

Case No: 64864  
Event No: 452620  
Dec. No: 406/08/COL

## EFTA SURVEILLANCE AUTHORITY DECISION

of 27 June 2008

to initiate the formal investigation procedure with regard to the relief of the Icelandic Housing Financing Fund from payment of a state guarantee premium

(ICELAND)

THE EFTA SURVEILLANCE AUTHORITY<sup>1</sup>,

Having regard to the Agreement on the European Economic Area<sup>2</sup>, in particular to Articles 59, 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<sup>3</sup>, in particular to Article 24 thereof,

Having regard to Article 1(2) of Part I and Articles 4(4) and 6 of Part II of Protocol 3 to the Surveillance and Court Agreement<sup>4</sup>,

Having regard to the Authority's Guidelines<sup>5</sup> on the application and interpretation of Articles 61 and 62 of the EEA Agreement,

Having regard to the Authority's Decision No 195/04/COL of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3<sup>6</sup>,

Having regard to the Authority's Decision No 405/08/COL of 27 June 2008 close the formal investigation procedure with regard to the Icelandic Housing Financing Fund<sup>7</sup>,

Whereas:

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<sup>1</sup> Hereinafter referred to as the Authority.

<sup>2</sup> Hereinafter referred to as the EEA Agreement.

<sup>3</sup> Hereinafter referred to as the Surveillance and Court Agreement.

<sup>4</sup> Hereinafter referred to as Protocol 3.

<sup>5</sup> Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19 January 1994, published in the Official Journal of the European Union (hereinafter referred to as OJ) L 231 and EEA Supplement No 32 of 03.09.94. The Guidelines were last amended on 19.12.2007. Hereinafter referred to as the State Aid Guidelines. The updated version of the State Aid Guidelines is published on the Authority's website: <http://www.eftasurv.int/fieldsOfWork/fieldstateaid/guidelines/>

<sup>6</sup> Published in OJ C 139 of 25.05.2006 p. 57 and EEA Supplements No 26 of 25.05.2006.

<sup>7</sup> Not published yet. The non-confidential full text of the Decision will be available at [www.eftasurv.int/fieldofwork/fieldstateaid/stateaidregistry/](http://www.eftasurv.int/fieldofwork/fieldstateaid/stateaidregistry/)

## I. FACTS

### 1 Procedure

By letter dated 28 September 2007 (Event No 442805), the Authority requested information from the Icelandic authorities regarding state guarantees and the obligation to pay a state guarantee premium under the Act on State Guarantees. By letter from the Icelandic Mission to the European Union dated 24 October 2007, forwarding the letter from the Icelandic Ministry of Finance of the same date, received and registered by the Authority on 25 October 2007 (Events No 448739 and 449598), the Icelandic authorities responded to this request.

The case was subject to discussions between the representatives of the Authority and the Icelandic Government on 7 September 2007 in Brussels and on 29 October 2007 in Reykjavik as well as between the representatives of the Authority and the complainant, the Icelandic Financial Services Association, in a meeting on 6 March 2008 in Brussels.

### 2 Description of the relevant Icelandic law provisions

#### 2.1 Introduction

The Housing Financing Fund (hereafter referred to as the HFF) is a State institution governed by public law, cf. Article 4 of the Housing Act No 44/1998 (*lög um húsnæðismál*). As such, it enjoys, under the general principles of Icelandic public law, a state guarantee on all its obligations without any special legal provision to that effect. The same applied to its predecessor, the State Housing Agency, and the State Building Fund and the Workers' Housing Fund operated by the Agency as well as the State Housing Board, cf. Act No 97/1993 on the State Housing Agency (*lög um Húsnæðisstofnun ríkisins*).

On 1 January 1999, the Housing Act No 44/1998 entered into force. Under the terms of the Housing Act, the Housing Financing Fund replaced the former State Housing Agency and took over its predecessor's obligations. Furthermore, the State Building Fund and the Workers' Housing Fund were merged and taken over by the HFF.<sup>8</sup>

#### 2.2 Act No 37/1961 on State Guarantees, as amended by Act No 65/1988

Act No 68/1987 introduced an obligation to pay a guarantee premium to the State for State guarantees that were not subject to the risk premium. Article 8 of the Act No 37/1961 on State Guarantees (*lög um ríkisábyrgðir*), as subsequently amended by Act No 65/1988 on State Guarantees, (*lög um breyting á lögum nr. 37/1961, um ríkisábyrgðir, með síðari breytingum*) required banks, credit funds, financial institutions, enterprises and other such entities that, according to law, enjoy a state guarantee whether through the ownership of the State or other reasons, to pay a guarantee premium to the State as regards their commitments towards foreign entities. In contrast, no similar premium was imposed on domestic commitments at the time of the entry into force of the EEA Agreement in Iceland on 1 January 1994.

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<sup>8</sup> For more information on this aspect and the continuity of activities, see the Authority's Decision No 405/08/COL.

The premium was set at 0.0625% per quarter on the principal of foreign commitments based on their average for each period, cf. paragraph 2 of Article 8. Loans for which a risk premium had been paid, certain export guarantees and commitments due to credit balance in domestic currency accounts did not constitute basis for calculation of the guarantee premium, cf. paragraph 2 of Article 9 of the Act.

In its submission of 24 October 2007, the Icelandic Government has claimed that the State Housing Agency was not liable to pay a guarantee premium under the terms of the Act No 37/1961 on State Guarantees. The Government did not, however, present arguments as to why the general obligation should not also cover the State Housing Agency. The Authority does not dispute the statement of the Icelandic Government that the Agency in fact never paid any premium as it did not have any foreign commitments. However, this does not change the fact that according to the Act, the Agency would have been liable for the premium in the event of undertaking foreign commitments. Hence, the Authority is of the preliminary opinion that the obligation to pay a guarantee premium did indeed apply to any foreign financial commitments that the State Housing Agency might have had.

### 2.3 Act No 121/1997 on State Guarantees

On 22 December 1997, a new Act on State Guarantees No 121/1997 was adopted. This Act, which entered into force on 1 January 1998, extended the obligation to pay a premium also to cover domestic commitments. Paragraphs 1 and 2 of Article 6 of the Act stated:

*“Banks, credit funds, financial institutions, enterprises and other such entities that according to law enjoy or have enjoyed the guarantee of the Treasury, whether through the ownership of the State or for other reasons shall pay a guarantee premium on their state-guaranteed commitments. ...*

*The guarantee premium according to paragraph 1 shall amount to 0.0625% per quarter on the principal of foreign commitments subject to the premium and 0.0375% per quarter on the principal of the average of domestic commitments during each payment period, cf. Article 8. The proceeds shall accrue to the Treasury.”<sup>9</sup>*

Article 7 of Act No 121/1997 provides for an exemption from the general obligation to pay a premium pursuant to Article 6 of the Act. In its original form paragraph 1 of Article 7 read as follows:

*“Credits on which a risk premium has been paid cf. Article 4, housing bonds issued by the Housing Bond Division of the State Housing Agency, commitments in lieu of deposits in deposit accounts of deposit money banks and government-guaranteed export guarantees as well as the Central Bank of Iceland are exempt from payment of the guarantee premium cf. Article 6.” (emphasis added)*

The State Housing Agency had other commitments than those relating to housing bonds issued by the Housing Bond Division of the Agency. It therefore seems to follow from an *a contrario* interpretation of Article 7 that the main rule on the payment of a fee was applicable to such activities. The same goes for the other public bodies operating on the basis

<sup>9</sup> Translation of the Act available at the website of the Ministry of Finance.

of Act No 97/1993: the State Housing Board, the State Building Fund and the Workers' Housing Fund.

The Icelandic Government has, however, in its letter of 24 October 2007, submitted that as regards commitments other than housing bonds, the levying of the guarantee fee “*was based on questionable legal basis*”. According to the Government, due to their social character, the State Building Fund and the Workers' Housing Fund, operated by the Agency, were never intended to pay a guarantee premium under the Act. In this respect, the Government refers to a memorandum of 16 October 1998 by the Minister of Social Affairs as well as a report of a working group of June 1999 on the collection of a guarantee premium of the debts of the State Building Fund and the Workers' Housing Fund and the HFF.<sup>10</sup> The conclusion of the working group's report was that it was arguable that the commitments of the State Building Fund and Workers' Housing Funds fell outside the scope of Article 6 of Act No 121/1997. In arriving at that conclusion, the working group stated that the funds were of a social character which justified that they were operated under the responsibility of the State and were dependant on State contributions as well as always having been operated with a negative interest margin. Furthermore, the report referred to the general comments to the bill, which became Act No 121/1997, whereby distinction was made between funds in “commercial” operation and those with a social role.

For the reasons set out below, the Authority questions this legal reasoning:

- First, according to Article 6 of the Act: “*Banks, credit funds, financial institutions, enterprises and other such entities that according to law enjoy or have enjoyed the guarantee of the Treasury, whether through the ownership of the State or for other reasons shall pay a guarantee premium on their state-guaranteed commitments.*” Even assuming, hypothetically, that HFF was not considered a “*bank, credit fund, financial institution or enterprise*” the wording “*any other entities*” seems to indicate that the provision covers all bodies enjoying a State guarantee, irrespective of operating form. Furthermore, it was considered necessary to explicitly exempt the commitments related to the Housing Bond Division, cf. Article 7 of the Act.
- Second, as will be shown below in point 2.4, the preparatory works to Act No 70/2000 contain several statements which indicate that the Act was based on the premise that the HFF was indeed, at that time, subject to the guarantee premium on other commitments than those related to the housing bonds.
- Third, a specific provision in the 2001 Supplementary Budget Act was inserted to cancel the debts relating to unpaid premiums the HFF had accrued under Act No 121/1997 until the entry into force of Act No 70/2000.<sup>11</sup> Such a provision would hardly have been necessary if the HFF and its predecessors had never been subject to the premium.

<sup>10</sup> Skýrsla starfshóps um innheimtu ábyrgðargjalds af skuldum Byggingarsjóðs ríkisins, Byggingarsjóðs verkamanna og Íbúðalánasjóðs.

<sup>11</sup> Item 1.4 of Article 4 of the Supplementary Budget Act amending Article 7 of the Budget Act, which grants various permissions to the Minister of Finance provided as follows: “*To abolish guarantee premiums pursuant to Article 6 of Act No 121/1997 on State Guarantees levied on the House Financing Fund until the entry into force of Act No 70/2000 which exempts the Fund from the payment of the premium.*”

- Fourth and finally, as far as the Authority can understand, the comments referred to by Iceland concerning the distinction between funds in commercial operation on the one hand, and those with a social role on the other, did not relate to the issue of whether or not a guarantee premium should be collected for commitments enjoying a State guarantee. Rather, they indicate that the legislator was of the opinion, that when it came to granting a Fund a State guarantee, it was of importance whether the Fund in question was operated on a commercial or social basis.

In any event, as already indicated, in the 2001 Supplementary Budget Act, a provision was inserted to cancel the debts related to unpaid premiums the HFF had accrued until the entry into force of Act No 70/2000. It therefore seems that the HFF, either was never liable to pay the fee or retroactively was exempted from it. Thus, in either situation the HFF was from the start, or with retroactive effect, exempted from the main rule in Act No 121/1997 on State Guarantees that State bodies enjoying a guarantee should pay a premium for it.

#### **2.4 Act No 70/2000 amending Act No 121/1997**

By Article 1 of Act No 70/2000 which entered into force on 26 May 2000, Article 7 of the Act No 121/1997 was amended and is currently as follows:

*“Credits on which a risk premium has been paid cf. Article 4, commitments in lieu of deposits in deposit accounts of deposit money banks and government-guaranteed export guarantees as well as the ... the Housing Financing Fund ... are exempt from payment of the guarantee premium cf. Article 6.”*

The bill, which subsequently became Act No 70/2000 did not originally include a proposal to exempt all obligations of the HFF guaranteed by the State from the guarantee premium. It was originally foreseen only to exempt the HFF’s obligations taken over from the State Building Fund and the Workers’ Housing Fund upon the entry into force of Act No 44/1998. Indeed, in the bill, it was stated that the exemption for the obligations deriving from the housing bonds (cf. Article 7 of the Act) was based on the fact that the Housing Bonds Division collected an interest margin of 0.35% of mortgage instruments guaranteeing commitments relating to housing bonds. Other commitments of the HFF were not supposed to be exempted from the payment obligation of the guarantee premium as no money was put aside in a reserve fund to meet losses connected with lending on that basis.<sup>12</sup>

However, during the Parliamentary procedure, the bill was changed so that the exemption covered all the obligations of the HFF:

*“During the procedure before the Committee it was specifically examined that the bill presupposes that a premium will still be paid on some of the loans taken by the Housing Financing Fund such as loans, which the Fund takes to finance additional loans and loans for rental apartments. ... Having regard to the above, the*

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<sup>12</sup> The original Icelandic text is as follows: “Aðrar skuldbindingar Íbúðalánasjóðs eru hins vegar ekki undanþegnar gjaldskyldu þar sem ekki er lagt fé í varasjóð til að mæta útlánatöpum vegna lánveitinga á grundvelli þeirra.”

*Committee proposes to amend the bill so that all the obligation of the Housing Financing Fund will be exempt from the premium.”<sup>13</sup> (emphasis added)*

Therefore, as approved by Alþingi, the Act No 70/2000 amending Act No 121/1997 extended the exemption from the payment of a guarantee premium and covered all the obligations of the HFF. As a consequence, the HFF has not been paying a guarantee premium on its commitments, foreign as well as domestic, to the State Treasury.

## **2.5 Act No 180/2000 amending Act No 121/1997**

In its judgment in *State Debt Management Agency*, the EFTA Court held that the difference in the amount of the state guarantee premium due under the provisions of the Act on State Guarantees was in breach of Article 40 EEA, as it was made dependant on whether the obligations were of domestic or foreign character.<sup>14</sup> Following this judgment, the Act on State Guarantees was amended. By Act No 180/2000, which entered into force on 11 January 2001, the difference between foreign and domestic commitments was abolished for the purpose of calculation of the state guarantee premium. As from Act No 180/2000, the premium has been set at 0.0625% per quarter irrespective of the origin of the commitments. Due to the above-mentioned exceptions pertaining to HFF, these changes did not apply to HFF.

## **II. ASSESSMENT**

### **3 State aid within the meaning of Article 61(1) EEA and the classification of such aid as new or existing**

#### **3.1 The aid elements of the Icelandic system of implicit State guarantees**

Article 61(1) of the EEA Agreement reads as follows:

*“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.”*

For a measure to be classified as State aid within the meaning of Article 61(1) of the EEA Agreement, it must be granted by the State or through State resources, confer an advantage on the recipient undertaking, be selective and thereby distort or threaten to distort competition and be liable to affect trade between the Contracting Parties. Before examining each of these conditions in turn, the Authority makes the following remarks concerning the scope of the present decision to open the formal investigation procedure:

As any other undertaking organised as a public institution, the HFF enjoys an implicit State guarantee in the same manner as did the predecessors of the HFF from the start of their operations in the 1950’s, cf. Act No 42/1957. The HFF pays neither a market based

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<sup>13</sup> Opinion of the Economic and Commerce Committee of Alþingi, the Authority’s unofficial translation.

<sup>14</sup> Case E-1/00 *State Debt Management Agency* [2000-2001] EFTA Court Report p. 8.

premium for the guarantee, nor the premium laid down in Act No 121/1997 on State Guarantees.

The implicit state guarantee for this type of public undertaking was at the outset granted without any obligation to pay a premium. However, Icelandic system for implicit state guarantees was changed in 1987. From this point in time, a guarantee premium was to be paid for foreign commitments, but not for domestic ones. The original state guarantee scheme, with the changes introduced in 1987, thus predates the EEA Agreement.

The Icelandic system relating to implicit guarantees was changed again as of 1 January 1998 when a general obligation to pay a guarantee premium was also introduced as regards domestic commitments. Considering the size of the premium the Authority finds it unlikely that the guarantee premium removed aid contained in the original guarantee scheme. Therefore, in the Authority's preliminary opinion, the original guarantee scheme still contains State aid. The State aid element will generally be the difference between the appropriate market price for the guarantee provided and the price paid for that measure according to Act No 121/1997 on State Guarantees.<sup>15</sup> This possible aid element will follow from the implicit guarantee in force since before the entry into force of the EEA Agreement, and would constitute existing aid. It will therefore be assessed separately following the procedures regarding existing aid.

Hence, the present decision to open the formal investigation procedure only relates to severable changes to the Icelandic system of implicit guarantees made after 1994 which would give a particular advantage to HFF.<sup>16</sup> Indeed, only such changes could be classified as new aid.<sup>17</sup>

With Act No 121/1997, Iceland introduced a premium for banks, credit funds, financial institutions, enterprises and other such entities that enjoy a State guarantee in respect of domestic commitments. The activities of the Housing Bonds Division were exempted from a guarantee premium both on domestic and foreign commitments from the entry into force of the Act. As regards other operations of the HFF, they were exempted from the premium by Act No 70/2000. In the 2001 Supplementary Budget Act the accrued unpaid premium for these activities was cancelled. Therefore, either from the beginning, or retroactively, the other operations of the HFF were exempted from this generally applicable guarantee premium. Indeed, according to Iceland itself, HFF has never paid any premium under the Act.

As HFF has, as a matter of fact, never paid any premium for the guarantee it enjoys, Iceland has in its letter of 24 October 2007 argued that the factual situation for HFF has remained the same over the years regardless of the introduction of the general premium with effect for other undertakings. Moreover, as the exemptions in the Act pertaining to

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<sup>15</sup> It could be questioned whether a guarantee covering the totality of a company's financial obligations exists on the market. It might therefore be difficult to establish a market premium for the guarantee in the present case.

<sup>16</sup> Joined cases T-195/01 & T-207/01, *Government of Gibraltar v Commission* [2002] ECR II-2309, paragraph 111.

<sup>17</sup> Hence, these changes are not dealt with in the context of decision No 185/06/COL to open the formal investigation procedure, partly because the rules in the State Guarantees Act were only briefly discussed in that opening decision, partly because the Icelandic authorities, in the above-mentioned letter of 24 October 2007, did not answer in the affirmative that the aid questions pertaining to HFF's exemption from the premium should be dealt with within that procedure.

HFF merely maintained the *status quo* in relation to that particular undertaking, Iceland is of the opinion that exemptions cannot constitute new aid.

In the Authority's view, it is not relevant for the assessment of the classification of the aid as new or existing whether or not the Act, as a matter of fact, changed the situation of HFF as regards the payment of guarantee premium. What is decisive is that the new Act introduced a new system where, for the first time, the HFF was being treated more favourably than provided for under the general rule for undertakings benefiting from the implicit State guarantee. It is therefore the Authority's preliminary opinion that any advantage to HFF following from the exemption granted to the Housing Bond Division introduced by Article 7 of Act No 121/1997 would constitute new aid. The same would apply to the exemption/relief from paying the premium relating to other operations of the HFF, cf. Act No 70/2000 amending Act No 121/1997, as well the 2001 Supplementary Budget Act.<sup>18</sup>

### 3.2 *Economic advantage*

Exempting the HFF from payment of the guarantee premium provides a financial advantage to that undertaking as the corresponding costs of the premium are not covered by the HFF. This advantage amounts to what the HFF would have had to pay each time on its commitments under the applicable rate of the guarantee premium.

The advantage following from the non-payment of the state guarantee premium can be determined as follows:

- 1) exemption (either originally or *ex post facto*) from payment of state guarantee premium amounting to 0.0625% per quarter of the value of foreign commitments relating both to housing bonds and other commitments in the period from 1 January 1998 to date,
- 2) exemption (either originally or *ex post facto*) from payment of state guarantee premium amounting to 0.0375% per quarter of the value of domestic commitments relating both to housing bonds and other commitments in the period from 1 January 1998 - 10 January 2001,
- 3) exemption from payment of state guarantee premium amounting to 0.0625% per quarter of the value of all HFF's domestic commitments in the period from 11 January 2001 to date

In its letter of 24 October 2007, Iceland seems to be of the opinion that the HFF does not enjoy any real advantage as it levies a margin on the general loans it issues. Iceland submits that the Housing Bonds Division of the State Housing Agency and subsequently the HFF were subject to a special regime which entailed paying a "*special state guarantee fee*", raised in the form of an interest margin, into a special reserve fund. According to Article 21 of the Act No 97/1993 (see subsequently Article 28 of the Housing Act), the Housing Bonds Division was permitted to claim an interest margin to cover its operating

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<sup>18</sup> In any event, the argumentation of the Icelandic authorities builds on the premise that HFF was never subject to a premium *de jure*. In contrast, it would not be sufficient that HFF never actually paid the fee, and that the legal obligation to do so was later cancelled, as such cancelling of a debt would in itself constitute aid. As illustrated above under point I.2.3, the Authority is not convinced that this premise is fulfilled in the case at hand.

expenses and estimated losses from outstanding loans.<sup>19</sup> On that basis, the Icelandic Government has stated that the exclusion of the housing bonds from the general system of Act No 121/1997 was based on the fact that the risk associated with the guarantee was no longer borne by the State.

The Authority has doubts about this reasoning. The system provided for by the levying of an interest margin does not entail that the HFF pays a premium for the state guarantee it has on commitments related to housing bonds. Rather, it required the borrowers to pay higher interest rates to the HFF. The money raised by the levying of the interest margin was set aside in a special reserve fund. As far as the Authority has been able to ascertain, this fund is merely a part of the HFF. The Authority cannot see that charging borrowers higher interest rates and setting that aside in an in-house fund can be equated with paying a State guarantee premium pursuant to Act No 121/1997.

In conclusion, the Authority takes the preliminary view that the exemption from the guarantee premium does give the HFF an advantage in the sense of Article 61(1) EEA. Whether any advantages could be offset by public service obligations imposed on HFF will be addressed below.

### **3.3 Presence of state resources**

HFF is exempted from the payment of a guarantee premium to the State Treasury otherwise applicable to all undertakings pursuant to Article 6 of Act No 121/1997. By exempting the HFF from paying a guarantee premium to it, the State foregoes revenues which would have normally to be paid to the State. The exemption therefore contains state resources. Similarly, to the extent HFF was originally liable to pay a guarantee premium, but later relieved of that obligation with retroactive effect, such *ex post facto* exemption would also imply a drain of state resources.

### **3.4 Selectivity**

As outlined above, the HFF is according to Article 7 of Act No 121/1997 exempted from paying a guarantee premium pursuant to Article 6 of the Act. The main rule according to Act No 121/1997 is that every entity enjoying a State guarantee is subject to the guarantee premium provided for in Article 6. Those exempted are obligations that are subject to the higher risk premium pursuant to Article 4 of the Act, the HFF, the Central Bank of the Iceland and the Student Loan Fund.

Consequently, under Article 7 of the Act, it is only the HFF and the two other public institutions that are exempt from paying a premium to the State for being granted State guarantees. The aid measure therefore appears to be selective.

The State Guarantees Act links the payment of a premium to the existence of a guarantee issued by the State. Moreover, it seems to be intended to (partly) compensate the State for the risk it undertakes by being the guarantor. On that basis, the Authority does not view the Act on State guarantees as a tax measure. The Authority has therefore not found it

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<sup>19</sup> The Minister of Social Affairs was to determine the level of the interest margin having obtained the proposal of the State Housing Board. On the basis of that Article, the Minister decided by Regulation No 540/1993 of 28 December 1993, amending Regulation No 467/1991, to charge an interest margin of up to 0.25%. By Regulation of 11 October 1994, the Minister raised the ceiling of the interest margin to 0.35%.

necessary to discuss whether the exemption pertaining to HFF would have been within the logic or nature of a tax system.

### 3.5 *Effect on trade between Contracting Parties*

The HFF provides services on the market for housing mortgage loans, *i.e.* long-term house financing for residential accommodation. Aid granted to HFF may make it more difficult for banks in the EEA to enter the Icelandic housing mortgage market. Also markets related to the mortgage market, such as other financial markets may be affected.<sup>20</sup> The aid therefore seems to affect trade between the Contracting Parties.

### 3.6 *Altmark conditions*

In the *Altmark* judgment, the European Court of Justice held that provided that the following conditions are cumulatively fulfilled, a measure does not confer an advantage on the beneficiary and, thus, does not qualify as state aid in the meaning of Article 87(1) of the EC Treaty, corresponding to the provision of Article 61(1) of the EEA Agreement:

- First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined.
- Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid conferring an economic advantage which may favour the recipient undertaking over competing undertakings.
- Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.
- Fourth, where the undertaking which is to discharge public service obligations in a specific case, is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.<sup>21</sup>

With regard to the first condition, *i.e.* the definition of public service obligations discharged to the HFF, it is highly doubtful, in light of the EFTA Court's judgment, that

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<sup>20</sup> See also, Case E-9/04, *The Bankers' and Securities' Dealers Association of Iceland v the Authority*, [2006] EFTA Court Report, page 42, paragraphs 80-81. Furthermore, in its recent *Concluding Report on the Retail Banking Sector Inquiry* (page 67) the Authority concluded that tying of different retail banking products is a common practice of financial institutions across EEA. In particular, in the above-mentioned report, the Authority underlined bundling of current accounts and other products such as mortgages or loans.

<sup>21</sup> Case C-280/00 *Altmark Trans GmbH* [2003] ECR I-7747, paragraphs 89-93.

the general loans system of the HFF as defined today fulfils the criteria for qualifying as a service of general economic interest.<sup>22</sup>

Concerning the second condition, the Court of First Instance of the European Communities (hereinafter “the CFI”) recalled in *BUPA*<sup>23</sup> that the Member States have wide discretion not only when defining a public service mission but also when determining the compensation for the costs, which calls for an assessment of complex economic facts. In the same ruling, the CFI also held that the second *Altmark* condition requires that the Community institutions must be in a position to verify the existence of objective and transparent parameters, which must be defined in such a way as to preclude any abusive recourse to the concept of a public service on the part of the Member State. The Icelandic Government has so far not demonstrated to the Authority that a methodology exists for calculation of public service compensation to the HFF. Moreover, to the Authority’s knowledge, the Icelandic Government did not establish in advance the criteria on the basis of which the compensation for public service activities of the HFF was to be determined.

With regard to the third *Altmark* condition, the CFI found in *BUPA* that a public service compensation system which operates independently of receipts does not require a strict interpretation of this criterion, in particular as regards taking into account the relevant receipts for discharging public services.<sup>24</sup> Nevertheless, as the aid measure in question benefits the entirety of the operations of the HFF, it cannot be established at this stage whether the level of compensation is limited to what is necessary to cover all or part of the costs incurred in the discharge of properly limited public service obligations.

Furthermore, with regard to the fourth condition set forth in *Altmark*, the HFF has neither been chosen by way of a public procurement procedure nor did the Icelandic authorities determine the level of compensation by way of a comparison between the HFF and a privately run efficient operator as a reference undertaking. As held by the CFI in *BUPA*, the purpose of the fourth *Altmark* condition is to ensure that the compensation does not entail the possibility of offsetting any costs that might result from inefficiency on the part of the beneficiary undertaking.<sup>25</sup>

In conclusion, it cannot be established, in the Authority’s view, that the four cumulative *Altmark* conditions are fulfilled.

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<sup>22</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, page 42, paragraph 79.

<sup>23</sup> Case T-289/03 *BUPA v Commission*, judgment of 12 February 2008, not yet reported, paragraph 214.

<sup>24</sup> Case T-289/03, *BUPA v Commission*, cited above, paragraph 241.

<sup>25</sup> Case T-289/03, *BUPA v Commission*, cited above, paragraph 249.

### ***3.7 Conclusion with regard to state aid character of the measure in question***

In light of the above, it is the Authority's preliminary conclusion that exempting HFF from paying a guarantee premium pursuant to Article 7 of Act No 121/1997 on State Guarantees, with subsequent amendments, involves State aid within the meaning of Article 61(1) of the EEA Agreement. Furthermore, it is the Authority's preliminary opinion that any such aid would constitute new aid.

## **4 Procedural requirements**

Pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement, "*the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. [...] The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision*".

The Icelandic authorities did not notify the Authority of the above-mentioned measures in the form of exemption of the HFF from payment of the guarantee premium. The Authority therefore concludes that Iceland has not respected its obligations pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement.

## **5 Compatibility of the aid**

### ***5.1 Possibilities to declare aid for housing purposes compatible***

Article 61(1) of the EEA Agreement sets out that state aid as a principle is prohibited. Article 61(2) and 61(3) provide, however, for certain exceptions from this general prohibition.

The derogations in Article 61(2) of the EEA Agreement do not seem to be applicable to the aid in question, which is not designed to achieve any of the aims listed in this provision. In particular, the aid measure involved cannot be considered to fulfil the conditions of derogation specified in Article 61(2)(a) of the EEA Agreement, namely aid having a social character, granted to individual consumers and without discrimination related to the origin of the product concerned.

Likewise, the derogations in Article 61(3) of the EEA Agreement do not apply to the aid measure under investigation. In particular, the aid measure is not granted with the aim of promoting or facilitating the economic development of certain areas or of certain economic activities. Thus, the derogations in Article 61(3)(a) and (c) of the EEA Agreement in conjunction with the Regional Aid Guidelines are not applicable in this case.

Furthermore, the aid measure under investigation is not given to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of Iceland, therefore Article 61(3)(b) of the EEA Agreement does not apply.

The aid in question is not linked to any investment, but reduces the costs which HFF would normally have to bear in the course of pursuing its day-to-day business activities and is consequently to be classified as operating aid. Operating aid is normally not considered suitable to facilitate the development of certain economic activities or of

certain regions as provided for in Article 61(3)(c) of the EEA Agreement, unless it is specifically envisaged by the Authority's Guidelines, which is not the case here.

Aid for housing purposes may, however, be declared compatible with the EEA Agreement on the basis of Article 59(2). That would be the case if the aid would be limited to provision of services of general economic interest and if the other conditions of Article 59(2) of the EEA Agreement would be fulfilled.

Article 59(2) of the EEA Agreement reads:

*“Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Agreement, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Contracting Parties.”*

Compliance with Article 59(2) of the EEA Agreement requires the fulfilment of the following conditions:

- that the aid is a compensation for the provision of services of general economic interest,
- that the undertaking receiving the aid is entrusted to provide such services,
- that the aid is necessary, and not more than necessary, to carry out the entrusted tasks, and
- that the aid does not affect trade against the interest of the Contracting Parties to the Agreement.

## ***5.2 General remarks with regard to the concept of services of general economic interest***

The concept of service in the general economic interest means, among other things, that the state assigns “particular tasks” to an undertaking.<sup>26</sup> In order to qualify for classification as service of general economic interest, a service must have certain characteristics, the most important of which is that the service in question cannot be provided in the same manner on the market and that the service should be clearly defined.<sup>27</sup> States may take account of objectives pertaining to their national policy when defining the service of general economic interest which they entrust to certain undertakings.<sup>28</sup>

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<sup>26</sup> See for example: Case 10/71 *Muller* [1971] ECR 723; Case 127/73 *BRT* [1974] ECR 313; Case 7/82 *GVL* [1983] ECR 483; Case C-393/92 *Almelo* [1994] ECR I-1520; Case C-266/96 *Corsica Ferries* [1998] ECR I-3949.

<sup>27</sup> Communication from the Commission – Services of General Interest in Europe (OJ C 17, 19.1.2001, p. 7), see paragraph 14

<sup>28</sup> Case E-9/04, *The Bankers' and Securities' Dealers Association of Iceland v the Authority*, cited above, paragraph 67.

As an exception to the main rule in Article 59(1) of the EEA Agreement, the concept of “services of general economic interest” must be interpreted restrictively<sup>29</sup> and applies only to activities of direct benefit to the public. Still, States remain free, in principle and where no common policy is established, to designate which services they consider to be of general economic interest and to organize these services as they see fit, subject to the rules of the EEA Agreement and the specific conditions laid down in Article 59(2) of the EEA Agreement.<sup>30</sup> Thus, the competence to define such services lies with the States, subject to scrutiny by the Authority. This scrutiny must essentially be conducted on a case-by-case basis. In such an assessment, the nature of the undertaking entrusted with the service is not of decisive importance, nor whether the undertaking is entrusted with exclusive rights, but rather the essence of the service deemed to be of general economic interest and the special characteristics of this interest that distinguish it from the general economic interest of other economic activities.<sup>31</sup>

### 5.3 *Services of general economic interest in the field of social housing*

The EFTA Court gave some guidance on how to assess the extent of the HFF’s activities in light of the requirements of Article 59(2) of the EEA Agreement. The Court primarily addressed the issue of whether the Authority should have been in doubt whether the general loans scheme of HFF was operated in compliance with Article 59(2) of the EEA Agreement. The Court ruled that the Authority should have been in doubt and consequently should have opened the formal state aid investigation procedure. (This was based on the implicit, but non-verified, assumption that the aid in question was new aid.) While the Court did not address whether the general loan category fulfilled the conditions of Article 59(2) of the EEA Agreement, the Court’s judgment raised issues of doubt in relation to:

- whether the HFF scheme fulfilled all conditions relating to services of general economic interest in Article 59(2)
- whether the derogation from the state aid rules was proportionate, and
- whether the scheme affected the development of trade contrary to the interest of the Contracting Parties.

In relation to the first issue the Court stated *inter alia*:

*“[...] The HFF general loans system is intended to promote security and equal rights as regards housing in Iceland by providing loans on manageable terms to the general public throughout the territory of Iceland and thereby foster private home ownership. This goes beyond the normal economic interest of operators in*

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<sup>29</sup> See Case C-242/95 *GT-Link A/S* [1997] ECR I-4449, paragraph 50; Case T-260/94 *Air Inter* [1997] ECR II-147, paragraph 135; Case C-159/94 *Commission v France* [1997] ECR I-5815, paragraph 53.

<sup>30</sup> See in this context for example: *Services of General Interest*, cited above, paragraph 22; Case T-106/95 *FFSA* [1997] ECR II-229, paragraph 192. As stated by Advocate General Léger in his opinion in Case C-438/02 *Krister Hanner* [2005] ECR I-4551, paragraph 139: “...it falls to the Member States to define the content of their services of general economic interest and, in so doing, they enjoy considerable leeway since the Court and the Commission will intervene only in order to penalise manifest errors of assessment”.

<sup>31</sup> Case E-4/97, *Norwegian Bankers’ Association v the Authority*, [1998] EFTA Court Report page 38, paragraph 47.

*the financial sector. A service with this objective may qualify as a service of general economic interest justifying State aid, provided that the service fulfils the requirements laid down in Article 59(2) EEA.”<sup>32</sup>*

When the EFTA Court later turned to the questions on proportionality, it held, *inter alia*, that:

*“[...] as long as it is not established that the effect of the low interest rate on HFF general loans is completely neutralised by an increase in housing prices, the HFF general loan scheme must be considered suitable to meet its aim.”<sup>33</sup>*

And moreover:

*“The Court does not find it doubtful that the State aid provided to the HFF system did not go beyond what is necessary in the case at hand to allow the HFF to cover expected losses and operate the general loans system under economically acceptable conditions [ ...] This does not mean, however, that the general loans system as operated by the HFF is necessarily compatible with the EEA Agreement.”<sup>34</sup>*

Then the Court went on to, *inter alia*, state that:

*“[...] it is necessary to address the question of whether the conditions under which the loans were granted did not go beyond what was necessary for HFF to perform the tasks entrusted to it. The Court recalls that the ultimate aim of the State’s intervention in lending services through the general loans scheme is to foster private home ownership in Iceland through lending on ‘manageable terms’. A service rendered with such an objective may, as has been stated above, be considered legitimate under Article 59(2) EEA. However, ESA has to make sure that public intervention does not, in reality, pursue other goals than those defined by Icelandic law or exceed what is necessary to achieve the defined goal.*

*In that regard, the Court notes that unlike the cost and size limitations practiced by the Norwegian Husbanken in Case E-4/97 Husbanken II, the HFF’s relative and absolute lending caps do not limit the subsidised lending scheme to dwellings which fulfil certain criteria. They only limit the amount one may borrow from the HFF for any dwelling, regardless of the value or size of that dwelling. There is no limit as to how big or valuable a dwelling may be and still be eligible for a general loan under the HFF scheme; there are only limits to how much the HFF may grant as a general loan.*

*Moreover, the HFF general loans scheme is not limited to the financing of one unit of residential housing for each borrower. This means that in principle the system may provide financing for houses or apartments built or purchased for investment purposes. In 2004, a general limit of two units was introduced. As the Government of Iceland has pointed out, there may be social policy reasons why certain persons*

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<sup>32</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, paragraph 68.

<sup>33</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, paragraph 71.

<sup>34</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, paragraph 73.

*need to own more than one unit. The provision of more than one loan to the same person has not, however, been made dependent on that person fulfilling any criteria relating to such reasons.*

*These features mean that in principle the HFF general loans scheme provides subsidised financing, up to a certain limit, for any house or apartment regardless of size and value, and also for construction or purchase of residential units for investment purposes. The scheme is not formally limited to assisting the average citizen in financing his or her own dwelling. Even if it may be so that few people have in fact exploited these features of the system, they raise questions under Article 59(2) EEA. The Court recalls in this context that the HFF scheme is intended to promote security and equal rights as regards housing by providing loans on manageable terms.”<sup>35</sup>*

#### **a) Manageable terms**

The EFTA Court did not rule out *per se* that state intervention in lending services through general loans, which pursues the objective of fostering private home ownership through lending on “manageable terms” might be considered legitimate under Article 59(2) of the EEA Agreement. In this respect, the EFTA Court clarified that the Contracting Parties enjoy a margin of discretion in deciding what “manageable terms” should mean in relation to a housing financing scheme which qualifies as a service of general economic interest.<sup>36</sup>

In the view of the Authority, the concept of “manageable terms” cannot be understood in any absolute or isolated manner. While noting the Court’s view that there should be a margin of discretion to decide what is manageable, the concept has to relate to certain general parameters of the national economy. What is manageable in a rich country may not be manageable in a less prosperous one. In a well-functioning market without a particular skewed distribution of income, it would appear reasonable to assume that the market interest rates on mortgages would be “manageable” for the population at large. Excluding that public activity itself is distorting the market, to the extent the market is not well functioning there could be a reason for government measures to provide for loans on “manageable terms”.

It was confirmed in the EFTA Court’s judgment that the commercial banks were only able to match the interest rate of HFF’s general loans from August 2004 onwards.<sup>37</sup> In its Decision No 185/06/COL, the Authority requested up-dated information on the development on the Icelandic mortgage market, in order to assess to what extent commercial banks had offered mortgage secured loans on terms the Icelandic State would consider as manageable. While some information has been provided the Authority would require up-dated information in this respect as there are indications that the state of the

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<sup>35</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, paragraphs 76 to 79.

<sup>36</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, paragraph 71.

<sup>37</sup> Case E-9/04, *The Bankers’ and Securities’ Dealers Association of Iceland v the Authority*, cited above, paragraph 74.

market has changed recently. The amount of mortgage loans, especially from the commercial banks has fallen considerably.<sup>38</sup>

A connected, but separate, issue is whether the market would be able to develop satisfactorily if it would operate under conditions without any state aid distorting the competitive situation of the respective lenders. Up till now, the Authority has not been presented with any arguments or factual information that give it reason to believe that this should be the case.

#### **b) Social element**

The general loan scheme of the HFF is not limited to those below certain income and/or assets thresholds but is available to everyone irrespective of those elements and as the EFTA Court has pointed out, without any cost and size limitations on the dwellings. Furthermore, the general lending system is also open to others than individuals, for example building contractors may qualify for loans under that system.

In the Court's words, the "*lending caps do not limit the subsidised lending scheme to dwellings which fulfil certain criteria*" and "*there is no limit as to how big or valuable a dwelling may be and still be eligible for a general loan under the HFF scheme; there are only limits to how much the HFF may grant as a general loan*".<sup>39</sup>

Moreover, the EFTA Court pointed out that the scheme provided for construction or purchase of individual units for investment purposes, and it was not formally limited to assisting the average citizen in financing of his or her house. The rules have now been changed and Article 21 of the Regulation No 522/2004, as subsequently amended, provides that lending from the HFF is limited so that an individual can only own one property carrying a mortgage from the Fund. However, the Board of the Fund may set rules providing for exemption from this requirement. On 10 August 2006, the Board passed such rules. The Icelandic authorities are requested to explain these exemptions and their application and how the HFF monitors that residential housing financed by the HFF's loans is actually used for purposes of being the applicant's own dwelling.

In a letter received by the Authority on 14 June 2007, the Icelandic Government argued that there were no grounds for questioning the compatibility of the general lending scheme with the EEA Agreement. In light of the observations of the EFTA Court, quoted above, the Authority is of the preliminary opinion that the Icelandic Government has not demonstrated that the current general loan scheme is in compliance with Article 59(2) of the EEA Agreement. Moreover, the Commission's practice regarding social housing shows that the Commission has only accepted systems of social housing, which contained limitations as to who could qualify for loans under the system.

In 2001, the Commission adopted a decision with regard to a guarantee for borrowings of the Irish Housing Finance Agency (hereinafter referred to as the HFA).<sup>40</sup> At the time of

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<sup>38</sup> See e.g. [http://www.mbl.is/mm/frettir/innlent/2006/04/27/samdrattur\\_i\\_ibudalanum\\_bankanna/](http://www.mbl.is/mm/frettir/innlent/2006/04/27/samdrattur_i_ibudalanum_bankanna/) and [http://www.mbl.is/mm/vidskipti/frettir/2008/05/26/verulegur\\_samdrattur\\_i\\_ibudalanum\\_bankanna/](http://www.mbl.is/mm/vidskipti/frettir/2008/05/26/verulegur_samdrattur_i_ibudalanum_bankanna/)

<sup>39</sup> Case E-9/04, *The Bankers' and Securities' Dealers Association of Iceland v the Authority*, cited above, paragraph 77.

<sup>40</sup> Decision of 3.7.2001 in State aid N 209/2001 – Ireland – Guarantee for borrowings of the Housing Finance Agency, SG(2001) D/289528. The Commission has also dealt with two Swedish schemes regarding social housing which it considered compatible aid on the basis of Article 87(3)(c) of the EC Treaty. In the

this decision, the HFA was itself not empowered to extend loans. Its objective was to raise funds at the best rate on the capital markets which were then advanced to local authorities to be used by them for social housing financing. In this case, social housing was defined as provision of housing for the most socially disadvantaged households, and in particular those which due to their economic circumstances were unable to fund their own housing requirement at socially acceptable conditions through recourse to commercial lenders. This objective was entrusted to local authorities who operated social housing programmes such as general mortgage finance, the operation of a share ownership scheme, and affordable housing schemes aimed at providing low cost housing, a rental subsidy scheme and miscellaneous grant schemes for elderly and disabled persons. The eligibility for social housing loan finance was assessed according to the following limitations: i) need must be established, ii) income and loan ceilings, iii) households which seek to avail of schemes unavailable in the private sector (this had to be proved by the applicant by attaching letters of rejection from two private sector mortgage lenders) and iv) only households which are mentioned on local authority housing lists. Thus, the Commission accepted that the operations of the Agency could be regarded as services of general economic interest for the purposes Article 86(2) of the EC Treaty.

The Authority also refers to a case concerning the financing of activities of Dutch Housing Corporations which is still pending before the Commission. In 2005, DG Competition sent an Article 17(2) letter, inviting the Dutch authorities to make appropriate changes to the system. DG Competition has, *inter alia*, criticised the broad scope of definition of services of general economic interest provided by the Housing Corporations. In particular, it was not considered acceptable that, whereas the priority to rental housing is given to persons that have difficulties in finding suitable housing, the activities in question are not restricted to socially disadvantaged persons. Therefore, DG Competition was of the opinion that the possibility to let dwellings to persons with a higher income or to enterprises must be regarded as a manifest error in the definition of a service of general economic interest. Moreover, this concern was not removed by the proposed solution of the Dutch authorities to limit the maximum value of the dwellings to be rented out which would be then defined as “social housing”. In the preliminary view of DG Competition, the definition of public service activities of Housing Corporations was to have a direct relation to socially disadvantaged households and not only be linked to the maximum value of the property.<sup>41</sup>

Furthermore, the Icelandic Government referred to the fact that the Authority, in its decision in the Norwegian Husbanken case, accepted loans that were not limited to those qualifying under certain income and assets criteria but limited the size of the of

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first case (Commission Decision of 24 June 2003 in State aid N 40/03 – Sweden – Measures to promote certain house building, C(2003) 1762 fin. ) a state support in the form of a VAT tax exemption was granted to constructions in certain areas of Stockholm, Gothenburg and Malmö. The scheme was restricted to rented dwellings measuring up to 70 m<sup>2</sup> and student accommodation at college and university sites with a maximum size of 25 m<sup>2</sup> with additional ceilings on the aid level per dwelling. The rent for both types of dwellings was regulated. In the second case (Commission decision of 7 March 2007 in State aid N 798/06 – Sweden – Support for construction of special housing for elderly people, C (2007), 652 fin) the scheme was targeted to benefit elderly people who were not able to continue living independently. The scheme provided direct grant support to special housing for elderly. According to the conditions of the scheme, the size of the apartment could not exceed 35 m<sup>2</sup> per one-person apartment and 50 m<sup>2</sup> per two-persons apartment with additional support to 15-20 m<sup>2</sup> for common space (used for example for meals, hobbies, group activities). The maximum aid intensity was 10% of actual construction costs.

<sup>41</sup> Letter dated 14 July 2005 from DG Competition to the Dutch authorities, 0/55413.

house/apartment being acquired. Iceland has argued that the Norwegian limit should not be regarded as being universal and that the situation in Iceland would justify a higher limit. The Authority will, at this stage, not pass judgment on whether only imposing a size limitations would be sufficient to ensure compliance with Article 59(2) of the EEA Agreement as it observes that currently the HFF system operates without any limitations as to the size of house/apartment that may qualify for loans under the general system.

In light of all of the above, it is the preliminary view of the Authority that the general loan scheme of the HFF does not pursue a sufficiently restricted social objective.

### **c) Territorial cohesion**

As regards the element of territorial cohesion, the Authority is aware of the particular situation of certain regions in Iceland, where the market for mortgage loans might be of such a nature that commercial providers do not have incentives to offer mortgage loans. Such a situation might justify exceptional treatment of certain territories as regards the conditions for eligibility of loans.<sup>42</sup> Currently, the general loans scheme of the HFF is operated without any criteria related to territorial cohesion.

In its Decision No 185/06/COL it was the Authority's opinion that SFF had not submitted any tangible evidence during the EFTA Court proceedings, which demonstrated that the commercial banks had offered loans on "manageable terms" outside the Reykjavik area during the period between 1999 and August 2004. In response to the Authority's request for information the SFF and the Icelandic Government submitted conflicting evidence as to the extent the commercial banks had offered mortgage loans outside the Reykjavík area and other more densely populated areas after August 2004. In light of the currently available information the Authority cannot conclude that the loans provided by the commercial banks have not been offered in rural areas as well, as far as the period after August 2004 is concerned.

### **5.4 Development of trade and the interest of the Contracting Parties**

Article 59(2) of the EEA Agreement further requires an assessment of whether the specific service in question affects the development of trade to an extent contrary to the interests of the Contracting Parties. The Authority is charged with striking a balance between the right of Iceland to invoke the derogation and the interest of the Contracting Parties to avoid distortions of competition and restrictions to the "four freedoms".<sup>43</sup>

This entails that it must be established that the performance of the service of general economic interest does not disproportionately affect competition and the internal market. In light of the EFTA Court's conclusions on this point,<sup>44</sup> the Authority will have to assess to what extent the aid granted to the HFF could affect other parts of the EEA internal market, in particular other financial markets, such as, for example, the private lending market. However, as outlined above, the Authority is of the preliminary opinion that the current lending scheme is not compatible with Article 59(2) as it is too widely defined. In

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<sup>42</sup> See for example the differentiation of ceiling for the level of aid per dwelling according to the area in the Swedish case N 40/03, referred to above.

<sup>43</sup> See similar Case E-4/97, *Norwegian Bankers' Association v the Authority*, cited above, paragraph 70.

<sup>44</sup> Case E-9/04, *The Bankers' and Securities' Dealers Association of Iceland v the Authority*, cited above, paragraph 81.

light of that, the Authority does not consider it necessary to assess whether the service affects the development of trade to an extent contrary to the interest of the Contracting Parties. In any event, an amended scheme will have to strike the right balance between the interests at stake.

Against the background of the various points referred to above, the preliminary view of Authority is that the general loan scheme of HFF does not comply with all the conditions laid down in Article 59(2) of the EEA Agreement.

### **5.5 Other loan categories of the HFF**

In the discussion above regarding the compatibility of the aid, only the general loans category of the HFF has been referred to. However, the exemption in Article 7 of Act No 121/1997, as amended, covers entire operations of the HFF. Currently, the HFF is also providing loans for rental housing to municipalities, etc. pursuant to Chapter VIII of the Housing Act. Furthermore, the Minister of Social Affairs has, on the basis of Article 16 of the Housing Act, issued Regulation No 458/1999, with subsequent amendments, which lists the other loan categories offered by the HFF, cf. Article 2 of the Regulation.<sup>45</sup>

As outlined above, the Authority is of the preliminary opinion that the general loans scheme of the HFF is incompatible with Article 59(2) EEA. Since the exemption from the guarantee premium benefits all the operations of the HFF, it follows that this measure cannot be regarded as compatible aid on the basis of Article 59(2). This is so even though the individual loan categories referred to above examined in isolation might comply with the conditions laid down in that provision.

### **5.6 Conclusion with regard to compatibility**

On the basis of the foregoing considerations, the Authority has doubts as to whether the guarantee premium exemption in favour of the HFF can be regarded as compatible with the functioning of the EEA Agreement.

## **6 Recovery**

According to Article 14(1) in Part II of Protocol 3 to the Surveillance and Court Agreement, “[w]here negative decisions are taken in cases of unlawful aid, the EFTA Surveillance Authority shall decide that the EFTA State concerned shall take all necessary measures to recover the aid from the beneficiary (hereinafter referred to as a ‘recovery decision’). The EFTA Surveillance Authority shall not require recovery of the aid if this would be contrary to a general principle of EEA law”.

In other words, any unlawful aid which cannot be declared compatible with the State aid rules will be subject to recovery. In case of recovery, it is the Authority’s preliminary view

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<sup>45</sup> Article of Regulation No 458/1999, as amended, provides for the following categories: “1. Loans for the construction or purchase of day-care institutions, service centres, homes and apartments specially designed for the needs of the elderly; 2. Loans for the construction or purchase of communal housing for the disabled; 3. Special loans – loans to those with special needs; 4. Maintenance loans; 5. Loans for major outdoor maintenance of redeemed apartments; 6. Loans or grants for technical innovations and other reforms in the construction industry; 7. Loans for rental housing; 8. Loans for the construction or purchase of homes and day-care institutions for children and young people.”

that, in the case at hand, no legitimate expectations could be invoked, which would preclude the recovery.

According to settled case-law, “[...] *undertakings to which an aid has been granted may not, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in that article. A diligent businessman should normally be able to determine whether that procedure has been followed*”.<sup>46</sup>

Consequently, any unlawful aid which will ultimately be declared incompatible with the state aid rules will be subject to recovery.

## 7 Conclusion

The Authority is of the preliminary opinion that the exemption from the guarantee premium in favour of the HFF constitutes aid within the meaning of Article 61(1) of the EEA Agreement. Furthermore, the Authority has doubts that this measure can be regarded as complying with Article 61(2) and (3) of the EEA Agreement or with Article 59(2) of the EEA Agreement. Any unlawful aid which ultimately will be declared incompatible with the state aid rules will be subject to recovery.

Consequently, and in accordance with Article 4(4) of Part II of Protocol 3 to the Surveillance and Court Agreement, the Authority is obliged to open the procedure provided for in Article 1(2) of Part I of Protocol 3 of the Surveillance and Court Agreement. The decision to open proceedings is without prejudice to the final decision of the Authority, which may conclude that the measure in question is compatible with the functioning of the EEA Agreement.

In light of the foregoing considerations, the Authority, acting under the procedure laid down in Article 1(2) of Part I of Protocol 3 to the Surveillance and Court Agreement, requests the Icelandic authorities to submit their comments within one month of the date of receipt of this Decision.

In light of the foregoing consideration, the Authority requires that, within one month of receipt of this decision, the Icelandic authorities provide all documents, information and data needed for assessment of the compatibility of the exemption from the payment of the guarantee premium in favour of the HFF. It requests the Icelandic authorities to forward a copy of this decision to the potential aid recipient of the aid immediately.

### **HAS ADOPTED THIS DECISION:**

#### Article 1

The EFTA Surveillance Authority has decided to initiate the formal investigation procedure provided for in Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement against Iceland regarding the exemption of the Housing Financing Fund contained in the Act on State Guarantees to pay a premium on the guarantee provided by the Icelandic State in its favour.

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<sup>46</sup> Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraph 14; Case C-169/95 *Spain v Commission* [1997] ECR I-135, paragraph 51.

Article 2

The Icelandic authorities are requested, pursuant to Article 6(1) in Part II of Protocol 3 to the Surveillance and Court Agreement, to submit their comments on the opening of the formal investigation procedure within one month from the notification of this Decision.

Article 3

The Icelandic authorities are required to provide within one month from the notification of this Decision all documents, information and data needed for the assessment of the compatibility of the aid measure.

Article 4

The Icelandic Government is requested to forward a copy of this Decision to the recipient of the potential aid immediately.

Article 5

The EC Commission shall be informed, in accordance with Protocol 27(d) of the EEA Agreement, by means of a copy of this Decision.

Article 6

Other EFTA States, EC Member States, and interested parties shall be informed by the publishing of this Decision in its authentic language version, accompanied by a meaningful summary in languages other than the authentic language version, in the EEA Section of the Official Journal of the European Communities and the EEA Supplement thereto, inviting them to submit comments within one month from the date of publication.

Article 7

This Decision is addressed to the Republic of Iceland.

Article 8

Only the English version is authentic.

Done at Brussels, 27 June 2008

For the EFTA Surveillance Authority,

Per Sanderud  
President

Kurt Jaeger  
College Member