Case No: 68972
Event No: 645913
Dec. No: 292/12/COL

Public version of[1]
EFTA SURVEILLANCE AUTHORITY DECISION
of 11 July 2012
regarding state aid granted in the winding up of certain investment funds connected to New Glitnir, New Landsbankinn and New Kaupþing

(Iceland)

The EFTA Surveillance Authority ("the Authority"),

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

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement ("Protocol 3"), in particular to Article 1(2) of Part I and Articles 6, 7(3) and 13 of Part II,

HAVING CALLED on interested parties to submit their comments pursuant to those provisions[2] and having regard to their comments to the decision to open the formal investigation procedure,

Whereas:

I. FACTS

1. Procedure

(1) By letter dated 8 April 2009, Byr sparisjóður, Rekstrarfélag Byrs, Íslensk verðbréf, Rekstrarfélag íslenskra verðbréfa, MP banki, MP sjóðir, Sparisjóður Reykjavíkur og nágrennis, and Rekstrarfélag Spron (referred to collectively throughout as "the complainants") made a complaint against alleged state aid granted in the winding up of investment funds connected to the three failed Icelandic banks Glitnir, Kaupþing and Landsbankinn. The letter was received and registered by the Authority on 17 April 2009 (Event No. 515439).

(2) After various exchanges of correspondence[3], by letter dated 8 September 2010 the Authority informed the Icelandic authorities that it had decided to initiate the procedure

[1] This document is made available for information purposes only. In this public version, some information has been omitted so as not to divulge confidential information. This is denoted by […] or a range in square brackets providing for a non-confidential approximation of the relevant figure.

[2] Published in OJ C 292 of 28.10.2010, p. 8.

EFTA SURVEILLANCE AUTHORITY

laid down in Article 1(2) of Part I of Protocol 3 in respect of the measures taken to acquire certain assets from investment funds connected to the three failed Icelandic banks Glitnir, Kaupþing and Landsbankinn.

(3) The Authority's Decision No 338/10/COL to initiate the procedure was published in the Official Journal of the European Union and the EEA Supplement thereto.[4] The Authority called on interested parties to submit their comments thereon.

(4) The Authority received comments on the Decision from the Icelandic authorities by letters dated 19 and 23 November 2010 (Events No 578292 and 578700). Enclosed to the comments from the Icelandic authorities were the observations of Arion Banki hf. (formerly New Kaupþing Bank), Stefnir hf. (formerly Rekstrarfélag Kaupþings banka), Landsvaki hf., and joint comments of Íslandsbanki hf. and Íslandssjóðir hf. (formerly New Glitnir and Glitnir Sjóðir).

(5) The Authority received joint comments from the complainants by letter dated 28 November 2010 (Event No 579161). By letter dated 12 April 2011 (Event No 594179), the Authority forwarded these to the Icelandic authorities, who commented by letter dated 27 May 2011 (Event No 599625).

(6) By letter dated 1 February 2012, the Authority sent a request for information (Event No 623041) to the Icelandic authorities to clarify certain factual issues. The request was responded to by a letter dated 17 February 2012 (Event No 625442).

(7) By letter dated 2 April 2012, Arion Bank sent additional comments to the Authority (Event No 630781) which were forwarded to the Icelandic authorities on 16 May 2012 (Event No 634837).

2. The complaint

(8) In April 2009, several management companies and financial undertakings related to them complained to the Authority alleging that in the autumn of 2008 the Icelandic authorities intervened in the market for investment funds that operated in accordance with Act No 30/2003 on Undertakings for Collective Investment in Transferable Securities ("the UCITS Act"). The complainants contended that competing fund management companies and depository banks received unlawful state aid from the Icelandic authorities through the purchase of those funds' assets on favourable terms, enabling them to wind up the funds and repay investors at a time when there was no effective market for these assets in Iceland. The complaint concerned non-UCITS funds managed by subsidiaries of the three main Icelandic banks.[5]

3 For more detailed information on the various correspondence between the Authority and the Icelandic authorities, reference is made to the Authority's Decision to open the formal investigation procedure, Decision No 338/10/COL. Published in OJ C 292 of 28.10.2010, p. 8.

4 Published in OJ C 292 of 28.10.2010, p. 8.

5 In the complaint, reference was made to both the failed banks Glitnir Bank hf, Kaupþing Bank hf and Landsbankinn hf as well as to the new banks established after the split. Owned by the old failed banks, the management companies were not part of the estate of the old banks but were transferred to the new banks. The new banks were renamed as Islandsbanki, Arion and Landsbankinn. The banks are hereinafter collectively referred to as "the three main Icelandic banks".

EFTA SURVEILLANCE AUTHORITY

3. Aid measures under assessment

(9) The measures under review are the decisions taken by the boards of directors of the new restored main three Icelandic banks to acquire the assets held by non-UCITS funds managed by their subsidiaries.

(10) On 23 October 2008, the board of directors of New Glitnir decided to purchase debt securities held by the investment fund Sjóður 9 managed by its subsidiary Glitnir sjóðir. The purchase price was ISK 12.9 billion which corresponded to 70% of the last recorded value of the securities when the fund suspended from trading.

(11) On 27 October 2008, the board of directors of New Landsbankinn decided to purchase assets held by five investment funds managed by its subsidiary Landsvaki. The purchase price was ISK 61.6 billion and the assets purchased were debt securities issued by Icelandic companies and financial institutions.

(12) Equally on 27 October 2008, the board of directors of New Kaupþing decided to purchase debt securities held by the investment funds Peningamarkaðssjóður and Skammtímasjóður which were part of New Kaupþing's subsidiary Rekstrarfélag Kaupþings Banka. Bonds issued by Kaupþing and Glitnir were purchased at 30% of the last recorded value on 3 October 2008 and other assets were purchased on the basis of an assessment made by KPMG. New Kaupþing paid in total ISK 7.7 billion.

4. Potential aid recipients

(13) The recipients of the aid are the investors in the funds redeemed through the intervention of the three main Icelandic banks. Moreover, the management companies owned by the three main Icelandic banks also benefited from the early closure of the funds and the redemption of the investors.

(14) Several of the entities involved have changed names after the events of October 2008.

Rebranding and relation of the entities involved

Rebranding of the banks	Rebranding of the subsidiary management companies
New Landsbankinn > Landsbankinn	Landsvaki > Landsvaki
New Glitnir > Íslandsbanki	Glitnir sjóðir > Íslandssjóðir
New Kaupþing > Arion	Rekstrarfélag Kaupþings banka > Stefnir

5. Legal and factual background

5.1 The Icelandic UCITS legislation

(15) For a detailed description of the Icelandic UCITS legislation (Act No 30/2003) reference is made to the decision to open the formal investigation procedure.[6] Only the most relevant features of this legislation are recalled hereafter.

(16) The UCITS Act provides that investment funds must be established and operated by independent management companies. Supervision of the funds and deposit of their assets must be undertaken by a separate financial undertaking approved by the Icelandic Financial Supervisory Authority (the "FME").

6 See Authority's Decision No 338/10/COL, Section I.2.2.

(17) The UCITS Act differentiates between "UCITS" and "non-UCITS" funds. The most relevant differences for the purpose of this decision are that non-UCITS funds do not fulfil all the conditions of the Directive and must therefore obtain express authorisation to operate outside Iceland and that non-UCITS funds are not under the obligation to allow investors to redeem their unit shares at any time. The funds under assessment in this decision were non-UCITS funds.

(18) The management companies issued unit share certificates which were subsequently sold to investors and which confirm the right to the assets of the respective fund.[7] Unit share certificates in non-UCITS funds should be accounted for as debt on the balance sheet for the concerned fund. [8] These certificates derived their value from the current market value of a particular asset portfolio contained within a specific investment fund.

5.2 The financial collapse in Iceland in October 2008

(19) The management companies of the funds under assessment Glitnir Sjóðir, Rekstrarfélag Kaupþings banka and Landsvaki were subsidiaries of the three main Icelandic banks. Each subsidiary used its parent as the depositary.

(20) The funds subject to assessment invested mainly in bonds issued by domestic (Icelandic) undertakings (mainly corporations and financial undertakings), and also held a considerable proportion of their assets as deposits in financial institutions.

(21) On 29 September 2008, the Icelandic Government announced plans to rescue Glitnir Bank. This led (among other things) to a run on the investment funds. On 6 October 2008, the FME decided to temporarily suspend from trading on regulated markets all financial instruments issued by several large Icelandic companies, including the three large Icelandic banks. According to the information provided by the Icelandic authorities, "[t]his did not automatically led to the closing of the funds, but later on the same day the funds themselves decided to suspend trading."[9]

(22) On Monday 6 October 2008, the Icelandic Parliament (*Althingi*) passed emergency legislation (Act no. 125/2008 – the "Emergency Act") empowering the FME (among other things) to take over Icelandic banks if this proved necessary.

(23) Over the following week the three major banks in Iceland collapsed and the FME assumed the powers of the meeting of the banks' shareholders and immediately suspended the banks' board of directors. The FME appointed a winding-up committee which, with immediate effect, assumed the full authority of the board.[10]

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7 The management companies issue the unit share certificates and are parties to the agreement with the investors. In the explanatory notes to Article 22 of the UCITS Act No. 30/2003 it is noted that in the previous legislation the funds themselves issued the certificates, but that from now on the managment companies would do so.

8 Article 17 of the Icelandic Government's Regulation No 97/2004 (Reglur nr. 97/2004, um reikningsskil rekstrarfélaga verðbréfasjóða).

9 See letter from the Icelandic authorities dated 19 November 2010 (Event No 578292).

10 Recalled i.a. in the Order of the President of the EFTA Court of 23.4.2012 in Case E-16/11, EFTA Surveillance Authority vs. Iceland.

(24) In three decisions taken on 9, 14 and 21 of October 2008, the FME restored the banking system by forming new banks and transferring (most) of the domestic assets of each failed bank to corresponding “New” Glitnir, Kaupþing and Landsbankinn[11] banks. The new banks were also provided with working capital to ensure continued domestic banking operations. The Government appointed temporary boards of directors for each new bank, mostly consisting of civil servants, who were replaced by permanent appointments on 7 November 2008.[12]

5.3 The winding up of funds in Iceland

(25) On 17 October 2008, the FME issued a recommendation to management companies of investment funds to wind up certain investment funds (money market funds). It advised that all available cash should be paid to the unit shareholders and that other assets should be realised gradually, and the value paid to unit shareholders on a monthly basis until no assets remained in the funds. The liquidation was to be executed in a manner that would ensure the equality of the unit shareholders.[13]

(26) By the end of October 2008, the three management companies owned by the three main new Icelandic banks[14] had all wound up their funds and the unit share certificate holders had received between 60 and 85% (depending on the fund) of the last recorded value of their unit shares. The new banks had bought the assets of the respective funds and created deposit accounts in favour of each of the investors in the funds with the full amount of their share of cash deposits and an amount corresponding to 61% to 70% (depending on the fund) of the value of their share of the assets as recorded on 3 October 2008.

5.3.1 Funds held by Glitnir Sjódir

(27) On 3 October 2008, Fund 9 operated by Glitnir Sjódir (now Íslandssjódir) held securities worth ISK 42.76 billion. The largest issuers were Baugur (29%)[15], and Exista (11%)[16]. As a strategy to counter a run on the fund, the depositary bank, acting through a holding company, had acquired 54% of the fund.[17]

(28) KPMG made an assessment of the assets held by Fund 9. KPMG estimated positive and negative scenarios of the likely recovery value of the assets. In the worse case scenario, the bank would be able to recover an average of 56% of the value of the assets bought. In a best case scenario, 82% of their value.

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11 Now called Islandsbanki, Arion and Landsbankinn respectively.

12 See “Valdamiklir embættismenn” in Morgunblaðið on 14.10.2008.

13 See FME’s website: http://www.fme.is/?PageID=14&NewsID=347

14 The Authority understands that these subsidiary companies were transferred from the old to the new banks as “domestic assets” under the Emergency Act.

15 See The Report of the Special Investigation Commission formed to investigate and analyse the processes leading to the collapse of the three main banks in Iceland (the Report of the Special Investigation Commission), Chapter 14, page 157.

16 Exista was a 24,7% shareholder in Kaupþing Bank. See the Report of the Special Investigation Commission, Chapter 6, page 297

17 The holding company became part of New Glitnir when the bank was restored. Before the transaction was made to acquire the assets from Fund 9, a separate deal was made in which the holding company of New Glitnir received 54% of the assets held by Fund 9 in return for its unit share certificates.

(29) Due to concerns (among other things) about the value of bonds issued by Kaupþing, KPMG revised the assessment on 23 October 2008 and estimated recovery worth in a range between 48% and 78%, of which 63% is the median. The table below contains an overview of KPMG's estimations:

KPMG´s estimation of recovery value of securities in Fund 9[18]			
Name of issuing company	**Bond**	**Worse case %**	**Best case %**
Atorka	ATOR 04 1	50	100
	ATOR 07 2	50	100
	ATOR 07 3	50	100
	ATOR 07 4	50	100
Bakkavör	BAKK 03 1	75	100
Baugur Group	BAUG 02 09	50	75
	BAUG 07 3	50	75
	BAUG 07 7	50	75
	BAUG 08 1210	50	75
	BAUG 09 0227	50	75
	BAUG 09 0310	50	75
	BAUG 09 0310A	50	75
	BAUG 10 0629	50	75
BG Capital (Baugur)	BGCAP 11 09	0	0
Clearwater fine foods	CFFI 08 1217A	75	100
	CFFI 08 1228	75	100
Ehf. Fasteign	EFF 09 0522	75	100
Eik fasteignafélag	EIK 05 1	75	100
Exista	EXISTA 06 3	0	50
	EXISTA 07 2	0	50
Eyrir fjárfestingafélag	EYRI 07 2	75	100
Eimskip	HFEIM 07 2	50	75
	HFEIM 08 1	50	75
Íbúðalánasjóður	HFF 150224	100	100
	HFF 150914	100	100
Icelandair	IAIR 09 0123	75	100
Invik & Co	INV 08 0904	75	100
	INV 08 1121	75	100
Ehf. Kirkjuhvol	KIRK 07 11	50	75
Marel	MARL 08 1	75	100
Milestone	MILE 05 1	50	100
	MILE 08 1026	50	100
	MILE 08 1121	50	100
N1	N1 08 1	75	100
Norðurturninn	NOT 08 1	50	100
Nýsir	NYSI 08 0415	25	75
Samson	SAMS 07 5	0	25
Sparisjóður Hafnarfjarðar	SPH 03 1	75	100
	SPH 05 1	75	100
Straumborg	STBO 08 1019	75	100
Stoðir	STOD 06 2	50	75
Straumur	STRB 03 1	75	100
Recovery rate at worst and best scenario:		**50.23%**	**79.70%**
Kaupþing banki	KAUP 06 09	0	25
	KAUP 07 09	0	25
Recovery rate at worst and best scenario:		**0%**	**25%**
SUMMARY:		**48.28%**	**77.58%**
AVERAGE:		**62.9%**	

(30) On 23 October 2008, New Glitnir (now Islandsbanki) decided to buy the assets of Fund 9 for approximately ISK 12.9 billion, a price corresponding to 70% of the last recorded value.

18 Based on information provided by the Icelandic authorities by letter dated 7.1.2010 (Event No 542323 – enclosure No 23).

(31) A memorandum prepared on 22 November 2010 by the management company Íslandssjóðir explains that the purchase decision was based on the average of 67.7%, of three estimations on the likely recovery of the securities portfolio, plus a modest sum as an investment in the defended value of the management company.

(32) The Icelandic authorities and the companies involved have argued that buying the assets at a premium on the estimated recovery value was a strategic investment to protect the value of the subsidiary. By this the bank allegedly defended the value of the management company which now is worth, according to their own submission, ISK [...] billion[19].

5.3.2 Funds held by Landsvaki

(33) Five funds operated by Landsvaki were wound up following the recommendation issued by the FME. On 3 October 2008, the Money Market Fund ISK contained securities worth ISK 103 billion. The largest issuers were Kaupþing (32.3%), Landsbankinn (14%), Straumur-Burdarás (13.2%), Baugur (12.8%) and Eimskip (8.4%). The Money Market Fund USD contained securities worth USD 44.8 million mainly issued by Kaupþing (35.6%), Glitnir (20.1%) and Landsbankinn (17.7%). The Money Market Fund GBP contained securities worth GBP 4.5 million. The largest issuers were Landsbankinn (40.3%) and Kaupþing (21.3%). The Money Market Fund EUR contained securities mainly from Kaupþing (23.5%), Atorka (22.8%), Landsbankinn (20.3%) and Nýsir (13.3%) worth € 87.8 million. The Money Market Fund DKK contained securities worth DKK 10.6 million. The largest issuers were Landsbankinn (38.2%), Irish Nationwide (17.6%), Glitnir (17.5%), FL Group (13.8%) and Kaupþing (13.2%).

(34) On 21 October 2008, KPMG was contracted by Landsvaki to provide an estimate of recovery rates of selected bonds held by Landsvaki. The estimate had to be available the following day, on 22 October 2008. KPMG accepted the engagement on the premises that due to the limited time to gather information the recovery rates would not necessarily represent fair value estimates of these bonds.[20] The assessment prepared for Landsvaki is illustrated in the table below:

KPMG's assessment of likely recovery[21]

Name of issuing company	**Bond**	**Negative scenario (%)**	**Positive scenario (%)**
Atorka	ATOR 07 6	50	100
	ATOR 07 7	50	100
	ATOR 05 1	50	100
Eimskip	AVION 06 2	25	75
	EIM 04 1	25	75
	HF EIM 07 2	25	75
Baugur	BAUG ISK 07 3	50	100
	BAUG ISK 07 4	50	100
	BAUG ISK 07 2	0	50
FL Group	FL 08 1	50	100
Samson	SAMS 07 5	0	25
	SAMS 07 6	0	25
Nýsir	NYS 08 1	0	0
Egla	EGLA 05 1	0	25
Exista	EXISTA 04 1	0	50
Marel	MARL 06 1	75	100

19 This number is reached by adding together the net annual return on equity of the subsidiary and the net annual return on the service sold by the bank to the subsidiary multiplied by 15 years.

20 See letter from KPMG Iceland dated 13.2.2012 (Event No 625442).

21 KPMG's report to Landsbankinn, dated 22.10.2008 (Event No 625442).

EFTA SURVEILLANCE AUTHORITY

Mosaic	MOSAIC 05 1	50	100

(35) The table below was prepared by Landsbankinn and provides an overview of the funds affiliated with Landsvaki. The actual purchase prices are highlighted in yellow and can be compared to KPMG's assessment in the column to the far right.

Seðlabankagengi 21/10/08	1	150,50	113,89	193,62	20,19				
ISK m	*ISK*	*EUR*	*USD*	*GBP*	*DKK*	*Alls kröfur*	*Endurh. %*	*Kröfur m.v. endurheimtur*	Mat KPMG
Landsbanki - innstæður	29.730	-522	750	82	188	**30.227**	100%	30.227	
Landsbanki - skuldabréf	6.818	5.154	494	183	407	**13.056**	50-100%	11.385	
Landsbanki - afleiður	-16.445	0	0	0	0	**-16.445**	100%	-16.445	
Straumur - innlán	9.495	0	0	0	0	**9.495**	100%	9.495	
Kaupþing - skuldabréf	32.929	3.127	2.416	146	212	**38.829**	45%	17.473	
Kaupþing - afleiður	-479	0	0	0	0	**-479**	100%	-479	
Glitnir	0	536	1.363	44	281	**2.224**	30%	667	
Sparisjóður Bolungavíkur	187	0	0	0	0	**187**	100%	187	
Atorka	3.993	2.942	0	59	0	**6.994**	100%	6.994	50-100%
Baugur (1)	13.293	0	0	0	0	**13.293**	80%	10.635	50-100%
Egla	1.361	0	0	0	0	**1.361**	0%	0	0-25%
Exista	1.201	0	0	0	0	**1.201**	50%	600	0-50%
Stoðir (2)	4.058	41	0	0	231	**4.330**	100%	4.330	50-100%
Eimskip	8.695	0	0	0	0	**8.695**	70%	6.086	25-75%
Marel	1.145	0	0	0	0	**1.145**	100%	1.145	75-100%
Mosaic	1.965	0	0	0	0	**1.965**	100%	1.965	50-100%
Nýsir	29	0	0	0	0	**29**	0%	0	0-0%
Samson (3)	5.357	11	0	0	0	**5.368**	0%	0	0-25%
Bankabréf ERL	0	1.797	1.585	166	283	**3.831**	100%	3.831	
Aðrar eignir	0	111	7	7	10	**135**	100%	135	
Aðrar skuldir	0	-9	-110	-1	-5	**-125**	100%	-125	
	103.333	**13.187**	**6.504**	**685**	**1.608**	**125.317**		**88.107**	
						Samtals selt til NBI		**62.940**	

(1) 1. veðréttur í hlutabréfum í BG Holding
(2) 190% veðþekja af víkjandi skuldabréfum á Landic
(3) var 140% veðþekja í hlutabréfum í Landsbankanum

(36) On 27 October 2008, Landsbankinn decided to purchase the assets of the five funds for the total price of ISK 61.6 billion, which corresponded to 63% of the last recorded value.[22]

(37) According to a letter from the bank's head of legal department dated 1 December 2009 in October 2008 there was a growing pressure from clients to resolve the issue of the investment funds, which was responded to by the issuance of the windup recommendation by the FME. After the windup recommendation the directors of Landsbankinn and Landsvaki were of the opinion that it would be in the best interest of the unit share certificate holders to sell all assets immediately and to dissolve the funds quickly. Additionally the directors considered it important to maintain the goodwill of the new bank which was being harmed by negative press coverage concerning the funds and as a consequence they feared losing some customers.

5.3.3 Funds held by Rekstrarfélag Kaupþings banka

(38) Two funds operated by Rekstrarfélag Kaupþings banka (now Stefnir) were wound up following new Kaupþing´s (now Arion Bank) decision on 27 October 2008 to purchase their assets.

22 See letter of 17 February 2012 from the Icelandic authorities (Event No 625442).

(39) According to the information provided by the Icelandic authorities, the risk management division of Kaupþing prepared a recovery estimation containing both negative prospects and positive prospects for the assets held by the two funds. Bonds issued by Kaupþing were not part of this assessment. KPMG was then contracted to review the assessment and give its comments. The tables below contain an overview of the estimated recovery values prepared by KPMG[23]:

KPMG´s estimated recovery value of Peningamarkaðsjóður

Name of issuing company:	Bond	Book value ISK	Negative scenario (%)	Positive scenario (%)
Exista	EXIS 09 0317	[...] million	0	50
Atorka	ATOR 07 2	[...] million	50	100
Bakkavör	BAKK 03 1	[...] million	75	100
Deutsche BK	DBFloat 033012	[...] million	75	100
Ehf. Kirkjuhvol	KIRK 07 21	[...] million	50	75
Marel	MARL 08 1	[...] million	75	100
Eyrir fjárfestingafélag	EYRI 07 2	[...] million	75	100
Spb. Ísl.	SPB 06 1	[...] million	0	50
Exista	EXISTA 04 1	[...] million	0	50
Síf	SIFI 02 1	[...] million	75	100
Total:		**8108 million**	40	80
		Average:	**60%**	

KPMG´s estimated recovery value of Skammtímasjóður

Name of issuing company:	Bond	Bookvalue ISK	Negative scenario (%)	Positive scenario (%)
Landic Property (Stoðir)	STOD 03 1	[...] million	50	75
SPRON	SPR 05 2	[...] million	0	50
Exista	EXISTA 06 1A	[...] million	0	0
Sp. Hafnarfjarðar	SPH 06 1	[...] million	75	100
Marel	MARL 08 1	[...] million	75	100
Bakkavör	BAKK 05 1	[...] million	75	100
	BAKK 03 1	[...] million	75	100
Exista	EXISTA 05 1	[...] million	0	0
Lánasjóður sveitarfélaga	LSS 05 4	[...] million	100	100
Exista	EXISTA 04 1	[...] million	0	50
Hagar	HAGA 04 1	[...] million	75	100
Mosaic Fashions	MOSAIC 05 1	[...] million	50	100
Vinnslustöðin	VNST 03 1	[...] million	75	100
Síf	SIFI 02 1	[...] million	75	100
Rekjanesbær	11	[...] million	100	100
	Total:	**2917 million**	41	66
		Average:	**54%**	

(40) According to the information provided in the Report of the Special Investigation Commission, KPMG performed around the same time another assessment of the likely recovery value of assets held by investment funds affiliated with Kaupþing at the

23 Based on information provided by the Icelandic authorities by letter dated 7 January 2010 (Event No 542323 and 542324)

initiative of the FME and came to similar results than under the first assessment.[24] On this occasion, KPMG also assessed other assets, amongst others two types of bonds issued by Kaupþing. The estimated recovery in a positive scenario for the bonds issued by Kaupþing was set at 0%.[25]

(41) Kaupþing purchased the securities held by the two funds at the average recovery price of 54% estimated by KPMG, with the exception that bonds issued by Kaupþing Bank and Glitnir Bank were purchased at a 70% discount. The total purchase price was ISK 7.7 billion.[26]

(42) Stefnir, formerly Rekstrarfélag Kaupþings, explained that discussions were initiated with the resolution committee of old Kaupþing with the intention to sell the assets. This was eventually not considered optimal since the old bank *'was going into bankruptcy and rescission issues could be brought up later on.'* Subsequently it was decided to sell the assets to the new bank.

5.3.4 Effects of the redemption in the banks' balance sheets

(43) According to the information forwarded by the Icelandic authorities, within few months of the purchases, the three banks had made provisions for losses in their financial statements for the year 2008 on the transactions as is illustrated in the table below:[27]

Bank:	**Recorded value at closure 3 Oct 2008**	**Acquisition price in late Oct 2008**	**Acquisition price as a % of 3 Oct 2008 recorded value**	**Value in financial statements at the end of 2008**	**Value end 2008 as a % of recorded value 3 Oct 2008**
Kaupþing/ Arion	ISK 15.5 Billion	ISK 7.7 Billion	50%	ISK 2.4 Billion	15%
Glitnir/ Íslandsbanki	ISK 18 Billion	ISK 12.9 Billion	72%	ISK 2.3 Billion	10%
(New) Landsbankinn	ISK 98.5 Billion	ISK 61.6 Billion	63%	ISK 23.4 Billion	24%
Total:	ISK 132 Billion	ISK 82.2 Billion	62%	ISK 28.1 Billion	21%

5.4 Grounds for initiating the procedure

(44) Based on the information submitted by the Icelandic authorities, the Authority could not exclude the possibility that the redemption by the three main Icelandic banks of funds managed by companies linked to them constituted state aid within the meaning of Article 61(1) of the EEA Agreement. The Authority had doubts that the measures could be

24 See The Report of the Special Investigation Commission, Chapter 14, page 238, and table No. 27 on page 239.

25 See the Report of the Special Investigation Commission, Chapter 14, table No. 27 on page 239. The report mentions a third assessment made by PWC and delivered on 7 November 2008 which showed similar if slightly more positive results. The bank has explained that this third assessment was required to determine the need for making provisions for losses in the financial statement of the bank.

26 See email correspondence between Arion Bank and the Icelandic authorities forwarded to the Authority on 2 February 2010 (Event No 545192).

27 See email from Arion dated 2 February 2010 (Event No 545192), letter from Íslandsbanki to the Ministry of Finance dated 22 December 2009 (Event No 542323), and the 2008 annual report of Landsbankinn (Event No 638804).

regarded as complying with Article 61(3)(b) or (c) of the EEA Agreement as the Icelandic authorities had not put forward any arguments or information to justify these interventions under any of the compatibility provisions. The Authority therefore initiated the formal investigation procedure foreseen under Article 6 in Part II of Protocol 3 to the Surveillance and Court Agreement.

6. Comments by the Icelandic authorities

(45) The Icelandic authorities submitted comments by letters dated 19 and 23 November. They also enclosed to their submission comments from Arion Bank, Stefnir (fund management company owned by Arion Bank), Landsvaki (fund management company owned by Landsbankinn) and joint comments submitted by Islandsbanki and Íslandssjóðir (fund management company owned by Islandsbanki).

(46) In the Icelandic authorities' view, the Authority had misunderstood or misrepresented several factual details in its Decision to open the formal investigation procedure adopted on 8 September 2010. In particular, the Icelandic authorities dispute the Authority's preliminary finding that capital controls were in place in October 2008 when the winding up of the investment funds took place since they were implemented by Act No 134/2008 which came into force only on 28 November 2008.

(47) Further, in the opinion of the Icelandic authorities, several of the conditions for finding state aid in accordance with Article 61 EEA are not met.

(48) Firstly, there was no direct or indirect transfer of state resources. The Icelandic authorities claim that they had at the time of the transactions only contributed with an initial capital injection of ISK 775 million to each of the banks and thus the investments made for considerably larger amounts were not financed from state resources.

(49) Secondly, the decisions taken by the boards of directors of the new banks to relieve the funds of their assets were not imputable to the Icelandic State for the following reasons:

(50) The banks were established and governed in accordance with the Act on Public Limited liability Companies No. 2/1995 and the Act on Financial Undertakings No. 161/2002. This obliged the members of the boards of directors to act solely on behalf of the banks and not on behalf of their employers which in most cases were the Government Ministries or other entities of the Icelandic State.

(51) Although the Icelandic State was the sole owner and in possession of all shares in the banks at the time, the Government was not allowed to intervene into these business transactions. The only venue to exercise the shareholder power according to Icelandic company law is at a shareholder meeting on which the disputed transactions were never addressed.

(52) The FME is not to be considered as acting on behalf of the Icelandic State since it is a very independent authority which cannot be influenced by individual ministries.

(53) Thirdly, no advantage was granted to the management companies that managed the funds containing the purchased assets. The Icelandic authorities claim that the assets were owned by the funds which in turn were owned by the share certificate holders. Thus the management companies did not gain any economic benefits or profits through the purchase by the banks. As to the share certificate holders, many of which were individuals, the Icelandic authorities claim that they did not receive more favourable

treatment than share certificate holders of investment funds held by other management companies which were not subject to the asset acquisition by the three state owned banks. The Icelandic authorities contend that investors in funds managed by other companies did enjoy higher rates of return than those investing with management companies affiliated to the three state banks.

7. Comments from third parties

7.1 Comments by the three banks and their affiliated management companies

7.1.1 Comments by Arion Bank (formerly New Kaupþing)

(54) The Icelandic authorities forwarded, enclosed to their submission of 19 November 2010, comments made by Logos Legal Services on behalf of Arion Bank, dated 16 November 2010.

(55) Arion Bank mainly holds that the purchase decision were 'neither influenced nor financially aided by the Icelandic State or any employee of the State acting as a government official.' It is further argued that the board of the bank, 'despite being temporarily appointed by the State, was acting in the best interest of the Bank'.

(56) Arion Bank explains that at the time the bank had only been provided with a modest working capital from the State's budget which was not close to being equal to the value of the transaction in question. Thus the transaction was financed from the bank's own resources. This shows, according to Arion Bank, that state resources were not used in the transaction which excludes the presence of state aid. Arion Bank also explains that the two other large banks had already purchased assets at the time and thus the customers of Arion Bank pressured the bank to do the same. Arion Bank considers that there was not any potential disruption of competition because the three banks resolved the matter in a similar way, and that smaller competitors later managed to achieve similar redemption rates. Arion Banks also doubts that the investment had the potential to affect trade between the contracting parties due to limited investment options and restrictions on cross border capital movements.

(57) Arion Bank argues that the management companies could not have been the owners of the securities subject to the transaction since they were owned by the relevant funds which subsequently were owned by the owners of the share certificates. Thus, the management companies were not the ultimate recipients of any funds in connection to the transaction.

(58) Arion Bank considers the valuations of the estimated recovery made by KPMG have in retrospect been proven 'fairly accurate' compared with the actual outcome of the assets in question. Arion Banks also stresses that 'normal market conditions' within the meaning of the private investor test did not exist at the time and that the bank had to take a decisions based on the currently available information.

(59) Arion Bank argues that it is a standard market practice that parent companies support its subsidiaries and customers by buying impaired assets or assets with uncertain market value from investment funds to maintain credibility towards investors. Failure to do so would have had a negative impact on the value of the management company and thus the bank's asset. The bank also emphasises that due to a large supply of the type of assets within the investment funds, their sale value on the open market at the time would have

been lower than their ‘actual value’. The bank also refers to similar measures taken by the complainants in the case, but notes that although the bank considers its own investments viable, it did not have resources to purchase assets from its competitors.

(60) Arion Bank finally remarks that the transactions were taken under extreme circumstances, and that the bank faced at the time the prospect of losing the trust of its customers. In that situation the board of the bank could not take the risk of not acting.

7.1.2 Further comments by Arion Bank

(61) Logos Legal Services on behalf of Arion Bank submitted further comments by letter dated 2 April 2012. In the letter Arion Bank restated its previous position that none of the four criteria for finding state aid was present with regards to the bank’s investment.

(62) Additional new comments were presented to support the finding of compatibility in case the Authority would conclude that the investment involved state aid.

(63) Arion Bank argues that if the investment is considered state aid, it should be considered compatible aid with reference to the need to remedy the serious disturbance in the Icelandic economy at the time. This should especially be so with regards to the institutional investors, such as the pension funds. Arion refers to several of the Authority’s temporary financial crisis guidelines and to general principles underlying the state aid rules of the EEA Agreement in support of its argument.

(64) Arion Bank argues that the measure was necessary and well targeted towards the aim of restoring financial stability and minimising losses for the Icelandic economy. Arion Bank considers the measure proportionate on the basis that independent valuations were used to assess the value of the assets in the absence of normal market conditions. Arion Bank believes that negative effects on competitors were minimized because the investors, the actual beneficiaries of the measure, were not as such competitors.

7.1.3 Comments by Stefnir (formerly Rekstrarfélag Kauptings Banka)

(65) The Icelandic authorities forwarded, enclosed to their submission of 19 November 2010, comments made by Stefnir, dated 16 November 2010.

(66) Stefnir claims to have acted in the best interest of the share certificate holders and strived to achieve the best result for them. The agreement also protected the business model of the management company and was thus a reasonable investment for the parent bank. Stefnir argues that the resources used were the bank’s own resources and thus not state resources. Stefnir also argues that the transaction was made on terms that would have been acceptable to a similar market investor.

7.1.4 Comments by Landsvaki

(67) The Icelandic authorities forwarded, enclosed to their submission of 19 November 2010, comments made by Stefán Geir Þórisson, Supreme Court Attorney, on behalf of Landsvaki, dated 15 November 2010.

(68) Landsvaki argues that the measure in question does not confer an advantage upon a recipient since it was a part of a general measure affecting the overall economy of Iceland. Additionally Landsvaki contends that it could not have gained an advantage since it closed down the funds in question and that presently it does not operate any such

money market funds. Landsvaki further argues that since the funds were closed down the measure will not affect competition, and that investors in any case would probably turn their business to other more successful management companies in the future. In case the Authority finds the measure to constitute state aid, Landsvaki argues that it should be considered compatible on the basis of Article 61(3)(b) of the EEA Agreement. The breakdown of the funds in question affected the whole Icelandic population, which had either directly invested their savings in the funds, or indirectly through the pension funds. Landsvaki considers the measure in question to be adequate, well targeted, and proportionate towards remedying the serious disturbance at hand.

7.1.5 Comments by Íslandsbanki (formerly Glitnir)

(69) The Icelandic authorities forwarded with a letter dated 23 November 2010 comments made by Íslandsbanki dated 22 November 2010.

(70) Íslandsbanki mainly argues that the transaction in question was based on commercial objectives and decided by an autonomous board of directors based on professional advice.

(71) Íslandsbanki restates its explanations given prior to the opening of the formal investigation of the factual circumstances of the windup of its investment fund Sjódur 9. However Íslandsbanki now claims to have based the acquisition of the bond portfolio on two valuations made by KPMG and on a valuation made by the chairman of the board of its management company. The estimated weighted average recovery rate of these three valuations is claimed to have been 68% compared with a purchase price of 70%.

(72) Íslandsbanki claims that the Authority made several factual errors in the opening decision. Íslandsbanki claims that the board of directors was not under any influence of the FME in other ways than could be expected for any other normal financial institution. This influence was in any case based on the normal legislation applicable to financial institutions, not on the Emergency Act. Íslandsbanki also contends that the assets were owned by the respective fund, not the management company, and that the capital controls were implemented after the purchase decision was taken, not before as the Authority stated in its opening decision.

(73) Íslandsbanki mentions several points that in their view demonstrate that the transaction was based on commercial objectives:

(74) Firstly, Íslandsbanki needed to rebuild trust with its customers. Almost 9000 individual and 150 institutional investors were affected by the closure of Fund 9. After Landsbankinn first moved to acquire bonds of their affiliated funds a competitive pressure mounted on Íslandsbanki to do the same. There was a value in it for Íslandsbanki to solve the needs of its customers by giving them access to their savings and this could be achieved without jeopardising the solvency of the bank since the financing of the transaction did not lead to pecuniary outflow as most of the deposits created to redeem the investors stayed at the bank.

(75) Secondly, Íslandsbanki considers the measure to have been ‘necessary if the bank wanted to be able to continue to provide asset management services and operate a management company’. The management company is considered being worth ISK [...] billion and during ‘these days in October 2008, the future business of the management company and, in fact, all asset management activities of the bank was in real jeopardy.’

(76) Thirdly, Íslandsbanki considers that the acquisition of the bond portfolios was processed in a prudent way on the basis of both internal and external professional valuations. It was difficult to evaluate them at the time due to the uncertainty in the Icelandic economy, but the cost of not acting would, in the bank's opinion, have been higher. Unexpected later development in the Icelandic economy has since resulted in a worse recovery than expected, but that does not affect that the decisions were based on the best available information at the time. Later the creditors of Glitnir could be seen as having sanctioned the transaction by not claiming any reimbursement relating to the transaction during the takeover of 95% of the share capital in Íslandsbanki.

(77) Fourthly, Íslandsbanki refers to SPRON and Byr which later engaged in a similar solution for similarly situated funds.

(78) Further, Íslandsbanki believes that three indicators used by the Authority to establish imputability in the opening decision are based on wrong assumptions:

(79) One, Íslandsbanki denies to have been operated under the influence of the FME and the Emergency Act, but instead argue that it was operated as a normal autonomous financial institution on the basis of the normal applicable legislation.

(80) Two, Íslandsbanki considers that the indicator identified by the Authority with reference to the timing and the scale of the transaction is founded on the 'pre-defined position that the transaction in question was not based on commercial motives.' The bank argues that it was urgent to take a decision regarding the fund; that the scale of the transaction was small in comparison with the initial balance sheet of the bank, and that other private financial institutions took similar measures around the same time.

(81) Three, Íslandsbanki objects that a centralised decision was needed to unilaterally dissolve the investment funds of the banks in the way which was done; the banks were autonomous, the transaction with regards to Íslandsbanki involved not 'particularly large amounts', once the first bank had executed this solution others were under intensified pressure to come up with similar solutions, and additionally the Report of the Special Investigation Committee of the Parliament confirmed that 'the banks acquired the bond-portfolio of the funds based on the valuation of independent auditors.'

(82) Íslandsbanki finally believes that if the Authority finds that state aid was involved, 'it would have been permissible' under Article 61(3)(b) and (c) of the EEA Agreement. The bank, however, also points out that the first financial crisis guidelines of the Commission were not issued until 25 October 2008, and by the Authority until 29 January 2009.

7.1.6 Comments by Íslandssjóðir (formerly Glitnir Sjóðir)

(83) The Icelandic authorities forwarded with a letter dated 23 November 2010 comments made by Íslandsbanki's subsidiary management company Íslandssjóðir dated 22 November 2010.

(84) Íslandssjóðir argues that based on its own value for its parent company the investment made by New Glitnir (Íslandsbanki) in the bond portfolios of Fund 9 was commercially viable.

(85) Íslandssjóðir contends that the current value of the company for Íslandsbanki is around ISK [...] billion. This is based on the premises that the bank profits annually by ISK [...]

million from selling services to the management company in addition to an annual profit of ISK [...] million made by the management company. These annual profits combined equal approximately ISK [...] billion over a period of 15 years, which in turn Íslandssjóðir claims is the value of the company for its parent company.

7.2 Comments by the complainants

(86) The Authority received comments submitted jointly by the complainants by a letter dated 28 November 2010. The complainants restated the initial allegation that the management companies affiliated to the newly established state banks were in an exclusive position to sell securities on favourable purchase conditions to the new state banks. To substantiate the allegation further the complainants sent a recorded phone conversation which allegedly took place on 11 November 2008 between the Director of MP Funds and an employee of New Kaupþing discussing an unsuccessful offer made by MP Funds to New Kaupþing to purchase securities held by MP Funds.

(87) The complainants allege that the four management companies which took part in the complaint approached the new banks asking them to purchase the assets held in their funds. In support three letters dated 1 November 2008 addressed to each of the new banks were attached to the complaint and a reply from New Kaupþing dated 6 November 2008 as well. The reply from New Kaupþing informs that the board of directors of New Kaupþing had assigned the CEO of the bank to initiate discussions on the possibility of acquiring the assets held by the funds of the complainants on the condition that the discussions would be founded on commercial grounds. Valuations were prepared for MP Funds by the same independent experts (KPMG and PWC) that had estimated the recovery value of the funds connected to the new banks, and the assets were offered to New Kaupþing on those terms. The complainants have submitted to the Authority email correspondence between the CEO of MP Funds and an employee of New Kaupþing dating between 9 and 11 November 2011 in support of this alleged contact and in addition a recorded phone conversation allegedly between the same two persons discussing the possibility of New Kaupþing purchasing certain assets held by MP Funds. According to the complainants only New Kaupþing was willing to discuss a possible purchase, but at a price that was substantially lower than the independent valuation they had obtained and thus less than the amount paid for the assets in the funds connected to their own bank.

(88) MP funds claims to have been willing to sell certain securities based on price estimations made by KPMG and PWC as illustrated in the table below:

Assessments prepared for MP Funds

Name of issuing company:	Bond	KPMG assessment	PWC assessment	MP Funds asking price
Samson	SAMS 07 5	13%	0%	0-13%
Atorka	ATOR 07 8	75%	95%	75-95%
Marel	MARL 08 1	100%	100%	90-100%
Straumborg	STOB 08 1019	n.a	n.a	85-100%
Milestone	MILE 08 1026	75%	70%	70-80%
Exista	EXIS 09 0317	25%	50%	25-50%

(89) The estimations are within the same rough range as the estimations on which the large banks claim to have based their purchase decisions. The securities the three large banks

purchased from the funds managed by their companies had been issued by the same companies and were of similar categories, with the exception of the bond ATOR 07 8.

7.3 Comments from the Icelandic authorities on the complainants' observations

(90) The Icelandic authorities also submitted observations on the comments provided by the complainants by a letter dated 27 May 2011. They restated their view that the transactions are not imputable to the state and that the decisions taken by the new banks regarding the winding up of the investment funds were solely based on commercial motives. The Icelandic authorities further pointed out that a recorded phone conversation that was transmitted was not specific enough to draw from it any conclusions as the complainants alleged. The conversation had moreover taken place around 10 days after the new banks purchased assets from their own subsidiaries and during that time it could not be excluded that the market for the assets in question had substantially deteriorated.

(91) Attached to the comments from the Icelandic authorities were letters from Íslandsbanki dated 23 May 2011 and a joint letter from Landsbankinn and Landsvaki dated 24 May 2011. Both letters emphasise that the recorded conversation did not concern them directly. The arguments in previous submissions were also restated. Íslandsbanki further explained that they had rejected MP Fund's offer within three days because they were not interested in purchasing assets from other management companies. Íslandsbanki explains that was also consistent with the rationale and the commercial objectives behind their own purchase decisions, which was to protect its business reputation and support its subsidiary.

II. ASSESSMENT

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

(92) 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."

(93) In order for Article 61(1) of the EEA Agreement to be applicable, it needs to be assessed whether state resources were involved in the acquisition of the assets of the investment funds managed by subsidiaries of the three main Icelandic banks. In case state resources were involved, the Authority will assess whether the State granted an advantage to an undertaking through the transaction, and whether the potential advantage was liable to distort competition and effect trade on the EEA.

2. Presence of state resources

(94) For a measure to constitute state aid the first criterion that needs to be fulfilled is that it must be granted by the State or through state resources. Thus, in order to amount to state aid within the meaning of Article 61(1) of the EEA Agreement, the acquisition of the securities of the investment funds by the new banks must involve the use of state

resources, and the use of these resources must be imputable to the State. Both conditions must be cumulatively fulfilled.[28]

2.1 Use of state resources

(95) The European Court of Justice held in *Stardust Marine*[8] that:

"Art. 87(1) EC covers all the financial means by which the public authorities may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector. Therefore, even if the sums corresponding to the measure in question are not permanently held by the Treasury, the fact that they constantly remain under public control, and therefore available to the competent national authorities, is sufficient for them to be categorised as State resources. […] The State is perfectly capable, by exercising its dominant influence over such undertakings of directing the use of their resources in order, as occasion arise, to finance specific advantages in favour of other undertakings. […] the position of a public undertaking cannot be compared with that of a private undertaking. Through its public undertakings, the State may pursue objectives other than commercial ones, […]."

(96) Thus, at the outset, the resources of public undertakings constitute state resources. The Icelandic authorities argue, however, that the state at the time had only contributed a modest working capital of ISK 775 million to each of the banks which was not sufficient to finance the transactions. Therefore, the resources of the public banks used to relieve the management companies of their obligations were not State resources.

(97) The Authority disagrees. Whether or not the banks at the time had been granted specific state resources to finance the transactions is irrelevant given that the banks at the time were fully owned by the Icelandic State. The resources at the disposal of the banks were, thus, resources from the State. As explained above, the banks paid for the assets by establishing accounts in the name of each investor with a balance corresponding to the redemption value of each investor's unit share certificates. Thus, the transactions directly created liabilities on the balance sheets of the three banks in the form of deposits. Later, these and other liabilities on the banks balance sheets were covered by additional state aid to the banks.[29]

(98) Thus, the fact that the transactions at issue were financed by a debt on the balance sheets of the banks and that only later these liabilities were covered by additional state aid does not alter the finding that state resources were involved in the purchase of the assets.

2.2 Imputable to the State

(99) In order to constitute state aid, the measure must be imputable to the State. The Court of Justice held in *Stardust Marine*[30] that:

"…the mere fact that a public undertaking has been constituted in the form of a capital company under ordinary law cannot, having regard to the autonomy which that legal form is capable of conferring upon it, be regarded as sufficient to exclude the possibility

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[28] Case C-482/99 *France* v *Commission* (*Stardust Marine*) ECR [2002] I-4397, paragraph 24.

[29] See, inter alia, Authority Decision No 244/12/COL of 27 June 2012 on restructuring aid to Islandsbanki.

[30] Case C-482/99 *France* v *Commission* (*Stardust Marine*), paragraph 57.

of an aid measure taken by such a company being imputable to the State (Case C-305/89 Italy v Commission…paragraph 13). The existence of a situation of control and the real possibilities of exercising a dominant influence which that situation involves in practice makes it impossible to exclude from the outset any imputability to the State of a measure taken by such a company"

(100) While as a general rule imputability cannot be presumed (even if the State is in a position to influence and control the operations of a public undertaking), specific, compelling evidence is not always essential and in certain circumstances may not be available[31]:

"it cannot be demanded that it be demonstrated, on the basis of a precise inquiry, that in the particular case the public authorities incited the public undertaking to take the aid measure in question".

(101) Imputability can, therefore, be inferred from a set of indicators arising from the circumstances of the case, and the context in which the measure was taken:

- the fact that the body in question could not take the contested decision without taking into account the requirements of the public authorities;
- the nature of the undertaking's activities and the extent to which the activities were exercised on the market in normal conditions of competition with private operators[32];
- the integration of the public undertaking into the structures of the public administration;
- the intensity of the supervision exercised by the public authorities over the management of the undertaking, and the degree of control which the state has over the public undertaking; and
- any other indicator showing an involvement by the public authorities in the adoption of the measure, or the unlikelihood of their not being involved, having regard to the compass of the measure, its content or the conditions which it contains[33].

(102) The Icelandic authorities have submitted that the banks from their creation in October 2008 operated as commercial entities without any involvement from the State. They have explained that the banks were established and governed in accordance with the Act on Public Limited liability Companies No. 2/1995 and the Act on Financial Undertakings No. 161/2002, something that obliged the board members to act solely on behalf of the banks and not on behalf of their employers which in most cases were the Government Ministries or other entities of the Icelandic State. Further that the only way for the state to exercise influence was on the shareholders meeting were such transactions were never discussed. The three main Icelandic banks have largely argued the same, i.e. that from the creation in October 2008 the banks operated independent from the owner and that in essence, there was business as usual from day one.

(103) In reply, the Authority finds it necessary to recall the situation in Iceland in October 2008 as described by the Icelandic authorities in several other state aid cases. For instance, in the notification on aid for the establishment and capitalisation of

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31 Case C-482/99 *France* v *Commission* (*Stardust Marine*), paragraph 53.

32 AG Jacobs also referred in this context to the scale and nature of the measure.

33 Case C-482/99 *France* v *Commission* (*Stardust Marine*), paragraph 55-56.

Landsbankinn dated 20 September 2010[34] the authorities explained: *"The Government was faced with the task of trying to keep the economy of the country running and preventing its total collapse with an unequivocally foreseeable financial damage if nothing were to be done. The measures were aimed at ensuring effective flow of capital to and from the country, ensuring that funds were available to exchange for services and products, restoring confidence in the banking industry and the financial system, ensuring the domestic payment systems and ensuring that the banking collapse would not lead to an effective collapse of the Icelandic economy.[…] The main reasons behind the split of the banks into new and old banks, was to ensure that the Icelandic society would continue to function and to secure that the payment systems would continue to function. Almost every family and business was a customer of one of the three banks, holding cheque and savings accounts with the banks. The main objective of the operation was to prevent a total bank-run and loss of confidence in the system. By moving the domestic deposits to the new banks total chaos in Icelandic society was prevented. Deposits with banks are not just savings; the current accounts are used by the bank´s customers for their regular financial transactions. Limits in accessing such accounts would have crippled the economy in a blink of an eye, production companies could not have used funds to pay for their resources, pay wages to workers; retail companies could not have imported necessities for the public, drugs and food etc; Lawyers' trust accounts and other similar forms of "savings" would have been non-operable with catastrophic consequences.[…] With hindsight it is now clear that if the Government would not have taken coordinated measures and a strong official intervention in October 2008 to get a hold of the situation there would undoubtedly have been even worse consequences resulting in the total collapse of the general economy."*

(104) Moreover, the Authority finds it necessary to recall that while the banks were created as public limited liability companies their creation, including the capitalisation and transfer of assets from the old banks, was based on the extraordinary powers introduced for the Ministry of Finance, on behalf of the Treasury, under article 1 of the Emergency Act.

(105) Thus, the Authority considers that the imputability of a measure cannot be assessed on the basis of the corporate form of an undertaking as such. Rather account must be taken of the fact that the transactions at issue took place only days after the collapse of the Icelandic financial sector and the adoption of the Emergency Act in a situation often referred by the Icelandic authorities as an unprecedented crisis. In such serious circumstances there must, in the view of the Authority, be a presumption for that close control by the authorities was exercised vis-à-vis the new banks.[35] This is in particular so since the transactions had a close link to the need and the amount of future state aid.

(106) For the same reason, the second element of the *Stardust Marine* case law point to imputability. The market conditions were so precarious that the FME had recommended a winding-up procedure for all similar funds but explicitly recommended against trying to sell assets under the current market failure. Instead the assets should be sold over a longer time spam.

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[34] Letter from the Icelandic authorities dated 20 September 2010 enclosing the notification of aid granted to Landsbankinn (Event No 570138).

[35] The SIC report discusses the events leading up to the transactions in Chapter 14.12. The correspondence between the political assistants of two of the responsible Government Ministers described in the report indicates keen interest on behalf of the political authorities to resolve the issue of the investment funds.

(107) Turning to the third element in the *Stardust Marine* test, the Icelandic State was the sole owner of the three banks, a position that intrinsically guarantees the control of a company by appointing the board members. In this case, the appointments ensured a close integration of the company with the public administration. Indeed all the appointed board members but one were government employees. According to the information available to the Authority, there were 15 temporary directors of the boards, 13 of which were civil servants.[36] Of the 13 civil servants, 10 were in a position equal to or higher than a director of a unit within the Government. The only board member not directly employed by the Government was an attorney.[37] There was therefore an extraordinary strong integration of the companies into the structures of the public administration.

(108) Finally, the Authority notes that until the FME finalised the division of assets and liabilities between the old and the new banks, during the second half of 2009,[38] the banks operated on the basis of provisional balance sheets and were exempted from the minimum equity requirements for banks. During the first few weeks of operation the new banks relied completely on the support from the Icelandic State. The banks had at the time only been provided with a modest working capital which corresponded to only a fraction of the total cost of the transactions.

(109) The Authority considers it unlikely that taking on liabilities of this size involving considerable risk of large losses on provisional balance sheets could have happened without the involvement of the public authorities. This is especially so considering that at the same time the FME was negotiating with the creditors of the old banks on the premises of those same balance sheets, and considering that any initial losses by the banks would have to be paid for by increasing the planned equity contribution of the State to the new banks in order to fulfil the minimum equity requirements for financial institutions. Thus, there was a direct correlation between the price paid for the assets, the risk thereby assumed and the future recapitalisation need, i.e. the amount of the future state aid.

(110) In view of these considerations, the Authority considers that the decisions of the three banks to purchase assets from the investment funds managed by their subsidiary companies were imputable to the Icelandic State.

2.3 Conclusion on the presence of state resources

(111) On these grounds, the Authority considers that each of the three decisions to purchase assets from the management companies of the three state owned banks was imputable to the State and financed through state resources.

3. Favouring certain undertakings

(112) Secondly, according to Article 61(1) of the EEA Agreement, for a measure to be state aid it must be selective in that it favours "*certain undertakings or the production of certain goods*".

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36 The two others were an attorney with links to the Minister responsible for the banking sector and a newly retired government director.

37 According to the information available to the Authority, the attorney did not participate in the meeting where the asset purchase decision was taken. In his absence was a deputy board member who was a civil servant from one of the ministries.

38 See, inter alia, Authority's Decision No 244/12/COL of 27 June 2012 on restructuring aid to Islandsbanki.

(113) The measures at issue were selective because they benefited only the unit certificate holders in the three funds managed by the subsidiaries of the three main Icelandic banks. Despite their attempts,[39] as described above, other competing management companies did not manage to have the assets they managed purchased by the state owned banks.

(114) Thus the Authority considers that this possibility was not open to other funds managed by third companies and therefore the measures were selective.

(115) Nevertheless, Article 61(1) of the EEA Agreement only refers to undertakings as possible recipients of state aid. A significant amount of investors in the concerned funds were individuals. To the extent that the measures benefit individual investors which per definition do not constitute undertakings within the meaning of Article 61(1) of the EEA Agreement, the measure does not satisfy the second condition to be considered state aid. Accordingly, no state aid is involved in so far as the measures concerned non-undertakings.

(116) Conversely, to the extent that the investors were undertakings, the measures are selective within the meaning of Article 61(1) of the EEA Agreement.

4. The market economy investor principle

4.1 Introduction

(117) For a measure to involve state aid, it must confer on the beneficiaries economic advantages that they would not have obtained under normal market conditions. During the formal investigation the Icelandic authorities have argued that the purchase of the securities by the banks was in line with the market economy investor principle and thus no advantage was granted through state resources to any of the potential beneficiaries. The Icelandic authorities contend in that regard that each of the new banks was investing on reasonable commercial terms, and that in consequence, no advantage was gained by the management companies or the unit certificate holders/investors. Further, they claim that the banks did not incur any additional burdens as a result of the transactions on the basis that the value of the deposits issued to the investors should correspond to the real value of the assets acquired by the banks at the time of acquisition.

(118) The existence of an advantage within the meaning of Article 61(1) of the EEA Agreement depends on whether in comparable circumstances a private investor would have made similar investment choices and acquired the relevant securities under similar conditions.

(119) The market economy investor principle is a test applicable under normal market conditions. Thus, the application of the MEIP principle to crisis related measures is normally excluded exactly for the reason that there is a market failure during the period of the crisis. [40]

(120) As mentioned above, the market conditions in Iceland in October 2008, were far from normal, indeed, there was probably no market at all for the assets in question.

39 See letter dated 28 November 2010 providing comments on the opening decision (Event No. 579161).

40 See, inter alia, Authority Decision No 244/12/COL of 27 June 2012 on restructuring aid to Islandsbanki.

EFTA SURVEILLANCE AUTHORITY

(121) The stock market index had dropped from 3500 in July 2007 to 1600 at the end of September 2008. Following the plans that were announced of State intervention in Glitnir, the index dropped to 400 around 20 October 2008. It would slide further down to 255 at the end of 2008.[41] Moreover, the yield rates on treasury bonds can be indicative for the panic in the Icelandic financial markets at the time. On 22 October 2008 the yield rate was within the range of 11.96% and 13.58% depending on the maturity date.[42] The same was true for interest rates on the interbank market for ISK during October 2008. The 3 month REIBOR interests were 16.1 % on 3 October, 12.6% on 21 October and 18.575% on 31 October.[43]

(122) On 27 October 2008 the International Swaps and Derivatives Association (ISDA) announced the launch of protocols to settle credit default swaps (CDS) referencing to the three collapsed Icelandic banks.[44] Auctions were held on 4, 5 and 6 November to determine the final price of certain debt obligations of the three banks. The results of the three auctions are illustrated in the table below:

Results of ISDA's auction to settle credit derivative trades for the three Icelandic banks[45]

Auction date	Issuer of debt	Results for senior debt	Results for subordinated debt
04.11.2008	Landsbankinn	1.25%	0.125%
05.11.2008	Glitnir	3 %	0.125 %
06.11.2008	Kaupthing	6.625%	2.375%

(123) The results of the auctions show the market price in October 2008 of debt securities issued by the three Icelandic banks as determined in an auction to settle CDS claims. The issuers of CDS insurances on the three banks had to pay the policy holders almost the entire debt amount to settle the claims. Investors were not willing to offer more than 0.125% - 6.625% for the insured securities due to the uncertainty of their real value. Large international investors participated in the auction including; Bank of America, Barclays Bank, BNP Paribas, Credit Suisse International, Deutsche Bank AG, HSCB Bank, JPMorgan Chase Bank, UBS and several other leading international investment banks. This shows the uncertainty of the value of financial instruments at the time the transactions under assessment in this decision were carried out.

4.2 Application of the MEIP test

(124) The Authority would not as such exclude that also a state owned bank during a financial crisis could make investments as a private investor on commercial terms, in particular so when the investments were made to protect existing business or claims of the banks.

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41 See OMX Iceland All-Share GI during the years 2007 and 2008. Available at Nasdaq-OMX's website: http://www.nasdaqomxnordic.com/indexes/historical_prices/?Instrument=IS0000009157

42 Yield on the OMX bond market for; RIKB 08 1212, RIKB 09 0612, RIKB 10 0317. Published on the website of the Icelandic Central Bank; http://www.sedlabanki.is/?PageID=8

43 See 3 month REIBOR interests published on the website of the Icelandic Central Bank; http://www.sedlabanki.is/?PageID=8

44 See ISDA press release dated 27 October 2008 available at ; http://www.isda.org/press/press102708.html

45 For detailed information on the results of the auctions see the website of the administrator of the auction; http://www.creditfixings.com/information/affiliations/fixings/auctions/2008.shtml

(125) In the Authority's Guidelines[46] the Market Economy Investor Principle (MEIP)[47] is expressed as the benchmark against which investments of the State should be assessed. It is not the aim of the Authority to replace the investor's judgement when state resources are being invested and any investment decision requires risk analysis which by their very nature imply a wide margin of judgement on behalf of the investor. Only where there are no objective grounds to reasonably expect that an investment gives an adequate rate of return that would be acceptable to a private investor in a comparable position under normal market conditions is state aid involved.

(126) As described above, on 17 October 2008, the FME issued a recommendation to management companies of investment funds to wind up investment funds (money market funds) such as those at issue here. It advised that all available cash should be paid to the unit shareholders and that other assets should be realised gradually and the value paid to unit shareholders on a monthly basis until no assets remained in the funds. The liquidation was to be executed in a manner that would ensure the equality of the unit shareholders. It is also important to note that the recommendation does not suggest any transfer of risk in connection with the outcome of the underlying assets, nor does it encourage any compensatory measures in favour of the investors in the funds.

(127) It is also important to keep in mind that unlike in the case of regular UCITS funds, the non-UCITS funds subject to this assessment were not required by law to redeem their investors immediately upon request. This special nature of the investment is liable to affect any decisions taken to liquidate such funds by somewhat lessening the entitlement of investors to an expedited resolution.

(128) It should also be noted that the recommendation appeared to recognise that the current market value of the assets was low and that such assets therefore should be realised gradually over time. This is also in line with the strategies followed by the resolution committees of the old banks.

(129) The recommendation of the FME was general and applied to all funds whether managed by management companies owned by public banks or private banks. Thus, based on the recommendation itself the Authority sees no grounds for why the banks considered it necessary to immediately acquire the assets of the funds.

(130) The Icelandic authorities and the three main Icelandic banks have all referred to a need to protect the goodwill of the management companies and rebuild trust among the banks customers. With the transaction they argue that the banks pursued a long-term perspective.

(131) However, none of the three main Icelandic banks have submitted contemporary documentation showing how the risk of the transactions correlated to the value of such trust and goodwill. While the Authority understands the difficulties of putting numbers on such trust and goodwill, it takes the view that given the risky nature of the

[46] See Part VI of the Authority's State Aid Guidelines: Rules on public service compensation, state ownership of enterprises and aid to public enterprises: Application of State aid provisions to public enterprises in the manufacturing sector - This corresponds to the Commissions Communication to the Member States on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector.

[47] The market economy investor test was adopted by the European Courts in cases such as C-303/*88 Italy v Commission* [1991] ECR I-1433 and C-328/99 and C-399/00 *Italy and SIM 2* [2003] ECR I-4035.

transactions and the possibility of future losses, the risk of losing goodwill and trust following a possible non-intervention should be quite clear and present.

(132) On the basis of factual information in its possession, the Authority has not been able to identify that such a clear danger for loss of goodwill and trust was present. As far as the Authority understands none of the competing management companies had at the time taken steps to sell the assets to their parent banks. At the outset, given the uncertainty of the value of the assets, as inherently recognised in the FMEs recommendation, the Authority would therefore assume that the prudent market investor would have followed the recommendation and sold the assets gradually over time.

(133) In that regard, it is the Authority's understanding that there was little or no risk at the time that the management companies would or could sell the assets to other investors so that the banks could have missed a good investment opportunity. Nor did the risk of dissatisfied unit certificate holders seeking the services of the competitors seem likely since all the competitors were in the same situation. It is on that basis difficult to understand the urgency of the situation, leading to external asset valuation being collected and decisions to acquire the assets taken within a few days.

(134) If one turns to the actual value assessments collected the urgency becomes even harder to comprehend. As explained above, the external value assessors expressed clear reservations about the accuracy of their assessments and provided for all the assets a considerable range in their assessments. Indeed for many of the assets the range was from (low) 50% to (high) 100%. Given the high combined value of the assets, with the intrinsically linked risk of huge losses, the Authority would already for that reason question whether a prudent investor, acting under no particular time pressure, would have taken a chance on a value somewhere in between.

(135) Such a risk-taking is also difficult to reconcile with the fact that the buyers of the assets were newly established state owned banks rising up from the ashes of a very recent collapse of the financial sector in Iceland. At the time the banks had as far as the Authority knows no reliable estimate about the value of their asset portfolios and liabilities transferred from the old banks. This uncertainty also meant that the banks at the time did not know how much state aid they would need in the future in order to comply with statutory capital requirements. For a comparable private investor the Authority would assume that extra caution would be exercised with regard to liabilities on the balance sheet for a company (here a bank) early in a rescue and restructuring phase. In other words, before the owner of a new bank could possibly know what it would take to establish this new bank he would show extra care not to make risky investments that could make the new establishment even more costly.

(136) Against this background and uncertainty the Authority fails to see that a prudent private investor would have undertaken similar risky transactions based on similarly weak and uncertain value assessments. Instead, the Authority would assume that the prudent investor would have used considerable more time and collected better documentation as a basis for making such investment decisions. In particular in a situation such as here where there was no apparent risk that either the customers or the assets could go/end up somewhere else.

(137) The Authority considers that these arguments demonstrate clearly why the banks did not act as private market operators. Indeed, it was exactly for the reason that the state had

intervened and would provide whatever state aid needed that the banks could afford to buy the assets on the basis of such imprecise value assessments and with only a vague, unsubstantiated upside in the form of goodwill as here.

(138) In their submissions the Icelandic authorities and the three main Icelandic banks have moreover argued that also other (at the time privately owned) banks bought assets from subsidiary management companies later in the autumn of 2008. They have also indicated that two of the complainants (Byr and SPRON savings banks) shortly after wound up their own investment funds in a similar manner, and that another of the complainants (MP Funds) was able to get even better returns from its liquidation than what was achieved by the management companies affiliated to the state owned banks.

(139) The Icelandic authorities also refer to measures taken by Glitnir on 30 September 2008 to relieve Sjóður 9 of bonds issued by Stoðir which the day before was granted a permission by a court to suspend payments. During that time Glitnir was still in private ownership and the Icelandic authorities allege that this shows how a private investor would respond in a situation comparable to that of the three banks.

(140) In this regard the Authority finds it plausible, as contended by the complainants, that the investment made by the by far three biggest market players[48] created a considerable pressure on other smaller banks to ensure similar redemption result for their unit certificate holders. Thus, the Authority does not consider the subsequent transactions as proof, neither for the state owned banks acting as market investors nor that the conditions of the transactions corresponded to reasonable commercial terms. Rather the Authority emphasises that at the time the three banks bought the assets no other market player had expressed any intention to go beyond the recommendation of the FME.

(141) Moreover, with regard to the value of the assets, the Authority recalls that by the end of 2008, shortly after the transactions were completed, the assets were severely written down on the banks balance sheets. Some of the assets had to be evaluated in the context of the establishment of the balance sheets on the new banks. Independent experts considered that the value of the acquired assets was lower than purchased for and reduced it to an average of 21% of the last recorded price on 3 October 2008, i.e. to on average one third of the price paid for the assets. This is an indication that the price paid for the assets did not correspond to their market value, as any private economy investor would have required.

(142) On the basis of these considerations the Authority concludes that New Glitnir, Kaupþing, and Landsbankinn did not act in accordance with the MEIP by investing respectively ISK 12.9 billion, ISK 7.7 billion and ISK 61.6 billion in securities of investment funds managed by their subsidiaries.

4.3 The existence of an advantage

(143) The Authority has concluded above that the three banks did not purchase the assets of the investment funds managed by their subsidiary companies in accordance with the market

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[48] See FME´s report *"Heildarniðurstöður ársreikninga fjármálafyrirtækja og verðbréfa- og fjárfestingasjóða fyrir árið 2007"* published on 9 September 2008, page 7. The management companies affiliated to the three large banks had approximately 90% market share by investment volume at the end of 2007.

economy investor principle; a prudent market investor would not, under comparable circumstances, have bought instruments of such uncertain future value.

(144) The value assessments had been prepared in just a few days and the considerable range between high and low value provided limited guidance for the risk of the investments. The FMEs recommendation at the time was for the management companies not to sell the assets immediately. A sale in the open market in October 2008 would have resulted in at best a very low price. It is indeed questionable whether it would have been possible to sell at all bonds issued by mostly bankrupt Icelandic companies at the time.[49]

(145) A direct, immediate advantage was therefore that the unit certificate holders received immediate payment for the non-UCITS funds they had invested in. If the state had not intervened through the new state owned banks the investors would most likely have had to wait for the return on their investments, except for the cash part that was to be paid out immediately. As mentioned above, the unit certificate holders in such non-UCITS funds as in the present case, did not have a right to be redeemed immediately.

(146) The Authority, moreover, considers that the unit share certificate holders through the State's intervention received a higher return than they would have, had the assets been sold in the open market at the same time. As mentioned above in Section 4.1, the few known examples of open market sales of comparable assets at the time resulted in very low prices. Thus, in such a scenario the unit share holders received an advantage corresponding to the difference between the low market value and the redemption value of between approximately 60 and 70% of the last recorded value.

(147) However, the Authority does not necessarily consider such an open market sale to constitute a realistic counter factual scenario in the case at hand. The FMEs recommendation to the management companies was to not sell the assets at the time but rather do so in an orderly fashion over time with gradual repayments to the unit certificate holders.

(148) Whether the unit certificate holders also obtained a higher return than they otherwise would have received, following such an FME recommended asset sale over time, is more difficult to determine. The measures were never notified to the Authority, something that would have triggered the requirement for a proper evaluation in order to determine the state aid element of the transaction. In such an assessment the Authority would have requested the Icelandic authorities to carry out an appropriate asset evaluation to determine the long term or fair value of the assets.[50]

(149) Further, the contemporary value assessments made by the external value assessors are of limited relevance since they varied by as much as 50% from the high to low value for many of the assets.

(150) As mentioned above, the Authority understands that the banks wrote down the value of the assets shortly after they had been acquired. In the context of the establishment of the balance sheets on the new banks, independent experts considered that the value of the

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49 For the information regarding the companies in which the funds had invested reference is made to Section 5.3 above.

50 See in that regard the principles described in Part VIII of the Authority's Guidelines on the treatment of impaired assets in the EEA banking sector, which would have applied mutatis mutandis in this context.

acquired assets was lower than purchased for and reduced it to an average of 21% of the last recorded price on 3 October 2008, i.e. to in average one third of the price paid for the assets. The Authority has received no information indicating that the value of these assets has later increased. In the absence of any explanation to the opposite the Authority assumes that this was done in accordance with general accounting principles to reflect the lower value, i.e. that either the banks had paid an overprice for the assets, or the value had deteriorated even more immediately after the acquisition.

(151) In either case, the Authority assumes that a similar value reduction would also have taken place if the assets had continued to be held by the funds managed by the management companies. Thus, the unit share certificate holders would have received a correspondingly lower return if the assets had been sold later.

(152) On that basis the Authority concludes that the unit certificate holders received an advantage through the acquisition of the relevant assets. The advantage consisted, firstly, in immediate repayments. Secondly, the Authority finds it likely that the unit certificate holders, through that state intervention, received a higher return on their investments than a sale in accordance with the FMEs recommendation would have ensured.

(153) The Authority had, furthermore, requested the Icelandic authorities to provide it with information regarding the payment of any fees to the management companies in connection with these transactions. In a letter dated 15 April 2010,[51] the Icelandic authorities explained that in the case of Landsvaki and Glitnir funds an exit fee of ISK 300 was required and that the FME was aware of an entry fee in the case of Kaupthing Asset Management Company but was not aware of whether it had been collected. The Icelandic authorities also explained that the management fee normally due was not charged for some of the funds.

(154) On the basis of the information provided by the Icelandic authorities, the Authority considers that no additional payments were made from state resources to the management companies linked to the closure of the funds.

(155) That notwithstanding, the Authority is of the opinion that the management companies obtained an indirect advantage with these interventions. The early and advantageous redemption of the funds through the purchases of the three banks prevented their likely collapse or the worsening of their reputation as non reliable investment partners, maintained them on the market and ensured their customers would remain with the company. Their competitor management companies, on the contrary, did not enjoy this advantage.

5. Distortion of competition and effect on trade between Contracting Parties

(156) The aid measures must be liable to distort competition and affect trade between the Contracting Parties to the EEA Agreement. The provision of financial services is a highly competitive market across the EEA. The measures in this case allowed the management companies to perform better at their core business task than they otherwise would have, giving them a competitive advantage.

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51 See letter from the Icelandic authorities dated 15 April 2010 which complemented the information provided in a letter dated 23 February 2010 (Event No 553782).

(157) It has been argued during the formal investigation that there could be no distortion of competition as the money market funds were closed down. The Authority does not accept this narrow interpretation of the market. The management companies continue to be engaged on financial services markets and may also potentially once again establish similar investment funds.

(158) The measures strengthen the position of the management companies in comparison to competitors (or potential competitors) in Iceland and other EEA States. The management companies are undertakings active, as described above, on financial markets, which are open for international competition in the EEA. Whilst the Icelandic financial markets are currently, particularly due to the capital controls, rather isolated, (a potential for) cross-border trade still exists, which will increase as soon as the capital controls are lifted. All measures under assessment must therefore be regarded as distorting competition and affecting trade between the Contracting Parties to the EEA Agreement.[52]

(159) At the level of the undertakings that hold unit share certificates, the increase in the redemption value of the unit share certificates and the immediate disposal of the funds is liable to have distorted competition on their respective markets of operation. The distortive affects are though likely to have been minimal for the largest numbers of these undertakings which invested relatively low amounts of their short term liquidity as an alternative safekeeping to a normal bank deposit. This would however not apply to institutional investors. Any selective advantage gained by them through investments is liable to harmfully distort competition on different markets within the financial services sector of the EEA.

(160) The Authority is of the view, therefore, that the measures were liable to have effect on trade between the Contracting Parties and distortion of competition.

6. Conclusion – existence of state aid within the meaning of Article 61(1)

(161) On the basis of the foregoing considerations, the Authority concludes that the acquisition by the three Icelandic banks of the assets of the concerned investment funds managed by their subsidiaries constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

7. Procedural requirements

(162) Pursuant to Article 1(3) of Part I of Protocol 3, “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”.

(163) The Icelandic authorities did not notify the aid measure to the Authority. The Authority therefore concludes that the Icelandic authorities have not respected their obligations pursuant to Article 1(3) of Part I of Protocol 3.

8. Compatibility of the aid

(164) Support measures caught by Article 61(1) of the EEA Agreement are generally incompatible with the functioning of the EEA Agreement, unless they qualify for a derogation under Article 61(2) or (3) of the EEA Agreement.

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52 See Case 730/79 *Phillip Morris v Commission* [1980] ECR 2671.

(165) As described above, the financial sector in Iceland collapsed within a few days in October 2008. The difficulties were coupled with a breakdown of confidence in the country's currency. Iceland's real economy was also severely hit by the financial crisis. Although more than three years have passed since the onset of the crisis, vulnerability still remains in the Icelandic financial system. The three main banks had a combined market share of more than 90% in most segments of the Icelandic financial market. The FME, acting on the basis of special powers granted under the Emergency Act, transferred the domestic operations of the failed banks to new state owned banks. Similar measures were soon to follow for some of the savings banks and other financial institutions. The aims of these measures *was to keep the economy of the country running and preventing its total collapse with an unequivocally foreseeable financial damage if nothing were to be done. The measures were aimed at ensuring effective flow of capital to and from the country, ensuring that funds were available to exchange for services and products, restoring confidence in the banking industry and the financial system, ensuring the domestic payment systems and ensuring that the banking collapse would not lead to an effective collapse of the Icelandic economy.*[53]

(166) Particular measures were also introduced to try to protect depositors. The rules governing bankruptcy proceedings were amended to give the depositors first priority. The Deposit Guarantee Act was also amended to cover the cash deposits held by the non-UCITS funds. Moreover, the Government introduced an unlimited guarantee on all domestic deposits, which is still in force. This measure has been described as a crucial one for the new banks ability to finance their new operations.

(167) The Authority notes that the non-UCITS funds were offered by subsidiaries (management companies) of the old banks as an alternative to regular deposits/savings accounts. The name of the subsidiaries were very similar to those of the banks and the management companies applied what has been referred to as aggressive marketing strategies to sell the unit share certificates. It was probably not clear to a number of the investors that the funds were not covered by the Icelandic deposit guarantee scheme. [54]

(168) Considering the amount of assets held by the funds as compared to the small Icelandic population[55], the funds were indeed successful in attracting investments. The investors represented all layers of the Icelandic economy, from private persons to pension funds and other institutional investors. The investment portfolios appeared at the time the FMEs winding-up recommendation was made to be far from diversified and robust. It seems as if the funds at the time mainly had invested in bonds issued by a small group of Icelandic companies controlled to a large extent by the owners of the old banks.[56]

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53 Reference to paragraph 103 above.

54 See Chapter 14.12.2 of the Report of the Special Investigation Commission.

55 ISK 538 billion were invested in non-UCITS at the end of 2007 and the management companies affiliated to the three large banks had approximately 90% market share by investment volume (see FME´s report "*Heildarniðurstöður ársreikninga fjármálafyrirtækja og verðbréfa- og fjárfestingasjóða fyrir árið 2007*" published on 9 September 2008, page 7). For comparison, the GDP in Iceland for 2007 and 2008 corresponded to ISK 1308 billion and ISK 1481 billion respectively (in current prices) (see National Accounts 2012:1– Gross Domestic Product 2011, issued on 8 March 2012. By the end of 2007, the domestic deposits amounted to ISK 1218 billion (see 2008 Annual report of Sedlabanki Íslands (Central Bank of Iceland) page 80 published on the website; http://www.sedlabanki.is/?PageID=88).

56 See Section 5.3 of this Decision and Chapter 14.11.2 of the Report of the Special Investigation Commission.

Therefore, when the banks collapsed the value of bonds issued by the banks and the owners immediately became of highly uncertain value. The risk of considerable losses of savings for people and institutions representing all levels of the Icelandic economy was therefore imminent.

(169) The Authority considers these dramatic events and the legislative amendments that were introduced to protect savings to also be of relevance for the state aid assessment in the case at hand. It considers the state intervention in the non-UCITS funds to form part of the objective to safeguard the financial system in Iceland. In the Authority's view the measures should therefore be seen in conjunction with other measures introduced to protect depositors. These measures were considered crucial in order to restore confidence in the financial sector and to limit the damaging consequences of the collapse for the real economy.

(170) Regrettably, the Icelandic authorities have not provided any information or put forward any compatibility arguments which may justify the measures under assessment. Instead they have consistently argued that the measures were not imputable to the state and that the new banks acted as market investors in their efforts to rebuild the banks. As described above in Section 7, several of the banks/third parties have however submitted compatibility arguments in case the Authority should consider the measures as state aid. They argue that the measures should be seen as necessary and proportionate in order to safeguard financial stability.

(171) For the reasons explained above, the Authority considers that the arguments of the Icelandic authorities concerning non-imputability and market economy investor principle are unfounded. The arguments appear, however, somewhat consistent with the assessments made by the Icelandic authorities in the early stages of the crisis where indeed a number of measures were not notified with reference to that the Icelandic state had been acting as a private market investor.

(172) The Authority considers, despite the absence of compelling arguments thereto from the Icelandic authorities, that the measures in the present case should be considered under Article 61(3)(b) of the EEA Agreement. Under that provision state aid *"to remedy a serious disturbance in the economy of an EC Member State or an EFTA State"* may be considered compatible. As is stated in paragraph 8 of the Banking Guidelines[57], the Authority reaffirms that, Article 61(3)(b) of the EEA Agreement necessitates a restrictive interpretation of what can be considered a serious disturbance of an EFTA State's economy.

(173) As mentioned above, Iceland's financial system entered into a state of systemic crisis in October 2008; and the various state measures taken were intended to remedy a serious disturbance in the Icelandic economy. Consequently, given the circumstances under which the measures under assessment in this decision were adopted, the Authority considers that Article 61(3)(b) of the EEA Agreement is applicable. In the following, it will assess whether the criteria to consider the aid compatible are satisfied.

57 See Part VIII of the Authority's State Aid Guidelines. Temporary rules regarding financial crisis. The application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, available at http://www.eftasurv.int/?1=1&showLinkID=16604&1=1

(174) The Authority has issued guidelines explaining the criteria it will apply in the assessment of certain state interventions in the real economy as well as in the financial sector regarding the financial crisis. None of the guidelines issued by the Authority interpreting Article 61(3)(b) of the EEA Agreement are directly applicable to the case at hand. The Guidelines on the application of state aid rules to measures taken in relation to financial institutions (mainly guarantees and capital injections) cover direct interventions to save financial institutions. The applicable criteria were further designed in the Recapitalisation Guidelines. The Authority issued guidelines on the treatment of impaired assets in the EEA banking sector to address asset relief as a measure of intervention at the banks to safeguard financial stability and underpin bank lending with the ultimate objective of protecting the customers of the banks. In that regard the measures in the present case share the same objective as asset relief measures subject to the Authority's guidelines. The aid under assessment was, however, granted directly to the customers and not on the level of the bank as such. This means *inter alia* that the impact on competition is less severe in the case at hand, as will be explained in more detail below.

(175) Although the transactions under assessment do not correspond to any of the situations for which the Authority has already issued guidelines, the guidelines are not an exhaustive instrument for the assessment of the compatibility of a measure with the state aid rules of the EEA Agreement. [58] Rather, they contain general principles that the Authority applies when assessing the compatibility of state aid with the EEA Agreement in the case of serious disturbance of the economy of an EFTA State.

(176) In line with the general principles underlying the state aid rules of the EEA Agreement, which require that the aid granted does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimized as far as possible, and taking due account of the circumstances surrounding the financial crisis, all general support measures have to be:[59]

- necessary and well-targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy,
- proportionate to the challenge faced, not going beyond what is required to attain the legitimate aim, and
- designed in such a way as to minimise negative spill over effects on competitors, other sectors and other EEA States.

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58 Another set of rules issued by the Authority regarding the assessment of measures adopted by EU or EFTA States concerned the intervention in undertakings active in areas of the economy other than the financial sector and limited the amount of aid to 500.000 €. The aim of these guidelines was to facilitating companies' access to finance and at the same time encouraging companies to continue investing during these exceptional circumstances. The last set of rules, Guidelines regarding the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the state aid rules concern the rescuing and restructuring of financial undertakings.

59 See Part VIII of the Authority's State Aid Guidelines: The application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis – Corresponds to the Communication from the Commission: The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270 of 25.10.2008, p. 8.

1.1.1 *Necessary and well-targeted measures*

(177) As mentioned above, the non-UCITS funds had to a large extent invested in bonds issued by the failed banks and their owners. The investment strategies of the management companies entailed that the value of the assets was highly uncertain. This is illustrated by the independent value assessments referred to above from October 2008 as well as the valuation made for the purposes of the banks' accounts.

(178) The fact that a significant number of investors in all sectors of the Icelandic economy, including some of the pension funds, would suffer considerable losses and have their investments tied up in lengthy winding-up procedures would have had additional negative implications for the real economy.

(179) The State had adopted various other measures to prevent the collapse of the financial sector in Iceland from damaging the wider Icelandic economy. Examples of the measures adopted by the Icelandic authorities to prevent a total collapse and to restore confidence in the financial sector are mentioned above. [60] On that basis, the Authority can accept that the intervention in the non-UCITS funds was necessary as well.

(180) The fact that the FME had recommended that such funds be liquidated and that the assets should be sold over longer time period does not alter this assessment. Ultimately, the aim was the same namely to avoid massive losses for the investors. Facilitating the prudent liquidation of these specific investment funds was thus pursuing the legitimate interest of stabilizing the financial sector and thus remedying a serious disturbance in the economy of Iceland. The Authority also considers that the measures were necessary to achieve the objective of re-establishing and rebuilding confidence of individual investors in the system.

(181) Whether the measures were well targeted to the objective pursued needs to be assessed in light of the difficult situation in Iceland in October 2008. Although the ultimate objective of the interventions was to protect the many investors in the non-UCITS funds, the State only purchased the assets of three funds at issue and not of all funds subject to the FME's winding up recommendation.

(182) The Authority nevertheless considers that under the circumstances existing in October 2008 the intervention seems reasonable. The State made use of the three banks it owned which had the biggest share in the market of investment funds to intervene in the economy targeting the highest number of investors with the smallest number of transactions. Moreover, the measures aimed to compensate the investors and not the management companies as such, and therefore also appear to be well-targeted. It is also reasonable to assume that the state at the time hoped that the real value of the assets would correspond to the purchase price and therefore that the losses measured over time would be limited. On that basis it may be that the Icelandic authorities considered that also other banks, that at the time were not in state ownership, could carry out similar transactions to protect their investors from additional losses and lengthy winding-up procedures.

(183) For these reasons, the Authority considers that the purchase by the three main Icelandic banks of the assets of funds managed by their subsidiary companies constituted a

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60 See, inter alia ,Authority Decision No 244/12/COL of 27 June 2012 on restructuring aid to Islandsbanki.

necessary and well targeted measure to stabilise the confidence in the banking system in Iceland and avoid additional negative consequences for the real economy.

1.1.2 Proportionality

(184) The proportionality of the measure must be viewed in the light of the urgency of the situation. In the Authority's view, the State had to intervene quickly to create calm and restore the confidence in the system.

(185) It appears to the Authority near impossible at the time to establish the long term value of the assets since these mainly were bonds issued by the failed banks and their owners. Independent value assessors were nevertheless engaged to appraise the value of the assets. These assessments provided a range of the likely long term recovery value of the assets. Thus the authorities attempted to limit the amount of expenditure beyond the future realisable value of the assets.

(186) As mentioned above, the Authority considers that a prudent investor would not have acquired the assets at that time on the basis of such uncertain assessments. Nevertheless, the Authority acknowledges that these assessments were the best available information at the time. Thus, the situation for a prudent investor and for the Icelandic state was not comparable since the state had to act swiftly to avoid a serious disturbance in the national economy.

(187) The price established for the purchase of the assets corresponds to approximately the average between the best and the worst case scenario assessments of the likely recovery value, largely from between 48% and 78% of the last recorded values. The purchase price was finally decided to an amount corresponding to values between 54% to 70% of the last recorded values (with the exception of the banks bonds that were acquired for 30% of their value). This meant that the investors had to take considerable losses on their investments (in the range between 46% to 30% of their investments placed in assets). This clearly amounted to a burden sharing between the investors, who lost a significant amount of their savings, and the State.

(188) Therefore, Authority considers that the aid measures were proportionate given that they were limited to the minimum necessary to achieve the objective of protecting the investors from lengthy winding-up procedures and possibly even bigger losses on their investments.

1.1.3 Negative spill-over effects

(189) While the exceptional circumstances that prevailed at the moment of the intervention have to be duly taken into account, such measures must not generate unnecessary distortions of competitions or negative spill over effects on other EEA States.

(190) The measures under assessment allowed for quick redemption of the unit share certificates and, secondly, to prevent that the investors would suffer even higher losses in the long term. However, the management companies enjoyed also indirect advantages[61]

61 There were no additional state resources transferred to the management companies which would necessitate a separate compatibility assessment. If additional resources had been channelled to the management companies, the Authority would most likely have concluded that the measure would not be compatible due to the effects on the competitors.

in terms of customer goodwill since the measures prevented lengthy winding up procedures and possibly bigger losses for the investors.

(191) With regard to the direct beneficiaries, the investors, the negative spill-over effects appear to be limited and spread out evenly over all sectors of the economy. The measures provided the investors with liquidity that otherwise would have been tied up in the investment funds. While this liquidity provided certain competitive advantages vis-à-vis their various competitors in the various sectors, the investors also had to take considerable losses on their investments.

(192) As regards the negative spill-over effects for competitors on the market for asset management the situation in Iceland is quite unique. The competitive effect of certain state aid measures cannot be assessed in isolation. In Iceland, there was, as mentioned, a systemic collapse. State aid measures have been implemented in favour of almost all banks and financial institutions. Thus, even though there were other privately owned banks at the time that had to finance similar transactions without state aid they, in most cases, later were taken over by the FME under the Emergency Act or were otherwise subject to public intervention. These banks have later received rescue and restructuring aid in various forms. As for the negative effects on other market players, they must be assessed in light of the extremely difficult conditions which existed in Iceland in October 2008 when the transactions were carried out. Taking into account these circumstances, the Authority considers that although other investors and financial undertakings were affected, the spill over effects of the measures were limited considering the proportion of funds managed by the subsidiaries of the three main Icelandic banks and the broad variety of sectors in which the beneficiaries were active.

(193) It is therefore the Authority's conclusion that the negative spill over effects did not exceed what inherently would follow from state aid measures to remedy a serious disturbance in the economy.

1.1.4 Conclusion on the compatibility assessment

(194) For these reasons the Authority concludes that the aid granted to investors with the purchase of the assets of investment funds managed by the subsidiary companies of the three banks is compatible with the EEA Agreement on the basis of Article 61(3)(b).

2 Conclusion

(195) The Authority concludes that the Icelandic authorities have granted state aid with the acquisition by New Glitnir, New Kaupthing and New Landsbankinn of the assets in certain investment funds managed by their subsidiary companies in breach of Article 1(3) of Part I to Protocol 3.

(196) For the reasons set out above, the Authority considers the aid to be compatible with the functioning of the EEA Agreement on the basis of Article 61(3)(b).

HAS ADOPTED THIS DECISION:

Article 1

The acquisition by New Glitnir, New Kaupthing and New Landsbankinn of the assets of certain investment funds managed by their subsidiary companies constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

Article 2

The Authority finds the aid given to investors in the funds under assessment to the extent they were undertakings to be compatible with the EEA Agreement on the basis of Article 61(3)(b) of the EEA Agreement.

Article 3

This Decision is addressed to Iceland.

Article 4

Only the English language version of this decision is authentic.

Decision made in Brussels, on 11 July 2012

For the EFTA Surveillance Authority

Oda Helen Sletnes
President

Sverrir Haukur Gunnlaugsson
College Member