

Case No: 73094
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EFTA SURVEILLANCE AUTHORITY DECISION
of 27 January 2016
on restructuring aid to Norðurland Savings Bank's and its predecessors
Svarfdælir, Þórshöfn and Bolungarvík savings banks

(Iceland)

The EFTA Surveillance Authority (“the Authority”),

HAVING REGARD to the Agreement on the European Economic Area (“the EEA Agreement”), in particular to Article 61(3)(b) and Protocol 26 thereof,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (“the Surveillance and Court Agreement”), in particular to Article 24,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement (“Protocol 3”), in particular Article 1(3) of Part I and Articles 4(3) and 13 of Part II,

Whereas:

I. FACTS

1. Procedure

- (1) On 10 June 2010, the Icelandic authorities notified a rescue aid scheme involving the settlement of claims owned by the Central Bank of Iceland (“CBI”) on five Icelandic savings banks (“the CBI Scheme” or “the Scheme”).¹ The purpose of the Scheme was to ensure that the five savings banks would meet their respective regulatory capital requirements.
- (2) By Decision dated 21 June 2010,² the Authority approved the Scheme pursuant to Article 4(3) of Part II of Protocol 3 and authorised its immediate implementation. The approval was expressed to be temporary for six months and the Icelandic authorities were requested to

¹ The CBI's ownership of claims on the savings banks results from a decision of the Icelandic Financial Supervisory Authority (“the FME”) of 21 March 2009 on the allocation of assets and liabilities of the commercial bank Sparisjóðabanki Íslands (SPB) making the CBI responsible for the savings banks' deposits in SPB, in return for which the CBI obtained SPB's claims on the savings banks. The background is further explained in Chapter I.2.1 below.

² Decision No. 253/10/COL of 21 June 2010 on the rescue aid scheme involving settlement of claims owned by the Central Bank of Iceland on savings banks, OJ C 298 and EEA Supplement No. 61, 4.11.2010.

submit restructuring or liquidation plans for the savings banks at the latest by 21 December 2010.

- (3) By letter of 21 December 2010³, the Icelandic authorities notified amendments to the Scheme but also requested an extension of the deadline for submitting a restructuring plan for each of the five savings banks until 30 April 2011. By Decision of 13 April 2011⁴, the Authority approved the notified amendments to the Scheme and extended the deadline to submit restructuring plans until 30 April 2011. At the request of the Icelandic authorities, the Authority subsequently granted several further extensions for the submission of restructuring plans for the savings banks.
- (4) By letter dated 31 January 2012⁵, the Icelandic authorities submitted restructuring plans for the four following savings banks: Nordfjörður Savings Bank (*Sparisjóður Norðfjarðar*), Vestmannaeyjar Savings Bank (*Sparisjóður Vestmannaeyja*), Bolungarvík Savings Bank (*Sparisjóður Bolungarvíkur*) and Þórshöfn Savings Bank (*Sparisjóður Þórshafnar*).
- (5) No restructuring plan was submitted at that time for the fifth savings bank covered by the scheme, Svarfdælir Savings Bank (*Sparisjóður Svarfdæla*), as an agreement had been concluded for the acquisition by Landsbankinn of the assets and operations of that savings bank. However, following objections to this transaction by the Icelandic Competition Authority, this agreement was cancelled in September 2012.
- (6) By letter of 4 April 2012⁶, the Authority requested the Icelandic authorities to provide certain additional information, to which they responded by letters of the Ministry of Finance dated 7 May 2012⁷ and 11 May 2012.⁸
- (7) By letter of 14 November 2012⁹, the Authority requested the Icelandic authorities to provide clarifications concerning the restructuring plans of Vestmannaeyjar Savings Bank and Bolungarvík Savings Bank, in view of available information regarding the financial position of the two banks indicating that they did not meet the regulatory minimum capital adequacy (CAD) ratio requirement of 16% stipulated by the Icelandic Financial Supervisory Authority (*Fjármálaeftirlitið*; “the FME”).
- (8) The Icelandic authorities responded to the above request by letter of the Ministry of Finance and Economic Affairs dated 14 December 2012¹⁰, indicating, however, that full clarity would not be available until the ongoing Supervisory Review and Evaluation Process (SREP) regarding the two banks was finalised, which was expected to be in January 2013 regarding Vestmannaeyjar Savings Bank and January or February 2013 for Bolungarvík Savings Bank.
- (9) By letter of the Ministry of Finance and Economic Affairs dated 7 December 2012¹¹, a restructuring plan for Svarfdælir Savings Bank was submitted.
- (10) By email dated 4 June 2013¹², the Icelandic authorities submitted annual financial statements for 2012 of the savings banks covered by the CBI Scheme.

³ Doc. No. 581546.

⁴ Decision No. 127/11/COL of 13 April 2011 on amendments to the rescue aid scheme involving settlement of claims owned by the Central Bank of Iceland on savings banks, OJ C 222 and EEA Supplement No. 42, 28.7.2011.

⁵ Doc. No. 623690.

⁶ Doc. No. 627995.

⁷ Doc. No. 633946.

⁸ Doc. No. 634336.

⁹ Doc. No. 652819.

¹⁰ Doc. No. 656777.

¹¹ Doc. No. 656112.

- (11) In July 2013, general meetings of Svarfdælir Savings Bank and Þórshöfn Savings Bank decided to merge the two banks to form Norðurland Savings Bank (*Sparisjóður Norðurlands*; referred to below as NSB).
- (12) On 14 January 2014¹³ and 24 February 2014¹⁴, the Authority was informed of preparatory talks between the boards of NSB and Bolungarvík Savings Bank for the possible merger of the two entities.
- (13) On 4 April 2014¹⁵, the Authority sent a reminder letter requesting the Icelandic authorities to provide outstanding information on restructuring plans for NSB and Bolungarvík Savings Bank.
- (14) By letter of the Ministry of Finance and Economic Affairs dated 6 May 2014¹⁶, a reply was received providing summary information on the ongoing merger process in the savings banks sector and information on the report of the Special Investigation Commission of the Icelandic Parliament on the background and reasons for the difficulties and collapse of savings banks.
- (15) By email of 4 July 2014¹⁷, the Ministry of Finance and Economic Affairs informed the Authority that meetings of the guarantee certificate holders of Bolungarvík Savings Bank and NSB, held on 27 June and 30 June 2014, respectively, accepted unanimously proposals from the respective boards to merge the two savings banks under the name of NSB.
- (16) By letter of 17 July 2014¹⁸, the Icelandic authorities submitted an updated restructuring plan for NSB, after the merger with Bolungarvík Savings Bank.
- (17) By email of 10 October 2014¹⁹, a copy of NSB's interim financial statements as of 30 June 2014 was received.
- (18) By letter of 18 November 2014²⁰, the Icelandic authorities submitted a copy of NSB's ICAAP report (Internal Capital Adequacy Assessment Process). On the basis of the ICAAP report, a Supervisory Review and Evaluation Process (SREP) was initiated which would allow the FME to define the capital adequacy requirements for the new bank.
- (19) On 17 April 2015²¹, the Authority sent a letter to the Icelandic authorities requesting them in light of the above developments to provide updated information.
- (20) On 21 August 2015²², the Authority sent a further letter to Iceland regarding NSB, reminding them to respond to the information request of 17 April 2015.
- (21) On 8 September 2015²³, the Icelandic authorities responded to the above request by letter of the Ministry of Finance and Economic Affairs. The letter informs *inter alia* of the takeover of NSB by Landsbankinn hf., as further outlined in section I.3 below.

¹² Doc. No. 675399.

¹³ Doc. No. 695685.

¹⁴ Doc. No. 700239.

¹⁵ Doc. No. 704407.

¹⁶ Doc. No. 707506.

¹⁷ Doc. No. 714703.

¹⁸ Doc. No. 716356.

¹⁹ Doc. No. 725427.

²⁰ Doc. No. 730140.

²¹ Doc. No. 754176.

²² Doc. No. 770279.

²³ Doc. No. 772525.

- (22) Restructuring aid to the savings banks eligible under the CBI-Scheme was also discussed with the Icelandic authorities in package meetings on state aid in Reykjavík on 1 June 2010,²⁴ 7 June 2011,²⁵ 5 June 2012,²⁶ 4 June 2013²⁷ and 21 May 2014.²⁸

2. Background

- (23) The relevant background up to April 2011 is set out in Decisions No 253/10/COL and 127/11/COL.
- (24) The number of savings banks in Iceland peaked at 66 in 1950 and have since declined to 38 in 1985 and 17 in 2007. Although not expanding at a comparable rate to the exponential growth of the commercial banks prior to the crisis and its operations remaining national and mostly local in nature, the savings banks sector nevertheless experienced considerable growth in operations during 2004-2007, with combined total assets increasing from about ISK 220 billion in 2004 to about ISK 600 billion in 2007. The combined share of the savings banks in domestic retail markets, measured in terms of their share of total deposits, was for long in the region of 15-20%. However, as from 2008 onwards the savings banks sector has contracted substantially. The biggest and more centrally located savings banks have exited the market.²⁹ The combined assets of savings banks as a share of the total assets of credit institutions fell from 14% at year-end 2008 to below 2% at year-end 2014.³⁰
- (25) After the acquisitions by Landsbankinn of NSB and Vestmannaeyjar Savings Bank and by Arion Bank of Afl Savings Bank, there are currently four savings banks still operational in Iceland. This includes one savings bank that was eligible under the CBI Scheme (Nordfjorður Savings Bank; now named Austurland Savings Bank) and three other savings banks that did not benefit from the scheme.³¹ These small financial undertakings are all located outside the more densely populated south-west region of the country and provide services to individuals and SMEs in their local communities. Their total assets at year-end 2012 amounted collectively to ISK 57 billion (EUR 350 million) or 1.9% of the total assets of deposit money banks, with a workforce of about 110 employees in total.
- (26) In December 2013, the Authority approved the restructuring plans of Vestmannaeyjar Savings Bank³² and Nordfjorður Savings Bank.³³

²⁴ Doc. No. 559345.

²⁵ Doc. No. 601349.

²⁶ Doc. No. 637627.

²⁷ Doc. No. 674683, Annex 2.

²⁸ Doc. No. 780383, Annex 4.

²⁹ This includes Sparisjóður Reykjavíkur og nágrennis (SPRON), Byr, Sparisjóðurinn í Keflavík (SpKef) and Sparisjóður Mýrarsýslu (SPM).

³⁰ CBI Financial Stability Report 2015/2.

³¹ Sparisjóður Strandamanna, Sparisjóður Höfðhverfinga and Sparisjóður Suður-Þingeyinga.

³² Decision No 540/13/COL of 18 December 2013 on restructuring aid to Vestmannaeyjar Savings Bank available at <http://www.eftasurv.int/state-aid/state-aid-register/iceland/nr/1863>. See also press release <http://www.eftasurv.int/press--publications/press-releases/state-aid/nr/2127>. On 29 March 2015, Vestmannaeyjar Savings Bank was acquired by Landsbankinn, which as from that time took over all its assets and liabilities, including loans and deposits, and continued its operations under the name of Landsbankinn.

³³ Decision No 539/13/COL of 18 December 2013 on restructuring aid to Nordfjorður Savings Bank available at <http://www.eftasurv.int/state-aid/state-aid-register/iceland/nr/1863>. See also press release <http://www.eftasurv.int/press--publications/press-releases/state-aid/nr/2127>. In January 2015, Nordfjorður Savings Bank was converted to a limited liability company and its name changed to Austurland Savings Bank (*Sparisjóður Austurlands*).

- (27) Efforts to secure the operation and viability of the other three banks eligible under the Scheme turned out to be even more challenging and protracted. The assets and operations of Svarfdælir Savings Bank were sold to Landsbankinn hf. in the spring of 2012. However, following a merger review of the Icelandic Competition Authority, that transaction was cancelled later that year.
- (28) In July 2013, Svarfdælir and Þórshöfn savings banks merged under the new name of Norðurland Savings Bank (NSB). The aim of the merger was to promote viability, cost savings and efficiency in operations. The main clients of the bank were individuals and SMEs in the local areas. The bigger balance sheet would allow the merged entity to better serve its clients, including to offer loans to SMEs of the required scale that the balance sheets of the smaller entities would not allow. Likewise, the merger of Bolungarvík with NSB was intended to serve the same objective. Merging the operations of the small savings banks was considered the best way forward to secure their viability and improve their competitive position in an otherwise oligopolistic financial market, dominated by the three main commercial banks.³⁴
- (29) During the protracted restructuring and merger efforts of the savings banks, the Authority repeatedly obtained information on the progress from the Icelandic authorities. Once the merger of Bolungarvík with NSB had taken place, the Authority followed the evolution of the finances of the new entity. According to NSB's financial statements on 31.12.2014, the first year of operation of the new entity turned out to be financially more difficult than anticipated. While at the beginning of 2014, the CAD ratio was above 16%, it had declined to 8.2% at the end of the year, largely as a result of further impairments in the loan portfolio of one of the three merging banks, Bolungarvík Savings Bank. The minimum CAD requirement according to law is 8%, but the regulatory requirement that the FME had temporarily fixed for commercial and savings banks was 16%. Once it emerged that NSB's CAD ratio had declined to a level well below the minimum regulatory requirement, the FME decided to grant it a temporary exemption, valid initially until 15 May 2015. The FME then extended the deadline for NSB to remedy its equity situation until 26 June 2015.
- (30) NSB's initial reaction in these circumstances was to initiate negotiations with its creditors, to have them convert claims into guarantee capital, as well as to explore the interest of other investors to contribute new equity to the bank. Following non-binding proposals by two potential investors, they were granted access to relevant financial data and a due diligence review.
- (31) In April 2015, the Authority sent a letter to the Icelandic authorities requesting them in light of these developments to provide updated information. If it was not possible to provide a credible restructuring plan that would ensure return to long-term viability, the Icelandic authorities were obliged to submit a plan for an orderly winding-up of the bank. A reminder letter was sent in August 2015.
- (32) NSB's efforts to bring in new equity investors were not successful. After discussions with potential investors yielded no results, NSB discussed with each of the three main commercial banks. NSB's board then approached Landsbankinn on 9 June 2015 and a merger plan was agreed upon on 30 June 2015. The meeting of NSB's guarantee capital holders accepted the merger on 11 August 2015.

³⁴ See for instance the 2011 Annual Report of the Icelandic State Financial Investments (the ISFI; i. *Bankasýsla ríkisins*), p. 38-54 and other annual reports of the ISFI available at <http://bankasysla.is/fjolmidlar/skyrsla-br/>, as well as the press releases of NSB of 18 July 2013, available at <http://www.spar.is/spth-nordurlands/frettir/nanar/302/sameining-sparisjods-svarfdaela-og-thorshafnar>.

- (33) The takeover of NSB by Landsbankinn hf. was approved by the FME on 4 September 2015 and by the Icelandic Competition Authority (the ICA) on the same day (Decision No 23/2015). The board of Landsbankinn also approved the merger on the same day. NSB's operations have been run under the name of Landsbankinn as from 7 September 2015. While the ICA considered that the merger would have a negative impact on competition, it was nevertheless approved with reference to a failing firm defence. The ICA accepted in its decision that in the absence of the take-over, the results would not benefit competition. The premises for ICA's assessment of the merger will be further considered in section II.2.4-2.5 below.

3. Description of the measures

3.1 The beneficiaries

- (34) NSB conducted essential operations in retail banking mainly in the north-eastern region of Iceland and in the West fjords. As already outlined above, NSB was formed by the merger of Svarfdælir Savings Bank and Þórshöfn Savings Bank in July 2013. In June 2014, Bolungarvík Savings Bank merged with NSB. The operational history of the predecessors is more than a century old.
- (35) NSB and its predecessors operated on the basis of the Act on financial undertakings No. 161/2002 and had a licence to receive repayable funds from the public, mostly deposits, and granting of credit funded by those received funds. This has been the core business of the savings banks. In addition the savings banks issued and handled payment cards and electronic money, in accordance with their operating licences.
- (36) Branch offices of NSB were located in five rural communities with headquarters in the municipality of Dalvík, north-east Iceland. The five branch offices were in the municipalities of Bolungarvík and Sudureyri in the West fjords and of Þórshöfn, Kopasker and Raufarhöfn in north-east Iceland. On 30 June 2014, NSB's total assets amounted to ISK 10 373 million (EUR 67 million).

3.2 The aid measures

- (37) The main measure under examination in the current decision is the settlement of claims on the savings banks that came into the possession of the CBI as a result of the collapse of the SPB. The aid measures relevant here under the CBI Scheme relate to NSB's three predecessors, Svarfdælir, Þórshöfn and Bolungarvík savings banks. The scheme was implemented in full before NSB was founded. Accordingly, NSBs did not benefit directly from the scheme but is an indirect beneficiary through aid measures in favour of its predecessors.
- (38) According to the Icelandic authorities, none of NSB's predecessors received rescue or restructuring aid before the CBI scheme was implemented. However, Bolungarvík Savings Bank had received aid under the Housing Financing Fund's Mortgage Loan Scheme (cf. Decision No 206/11/COL); this aid was taken into account in the updated restructuring plan for NSB. It is the Authority's understanding that after the implementation of the CBI Scheme in 2010 no further aid measures have been taken by the Icelandic authorities.
- (39) The CBI Scheme entailed several types of measures: conversion of claims into guarantee capital, subordinated debt, general unsecured debt as well as the settlement of claims in cash and the writing down of claims. By the Authority's Decision 253/10/COL of 21 June 2010,

these rescue measures were approved, subject to the submission of restructuring plans or liquidation plans.³⁵

- (40) As a consequence of Supreme Court judgments on currency linking of loans denominated in ISK,³⁶ most of the savings banks subject to the CBI Scheme were faced with additional losses. The banks' capital therefore needed to be increased by ISK 399 million. The settlement of claims as notified to the Authority in June 2010 had to be amended. Financial restructuring was then amended and finalised in December 2010 and notified to the Authority on 21 December 2010. By Decision No 127/11/COL of 13 April 2011, the Authority approved the notified amendments subject to submission of restructuring plans.
- (41) Unlike the new commercial banks, the savings banks continued to operate under the same licenses as before the financial crisis. The FME nevertheless considered it imperative for the continued operation of the savings banks that they meet the same conditions as the commercial banks regarding capital and liquidity reserves. The financial restructuring of NSB and the three predecessor banks was aimed at meeting these regulatory requirements.
- (42) The negotiated financial restructuring of NSB's predecessors which was completed in December 2010 involved the CBI and also the participation of other creditors. The final treatment of the claims of the CBI is summarised in Table 1, which reflects the position envisaged in Decision No 253/10/COL as modified following Decision No 127/11/COL.

<i>Treatment of claims</i>	Bolungarvík Savings Bank	Svarfdælir Savings Bank	Thórshöfn savings Bank	Total	Total in million EUR
Converted to guarantee capital	543	382	105	1,030	7
Converted to subordinated debt	0	0	0	0	0
Converted to general unsecured debt	620	0	0	620	4
Settled in cash	388	0	0	388	3
Written down	2,326	343	812	3,481	23
Claims in total	3,877	725	917	5,519	36

Table 1: Financial restructuring of NSB's predecessor banks in December 2010
Summary of treatment of CBI claims
Amounts are in million ISK.
Conversion rate for amounts in EUR=154,27, i.e. exchange rate on 2 January 2015

- (43) The amounts of claims of creditors other than the CBI that participated in the financial restructuring amounted in total to ISK 1,008 million in the case of Bolungarvík, ISK 437 million in the case of Svarfdælir and ISK 137 million in the case of Þórshöfn. As in the case of CBI claims, the claims of other creditors were also converted in varying compositions into guarantee capital, subordinated debt, general debt, settled in cash or written off.
- (44) According to the FME decision of 21 March 2009 on the disposal of assets and liabilities of SPB, it was decided that the CBI would take over the obligations of SPB due to deposits of savings banks in SPB. As for the three savings banks concerned, their combined deposits in financial undertakings and other claims on them amounted to ISK 3,477 million at year-end 2008 or 17.9% of total assets.

³⁵ For a detailed description of the measures included in the CBI rescue scheme, see Decision 253/10/COL of 21.6.2010 on the rescue aid scheme involving settlement of claims owned by the Central Bank of Iceland on savings banks, section 2.5. The measures were based on the decision of the Governor of the Central Bank of Iceland of 22 January 2010.

³⁶ Icelandic Supreme Court ruling No 92/2010 *Óskar Sindri Atlason gegn SP-Fjármögnun hf.*, 16.6.2010, Icelandic Supreme Court ruling No 153/2010 *Lýsing hf. gegn Jóhanni Rafni Heiðarssyni og Trausta Snæ Friðrikssyni*, 16.6.2010 and Icelandic Supreme Court ruling No 471/2010 *Lýsing hf. gegn Guðlaugi Hafsteini Egilssyni*, 16.9.2010.

4. The restructuring plan

4.1 Measures to ensure return to long-term viability

- (45) Given that the operations of NSB have from September 2015 been fully merged with Landsbankinn, the main component of the restructuring plan for the savings bank – measures to ensure return to long-term viability of the savings bank – is no longer relevant.

4.2 Burden sharing and exit strategy

- (46) The financial restructuring completed in December 2010 implied, amongst other things, that the guarantee capital (i.e. equity) of existing owners was written down by 94–97%. The claims of subordinated creditors were also written down to a significant extent or converted to guarantee capital. It was furthermore a prerequisite that creditors other than the CBI participated actively in the restructuring measures.
- (47) Regarding the CBI claims converted into guarantee capital, all guarantee capital shares were taken over by the Ministry of Finance, which appointed the ISFI as administrator of the holding.
- (48) No definite changes were foreseen in the near future of the ownership of NSB. However, the State's involvement would remain of a temporary nature as the purpose of the ISFI was not only to hold the State's interests in the banks but also to sell the State's holdings on the best terms.
- (49) Information has also been provided on the intended remuneration of the aid instruments as well as on steps taken to ensure that the aid is limited to what is necessary in order to achieve the objectives. The details on burden sharing, remuneration and exit strategy are considered further in section II.2.3 below.

4.3 Measures to limit distortions of competition

- (50) The Icelandic authorities have argued that the measures were well targeted to maximise the recovery of the claims on the savings bank whilst stabilising the Icelandic economy.
- (51) Furthermore, the Icelandic authorities did not anticipate that there would be any adverse spill over effects on other EEA States or undue distortions of competition. This was especially true as the savings bank has been active only on local markets in Iceland.
- (52) The Icelandic authorities have indicated that no behavioural commitments have been or will be imposed upon NSB. In their view such commitments were unnecessary and would not prevent distortions of competition but rather encourage them by making it virtually impossible for the savings banks to compete with the larger commercial banks.

II. ASSESSMENT

1. The presence of state aid

- (53) The Authority concluded already in Decisions No 253/10/COL and 127/11/COL, and reaffirmed in Decisions No 539/13/COL and 540/13/COL, that the CBI Scheme involved state aid. The measures at issue accordingly constitute aid.

2. Compatibility of the aid

2.1 Legal basis for assessment of compatibility – Article 61(3)(b) EEA

- (54) The Authority concluded already in Decisions No 253/10/COL and 127/11/COL that it was appropriate to assess the CBI Scheme under Article 61(3)(b) of the EEA Agreement and authorised its implementation on that basis.
- (55) Although more than seven years have passed since the onset of the crisis, the Icelandic financial system still remains vulnerable. While the situation has eased significantly since 2008, it is nevertheless evident that at the time when the measures were taken, they were intended to remedy a serious disturbance in the economy, as the insolvency of the five small savings banks concerned could have led to spill-over effects that would have posed a threat to financial stability.
- (56) Given that the aid measures were notified in June and December 2010 and temporarily approved in June 2010 and April 2011, and also considering that restructuring plans for the aid recipients were submitted in January 2012 and August 2013, the aid measures at issue should be assessed primarily with reference to the State Aid Guidelines on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis (“Financial Crisis Restructuring Guidelines”)³⁷ in force at the time of notification. This is furthermore in line with what is foreseen in paragraph 90 of the 2013 Banking Guidelines³⁸, which replaced the Financial Crisis Restructuring Guidelines as of 1 December 2013.

2.2 The application of the Financial Crisis Restructuring Guidelines

- (57) In Decisions No 253/10/COL and 127/11/COL, approving temporarily as rescue aid the CBI Scheme under assessment in this case, the CBI measures were assessed on the basis of the Authority’s guidelines on the recapitalisation of financial institutions in the current financial crisis³⁹ applicable at the time. This involved assessing *inter alia* the appropriateness of the measures, their necessity and proportionality together with the remuneration of the aid instruments, as well as taking into account contributions from equity owners and other creditors in the form, notably, of significant write-downs. Given that no further aid has been granted in addition to the measures approved by the above decisions and that otherwise no change has taken place that would invalidate these evaluations, the assessments remain valid also in this decision.
- (58) However, as for the restructuring plan the Financial Crisis Restructuring Guidelines, in force until December 2013, set out the rules applicable to the restructuring of financial institutions in the current crisis. According to these Guidelines, in order to be compatible with Article 61(3)(b) EEA, the restructuring of a financial institution in the context of the current financial crisis has to:
- (i) Lead to a restoration of the long-term viability of the bank;
 - (ii) Include sufficient own contribution by the beneficiary (burden-sharing);

³⁷ Available on the Authority’s website at <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>.

³⁸ On 27 November 2013, the Authority adopted new Banking Guidelines (“2013 Banking Guidelines”), replacing the temporary Banking Guidelines adopted in January 2009. The new guidelines also supplement the Financial Crisis Restructuring Guidelines. OJ L 264 and EEA Supplement No. 50, 4.9.2014.

³⁹ Available on the Authority’s website at <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>.

(iii) Limit distortion of competition and ensure a competitive banking sector.

- (59) Following the merger of NSB with Landsbankinn, under the name of the latter, which has already been agreed upon and implemented, any assessment of (i) NSB's restructuring plan with regard to long-term viability is no longer relevant. It therefore merely remains for the Authority to assess whether the result of what has occurred in line with the submitted restructuring plans (ii) involves sufficient burden-sharing; and (ii) limits distortions of competition and, to the extent possible, ensures a competitive banking sector. It also falls to be considered whether the sale of NSB took place on market terms, so as not to unduly distort competition. This approach is also consistent with the criteria in section 6 on liquidation aid and sale of credit institutions in the currently applicable 2013 Banking Guidelines.

2.3 Burden-sharing

- (60) In order to limit distortion of competition and address moral hazard, aid should according to the Financial Crisis Restructuring Guidelines be limited to the minimum necessary. The beneficiary should provide an appropriate own contribution to the restructuring costs and when activities do not generate sufficient profits, state aid should not be used to remunerate own funds (i.e. dividends on equity and subordinated debt).
- (61) The CBI Scheme does not provide aid in the form of new capital injections by the state, but rather the restructuring of claims already owned by the CBI. It is designed to ensure that the savings banks concerned can meet the regulatory capital adequacy requirement under national law and as set by the Financial Supervisory Authority (the FME). The Icelandic authorities have underlined that the scheme is also to the benefit of the CBI, as the aim is at the same time to maximise the value of the claims to the CBI.
- (62) The CBI being a major creditor of the banks, the restructuring of its claims decided upon in June 2010 was initially sufficient for the savings banks to match the minimum requirements. However, following rulings of the Icelandic Supreme Court later in the same month, leading to a decline in the value of the banks' assets, it became clear that the initial measures were not sufficient to achieve their goal. Similarly, the amendments made to the scheme in December 2010 and approved by the Authority in April 2011, were designed only to ensure that the banks could meet the minimum 16% capital adequacy requirement prevailing at the time.
- (63) In order to achieve the required capitalisation, the measures included almost the full write-down of the value of the equity of existing guarantee capital owners, a significant write-down of claims of subordinated creditors and/or their conversion to equity, the conversion of other claims to equity and/or to sub-ordinated loans as well as an injection of equity capital from new guarantee capital owners. In short, the repeated need for adjustment of the settlement following decline in the value of the assets concerned demonstrates that the aid measures in the form of write-down and conversion of CBI claims on NSB's predecessors were at the time limited to what was strictly necessary for the banks to attain statutory capital requirements and were thus not excessive. As it turned out, the impairment in NSB's assets proved to be more severe than initially anticipated. In the circumstances of NSB's capital shortfall in the summer of 2015, the Icelandic State, which following the restructuring measures in 2010 had become the biggest guarantee capital owner, owning almost 80% of NSB, was not willing to contribute further equity capital or otherwise provide further financial assistance. In those circumstances, other potential investors were not willing to step in. Accordingly, the state aid provided to NSB's predecessors in 2010-2011 and other restructuring measures taken by NSB and its predecessors turned out not to be sufficient to secure long-term viability of the bank's operations.

- (64) As concerns own contribution, the financial restructuring of NSB's predecessors implied firstly that the previous owners of guarantee capital in the banks lost their assets, as existing guarantee capital was largely written off (cf. section I.4.2 above). Secondly, the CBI made it a condition for implementing the measures that other creditors participated actively in the financial restructuring of the savings banks, thus ensuring equality and fair burden sharing. Following the financial restructuring in 2010, the savings banks withdrew their applications for a capital injection from the State under section 2 of the Emergency Act. The Icelandic authorities have confirmed that apart from the rescue measures in 2010, the State has granted no financial assistance.
- (65) As for remuneration, reference is made to the assessment in section II.3.2 of Decision No 127/11/COL. According to the aid measures in 2010, the claims converted into guarantee capital were to be remunerated in the form of dividend payments and/or the sale of the guarantee capital when market conditions permit.
- (66) For claims converted into subordinated loans, the term was seven years. Remuneration is in the form of capital income of 400 bp premium on LIBOR interest rates for loans in foreign currency for the first two years, with a step up to 500 bp at the end of that period. For subordinated loans in ISK the remuneration is 300 bp on REIBOR interest rates for the first two years, rising to 400 bp at the end of that period.
- (67) For claims converted into general unsecured debt, the duration is five years. This was to encourage the banks to seek alternative forms of capital in the short term. The borrower may pay down or pay off a general loan at any time at no extra charge. Remuneration is in the form of capital income amounting to 350 bp premium on LIBOR interest rates for loans in foreign currency without collateral and 300 bp premium on LIBOR interest rates for such loans with collateral. For loans in ISK, the remuneration is 250 bp premium on REIBOR interest rates for loans without collateral and 200 bp for such loans with collateral.
- (68) With reference to the above, the Authority is of the view that an adequate own contribution to the restructuring costs was provided by the aid beneficiaries and their owners and that the burden was appropriately shared by those who had invested in the savings bank. The Authority also considers that the Icelandic authorities secured that the aid beneficiaries would appropriately remunerate the CBI for the support provided. This would further limit the amount of aid granted.

2.4 The sale of NSB to Landsbankinn

- (69) According to the Authority's Decision No. 290/12/COL of 11 July 2012 on restructuring aid to Landsbankinn, the Authority took note of certain commitments of the Icelandic government and Landsbankinn in relation to measures aimed at limiting distortion of competition, including that Landsbankinn would not acquire financial institutions, except if it obtained the Authority's approval beforehand. However, this commitment was valid only until the end of the restructuring period on 15 December 2014. Accordingly, the bank and the Icelandic authorities are no longer bound by this commitment.
- (70) According to the information from the Icelandic authorities, an effort to increase NSB's capital base was the focus of the savings bank's board in the months from the conclusion of the FME's Supervisory Review and Evaluation Process and leading up to the merger. The talks with potential new investors and NSB's claimants were admittedly not an openly advertised process but nevertheless a wide-ranging, extensive effort to strengthen the undertaking's capital base so that it could meet regulatory standards. The Icelandic authorities consider that an openly advertised process could have resulted in a run on NSB.

- (71) As already outlined at paragraph (32) above, after discussions with potential investors yielded no results, discussions took place between NSB and each of the three main commercial banks. The board of NSB then approached Landsbankinn on 9 June 2015 and a merger plan was agreed upon on 30 June 2015. The meeting of NSB's guarantee capital holders accepted the merger on 11 August 2015.
- (72) Owners of guarantee capital received ISK 594 million, in the form of shares in Landsbankinn, for their holdings. The nominal value of guarantee capital was ISK 1,008.79 million. The largest owners were the State Treasury with 79.2%, the Savings Banks Insurance Fund with 14.9%, ESI (a limited liability company owned by the Central Bank of Iceland) with 1.7% and the fund management company Rekstrarfélag verðbréfasjóða IV with 1.7%. Other owners held less than 1% but the total number of owners was 361. According to the Icelandic authorities, the price paid by Landsbankinn was considered appropriate. The equity of NSB was ISK 360 million according to the 2014 Annual Accounts. According to an assessment of NSB's loan and mortgage books by KPMG, NSB's equity may have been overestimated by ISK 104 million in those accounts.
- (73) The takeover of NSB by Landsbankinn hf. was investigated by the Icelandic Competition Authority on the basis of national merger provisions and approved on 4 September 2015, cf. Decision No 23/2015. The merger as such, leading to further concentration of the market, would have a negative impact on the market. Nevertheless, the merger was approved on the basis of a failing-firm defence. When considering whether relevant requirements for a failing-firm defence were met, the ICA investigated in detail the condition that a sale to another party, involving a smaller restriction of competition, was not possible.
- (74) In its decision, the ICA noted that NSB did not fulfil legal requirements for licenced financial institutions and could not by its own means fulfil the capital requirements made by the FME. The largest owner of NSB's guarantee capital, the Treasury, holding almost 80% of total equity, had rejected all efforts of further state involvement. According to the Icelandic authorities, that was *inter alia* the reason for other investors' and creditors' reluctance to come to NSB's aid.
- (75) NSB had taken measures to get third parties, other than the three main commercial banks, to provide funds to it and become its owners. The ICA considered the measures to have included all realistic potential bidders despite shortcomings in the sales efforts' publicity.
- (76) It was also apparent to the ICA that in the absence of the merger, the FME would exercise its powers under the Act on Financial Undertakings to place the savings bank under public administration. By a decision dated 4 September 2015, the FME approved the merger.
- (77) The Authority acknowledges that finding a competing buyer proved not to be feasible, despite extensive efforts. Under the circumstances of this case, particularly seeing as it cannot be excluded that an openly advertised process may have resulted in a run on the bank, more transparency cannot be required. This is particularly so as all three main commercial banks in Iceland were indeed approached. Moreover, whereas the remuneration agreed on is relatively low as compared to the nominal value of the guarantee capital it is rather high as compared to the equity of NSB. In the present case, with no other realistic potential bidders, and with no alternatives for NSB but to merge, the Authority thus considers that the sale of NSB was a commercial transaction concluded on market terms.

2.5 Limitations to distortions of competition

- (78) The overriding purpose of aid to financial undertakings is to support financial stability in times of systemic crisis. However, such aid can nevertheless create distortions of competition

in various ways. It is therefore normally required that restructuring plans of recipients of such aid include measures designed to limit distortions of competition, aiming to maintain a competitive banking sector. Nevertheless, as explained in Chapter 4 of the Financial Crisis Restructuring Guidelines, measures to limit distortions of competition should always be tailored to address the distortions identified on the markets where the beneficiary banks operate. As acknowledged in paragraph 20 of the 2013 Banking Guidelines, the application of measures to limit distortion of competition has in practice depended on the degree of burden-sharing. Thus, enhanced burden-sharing implies a reduced need for competition remedies.

- (79) When evaluating the need for such measures, the Authority takes into account *inter alia* the size, relative importance and market presence of the bank and the characteristics of the market on which the beneficiary bank will operate following implementation of the restructuring plan, the amount of aid it will receive, the degree of burden-sharing of the recipient, its owners and subordinate creditors as well as the conditions and circumstances under which the aid is granted.
- (80) Before the emergence of the financial crisis in 2008, the operations of Iceland's three major commercial banks had for a few years grown exponentially, particularly with activities abroad. Following the collapse of those banks in the wake of the financial crisis, the Icelandic financial sector has been restructured and successor banks have been founded taking over mostly the domestic operations of their predecessors, while activities abroad have been discontinued. The market is thus national in nature to a significant degree. This has been amplified by restrictions on capital movements which were introduced in November 2008 following advice of the IMF and still remain in place. Most segments of the financial market in Iceland are dominated by the three biggest commercial banks (Arion Bank, Íslandsbanki and Landsbankinn) which collectively account for over 90% of the market shares in most areas.
- (81) The Icelandic savings banks sector, which has always remained national and mostly local in nature, was hard hit by the financial and economic crisis. From 2008 onwards, the sector has contracted substantially. The biggest and more centrally located savings banks have exited the market. As a result, the combined market share of savings banks in the domestic banking market has collapsed from about 15-20% before the financial crisis to presently below 2%. After Landsbankinn's acquisition of NSB, and the recent acquisition by Arion Bank of AFL Savings Bank and by Landsbankinn of Vestmannaeyjar Savings Bank, the sector now consists of 4 small banks providing for the most part rudimentary financial services to individuals and SMEs. This includes one savings bank eligible under the CBI Scheme (Austurland Savings Bank, previously named Nordfjorður Savings Bank) and three other small savings banks that do not benefit from the scheme. These small financial undertakings are all located outside the more densely populated south-west region of Iceland. On 30 June 2015, their total assets amounted collectively to ISK 46 billion (EUR 299 million).
- (82) In view of the limited size of the savings bank under examination, its modest market presence, the significant burden-sharing of the owners and the subordinated creditors, the Authority considers it clear that its continued operation would not have constituted a competitive threat to other market participants. On the contrary, it appears more likely that the continued operation of smaller savings banks could promote market dynamism and help to restrain the consequences of an otherwise oligopolistic market structure. In this regard the

Authority has *inter alia* considered the review of the ICA of conditions of competition in the national financial market following the financial crisis.⁴⁰

- (83) The takeover of NSB by Landsbankinn hf. was investigated by the ICA on the basis of national merger provisions and approved on 4 September 2015, cf. Decision No 23/2015. According to that decision, the ICA considers that the very existence of savings banks on the Icelandic market was important and could provide opportunities to promote competition in an otherwise oligopolistic market. The merger as such, leading to further concentration of the market, would have a negative impact on the market. The merger was nevertheless approved on the basis of a failing-firm defence. In its Decision, the ICA accepts that in the absence of the take-over, the results would not benefit competition.
- (84) In view of the above considerations, the Authority accepts that the restructuring plans for NSB and its predecessors did not need to include any specific measures aimed at further limiting the potential distortion of competition resulting from the aid granted to the banks.

3. Conclusion

- (85) On the basis of the above assessment and in the light of the information submitted by the Icelandic authorities, the Authority is satisfied that the relevant conditions of the Financial Crisis Restructuring Guidelines were met. With reference to Article 61(3)(b) of the EEA Agreement it can therefore confirm its decisions not to raise objections to the notified measures.

HAS ADOPTED THIS DECISION:

Article 1

The measures which the Icelandic authorities implemented to rescue and restructure Norðurland Savings Bank's and its predecessors Svarfdælir, Þórshöfn and Bolungarvík savings banks, as set out in section I.3.2 above, are compatible with the functioning of the EEA Agreement pursuant to Article 61(3)(b) thereof.

Article 2

This Decision is addressed to Iceland.

⁴⁰ This includes ICA's Decision No 18/2013 regarding the planned acquisition of Landsbankinn of the assets and operations of Svarfdælir Savings Bank, one of NSB's predecessors. As the merger was abandoned following the infusion of equity capital of the Savings Banks Insurance Fund to Svarfdælir Savings Bank, the ICA did not render a final decision on the merger. However, in a decision closing the case, a reference is made to the statement of objections, which indicated that ICA was of the preliminary view that the merger infringed the competition act. The merger would reinforce the joint collective dominance of Iceland's three main commercial banks, Arion Bank, Íslandsbanki and Landsbankinn, in the operating region of the savings bank as well as nationally. In the Icelandic financial market, a reduction in the number of market players would reinforce entry barriers for new players. That development would also be to the detriment of the operating conditions of the few remaining savings banks and their ability to compete with the commercial banks.

Article 3

Only the English language version of this decision is authentic.

Decision made in Brussels, on 27 January 2016

For the EFTA Surveillance Authority

Sven Erik Svedman
President

Helga Jónsdóttir
College member

This document has been electronically signed by Sven Erik Svedman, Helga Jonsdottir on 27/01/2016