PROCEDURES RELATING TO THE IMPLEMENTATION OF COMPETITION POLICY

EUROPEAN COMMISSION

STATE AID — THE NETHERLANDS

(Articles 107 to 109 of the Treaty on the Functioning of the European Union)

State aid MC 10/09 — GHT1 hybrids call of ING

(Text with EEA relevance)

(2011/C 49/12)

The Commission notified the Netherlands by letter of 29 November 2010 of its *sui generis* decision regarding the aid MC 10/09.

TEXT OF LETTER

'I. **PROCEDURE**

(1) By decision of 18 November 2009, the Commission approved a capital injection of EUR 10 billion of capital (CT1 securities), additional aid of approximately EUR 2 billion resulting from the amendment of the repayment conditions for those securities, an impaired asset protection applied to a portfolio with an outstanding balance of about EUR 30 billion and liquidity guarantees in favour of ING in case C 10/09 (hereinafter referred to as the "ING Decision" or "the decision of 18 November 2009") (1).

(2) The third indent of recital 88 of the ING Decision records the following commitment of the Netherlands regarding the calling of Tier 1 and Tier 2 securities: "The calling of Tier 2 capital and Tier 1 hybrids will in the future be proposed case by case to the Commission for authorisation, for the shorter period of three years starting from the date of the present Decision or up to the date on which ING has fully repaid the Core-Tier 1 securities to the Netherlands (including the relevant accrued interest on Core-Tier 1 coupons and exit premium fees).".

(3) On 16 October 2010, the Netherlands transferred to the Commission a letter from ING requesting the authorisation of a call of a number of hybrid instruments, with a first calling date for a USD 1,5 billion 8,439 % Group Hybrid Tier 1 Instrument (hereinafter the "GHT1") on 31 December 2010.

(4) On 27 October 2010, the Commission indicated to the Netherlands that, on the basis of the ING Decision, at this stage it would see no reasons for authorising a call of the GHT1. The Commission requested the Netherlands to provide an updated schedule for the repayment of the CT1 securities.

(5) On 5 November 2010, the Dutch authorities transmitted a second letter from ING requesting a Commission Decision on its request to authorise the calling of the GHT1.

(6) On 9 November 2010, the Commission sent a reminder to the Netherlands as regards the CT1 repayment schedule. No official schedule has to date been provided.

(7) On 16 November 2010, the Netherlands requested a formal authorisation by the Commission. On 18 November 2010, the Netherlands informed the Commission via e-mail that they endorse the request by ING for authorisation of a call of the GHT1.

(8) The Netherlands informed the Commission that for reasons of urgency they exceptionally accept that this Decision as regards the GHT1 hybrid call is adopted in the English language.

II. **FACTS**

1. **Description of ING**

(9) ING is composed of ING Groep N.V. (hereinafter "ING"), the mother holding company that controls 100 % of ING Bank N.V., ING Verzekeringen N.V., and two sub-holding companies controlling banking and insurance subsidiaries respectively. As of the end of 2009, the group balance sheet totalled EUR 1,164 billion.

(1) OJ L 274, 19.10.2010, p. 139.

(10) In order inter alia to restore its long-term viability, ING had received the measures specified in point (1). Those measures were approved by the Commission in the ING Decision subject to several commitments made by the Dutch State. Those commitments included that ING will divest the entire ING Verzekeringen N.V. at the latest by the end of 2013 (recital 82) and that ING will abide by certain behavioural safeguards including seeking an authorisation from the Commission prior to calling hybrid capital instruments (third indent of recital 88). Those behavioural safeguards remain in effect for three years or until ING has repaid the CT1 securities, whichever is earlier.

(11) Recital 76 of the ING Decision describes the repayment schedule of the CT1 securities in the base case according to the financial projections of the approved restructuring plan. ING has subsequently made public statements which put those plans in doubt (1).

2. **Description of the GHT1**

(12) In December 2000, ING Holding issued the GHT1 amounting to USD 1,5 billion with a first call date on 31 December 2010. After that date a call is possible every quarter. The instrument bears a semi-annual coupon of 8,439 % p.a. After the first call date the coupon will change into a quarterly coupon of 3 month-Libor (2) plus 3,6 % p.a. In order to call the instrument ING has to announce a call 30 to 60 days before the call date.

(13) The GHT1 issued by ING Holding was placed at the level of ING Insurance (INGV) through a corresponding Tier 1 instrument. No voting right is attached to the GHT1.

(14) When ING first approached the Commission to discuss the hybrids calling on 22 July 2010, the GHT1 was trading at around 85 % of par. However as the call date approached, and the market expected the instrument to be called, the price went up to close to 100 %.

3. **Position of the Netherlands**

(15) In the e-mail of 18 November 2010, the Netherlands justified its notification by reference to the expressed intentions of ING, according to which “ING is at this moment well positioned to pay back a first tranche of the core tier 1 in cash soon”. The timing of that pay back announcement was however left unspecified.

(16) In support of the call, the Netherlands explained that any desire to see burden-sharing by the GHT1 investors, under which they would accept a price substantially below par, would be no longer realistic given the current market price of 96-98 cents on the dollar, with the consequence that a buy back tender offer would no longer be economically feasible. The cash call back would therefore be the only option available for ING for removing the hybrid from its book.

(17) Not calling would also send a negative signal to the market and failure to call would suggest that ING is (irrespective of the reason) not able to efficiently manage its capital in accordance to market customs and expectations, rendering it more difficult for ING to issue such instruments in the future. In that respect it is also argued that not calling would raise ING’s financing costs and reduce its profits and thus the funds available to redeem the CT1 securities.

(18) The GHT1 in question has an upcoming first call date on 31 December 2010 with a step-up to Libor plus 3,6 % instead of the current interest rate of 8,439 %. Although this would result in a lower interest payment on the GHT1 due to the current low Libor rates, ING claims that it has swapped the fixed coupon of 8,439 % to Libor plus 2 %, a level below that which will be payable on the coupon after the step-up. In addition, it is argued that Libor rates are floating and therefore uncertain. In consequence, it is argued that the relevant measure would be how the market assesses that cost via the swap curve and this premium will increase by 156 bps.

(19) While the proposed Basel III changes would limit the value of the GHT1 for capital purposes, the GHT1 would no longer be eligible for Tier 1 treatment under the revised CEBS Tier 1 guidelines which are to be implemented and applied by national regulators by 31 December 2010. It is submitted that the existing structure could be grandfathered, but the expectation is that any such grandfathering would be permissible only until 1 January 2013. Effectively, therefore, that prospect would make the GHT1 already redundant from a capital perspective as it is not providing a capital buffer on a going concern basis.

(20) In addition, not calling the hybrid would imply continued linkage between the Holding/Group or bank and INGV through ongoing interest payments on the current intergroup instrument. Such ongoing links would hinder the divestiture of the Insurance part of ING. It is argued that a divestment of INGV would result in excess Hybrid Tier 1 capital at the level of the Group/Holding.

(1) In ING’s investor day presentation by its CEO Jan Hommen: “Shaping our Future — Strategic priorities 2010” from 19 April 2010, page 20 states: “Currently no incentive for early repayment until appeal of EC decision is addressed”. http://www.ing.com/group/showdoc.jsp?docid=445250_EN&htmlid=445263_EN&menopt=ivr|qtr|irs&lang=en&menopt=ivr|qtr|irs&lang=EN

(2) 22 November 2010 USD 3 month-Libor was 0,284 %.

III. **ASSESSMENT**

(21) Regarding the legal basis for the present decision, it should be noted that the question of authorising calling the GHT1 arises in the context of the implementation of the ING Decision. As a result of the commitments made by the Dutch State, the ING Decision does not allow the calling of hybrid capital instruments unless authorised by the Commission (*ex ante* prohibition of calls). Therefore, that decision does not exclude the authorisation of a call at a later stage should new facts or arguments supporting such a call be presented. This decision will thus specify the implementation of the ING Decision.

(22) The present monitoring decision is a decision *sui generis*. Although it is not foreseen in Regulation (EC) No 659/1999, recital 88 of the decision of 18 November 2009 lays down an authorisation procedure under which the Member State may request the Commission to permit ING to call hybrid instruments. Since the Netherlands has presented such a request, the Commission must assess whether the proposed call should be permitted.

(23) Regarding the scope of the assessment, any calling of hybrids has to be assessed in the light of the principles set out in the Restructuring Communication ([1]), which requires in point 22 that aid should be limited to the minimum necessary and the bank and its capital holders should contribute to the restructuring as much as possible with their own resources. Such burden-sharing is necessary for ensuring that rescued banks bear adequate responsibility for the consequences of their past behaviour and to create appropriate incentives for their future behaviour, thereby avoiding moral hazard.

(24) The Commission notes that the exercise of call-options of Tier 1 and Tier 2 capital instruments implies an outflow of capital from the bank in favour of hybrid capital holders and protects the latter from their exposure to the inherent risk of their investment. Such an outcome might be problematic prior to the repayment of State aid and is a matter where burden-sharing has to be assessed. ([2]) Therefore the prohibition on banks repurchasing their own shares mentioned in point 26 of the Restructuring Communication must be understood as referring to all capital instruments of banks including Tier 1 and Tier 2 capital instruments as long as those capital instruments do not satisfy the broader burden-sharing requirement.

(25) That conclusion is the basis for prohibiting calls in principle, subject to the possibility of authorisation, as set out in recital 88 of the ING Decision and is reaffirmed in the ING Decision at recital 138 where the Commission considered the unauthorised calling of a capital instrument made before the adoption of the ING Decision was as aggravating factor when it analysed the scope of measures limiting distortions of the competition. That approach is also in line with the established Commission practice as to temporary calling bans on capital instruments — as long as calling those instruments is not legally required — which has been followed in the cases of Bank of Ireland, Lloyds, RBS and ABN Amro/Fortis ([3]).

(26) On the basis of the information provided the Commission sees no grounds to depart from its assessment in the ING Decision and to authorise a call of the GHT1. For the reasons set out below, the Commission considers that the proposed call neither ensures burden-sharing nor ensures that sufficient incentives for ING remain in place for repaying the CT1 securities.

(27) First, the Commission notes that ING plans to call the GHT1 at par, thus implying no burden-sharing on the part of the hybrid investors. That assessment is also shared in the submission presented by the Dutch State to the Commission on 5 November 2010, when any desire for burden sharing is called no longer realistic given the current market price of the instruments. The Commission notes in that respect, however, that the fact that the instruments trade very close to par (i.e. 100 %) is due to a market expectation that the instruments would be called, i.e. bought back at 100 % on 31 December 2010. Therefore the current market price of the GHT1 does not reflect the intrinsic value of the capital instrument.

(28) The Commission's view on burden-sharing is not called into question by the argument that failure to call the GHT1 would send a negative signal to the market. The Commission notes in this respect that the market is aware of the concept of burden-sharing required under EU State aid rules. That concept has been discussed by ratings agencies ([4]) and a rational investor should therefore be capable of differentiating between not calling an instrument because of inherent weakness of the financial institution and not doing so because the Commission has not authorised such a call so as to ensure burden-sharing. Therefore, the Commission does not accept that not calling the GHT1 for those reasons would result in any significant longer-term funding cost rise for ING.

([1]) OJ C 195, 19.8.2009, p. 9.

([2]) In that regard, see the Commission press release of 8 October 2009 on Tier 1 and Tier 2 capital transactions for banks subject to a restructuring aid investigation. http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/441

([3]) Commission Decision of 15 July 2010 *Bank of Ireland* (not yet published), point 133; Commission Decision of 18 November 2009 *Lloyds Banking Group* (OJ C 46, 24.2.2010, p. 2), point 112; Commission Decision of 14 December 2009 *RBS* (OJ C 119, 7.5.2010, p. 1), point 104. Pending the adoption of a final decision, the Commission has not authorised a number of proposed hybrid capital calls in the case of ABN/Amro Fortis via service letters and e-mails.

([4]) See for instance: FitchRatings Europe Special Report: Burden sharing and bank hybrid capital within the EU, 20 August 2009.

(29) In addition to that, the magnitude of the alleged increase in funding costs is not such as to affect the financial situation of ING and its capacity to repay the State. Further an increased capital base could in fact lower ING's overall financing costs, as it could — *ceteris paribus* — enhance the perceived credit worthiness of the company.

(30) The argument that investors would see ING as not being capable of managing its capital, if the GHT1 instrument would not be called is unconvincing since other large financial groups such as Deutsche Bank in December 2008 or the smaller bank Credito Valtellinese in April 2008, have in the past decided not to call a hybrid without raising such concerns.

(31) Third, the Commission has not been provided with sufficient evidence that the calling of GHT1 does not affect the repayment schedule of the CT1 securities. The Commission notes in that regard that its requests for further information about that schedule (see points (4) and (6)) have not been sufficiently answered. The Commission has not received a reply from the Dutch authorities themselves and the intention to repay expressed to the Netherlands by ING (see point 15) is not detailed and remains vague.

(32) The need for ING to request authorisation for calling hybrid capital instruments is a key incentive for it to repay the CT1 securities as rapidly as possible and thus ensures that the aid is limited to the minimum necessary. If ING were allowed to call its hybrids one-by-one (as indicated in point 3), its incentives for repaying the State would progressively and significantly diminish. That factor is particularly relevant given that the Commission has become unsure — following public comments from the CEO of ING — whether the planned repayment schedule for the State capital set out in the restructuring plan will be followed by ING and the information requests sent by the Commission on this issue have not yet been answered.

(33) Furthermore, the Commission does not see how the remaining arguments in favour of allowing the GHT1 to be called alter the above conclusion. First, as regards the coupon step up, the Commission notes that in absolute terms the coupon will decrease given the current levels of Libor. It is unconvinced by the arguments that the coupon decrease is irrelevant in light of ING's existing interest rate hedging arrangements, since those arrangements pertain to ING's asset liability management decisions and do not affect the assessment of the burden-sharing by private hybrid capital holders of ING. Moreover, the existence of the swap arrangement, either terminated or continued, is irrelevant to the assessment of the opportunity costs for ING of a call in the current market environment.

(34) Second, as regards the regulatory changes affecting the GHT1 the Commission acknowledges the point made by the Netherlands that the instrument will cease to be relevant from a regulatory capital perspective by 1 January 2013 at the latest. However, as the requirement flowing from the Dutch State's commitment that the Commission's authorisation is necessary prior to any hybrid call will expire at that latest within three years from the adoption of the ING Decision, ING will be free to call the instrument before that date.

(35) In respect of the introduction of new CEBS guidelines by the Dutch regulator, the Commission first notes that it is not clear at this stage whether the GHT1 will qualify for grandfathering. Further the Commission notes that the date of the implementation of the new guidelines is not certain. The Commission considers that given the uncertainties about the impact of a future regulation to be introduced, there is currently no ground to consider that the instrument must be treated as redundant.

(36) While the Commission sees merit in the argument that not calling the GHT1 could make it more difficult for ING to issue such an instrument in the future, it considers that the usefulness of issuing such instruments will decrease in view of regulatory changes which end the recognition of the instrument as Tier 1 over the coming years. Hence, it cannot accept that argument as a justification for authorising the proposed call.

(37) It is further argued that a failure to call will result in excess capital at the level of the Group/Holding once the insurance part of ING is divested [1]. Here, the Commission notes that such a divestment has not taken place so far.

(38) Finally, the Commission is unconvinced by the argument that the hybrid will constitute, if not called, a "continued linkage" between the insurance part of ING, which is to be divested, and the ING Group and that this linkage would hinder the divestment of ING Insurance. The Commission notes that no voting rights are attached to the hybrids. Therefore, ING Group cannot exercise any influence on ING Insurance through holding the hybrids. The Commission therefore does not consider that the uncalled GHT1 would constitute any such linkage.

(1) However, even if insurance were divested and there were excess capital, at present the Commission is unconvinced that it should authorise the call because more rather than less capital would tend to reinforce the resilience of the Group, even in the present case where the capital is only usable on a gone concern basis by reassuring senior creditors as regards their claims in such a gone scenario.

IV. **CONCLUSION**

(39) For the reasons set out above, the Commission finds no grounds to depart from its previous assessment in the decision of 18 November 2009, and therefore does not authorise a call of the GHT1 hybrid under the presented conditions.

V. **DECISION**

The call of the GHT1 hybrid for the end of the year 2010 is not authorised.’