Case No: 73197
Event No: 661303
Dec. No: 127/13/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 20 March 2013

on the pricing mechanism of Export Credit Norway

(Norway)

The EFTA Surveillance Authority ("the Authority"),

HAVING REGARD to the Agreement on the European Economic Area ("the EEA Agreement"), in particular to Article 61 and Protocol 26,

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 to Article 1(3) of Part I and Article 4(2) of Part II,

Whereas:

I. FACTS

1 Procedure

(1) By letter of 24 January 2013, received and registered by the Authority on the same day (Event No 660606), the Norwegian authorities submitted a notification for legal certainty concerning a new permanent pricing mechanism of Eksportkreditt Norge AS ("Export Credit Norway"), pursuant to Article 1(3) of Part I of Protocol 3.

(2) On 5 March 2013 (Event No 665019), the Authority received further information from the Norwegian authorities.

2 Description of the scheme

2.1 Background

(3) A scheme for export financing has been in existence in Norway since 1978. Historically, it was administered by Eksportfinans ASA ("Eksportfinans"), which granted loans to customers of Norwegian exporters. The loans under the scheme were issued in accordance

Rue Belliard 35, B-1040 Brussels, tel: (+32)(0)2 286 18 11, fax: (+32)(0)2 286 18 00, www.eftasurv.int

with the OECD arrangement on officially supported export credits[1] ("the Arrangement"), which provides a framework for the orderly use of officially supported export credits.

(4) After the financial crisis in 2008, the regulatory rules for large exposures on credit institutions were tightened. As a result, Eksportfinans required fresh capital to maintain its activity. However, the plans to raise capital for Eksportfinans did not succeed. On 18 November 2011, the Norwegian authorities announced that they would cease new loan commitments from being issued under the agreement with Eksportfinans, and establish a new state entity for export financing, Export Credit Norway.

(5) To make sure that the export industry had access to export credit financing until Export Credit Norway was operational, an interim scheme was set up from 21 December 2011. At first, Eksportfinans provided loans on behalf of the Norwegian state, on the basis that the Norwegian state provided the funding for the loans and the loans were placed on the state's balance sheet.[2] From 2 July 2012, the responsibility for the interim scheme was transferred to Export Credit Norway.

(6) For all market loans provided under the interim scheme, the reference rates contained in the Authority's Reference Rates Guidelines constituted the floor for pricing of interest rates. This pricing floor was chosen to ensure that the interim system does not contain any state aid element. Commercial Interest Reference Rate[3] ("CIRR") loans are always priced according to the Arrangement by reference to the rates published by the OECD. This will remain unchanged.

(7) Besides the export credit scheme, Norway also has a system of public medium- and long-term export finance guarantees, which is managed by the Norwegian Guarantee Institute for Export Credits ("GIEK"). This system will remain in place unchanged. GIEK is not allowed to fully guarantee a loan, which means that commercial financial institutions normally provide a guarantee for the remainder, alongside GIEK.[4]

2.2 Export Credit Norway

2.2.1 Organisation

(8) Export Credit Norway is a state-owned limited liability company, established under the Norwegian Export Credit Act.[5] The main purpose of Export Credit Norway is to offer long-term financing to international buyers of Norwegian capital goods and services.

(9) Export Credit Norway has its own board of directors, which is responsible for the administration of the company, appoints the managing director and makes decisions in all individual credit cases. The Norwegian authorities are responsible for determining Export Credit Norway's operational and legal framework, and constitute the general meeting. The lending activities of Export Credit Norway are entirely financed by budget allocations from the state. The state receives all instalments and interest rates from the loans in full and is liable for the obligations incurred by the company in connection with the lending activities. All funds connected with the lending activities are passed directly from and to

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1 Available at: http://search.oecd.org/officialdocuments/displaydocumentpdf/?doclanguage=en&cote=tad/pg(2013)1.

2 From 21 December 2011 until 1 July 2012, the Norwegian authorities disbursed loans with a total worth of approximately NOK 12.6 billion.

3 CIRR loans are loans arranged according to the Arrangement. CIRR rates are quoted on the 14th of every month and made publicly available on www.oecd.org.

4 According to the Norwegian authorities, GIEK's participation is normally 70% or less, which means that 30% or more of a loan is guaranteed by commercial financial institutions.

5 Act of 22 June 2012 No 57.

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the state. The loans are part of the Norwegian state's overall asset management and are on the state's balance sheet. Funds for the operation of Export Credit Norway are allocated by the state, but as Export Credit Norway is a limited liability company, the state is not liable for obligations incurred in association with the operation of the company.

(10) Export Credit Norway received NOK 71 million for its lending operations in the second half of 2012. For its first full year of operation in 2013, Export Credit Norway will receive NOK 110 million.

(11) Export Credit Norway offers medium- to long-term export financing for up to 85% of the export contract value. It can issue both CIRR loans (which are priced according to the Arrangement by reference to the rates published by the OECD) and loans on market terms. The choice between these two types of loans is with the borrower. Export Credit Norway can only issue loans if there is a guarantee from GIEK and/or highly rated financial institutions. Generally, loans have a maturity of between two and 12 years.

2.2.2 Intended permanent pricing mechanism for market loans

(12) Under the proposed permanent pricing mechanism, market loans will be priced according to the following principles:

- *Profit maximisation*: Export Credit Norway will operate as a market player and seek to maximise profits in each transaction. The interest rate will be commercially set and reflect what is considered to be the market price for similar loans.

- *Coverage of base price*: The interest rate will at least cover Export Credit Norway´s base price, i.e. all costs related to the loan and a reasonable margin. The base price is derived from the Norwegian Government Fixed rate yield curve and includes a market-based estimate of all relevant costs a private lender would take into account, including hedge/swap premiums. This base price will be the absolute lowest lending price, even if the market price is considered to be lower.

- *Market benchmarks*: The interest rate will not be lower than the observed market prices for similar loans, which will be used as benchmarks. There are mainly three sources of documentation for establishing the market price:

  - If the loan is syndicated, Export Credit Norway will get a good and well documented indication of market terms in the relevant transaction through its participation, and this will be used as a benchmark.

  - If Export Credit Norway is not part of a bank syndicate, and a term sheet from a similar lender, no older that one month, is available, this will be a good and well documented indication of market terms in the relevant transaction.

  - The OECD publishes a margin benchmark for officially supported floating rate loans based on commercial banking prices for aircraft transactions on a monthly basis as part of its Sector Understanding for Financing of Civil Aircraft[6] under the Arrangement. The benchmark is compiled from all reported prices of officially guaranteed export loans issued by commercial providers from the last three months and calculated as an average of the lowest 50% of the observations. It represents publicly available

[6] Available at: http://www.oecd.org/tad/exportcredits/aircraftsectorunderstandings.htm.

documentation of market prices that can be used as a benchmark in all transactions if none of the other two benchmarks is available.

(13) Export Credit Norway will have to document the market rate in each transaction by using the relevant one of these three methods.[7] This benchmark will then be used as a pricing floor for the interest rate fixing. It is up to Export Credit Norway to set the actual rates on or above this floor according to commercial principles. In any event, the final rate cannot be lower than the base price.

(14) The Norwegian authorities highlight that the actual interest rates resulting from this method may deviate upwards as well as downwards from the Authority's reference rates.

3 Comments by the Norwegian authorities

3.1 Need for a medium- and long-term export credit scheme

(15) According to the Norwegian authorities, there are several reasons for the Norwegian state to assume a role in medium- to long-term export credit financing:

- Only a few Norwegian financial institutions, which are comparatively small by international standards, provide long-term export financing. The contracts for delivery of Norwegian capital goods (e.g. ships and offshore vessels), however, are often of a considerable size and consequently require large loan amounts to be financed, which can exceed the lending capacity of these institutions. Furthermore, new, stricter capital and liquidity requirements, in combination with more expensive equity and funding, have adversely affected financial institutions' capacity to provide long-term financing.

- Norwegian exporters are often smaller enterprises, and their export financing needs are in many cases "stand alone" contracts. Such contracts are generally of limited interest to financial institutions that supply long-term export financing. In order to secure small- and medium-sized exporters a reasonable offer of long-term export financing, there is a need for intervention by the state.

- Norwegian exporters compete with companies domiciled in jurisdictions with publicly-owned or publicly-guaranteed institutions that provide market-based financings to their exporters. These institutions are to a certain degree not subject to the regulations on capital requirements and large exposures. State intervention thus also serves to secure a level playing field.

3.2 Shortfalls of the interim pricing system for market loans

(16) The Authority's reference rates have been used as a pricing floor under the interim scheme for market loans. However, the Norwegian authorities argue that they cannot represent a permanent solution for the following reasons:

- *Deviations from real credit spreads*: the Authority's reference rates consist of one-year IBOR as the calculation basis plus a standard loan margin to reflect credit risk. This margin is not market-based and will normally deviate from the actual market-based credit spread for a specific loan.

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[7] In the unlikely event that none of these three sources for documentation are available, Export Credit Norway would use the Authority's reference rates as a benchmark.

- *Reference rates are only available for one-year IBOR in NOK*: The reference rates use one-year IBOR as the calculation basis. In practice, however, loans are often offered with underlying rate fixing periods of one-, three- and six-month IBOR, plus a margin fixed for a period from two to 12 years. Neither the calculation basis nor the margin of the reference rates, however, take into account different tenors and loan durations. Furthermore, about 75% of Export Credit Norway's lending is denominated in US-dollars, whereas the reference rates are only available in NOK. The transformation from the reference rates to other durations, interest periods and currencies must be done by Export Credit Norway, which increases operational risk.

- *Yearly updates imply deviations from the market development*: The Authority's reference rate is only updated once a year. To accurately reflect the real market rates, however, a pricing mechanism has to follow the market on a more regular basis.

3.3 New pricing method for market loans ensures absence of aid

(17) The Norwegian authorities argue that applying the new pricing mechanism will secure that market loans are priced at market level and thus do not confer a state aid advantage on the borrower.

(18) In order to ensure that its pricing is in line with the market, Export Credit Norway will refer to recent market price information to determine the minimum price it can charge. Depending on the circumstances, this information will derive from its participation in a syndicate, from a very recent term sheet or, in absence of the above, from the OECD's margin benchmark for officially supported floating rate loans based on commercial banking prices for aircraft transactions.[8]

(19) The market price floor established according to this method will most likely differ from the Authority's reference rates. In particular, the pricing method can result in both upwards and downwards deviations from the reference rates. This symmetric approach shows that the system closely follows market prices in both directions.

(20) Regarding the use of the OECD market price benchmark, the Norwegian authorities argue that it is a suitable market proxy for determining a market pricing floor. The choice of the 50% lowest of the margins forms an integral part of the official OECD quotation. It results from negotiations between the OECD members involved in aircraft financing, and reflects that the benchmark is to be a floor (minimum price) for officially supported export financing. Furthermore, the pricing of officially supported loans varies among countries, based on, among others, the conditions of the credit insurance, the credit quality of the insurance (country risk) and the cost of funding for the financial institutions locally. The OECD methodology therefore aims at fixing a reasonable benchmark, and does not simply use the absolute lowest market observation at the price floor. Finally, the use of an official, reported OECD quotation reduces operational risk for Export Credit Norway.

(21) Export Credit Norway will adjust the OECD benchmark for each project according to who the guarantors in the particular project are. Furthermore, the Norwegian authorities highlight that this benchmark will only be used as a pricing floor. Export Credit Norway will determine its actual prices on a commercial basis in order to maximise profits.

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[8] In addition, loans will never be priced below cost as Export Credit Norway's base price will be the absolute pricing floor.

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3.4 Duration and reporting

(22) The Norwegian authorities have committed to subject the proposed pricing mechanism to a time limit of four years, after which they will submit a new notification.

(23) Furthermore, the Norwegian authorities will organise an annual audit by an independent expert. The main purpose of the audit will be to ensure Export Credit Norway's compliance with the pricing mechanism. It will also include a comparison between the actual prices, the pricing benchmark and the Authority's reference rates.

II. ASSESSMENT

1 Existence of state aid

(24) According to Article 61(1) of the EEA Agreement "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."

(25) Export Credit Norway is entirely financed by the Norwegian state and all funds connected with its lending activities are passed directly from and to the state. The loans granted by Export Credit Norway therefore involve the use of state resources. Furthermore, the lending activity is selective as it is only available to purchasers from Norwegian-based companies exporting goods and services. Given that the scheme concerns the provision of loans on a commercial basis in the context of commercial export activities, it is also liable to affect trade within the EEA and distort competition.

(26) The Norwegian authorities argue that Export Credit Norway prices loans according to market rates, and that these loans therefore do not confer any advantage on individual borrowers.

(27) Export Credit Norway grants state-financed loans to borrowers. The Authority's Reference Rates Guidelines [9] indicate that "[w]ithin the framework of State aid control, the Authority makes use of reference and discount rates. The reference and discount rates are applied as a proxy for the market rate […]". The reference rates are the Authority's principal instrument for assessing whether state-financed loans contain any aid element.

(28) The Authority notes that under the interim system for market loans, Export Credit Norway uses the reference rates as its absolute pricing floor, which ensures that the pricing of loans does not confer any state aid on the borrower. Under the new pricing mechanism, however, the pricing floor is determined by reference to market benchmarks, which may result in pricing below the reference rates.

(29) According to the Reference Rates Guidelines, the reference rates are applied only as a proxy for the actual market rates. The Authority notes that the reference rates have certain characteristics – as highlighted by the Norwegian authorities in the context of the present

[9] The Authority's Guidelines on Reference And Discount Rates ("the Reference Rates Guidelines"). Procedural and Substantive Rules in the Field of State Aid, adopted and issued by the Authority on 19 January 1994, published in OJ 1994 L 231, as amended by Decision 313/06/COL. The State Aid Guidelines are available on the Authority's website: http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/.

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case – that may make them less appropriate than other benchmarks. Accordingly, if it can be demonstrated on the basis of recent market indicators that a private lender would find it acceptable to make a similar loan at a lower price than the Authority's reference rates, it can be accepted that the actual market price is indeed lower at that moment in time.[10] Under these circumstances, the corresponding pricing of state-financed loans below the reference rates would not confer an advantage on the borrower.

(30) In the case of Export Credit Norway, the proposed pricing mechanism foresees three different benchmarks to be used as a pricing floor.

(31) The Authority considers that pricing information from an actual participation in a syndicate with commercial lenders and the use of a very recent term sheet for the same transaction from another commercial lender represent well documented indications of recent market terms. These mechanisms can be used to demonstrate that the actual market price differs from the Authority's reference rates in a particular case.

(32) Regarding the use of the OECD margin benchmark for officially supported floating rate loans, the Authority notes that it is based on recent commercial banking prices for aircraft transactions. It relies on actual market data of the past three months, from which the average of the 50% lowest observations is compiled. This methodology was chosen by the OECD members involved in aircraft financing, which include Norway and the European Union, to set a minimum price for officially supported floating rate loans for aircraft transactions. Given the specific situation of Export Credit Norway, which can only issue loans if there is a full guarantee from GIEK and/or highly rated financial institutions, the Authority considers that the OECD margin benchmark represents an acceptable method for approximating a market price floor in the absence of other market price information.[11]

(33) The Authority notes that if the market benchmarks indicate a pricing floor that is higher than the reference rates, Export Credit Norway will nevertheless use this higher benchmark. This symmetric approach shows that the pricing mechanism tries to the largest extent possible to mimic market prices. The Authority also notes that the benchmarks are only used as a pricing floor. The actual pricing decision of Export Credit Norway is taken on a commercial basis with a view to maximising profit.

(34) The Authority takes note of the commitment by the Norwegian authorities to set up an annual audit by an independent expert in order to ensure Export Credit Norway's compliance with the pricing mechanism, and which will in particular include a comparison between the actual prices charged, the pricing benchmark and the Authority's reference rates. The Authority also takes note of the commitment to renotify the pricing mechanism after four years. This will allow the Authority to assess whether its conclusions are still valid at that point in time.

2 Conclusion

(35) Based on the information submitted by the Norwegian authorities and for the reasons set out above, the Authority concludes that the proposed permanent pricing mechanism of Export Credit Norway does not constitute state aid within the meaning of Article 61 of the EEA Agreement.

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[10] See e.g. the decision in Case NN 4/2010 – Denmark – State financing of long term export loans, available on the European Commission's website at http://ec.europa.eu/competition/state_aid/register/.

[11] The Authority notes that the margin for each project will be adjusted according to the financial situation of each guarantor in a particular project.

HAS ADOPTED THIS DECISION:

Article 1

The proposed permanent pricing mechanism of Export Credit Norway does not constitute state aid within the meaning of Article 61 of the EEA Agreement.

Article 2

This Decision is addressed to the Kingdom of Norway.

Article 3

Only the English language version of this decision is authentic.

Made at Brussels, 20 March 2013

For the EFTA Surveillance Authority

Oda Helen Sletnes *President*	Sabine Monauni-Tömördy *College Member*