for the presence of state aid are cumulative, it is not necessary to consider other requirements. On this basis, the Authority concludes that the financial relations between the Icelandic State and Landsbankinn as reflected in the contested measure did not involve state aid within the meaning of Article 61(1) of the EEA Agreement.

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<sup>34</sup> See in particular paragraphs 195-196 of Decision 290/12/COL.

<sup>35</sup> See point 43 of the notes to Landsbankinn Consolidated Financial Statements for the year 2012.

<sup>36</sup> The Icelandic authorities also granted aid in the form of a declaration of a comprehensive state guarantee of deposits in all domestic commercial and savings banks.

**HAS ADOPTED THIS DECISION:**

*Article 1*

The measure undertaken by Landsbankinn to refund 20% of interest paid by prompt clients during the period 31 December 2008 to 30 April 2011 did not involve state aid within the meaning of Article 61(1) of the EEA Agreement.

*Article 2*

The case concerning alleged state aid in favour of Landsbankinn through the forgoing of an expected return on public funds is hereby closed.

*Article 3*

This Decision is addressed to the Republic of Iceland.

*Article 4*

Only the English version is authentic.

Done at Brussels, 10 April 2013.

*For the EFTA Surveillance Authority,*

Oda Helen Sletnes  
President

Sabine Monauni-Tömördy  
College Member