EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

OF 26 JULY 2000

ON THE CLOSURE OF A COMPLAINT CONCERNING ALLEGED STATE AID TO TWO ICELANDIC BANKS

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area[1], in particular to Articles 61 to 63 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[2], in particular to Article 24 and Article 1 of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. The complaint

By letter of 28 December 1994, registered with the Authority on 4 January 1995 (Doc. No. 95-91-A), the Authority received a complaint alleging that the system of State guarantees to the State owned commercial banks Búnaðarbanki Íslands (hereinafter referred to as Búnaðarbanki) and Landsbanki Íslands (hereinafter referred to as Landsbanki) constituted State aid, and was therefore incompatible with the functioning of the EEA Agreement. The complainant requested the Authority to examine whether it was warranted to initiate the procedure provided for under Article 1(2) of Protocol 3 to the Surveillance and Court Agreement. It also questioned whether the State expected a normal return on its investment in the banks. In this respect, reference was made to a capital injection by the State in Landsbanki in 1993.

[1] Hereinafter referred to as the EEA Agreement.
[2] Hereinafter referred to as the Surveillance and Court Agreement.

2. Correspondence

By letter of 24 February 1995 (Doc. No. 95-1124-D), the Authority sought information from the Icelandic authorities regarding the issues raised by the complainant. The Icelandic authorities submitted information by letter of 27 March 1995, which was registered with the Authority on 29 March 1995 (Doc. No. 95-210-A). In this letter, the Icelandic authorities expressed their intention to convert the two banks into limited liability companies in the very near future. By letter of 14 July 1995 (Doc. No. 95-4269-D), the Authority informed the Icelandic authorities of its preliminary conclusion that the financial relations between the Treasury and the State owned banks involved State aid in the meaning of Article 61(1) of the EEA Agreement. The Authority also informed the Icelandic autorities that the proposed change of legal status of the banks could significantly alter the assessment in relation to Article 61 of the EEA Agreement. In this regard, the Authority requested the Icelandic authorities to indicate a timetable for the planned changes.

By letter of 31 August 1995, registered with the Authority on 11 September 1995 (Doc. No. 95-5262-A), the Icelandic authorities announced their intention to present a bill to Parliament, proposing the conversion of the State owned banks into limited liability banks, with a view to establishing the new entities at the end of 1996. By letter of 20 September 1995 (Doc. No. 95-5396-D) to the Icelandic authorities, the Authority again welcomed the plans to incorporate the banks. Despite these developments, the complainant maintained its complaint, and informed the Authority thereof by letters of 24 June 1996, registered with the Authority on 2 July 1996 (Doc. No. 96-3601-A), and 16 December 1996, registered with the Authority on 23 December 1996 (Doc. No. 96-7657-A).

Since 1996 the case has been addressed in several letters and meetings between the Authority and the Icelandic authorities. The conversion into limited liability companies took longer than anticipated. However, by letter of 7 January 2000, registered with the Authority on 13 January 2000 (Doc. No. 00-503-A), the Icelandic authorities confirmed that the conversion had been implemented in early 1998, and that the system of State guarantees on the banks' obligations had been abolished. Furthermore, they announced that both banks had been partially privatised.

By letter of 21 March 2000 (Doc. No. 00-2325-D), the Authority informed the complainant of these significant changes of the Icelandic banking sector. In that letter, the Authority expressed its view that it appeared that these changes have put the former State owned banks on an equal footing with its private competitors, and thus removed any State aid, which those banks previously may have benefited from. Considering these changes, and keeping in mind the long time lapse since the complaint was lodged, the Authority asked the complainant to inform it before 25 April 2000 whether the complaint was to be upheld or withdrawn. The Authority has to date not received any reply to this letter.

3. Background

3.1 Búnaðarbanki and Landsbanki

Búnaðarbanki was established in 1929 to provide financing to the agricultural sector in Iceland. In the 1960s it was decided to diversify the bank's portfolio, and it has since then offered a full range of services to all sectors of the economy. Until the privatisation in 1998 it was an independently managed State owned entity.

Landsbanki was established by an act of Parliament in 1885. Also Landsbanki was until the privatisation in 1998 a wholly State owned undertaking. Between 1928 and 1961 it was also the Central Bank of Iceland, but it has since 1961 been operated solely as a universal commercial bank.

3.2 The legal framework governing the banking sector at the time of the complaint

In 1994, the commercial banking system in Iceland consisted of four commercial banks and 30 savings banks. Of the commercial banks, Búnaðarbanki and Landsbanki were wholly State owned, while the other two were limited company banks.

Act No. 43/1993 on Commercial Banks and Savings Banks was the main act applying to the Icelandic commercial banks. According to this act, limited company banks were to be organised as any other limited liability company. Concerning the State owned banks, the act stated that the Parliament should appoint their Board of Directors.

3.3 The State guarantee

Act No. 37/1961 on State Guarantees prescribes that the Treasury can act as a guarantor only if authorised by law. Such authorisation was given in the above referred Act No. 43/1993, according to which the Treasury should be responsible for all obligations contracted by the State owned banks. No distinction in this respect was drawn between domestic and foreign obligations. However, the State guarantee afforded to the State owned banks was not made available to the private banks.

3.4 Capital provision to Landsbanki in 1993

Landsbanki had to make considerable provisions for bad debt in 1992. As a result of that, its own funds ratio fell below the legally required minimum of 8 %. The State, as the owner of the bank, took the following supporting measures:

- The Central Bank of Iceland granted a subordinated loan of ISK 1.250 million.
- The Parliament passed an act authorising an ISK 2.000 million capital injection by the State into Landsbanki.
- The Commercial Banks' Deposit Guarantee Fund granted an ISK 1.000 million subordinated loan to the bank in 1993.

The Authority is not aware of any further capital injections by the State into either of the two banks since 1993.

4. The conversion to limited liability companies

In accordance with Act No. 50 of 22 May 1997 on the Establishment of Limited Liability Companies to operate Landsbanki Íslands and Búnaðarbanki Íslands, the two banks were converted into limited liability companies with effect from 1 January 1998. The conversion was carried out by transferring all assets, rights, debts and obligations of the State owned banks to the respective limited liability companies. The incorporation of the banks was an element in a comprehensive restructuring of the Icelandic financial sector.

Act No. 50 states that the Minister of Commerce shall manage the State's shareholdings in the two banks, whereas the entire share capital of the two banks shall be owned by the Treasury. It further provides for a limited sale of share capital, subject to approval by the Parliament.

The first step in the privatisation of the two banks was taken in 1998, when public offerings of 15 % of new equity were launched in each of them. In December 1999 a further 15 % of the two banks' equity was sold off. The shares of both banks are now listed at the Iceland Stock Exchange.

Act No. 50 abolishes the previous system of a statutory State guarantee on all obligations of the new banks. However, the Treasury guarantee on all domestic and foreign obligations entered into by Landsbanki and Búnaðarbanki prior to 1 January 1998 will remain intact until those obligations have been fully repaid. The guarantee for deposits likewise ceased on 1 January 1998, with the exception of term deposits deposited before that date, which will be covered by the State guarantee until the expiry of their fixed term.

Act No. 50 prescribes that the Treasury shall guarantee all obligations towards the retirement pension funds of employees of the two banks, which were incurred prior to the take-over by the limited lialibility banks.

Article 20 of Act No. 50 stipulates that the two new limited liability banks shall comply with provisions on the activities of limited liability company banks according to Act No. 113/1996 on Commercial Banks and Savings Banks, and the provisions of Act No. 2/1995 Respecting Public Limited Companies, as appropriate.

In 1998, their first year of operation as limited liability companies, both banks recorded good financial results. Búnaðarbanki achieved a return on its equity of 14,6 %. The corresponding figure for Landsbanki was 12,4 %.

II. APPRECIATION

1. Applicability of Article 61(1) and scope of the examination

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."*

Article 1(1) of Protocol 3 to the Surveillance and Court Agreement states:

> *"The EFTA Surveillance Authority shall, in co-operation with the EFTA States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the EEA Agreement."*

Existing aid within the meaning of Article 1(1) of Protocol 3 to the Surveillance and Court Agreement includes, inter alia, old or "pre-EEA" aid, i.e. aid schemes in operation at the time of the entry into force of the EEA Agreement[3]. This procedure concerning existing aid is designed to enable the Authority to secure the abolition or adaptation of "pre-EEA" aid that is incompatible with the functioning of the EEA Agreement.

The complaint gave rise to an investigation of possible State aid by the Icelandic Government to Búnaðarbanki or Landsbanki, in the light of the above procedure and provisions, through:

a) the system of State guarantees on the obligations of the banks,
b) the failure of the State to require a normal rate of return on its capital investment in the banks, and in this respect in particular
c) the commercial soundness of the capital injection in Landsbanki in 1993.

The three potential cases of State aid will be examined in turn below. In addition, the Authority will under point d) below give its opinion as to whether the new legislative framework, which took effect as from 1 January 1998, might contain any State aid in the meaning of Article 61(1) of the EEA Agreement.

[3] Chapter 7.2 of the Authority's Procedural and Substantive Rules in the Field of State Aid (the State Aid Guidelines), adopted on 19 January 1994 and published in OJ 1994 L 231, EEA Supplement 03.09.94 No. 32.

a) Aid through the State guarantee for the obligations of the banks

The system of State guarantees for obligations of the State owned banks was laid down in Act No. 43/1993, i.e. prior to the entry into force on 1 January 1994 of the EEA Agreement. Pre-EEA aid schemes are for the purpose of the Authority's assessment categorised as existing aid. Accordingly, any aid involved in the system of State guarantees to the two State owned banks would have to be examined pursuant to the Authority's procedural guidelines applicable to existing aid[4].

Those guidelines foresee that if the Authority, after having assessed the merits of the allegations raised by the complaint, were to conclude that the State guarantees were incompatible with the functioning of the EEA Agreement, it would have to propose appropriate measures aimed at bringing the scheme into line with the EEA Agreement. If the Member State concerned agreed to the Authority's proposal, aid granted prior to the proposal of the appropriate measures would, however, not have been considered as illegal aid.

Since a decision by the Authority with respect to the State guarantee provisions enacted prior to 1994 would have no retroactive effect, the Authority does not consider it relevant to undertake an examination of those rules. The Authority will therefore limit itself to assessing the compliance of the present rules concerning State guarantees to the banks with the State aid provisions of the EEA Agreement.

Act No. 50/1997 abolished the State guarantee previously enjoyed by the two banks. They were thereby put on an equal footing with its competitors as concerns guarantees for new obligations. However, the Treasury guarantee for certain obligations entered into prior to the incorporation continues to exist. The continuation of these guarantees is, however, limited in time and will gradually be phased out. In the light of these circumstances, the Authority does not at this time consider it necessary to further investigate these individual guarantees[5].

b) Aid through the failure by the State to require a normal rate of return on invested capital

The initial capital investment by the State in the banks preceded the EEA Agreement. Thus, following the discussion above on guarantees, the Authority will limit its assessment to the issue of whether the State as an investor in the limited liability banks as from 1 January 1998 onwards grants State aid by failing to require a normal rate of return.

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[4] Chapter 7 of the State Aid Guidelines.

[5] The still active guarantees for the obligations of the former State owned banks will, however, be assessed in the framework of an overall examination by the Authority of existing guarantee schemes and individual guarantee measures in the EFTA States, the purpose of which is to ensure that all such measures are in conformity with the new Guidelines on State aid in the form of State guarantees (adopted by the Authority on 12 April 2000). The Icelandic authorities were by letter from the Authority of 3 July 2000 (Doc. No. 00-4764-D) requested to submit relevant information in this respect.

In assessing whether the State's behaviour as an investor constitutes State aid, the Authority applies the "Market Economy Investor Principle"[6]. According to this principle, the aid element is the difference between the terms on which the funds were made available through public sources, and the terms which a private investor would find acceptable in providing funds to a comparable private enterprise when the private investor is operating under normal market economy conditions.

The limited liability banks were established by transferring all assets and obligations of the State owned banks to the respective new entities. As concerns the operations of the banks, the act establishing them prescribes that they shall be governed by the same legislation as other commercial banks in Iceland.

The Authority is not in possession of any information indicating that the setting-up of the limited liability banks involved any form of State aid. Moreover, there is to the Authority's knowledge nothing to suggest that the Icelandic State, in its capacity as holder of shares in the banks, does not act as a normal market economy investor. The results recorded by both banks in 1998 are in keeping with this presumption.

In view of the above, the Authority has concluded that there is no reason to believe that the two banks today benefit from any State aid by virtue of the State failing to demand a normal rate of return on its investment.

c) Aid provided by the ad hoc measures in 1993

Also the capital injections into Landsbanki in 1993 took place before the EEA Agreement entered into force. The Authority does not have the competence to investigate whether one-off transactions predating the EEA Agreement involve State aid, since the Authority keeps only existing aid schemes under constant review.

d) Aid provided for by means of the new legislative framework which took effect from 1 January 1998

Any State aid provided for by virtue of the act on the establishment of the limitied liability banks would be categorised as new aid. As such it would be subject to the requirement in Article 1(3) of Protocol 3 to the Surveillance and Court Agreement of notification to the Authority and could not have been put into effect until approved by the Authority.

The Authority has outlined above that there is nothing to suggest that the new legislative framework concerning the two banks gives rise to any State aid in the form of guarantees or failure by the State to act as a normal market economy investor. Nor is the Authority aware of, either through complaints or otherwise, any reason to suggest that this new legislation confers any other forms of State aid to the two banks.

[6] The Market Economy Investor Principle is elaborated on in Chapter 19 (Public Authorities' Holdings) and Chapter 20 (Application of State Aid Provisions to Public Enterprises in the Manufacturing Sector) of the State Aid Guidelines.

2. Conclusion

Based on the above facts and considerations, the Authority concludes that the Icelandic State does not grant any State aid to Landsbanki and Búnaðarbanki, which could be considered incompatible with Article 61(1) of the EEA Agreement. The Authority has in this connection also taken note of the fact that the complainant has refrained from requesting the complaint to be upheld, although it was explicitly invited to do so by the Authority's letter of 21 March 2000.

The case will therefore be closed without further action by the Authority.

HAS ADOPTED THIS DECISION:

The investigation of the complaint concerning aid to Búnaðarbanki Íslands and Landsbanki Íslands is closed without further action.

Done at Brussels, 26 July 2000

For the EFTA Surveillance Authority

Knut Almestad
President

Hannes Hafstein
College Member