

## III

(Other acts)

## EUROPEAN ECONOMIC AREA

## EFTA SURVEILLANCE AUTHORITY DECISION

No 305/13/COL

of 10 July 2013

on the recapitalisation of Sjóvá Insurance Company (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(3)(b) and Protocol 26,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ('the Surveillance and Court Agreement'), in particular to Article 24,

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

Whereas:

## I. FACTS

## 1. PROCEDURE

- (1) The Authority became aware of the Icelandic state's intervention in the insurance company Sjóvá-Almennar tryggingar hf. (Sjóvá) in the summer of 2009 through the Icelandic media. Subsequently, the Authority included this case in the agenda of an annual meeting on pending cases in the field of state aid between the Authority and the Icelandic authorities that was held in Reykjavik on 5 November 2009. At this meeting, the Icelandic authorities provided brief information concerning the background and history of the case. At the same meeting, due to the complexity of the intervention and the circumstances surrounding it, the Authority asked the Icelandic authorities to provide detailed written information.
- (2) On 7 June 2010, the Authority received a complaint (Event No 559496) against alleged state aid granted when the Icelandic state intervened in Sjóvá.
- (3) After having sent written requests for information and adopted an information injunction decision requesting information on the state intervention in Sjóvá, as well as subsequent correspondence, by letter dated 22 September 2010 the Authority informed the Icelandic authorities that it had decided to initiate the procedure laid down in Article 1(2) of Part I of Protocol 3 in respect of the recapitalisation of Sjóvá.
- (4) The Authority's Decision No 373/10/COL to initiate the formal investigation procedure (Opening Decision) of 22 September 2010 was published in the *Official Journal of the European Union* and the EEA Supplement thereto <sup>(1)</sup>. The Authority called on interested parties to submit their comments thereon.

<sup>(1)</sup> Decision No 373/10/COL of 22 September 2010 on State aid issues concerning the recapitalisation of Sjóvá insurance company in Iceland, OJ C 341, 16.12.2010, p. 15 and EEA Supplement to the Official Journal No 69, 16.12.2010, p. 2.

- (5) The Icelandic authorities, Sjóvá and Íslandsbanki submitted comments by letter dated 14 January 2011 (Event No 583507). The Authority also received comments from two competitors of Sjóvá. By letter dated 31 January 2011 (Event No 584930) the Authority forwarded these comments to the Icelandic authorities, which were given the opportunity to respond. The response was received by letter dated 25 February 2011 (Event No 588606).
- (6) On 3 October 2011, the Icelandic authorities submitted a first restructuring plan for Sjóvá (Event No 610472), which was updated on 13 April 2012 (Event No 631003) and 28 May 2013 (Event No 673746), as well as supplementary information on 6 March 2013 (Event No 665021). Additional commitment proposals were received on 25 June 2012 (Event No 641330), 4 October 2012 (Event No 648708), 3 May 2013 (Event No 671655), 28 May 2013 (Event No 673746) and 2 July 2013 (Event No 677440).

## 2. DESCRIPTION OF THE CASE

### 2.1. Background

- (7) In 2005, the financial group Moderna/Milestone Finance (Milestone) <sup>(1)</sup> bought 66,6 % of Sjóvá's shares from Glitnir and acquired full ownership as from 2006. In the following, Milestone decided in particular to change the focus of Sjóvá's investments towards highly leveraged foreign real estate projects, and enabled assets swaps and unsecured loans to shareholders to the detriment of Sjóvá's financial situation. According to a report <sup>(2)</sup> by the Icelandic Financial Supervisory Authority (FME), these investments led to major financial difficulties, and did not comply with the prescriptions of Article 34(2) of Act on Insurance Activities No 60/1994.
- (8) From October 2008 to September 2009, Sjóvá was subjected to special supervision by the FME under Article 90 of the Act on Insurance Activities No 60/1994. From thereon, Sjóvá's creditors started managing the company, culminating in Glitnir — its biggest creditor — taking it over in March 2009. Glitnir also acquired control over Askar Capital, an Icelandic investment bank formerly controlled by Milestone, as well as its subsidiary, Avant hf. (Avant), which was active on the car financing market.
- (9) In April 2009, Glitnir and Íslandsbanki, which was also a major creditor of Sjóvá, approached the Icelandic state requesting its assistance in refinancing and restructuring Sjóvá, having exhausted all alternative market solutions to rescue the company.
- (10) On 20 June 2009, Sjóvá on the one hand and Glitnir, Íslandsbanki, and SAT Eignarhaldsfélag hf. (a holding company wholly owned by Glitnir, hereinafter referred to as SAT Holding) on behalf of SA tryggingar hf. on the other hand signed an Asset Transfer Agreement, according to which all assets and liabilities of Sjóvá related to the company's insurance operations, including the insurance portfolio, were transferred to SA tryggingar hf., in accordance with Article 86 of the Act on Insurance Activities No 60/1994. The remaining assets of Sjóvá were placed in SJ Eignarhaldsfélag (SJE), a holding company. SJE would then be wound down in a regular insolvency process.
- (11) Following the transaction the new company, SA tryggingar hf., was renamed Sjóvá. According to its Articles of Association, dated 20 June 2009, the shareholders of the new company (Glitnir, Íslandsbanki and SAT Holding) were to contribute new equity of about ISK 16 billion, required to continue insurance operations, as follows <sup>(3)</sup>:

Company	Amount	Form of payment	Share-holding
Glitnir	ISK 2,8 billion	Bond issued by Avant with interest of REIBOR plus 3,75 % with the following collaterals: — 4 <sup>th</sup> priority (later changed to 3 <sup>rd</sup> priority in parallel with a bond issued by Askar Capital, see below) in Avant's portfolio — 1 <sup>st</sup> priority in Glitnir's claim against Milestone, equivalent of 54,9 % of total claims against Milestone	17,67 %

<sup>(1)</sup> Moderna Finance AB was a Swedish holding company owned by the Icelandic company Milestone hf. Further information on Sjóvá and Milestone and their ties with Glitnir Bank are contained in the report of the Icelandic Parliament's Special Investigation Commission (SIC), available at <http://rna.althingi.is/> (Icelandic version) and <http://sic.althingi.is/> (excerpts in English).

<sup>(2)</sup> Response from the FME regarding the state intervention in the recapitalisation of Sjóvá Almennar tryggingar hf., dated 23 November 2010.

<sup>(3)</sup> Subject to the FME's approval, which was granted on 22 September 2009.

Company	Amount	Form of payment	Share-holding
Íslandsbanki	ISK 1,5 billion	Various bonds issued by 10 different companies and municipalities	9,30 %
SAT Holding	ISK 11,6 billion	Bond issued by Askar Capital and bond issued by Landsvirkjun (the National Power Company) obtained from the Icelandic state (see below)	73,03 %

- (12) On the same date, the shareholders of Sjóvá also made an agreement to sell their shares in the company within 18 months. The proceeds would be used to transfer the assets set forth as share capital back to the shareholders. Accordingly, an open sales process was launched for Sjóvá in the beginning of 2010, with plans to sign a Sales and Purchase Agreement at the end of March 2010. However, the sales efforts ended in November 2010 when the highest bidder withdrew its offer.
- (13) The Authority provided a more detailed description of the events, facts and economic and political developments relating to the collapse and the reconstruction of Sjóvá in the Opening Decision.

### 3. DESCRIPTION OF THE INTERVENTION BY THE STATE

#### 3.1. The beneficiary

- (14) Sjóvá was founded in 1918 and has been a key player in the Icelandic insurance market ever since. It services individuals as well as organisations of all sizes and offers a wide product range through a large service network around the country. Sjóvá is one of the three leading insurance companies in Iceland providing its customers with the full range of both non-life and life products.
- (15) Sjóvá has defined six product classes: property, motor, accident & sickness, marine, aviation & cargo, liability and life. However, the company focuses on providing comprehensive insurance services instead of product-specific services.
- (16) Sjóvá owns one subsidiary, Sjóvá Life. According to Art. 12 of the Act on Insurance Activities No 56/2010, life insurance business cannot be run in the same company as non-life primary insurance operations. Although Sjóvá Life is a separate legal entity from Sjóvá, with separate accounting and balance sheet, Sjóvá Life purchases through an agreement with Sjóvá all day-to-day operations and access to IT systems and support. Sjóvá Life products are integrated into Sjóvá's product range.
- (17) As set out above, Sjóvá is active both on the Icelandic non-life and life insurance markets. In the non-life insurance segment, Sjóvá has a market share of around 28 %, whilst its main competitors have the following approximate market shares: Vátryggingafélag Íslands hf. (VIS) 35 %, Tryggingamiðstöðin hf. (TM) 26 % and Vörður tryggingar hf. 11 %. In the life insurance segment, the approximate market shares are as follows: Sjóvá Life 35 %, Okkar (Arion Bank) 27 %, LÍS (part of VIS) 24 %, LM (part of TM) 10 % and Vörður Lif 4 % <sup>(1)</sup>.

#### 3.2. The recapitalisation of Sjóvá

- (18) The Icelandic state undertook two measures to recapitalise Sjóvá: it contributed directly to the initial recapitalisation of Sjóvá in 2009 by transferring two bonds to SAT Holding (see paragraphs 19 to 22 below) and contributed a further ISK 683 to 739 million to the stabilisation of Sjóvá in 2010 (see paragraphs 24 and 29 to 31 below).
- (19) The state aid for the initial recapitalisation of Sjóvá was put in place by way of an agreement dated 8 July 2009 on the transfer of bonds <sup>(2)</sup> ('Samningur um kröfukaup') owned by the Icelandic state to SAT Holding.

<sup>(1)</sup> The market share estimates are based on share of total premium income in 2012. Prior to the financial crisis, Sjóvá had a market share of over 40 % in the non-life insurance segment.

<sup>(2)</sup> For the purpose of this decision, the assets transferred to SAT Holding by the state will be referred to as bonds.

- (20) At this point, Sjóvá's equity was ISK 13,5 billion in the negative. A minimum positive equity of ISK 2 billion was required according to law. In order to fulfil the minimum equity requirements, a capital injection of at least ISK 15,5 billion was therefore required.
- (21) The agreement between the state and SAT Holding covers the following two bonds that were in the possession of the state, valued by an external expert on 16 June 2009:

Asset	Estimated value	Description and securities
Claim against Askar Capital	ISK 6 071 443 539	An indexed loan agreement with 3 % interest. The loan had come into the possession of the state when it took over Central Bank collateral in 2008. The loan is secured by: <ul style="list-style-type: none"> <li>— 3<sup>rd</sup> priority collateral in Avant's portfolio (in parallel with a bond issued by Avant to Glitnir, book value of the portfolio was ISK 26 billion and Landsbanki Íslands' 1<sup>st</sup> priority lien of ISK 16 billion), and</li> <li>— 1<sup>st</sup> priority collateral in indexed bonds issued by Landsvirkjun (the National Power Company) of nominal value ISK 4,7 billion.</li> </ul>
Bond issued by Landsvirkjun (the National Power Company)	ISK 5 558 479 575	Issued in 2005 payable in 2020, with state guarantee, indexed and 3 % interest. The bond came into the possession of the state as collateral against lending made by the Central Bank to Landsbanki Íslands.

- (22) The purchase price was ISK 11,6 billion and SAT Holding was to pay for the bonds within 18 months, i.e. before year-end 2010, without any interest being charged during that period. As a security for the payment of the purchase price of the bonds, the state was granted 1<sup>st</sup> priority collateral in SAT Holding's shares in Sjóvá.
- (23) The agreement provided for the option of payment by the delivery of SAT Holding's original 73,03 % shareholding in Sjóvá to the state, which would be considered payment in full. SAT Holding could exercise this option without prior consent of the state.
- (24) Besides, prior to the creation of SA tryggingar hf. (later named Sjóvá) on 20 June 2009, the Icelandic state accepted to upgrade Glitnir's security in the bond issued by Avant from 4<sup>th</sup> to 3<sup>rd</sup> priority, in line with the priority of the collateral in Avant's portfolio held by the state itself. This was considered necessary for the FME to accept Glitnir's contribution to Sjóvá's equity. In exchange, Glitnir ceded 12,5 % of its claims against SJE, which held the former investment portfolio of Sjóvá, to the Icelandic state.

### 3.2.1. Glitnir sells its shares in Sjóvá to its subsidiary SAT Holding

- (25) The FME considered that Glitnir, in moratorium and undergoing winding-up proceedings, was not eligible to own a qualifying holding in Sjóvá. Subsequently, on 16 September 2009, Glitnir sold its 17,67 % shareholding in Sjóvá to SAT Holding. Following the above transaction, shareholders in Sjóvá were:

Company	Ownership (%)
Íslandsbanki	9,30
SAT Holding	90,70

- (26) On 22 September 2009, the FME finally issued an insurance operation licence to Sjóvá and lifted the special supervision Sjóvá had been under since October 2008. The portfolio transfer took place on 1 October 2009 <sup>(1)</sup>.

<sup>(1)</sup> At the same time, a public notice was issued by the FME under Articles 86 and 87 of the then-applicable Act on Insurance Activities 60/1994 to all policyholders to remind them that they can cancel their policies, irrespective of the renewal date, within a 30-day 'transfer window'.

### 3.2.2. The state becomes Sjóvá's biggest shareholder through an option exercised by SAT Holding

- (27) At year-end 2009, the management of claims owned by the Ministry of Finance and the Central Bank of Iceland (CBI) was merged, and transferred to a new entity; CBI asset management (ESI). From that time, ESI — which is fully controlled by the Icelandic state — took over the management of the claims against SAT Holding.
- (28) On 3 May 2010, SAT Holding exercised the option to transfer 73,03 % of shares in Sjóvá to the state in lieu of repaying the debt. From that point in time, the shareholders in Sjóvá were:

Company	Ownership (%)
Íslandsbanki	9,30
SAT Holding	17,67
ESI (the state)	73,03

- (29) On 16 June 2010, the Icelandic Supreme Court ruled that loans granted in ISK but linked to a basket of foreign currencies were illegal. This affected the value of the bonds issued by both Avant and Askar Capital that had been used for the recapitalisation of Sjóvá. In order to maintain the capital of Sjóvá, an asset transfer agreement was signed on 28 July 2010 between Sjóvá on the one hand and SAT Holding, ESI and Íslandsbanki on the other hand. This agreement resulted in (i) SAT Holding acquiring the Avant bond for ISK 2,1 billion (the difference to the original valuation of ISK 2,8 billion being covered by Sjóvá) and (ii) ESI transferring the Landsvirkjun bond, which had been used to collateralise the bond issued by Askar Capital, to Sjóvá.
- (30) ESI subsequently acquired the Avant bond from SAT Holding for ISK 880 million. This bond had a nominal value of ISK 2 813 million but was of uncertain value as the bondholders of Avant expected to recover only 5-7 % of the bond's value after the liquidation of Avant. This would correspond to a value of the bond acquired by ESI of between ISK 141 million and ISK 197 million. As a result, ESI contributed a further ISK 683 to 739 million to the stabilisation of Sjóvá.
- (31) In December 2010, Avant's creditors approved a composition agreement with the company. At that point, Avant's portfolio was valued at ca. ISK 13 billion. The 1<sup>st</sup> priority claim on the portfolio amounted to ca. ISK 15 billion. The 3<sup>rd</sup> priority security in the portfolio, which was jointly held by Glitnir and ESI, was therefore worthless.

### 3.2.3. Sale to SF1

- (32) On 18 January 2011, SF1 slhf (SF1), a fund managed by Stefnir hf., agreed to acquire 52,4 % of Sjóvá from ESI for ISK 4,9 billion. Following regulatory approval, the transaction took place on 1 July 2011.
- (33) In addition, SF1 was granted an option to purchase the remaining 20,63 % stake from ESI for ISK 2,4 billion. This option was exercised in July 2012.
- (34) Following that transaction, the shareholding in Sjóvá is as follows:

Company	Ownership (%)
Íslandsbanki	9,30
SAT Holding	17,67
SF1	73,03

- (35) The Icelandic authorities thus managed to sell their holding in Sjóvá for a total amount of ISK 7,3 billion. This compares to an initial value of ISK 11,6 billion of the bonds Iceland used in its contribution to the recapitalisation of Sjóvá.

## 4. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

- (36) In its Opening Decision, the Authority came to the preliminary conclusion that the Icelandic State's participation in the recapitalisation of Sjóvá constitutes aid within the meaning of Article 61(1) of the EEA Agreement. Furthermore, the Authority expressed doubts as to whether these measures comply with Article 61(3) of the EEA Agreement, in conjunction with the requirements laid down in the Authority's financial crisis guidelines.
- (37) In particular, the Authority stated that the Icelandic authorities had not submitted information to demonstrate that the systemic effects that might have resulted from a bankruptcy of Sjóvá could have reached a size constituting 'a serious disturbance in the economy' of Iceland within the meaning of Article 61(3)(b) of the EEA Agreement. It also stated that only limited information had been submitted regarding the operations of Sjóvá, on the causes of the difficulties and on the restructuring itself. This information was insufficient to enable the Authority to assess the measure under Article 61(3)(b) as well as in particular the chapter on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the state aid rules (Restructuring Guidelines) of the Authority's state aid guidelines <sup>(1)</sup>.

## 5. COMMENTS FROM INTERESTED PARTIES

- (38) The Authority received submissions from the following interested parties.

**5.1. Comments from Sjóvá and Íslandsbanki**

- (39) The beneficiary, Sjóvá, as well as Íslandsbanki, one of its shareholders, submitted comments to the Authority.
- (40) Sjóvá's submission provides mainly information on the restructuring measures undertaken by the company's new management as well as financial data on its operations.
- (41) Íslandsbanki argues in its comments that the Icelandic state acted as a market economy investor in participating in the recapitalisation of Sjóvá. If, however, the Authority came to the view that the transaction involved state aid, Íslandsbanki states that the aid should be considered compatible under Article 61(3)(b) of the EEA Agreement. The comments highlight in particular the importance of the measures for the Icelandic financial market, the contribution of private parties (Glitnir and Íslandsbanki) to the recapitalisation and the success of the restructuring of Sjóvá so far.

**5.2. Comments from competitors**

- (42) The Authority also received comments from VIS and TM. Both are Icelandic insurance companies and in direct competition with Sjóvá.
- (43) VIS argues in its comments that the state intervention to enable the recapitalisation of Sjóvá should be considered as state aid. In particular, VIS notes that the market economy investor principle does not apply to the intervention given the economic situation of Sjóvá and more generally in Iceland at the time, as well as due to the terms of the intervention. No private investor would have participated in the recapitalisation under these circumstances. Furthermore, VIS argues that the aid should not be declared compatible. In particular, Article 61(3)(b) of the EEA Agreement is not applicable as the failure of Sjóvá would not have caused a serious disturbance in the Icelandic economy. The aid was therefore not necessary. In any event, VIS argues that the aid does not comply with the Restructuring Guidelines, both due to the absence of a restructuring plan and because of the distortive effect on competition, including the potential for aggressive pricing behaviour by Sjóvá.
- (44) TM notes in its comments that the intervention of the Icelandic authorities in the recapitalisation of Sjóvá did not take place on market terms and therefore should be considered as state aid. Concerning the compatibility of the measure, TM argues that the exceptions in neither Article 61(3)(b) nor Article 61(3)(c) of the EEA Agreement are applicable to the case at hand. In relation to Article 61(3)(b) of the EEA Agreement, TM argues that it needs to be applied restrictively and cannot be used to resolve the problems of a single company. In addition, TM submits that an insurance company should not be considered as systemically relevant, and therefore could be wound-up

<sup>(1)</sup> Available on the Authority's website: <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines>.

safely within the existing regulatory framework. In any event, TM argues that the aid to Sjóvá was neither necessary, well-targeted nor proportionate. It also lacks a restructuring plan that provides for sufficient burden sharing and measures to limit distortions of competition, in particular in relation to Sjóvá's pricing behaviour.

#### 6. COMMENTS FROM THE ICELANDIC AUTHORITIES

- (45) The Icelandic authorities do not contest the preliminary findings of the Authority that the participation of the Icelandic state in the capitalisation of Sjóvá constitutes state aid within the meaning of Article 61(1) of the EEA Agreement. In particular, they do not dispute the preliminary conclusion of the Authority that the market economy investor principle is not applicable. Neither does Iceland contest that the repurchase of the Avant bond by ESI — via SAT Holding — might have involved an element of state aid to Sjóvá.
- (46) The Icelandic authorities argue that the state aid is, however, compatible with the functioning of the EEA Agreement on the basis of Article 61(3)(b) of the EEA Agreement, as the intervention was required to remedy a serious disturbance in the economy of a Contracting Party. They explain the difficult economic situation Iceland was in at the time of the measure. After a severe depreciation of the Icelandic króna starting in September 2008 and the collapse of all three major banks in October 2008, Iceland faced the worst economic crisis in its recent history. The Icelandic government had to take bold steps to preserve the country's financial system from a complete breakdown with unforeseeable consequences for Iceland's society. At the time of the measure, Iceland's financial system was in a state of turmoil and suffered from a general lack of confidence in financial institutions.
- (47) Sjóvá, as one of the three major insurance companies in Iceland, is systematically important for Iceland's financial system. A collapse of Sjóvá would not only have left a large portion of Iceland's population without insurance cover and with a loss of their claims in a situation where Iceland's society already faced severe social hardship. It would also have further undermined the trust in the financial system's institutions and spread the contagion of the financial crisis to the insurance sector. Public trust in Iceland's insurance sector had already severely diminished at the beginning of 2009 since not only Sjóvá but also the owners of the other two major insurance companies were taken over by the creditors of their respective parent companies. Therefore, a failure of Sjóvá most likely would have resulted in the financial market crisis spreading from the banking to the insurance sector.
- (48) This analysis is shared by the FME, which notes that a bankruptcy of Sjóvá would have had severe consequences on the country's economy. The credibility of the financial market and the economy in general was heavily damaged during the collapse of the Icelandic banks in October 2008. The remaining institutions were fragile, as was the confidence in financial institutions. Sjóvá's continued existence was important to the functioning of the Icelandic financial market. Bankruptcy would have had spill-over effects on the non-life and the life insurance markets in general. It would have set back the on-going work of the Icelandic authorities to reconstruct the financial markets.
- (49) Regarding the scope of the necessary restructuring, the Icelandic authorities argue that the Authority should take into account that Sjóvá's financial difficulties were caused exclusively by its irregular investment activities and by transactions with its former owner Milestone. These have been possible due to a lack of proper risk control and corporate governance. They have no connection to the day-to-day insurance business continued by Sjóvá today. The viability of Sjóvá's insurance business is not only shown in the financial projections of the restructuring plan, but also confirmed by the FME. In addition, the willingness of a private third-party investor to acquire a majority stake in the company from the state evidences that the market considers Sjóvá to be viable. This transaction also resulted in the majority of the aid being recovered by Iceland.
- (50) The Icelandic authorities highlight that the historic owners of Sjóvá lost their entire investment, and that both Glitnir and Íslandsbanki took part in the recapitalisation. Besides, Sjóvá is contributing to the restructuring by cutting cost and rebuilding its capital from retained profits. There is therefore substantial burden sharing by both the shareholders in Sjóvá and the company itself.
- (51) Regarding the need for compensatory measures, the Icelandic authorities argue that further structural measures should not be required as the restructuring has already led to a reduction of Sjóvá's balance sheet by about 70 %, and any divestments in the core business segments would endanger viability. The Icelandic authorities also note that Sjóvá qualifies as an SME, which further reduces the need for compensatory measures. Finally, they argue that the proposed commitments, both regarding the behaviour of Sjóvá and regulatory change, are appropriate to minimise any distortions of competition.

- (52) In response to the third-party comments from VIS and TM, the Icelandic authorities mainly refer to previous submissions and provide further economic data.

## 7. THE RESTRUCTURING PLAN

- (53) On 3 October 2011, the Icelandic authorities submitted a first restructuring plan for Sjóvá. This plan was further updated on 13 April 2012 and 28 May 2013.
- (54) The restructuring plan addresses the substantive issues of viability, burden-sharing and limiting distortion of competition. According to the restructuring plan, Sjóvá will reduce the overall risk profile of its investment portfolio, improve its investment and risk management procedures, improve its corporate governance and increase profitability.

### 7.1. Financial projections

- (55) The Icelandic authorities have submitted detailed financial information and financial projections for Sjóvá until 2016, including a base case and three stress case scenarios. Even though the restructuring period only lasts until the end of 2014, the Icelandic authorities have submitted additional planning data for 2015 and 2016. This assists the Authority in particular in its assessment of the stress cases, which take into account stress events specific to the Icelandic market with effects beyond the restructuring period.
- (56) In all four scenarios, assumptions were presented for the period 2013-2016 in terms of Gross Domestic Product (GDP) growth, inflation, market share development, the return on index-linked government bonds, cash yield, equity premium and allocation as well as claims/premiums and cost/premiums ratios of Sjóvá.

#### 7.1.1. Base case

- (57) In the base case scenario, the financial projections are based on the five-year prognosis for GDP growth and inflation of the Icelandic economy published by Statistics Iceland on 30 March 2012, and updated on the basis of the actual results of Sjóvá and the actual data on the Icelandic economy in 2012 on 28 May 2013. The base case assumes in particular moderate economic growth, a reduction in inflation and flat development of interest rates, as well as constant market shares for Sjóvá.

#### Base case: assumptions

	2012	2013	2014	2015	2016
GDP growth	1,6 %	2,5 %	2,8 %	2,8 %	2,7 %
Inflation	4,2 %	3,4 %	2,5 %	2,5 %	2,5 %
Sjóvá's market share	[...]	[...]	[...]	[...]	[...]
Index-link gvt bonds	2,5 %	2,5 %	2,5 %	2,5 %	2,5 %
Yield cash real rate	1 %	1 %	1 %	1 %	1 %
Equity premium	5 %	5 %	5 %	5 %	5 %
Equity allocation	[...]	[...]	[...]	[...]	[...]
Claims/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]
Cost/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]



(58) The projected profit and loss statement as well as the balance sheet in the base case are set out in the table below.

**Base case: profit and loss statement (in ISK million)**

	2012	2013	2014	2015	2016
Premium earned	[...]	[...]	[...]	[...]	[...]
Claims incurred	[...]	[...]	[...]	[...]	[...]
Other income	[...]	[...]	[...]	[...]	[...]
	[...]	[...]	[...]	[...]	[...]
Operational expenses	[...]	[...]	[...]	[...]	[...]
<b>P/L of insurance operations</b>	[...]	[...]	[...]	[...]	[...]
Investment income	[...]	[...]	[...]	[...]	[...]
<b>Income before tax and depreciation</b>	[...]	[...]	[...]	[...]	[...]
Amortisation of goodwill	[...]	[...]	[...]	[...]	[...]
<b>Profit before tax</b>	[...]	[...]	[...]	[...]	[...]
Income taxes	[...]	[...]	[...]	[...]	[...]
<b>Profit</b>	[...]	[...]	[...]	[...]	[...]

**Base case: balance sheet (in ISK million)**

	2012	2013	2014	2015	2016
<b>Assets:</b>	[...]	[...]	[...]	[...]	[...]
Operating assets	[...]	[...]	[...]	[...]	[...]
Goodwill	[...]	[...]	[...]	[...]	[...]
Other intangibles	[...]	[...]	[...]	[...]	[...]
Tax deduction	[...]	[...]	[...]	[...]	[...]
Securities	[...]	[...]	[...]	[...]	[...]
Reinsurance assets	[...]	[...]	[...]	[...]	[...]
Account receivables	[...]	[...]	[...]	[...]	[...]
Cash and cash equivalents	[...]	[...]	[...]	[...]	[...]
<b>Total assets</b>	[...]	[...]	[...]	[...]	[...]
	[...]	[...]	[...]	[...]	[...]

	2012	2013	2014	2015	2016
<b>Equity:</b>	[...]	[...]	[...]	[...]	[...]
Equity at beginning of period	[...]	[...]	[...]	[...]	[...]
Profit of the year	[...]	[...]	[...]	[...]	[...]
Dividend	[...]	[...]	[...]	[...]	[...]
<b>Total equity</b>	[...]	[...]	[...]	[...]	[...]
	[...]	[...]	[...]	[...]	[...]
<b>Liabilities:</b>	[...]	[...]	[...]	[...]	[...]
Technical provisions	[...]	[...]	[...]	[...]	[...]
Tech. provisions for life insurance	[...]	[...]	[...]	[...]	[...]
Accounts payable	[...]	[...]	[...]	[...]	[...]
<b>Total liabilities</b>	[...]	[...]	[...]	[...]	[...]
	[...]	[...]	[...]	[...]	[...]
<b>Equity and liabilities</b>	[...]	[...]	[...]	[...]	[...]

(59) The main financial ratios as projected in the base case are presented in the table below.

**Base case: key financial ratios**

	2012	2013	2014	2015	2016
Adjusted solvency	[...]	[...]	[...]	[...]	[...]
Return on Equity	[...]	[...]	[...]	[...]	[...]

(60) At the end of the restructuring period, the projected return on equity of Sjóvá will reach about [...] % in the base case scenario.

7.1.2. *Stress case: 'double dip'*

(61) The Icelandic authorities have submitted a simulation of a 'double dip' stress scenario. Its GDP assumptions for 2013 to 2016 simulate a further recession and higher inflation. As a further stress, it is also assumed that interest rates are unchanged and that the equity premium turns negative. The 'double dip' scenario thus simulates a deep recession combined with further stress elements.

**'Double dip' stress case: assumptions**

	2012	2013	2014	2015	2016
GDP growth	1,6 %	1,2 %	- 6,6 %	- 4,0 %	2,6 %

	2012	2013	2014	2015	2016
Inflation	4,2 %	12,4 %	12,0 %	5,4 %	4,0 %
Sjóvá's market share	[...]	[...]	[...]	[...]	[...]
Index-link gvt bonds	2,5 %	2,5 %	2,5 %	2,5 %	2,5 %
Yield cash real rate	1 %	1 %	1 %	1 %	1 %
Equity premium	5 %	5 %	- 70 %	- 7,9 %	5 %
Equity allocation	[...]	[...]	[...]	[...]	[...]
Claims/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]
Cost/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]

**'Double dip' stress case: financials (in ISK million unless specified otherwise)**

	2012	2013	2014	2015	2016
P/L of insurance operations	[...]	[...]	[...]	[...]	[...]
Total profit	[...]	[...]	[...]	[...]	[...]
Adjusted solvency	[...]	[...]	[...]	[...]	[...]
Return on Equity	[...]	[...]	[...]	[...]	[...]

7.1.3. *Stress case: 'capital controls'*

- (62) The Icelandic authorities have submitted a simulation of a 'capital controls' stress scenario. In this stress test, it is assumed that capital controls will be lifted in Iceland in 2014. As a consequence, the ISK devalues to its current offshore value, which is about 30 % below the official exchange rate. This translates into an increase in the inflation rate. In turn, the higher inflation rate increases the loss ratio. Real interest rates are assumed to increase to 6,5 %, and the equity risk premium to reach -50 % due to capital flight.

**'Capital controls' stress case: assumptions**

	2012	2013	2014	2015	2016
GDP growth	1,6 %	2,5 %	2,8 %	2,8 %	2,7 %
Inflation	4,2 %	3,4 %	2,5 %	10,5 %	5 %
Sjóvá's market share	[...]	[...]	[...]	[...]	[...]
Index-link gvt bonds	2,5 %	2,5 %	6,5 %	6,5 %	6,5 %
Yield cash real rate	1 %	1 %	1 %	1 %	1 %
Equity premium	5 %	5 %	- 50 %	5 %	5 %
Equity allocation	[...]	[...]	[...]	[...]	[...]

	2012	2013	2014	2015	2016
Claims/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]
Cost/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]

**'Capital controls' stress case: financials (in ISK million unless specified otherwise)**

	2012	2013	2014	2015	2016
P/L of insurance operations	[...]	[...]	[...]	[...]	[...]
Total profit	[...]	[...]	[...]	[...]	[...]
Adjusted solvency	[...]	[...]	[...]	[...]	[...]
Return on Equity	[...]	[...]	[...]	[...]	[...]

7.1.4. *Stress case: 'cold winter II'*

- (63) The Icelandic authorities have submitted a simulation of a 'cold winter II' stress scenario. This stress case modifies the base case by the occurrence of two exceptionally cold winters. This results in a significant increase of the number of losses (in particular car accidents) that are relatively small and therefore not covered by reinsurance. The amount of losses is assumed at 100 % of premiums.

**'Cold winter II' stress case: assumptions**

	2012	2013	2014	2015	2016
GDP growth	1,6 %	2,5 %	2,8 %	2,8 %	2,7 %
Inflation	4,2 %	3,4 %	2,5 %	2,5 %	2,5 %
Sjóvá's market share	[...]	[...]	[...]	[...]	[...]
Index-link gvt bonds	2,5 %	2,5 %	2,5 %	2,5 %	2,5 %
Yield cash real rate	1 %	1 %	1 %	1 %	1 %
Equity premium	5 %	5 %	5 %	5 %	5 %
Equity allocation	[...]	[...]	[...]	[...]	[...]
Claims/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]
Cost/premiums net of reinsurance	[...]	[...]	[...]	[...]	[...]

**'Cold winter II' stress case: financials (in ISK million unless specified otherwise)**

	2012	2013	2014	2015	2016
P/L of insurance operations	[...]	[...]	[...]	[...]	[...]
Total profit	[...]	[...]	[...]	[...]	[...]

	2012	2013	2014	2015	2016
Adjusted solvency	[...]	[...]	[...]	[...]	[...]
Return on Equity	[...]	[...]	[...]	[...]	[...]

#### 7.1.5. *Stress cases: conclusion*

- (64) In all three stress scenarios, the solvency ratio remains strong during the entire restructuring period, and Sjóvá would be profitable with the exception of specific stress events in certain years. However, according to the additional planning data for 2015 and 2016, Sjóvá would recover its profitability rapidly thereafter even in these circumstances.

### 7.2. **Description of the restructuring measures**

- (65) The restructuring of Sjóvá is composed of several structural and behavioural measures, which are described below.

#### 7.2.1. *Separation of insurance activities and winding-down of investments*

- (66) As set out above, the main problems leading to Sjóvá's financial difficulties resulted from the investment decisions and the inter-group lending caused by its former owner, Milestone. As a result, Sjóvá experienced serious difficulties in relation to its investment portfolio. A key step in the restructuring of Sjóvá was therefore the transfer in the summer of 2009 of its insurance activities into a new company (later renamed Sjóvá) and the winding down of the legacy investment portfolio.

#### 7.2.2. *Change in corporate governance and control structures*

- (67) A new Icelandic Act on Insurance Activities came into force in 2010. It includes stricter rules on corporate governance and other control mechanisms within insurance companies.
- (68) The relevant changes are the following:
- A director of an insurance company cannot be a director of any other financial institution or insurance company. The FME can grant exemptions in the case of subsidiaries.
  - Any CEO or director must attend examinations carried out by the FME to assess the qualification and the knowledge of these individuals. The FME may refuse to accept individuals not passing this assessment as a director or CEO of an insurance company.
  - The board of directors must establish management rules, internal inspection rules, internal auditing rules, rules on financial activity and procedure, rules and procedures on any kind of lending activity as well as rules and procedures on business dealings with related parties.
  - The board of directors must establish rules on trading of financial instruments by the company itself and personally by the directors, the CEO and defined key personnel within the company.
  - The FME establishes rules applicable to any kind of bonus scheme forming part of the salary packages within insurance companies.
  - The board of directors must establish binding special rules on the investment procedures and on the conduct of investment activities where the company intends to invest in any financial instruments not listed on a registered stock exchange.
  - The board of directors must establish binding rules on real estate intended solely as investment and not for the company's own use.
  - All the internal rules required by the regulation as set out above must be submitted to the FME for review and confirmation.

- (69) Sjóvá has implemented the relevant changes to the legislation. In line with the new regulatory requirements, Sjóvá's board of directors has decided on rules regarding investments; any amendment of these rules must be approved by the FME. The board of directors of Sjóvá established and signed the rules on corporate governance on 4 April 2011 and submitted them to the FME. The CEO has also established and signed rules defining and determining the minimum qualification for key employees.
- (70) In addition, a new division 'Risk & Analysis' was formed by Sjóvá in April 2010. This division answers directly to the CEO and is headed by a qualified actuary and comprises six further employees. The purpose of this division is:
- to be responsible for writing and enforcing regulatory and prudent risk management procedure within the life and non-life insurance business segments of Sjóvá;
  - to analyse underwriting results from all classes of insurance conducted within Sjóvá;
  - to give reports and to propose amendments to the rating of tariffs;
  - to be responsible for accurate rating tariffs for all classes of insurance business;
  - to enforce all the procedures within Sjóvá related to risk management;
  - to analyse technical provisions at regular intervals and be responsible for accurate claims reserving;
  - to conduct stress tests and Own Risk and Solvency Assessment (ORSA);
  - to be responsible for the implementation of Solvency II and the enforcement of the Solvency II requirements within Sjóvá;
  - to give regular reports on any issues relating to risk management to CEO and board of directors; and
  - to communicate and report to the Financial Supervisory Authority on all matters regarding risk management and technical results and reports as statutorily required.
- (71) Finally, an internal audit committee has been set up by the board of directors in accordance with the statutory requirements.

#### 7.2.3. *Other viability measures*

- (72) Sjóvá has implemented measures to increase margin in its insurance business and to reduce cost. These measures include salary cuts, reductions in marketing and other operational costs as well as the implementation of strict rules for quoting insurance offers. Furthermore, there are currently no compensatory bonus schemes for employees. Finally, Sjóvá discontinued its reinsurance activities, through which it had in the past acquired an international insurance risk portfolio.
- (73) These measures aim in particular at ensuring that the combined ratio is below 100 %, i.e. that the insurance business is sustainable by itself, without taking undue risks in investment activities. As a result of these measures, Sjóvá was able to improve its combined ratio from 114,4 % in 2005 to 95,6 % in 2010. According to the base case projections, the ratio will stay below 100 % until 2016.

### 7.3. **Commitments**

- (74) As set out in the Annex, the Icelandic government and Sjóvá have committed to restrictions on the pricing of insurance quotes for certain corporate customers as well as bans on certain acquisitions and advertisement activities.
- (75) The Icelandic authorities have also committed to introduce certain regulatory changes to the functioning of the insurance market as set out in the Annex.

## II. ASSESSMENT

### 1. THE PRESENCE OF STATE AID

(76) 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.'

(77) The Authority will assess the following measures as set out in paragraph 18 above:

1. The Icelandic state contributed to the recapitalisation of Sjóvá by transferring to SAT Holding two bonds in its possession, valued by an external expert at ISK 11,6 billion (approx. EUR 76 million) to be used as equity in Sjóvá.
2. The Icelandic state also agreed to upgrade Glitnir's security in the bond issued by Avant from 4<sup>th</sup> to 3<sup>rd</sup> priority in order to enable Glitnir's contribution to the capital of Sjóvá. As the Avant bond lost most of its value after the Icelandic Supreme Court's ruling of 16 June 2010, the Icelandic state (through ESI) entered into the asset transfer agreement dated 28 July 2010. This agreement resulted in ESI contributing a further ISK 683 to 739 million to the stabilisation of Sjóvá through its acquisition of the Avant bond from SAT Holding for ISK 88 million.

(78) These measures will be referred to as the 'recapitalisation measures' below.

#### 1.1. Presence of state resources

- (79) As the Authority had already preliminarily concluded in the Opening Decision, it is clear that the first of the recapitalisation measures was financed through state resources provided by the Icelandic state.
- (80) Regarding the second recapitalisation measure, the payment for the later acquisition of the Avant bond from SAT Holding was also carried out by the Icelandic state from state resources. Furthermore, the enhancement of Glitnir's security in the Avant bond reduced the likelihood of the state receiving repayment under the bond, and therefore reduced the value of its claim. This reduction thus also affected state resources.
- (81) The Authority therefore concludes that state resources were involved in both recapitalisation measures in favour of Sjóvá.

#### 1.2. Favouring certain undertakings or the production of certain goods

- (82) In order to constitute state aid, a measure must confer a selective advantages on certain undertakings or the production of certain goods.
- (83) The aim of the recapitalisation measures was to ensure that Sjóvá could meet the regulatory minimum capital requirements, thereby enabling the company to remain active in the insurance business.
- (84) The Icelandic authorities have confirmed that the state took part in the recapitalisation of Sjóvá's insurance business because Glitnir and Íslandsbanki did not have the funds to provide the required capital themselves and no other private investor willing to do so could be found. This confirms the position of the Authority in the Opening Decision that the Icelandic state did not act as a market investor when participating in the recapitalisation of Sjóvá.
- (85) The Authority therefore concludes that the recapitalisation measures conferred an advantage on Sjóvá. This advantage is clearly selective, as the measures were designed to only benefit Sjóvá.

- (86) The state aid element corresponds to the equity that Sjóvá would not have received without the state's participation, i.e. the initial ISK 11,6 billion contributed by the Icelandic state as well as the further contribution by ESI of between ISK 683 and 739 million under the asset transfer agreement dated 28 July 2010. The Authority thus assesses the aid element to amount to about ISK 12,3 billion.

### 1.3. Distortion of competition and effect on trade between Contracting Parties

- (87) The recapitalisation measures strengthen the position of Sjóvá in comparison to competitors (or potential competitors) in Iceland and other EEA States. Sjóvá is an undertaking active, as described above, in the insurance market, which is open for international competition in the EEA. Whilst the Icelandic financial markets are currently rather isolated, particularly due to capital controls, cross-border trade in insurance services still exists, which will increase when the capital controls are lifted. The recapitalisation measures therefore distort or threaten to distort competition in a way that affects trade between Contracting Parties within the meaning of Article 61(1) of the EEA.

### 1.4. Conclusion on the presence of state aid

- (88) Based on the above, the Authority concludes that the recapitalisation measures involve state aid within the meaning of Article 61(1) of the EEA Agreement.

## 2. PROCEDURAL REQUIREMENTS

- (89) 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'.
- (90) The Icelandic authorities did not notify the recapitalisation measures to the Authority in advance of their implementation. The Authority therefore concludes that the Icelandic authorities have not respected their obligations pursuant to Article 1(3) of Part I of Protocol 3. The granting of these aid measures was therefore unlawful.

## 3. COMPATIBILITY OF THE AID

- (91) As a preliminary remark, the Authority notes that it is uncontested that Sjóvá would have faced bankruptcy without the state's intervention as it would not have been able to fulfil the regulatory capital requirements. Sjóvá was therefore an undertaking in difficulties at the time of the first recapitalisation measure.
- (92) The Authority also notes that the Icelandic authorities argue that the recapitalisation measures in favour of Sjóvá fall under the exception set out in Article 61(3)(b) of the EEA Agreement and fulfil the requirements of the Authority's Restructuring Guidelines.

### 3.1. Legal basis for the assessment of compatibility: Article 61(3)(b) of the EEA Agreement and the Authority's Restructuring Guidelines

- (93) While state aid to undertakings in difficulties such as Sjóvá is normally assessed under Article 61(3)(c) of the EEA Agreement, Article 61(3)(b) of the EEA Agreement allows state aid to 'remedy serious disturbance in the economy of an EC Member State or an EFTA State'.

#### 3.1.1. Applicability of Article 61(3)(b) of the EEA Agreement

- (94) As set out above, the Icelandic authorities provided the initial funds required for the recapitalisation of Sjóvá by way of an agreement on the transfer of bonds dated 8 July 2009.



- (95) At that date, the Icelandic economy was still acutely affected by the financial crisis. In particular, the major commercial banks were in receivership, the government had introduced capital controls, inflation increased dramatically and Iceland had to undergo a programme of austerity as part of the conditions of its stand-by arrangement and loan from the IMF. Against this specific background, the FME warned of the grave consequences for the Icelandic economy and society of letting Sjóvá fail, including the risk of a systemic effect on the financial markets <sup>(1)</sup>.
- (96) The Authority notes that the failure of a single company in the insurance sector is ordinarily less likely to have a systemic effect than in the banking sector. However, in the present case, the impact of a failure of Sjóvá has to be assessed against the background of a severe financial and economic crisis as experienced in Iceland in 2008-2009.
- (97) The Authority shares the Icelandic authorities' analysis according to which, until such time as confidence in the financial system is restored, the potential impact of such a crisis might not be confined only to Sjóvá, nor even to the financial system.
- (98) The Authority therefore considers that the state participation in the recapitalisation in July 2009 may be considered as being intended to remedy a serious disturbance in the Icelandic economy.

### 3.1.2. *Application of the Restructuring Guidelines*

- (99) The Authority's Restructuring Guidelines set out the state aid rules applicable to the restructuring of financial institutions in the financial crisis.
- (100) According to the Restructuring Guidelines, in order to be compatible with Article 61(3)(b) of the EEA Agreement, the restructuring of a financial institution in the context of the financial crisis has to:
- lead to the restoration of the viability of the company;
  - include sufficient own contribution by the beneficiary (burden sharing); and
  - contain sufficient measures limiting the distortion of competition.
- (101) The Authority will thus assess below, based on the restructuring plan submitted for Sjóvá whether these criteria are met and if the aid measures described above constitute compatible restructuring aid.

## 3.2. **Restoration of viability**

- (102) The Authority has identified the following causes for the difficulties of Sjóvá, which led to the state intervention: (i) inappropriate investment practices; (ii) insufficient corporate governance and risk management; and (iii) insufficient profitability of insurance products.
- (103) The restructuring plan addresses these causes of difficulties as well as other risk factors of the company.

### 3.2.1. *Assessment of the restructuring measures — separation of insurance activities and winding-down of investments*

- (104) The transfer of Sjóvá's insurance activities into a new company freed the insurance business from the risks stemming from the legacy investment portfolio. This measure enabled Sjóvá, once recapitalised, to focus once again on its insurance operations.
- (105) The Authority considers that following this transfer, Sjóvá does no longer face any excessive risk from its legacy investment portfolio, which is being wound down in a separate entity.

<sup>(1)</sup> See Memorandum of the FME dated 29 June 2009.

### 3.2.2. Assessment of the restructuring measures — improvement of corporate governance and risk management

- (106) The Authority notes that Sjóvá has implemented the requirements of the Icelandic Act on Insurance Activities that came into force in 2010, which include stricter rules on corporate governance and other control mechanisms. These changes enhance Sjóvá's corporate governance and foresee comprehensive supervision by the FME, including over investment policies.
- (107) Furthermore, Sjóvá has set up a 'Risk & Analysis' division with substantial resources to improve risk management and operational oversight, as well as an internal audit committee. It has also formalised essential policies e.g. on pricing of insurance quotes and investment policy. The adherence by employees to these policies is regularly monitored to ensure compliance.
- (108) Finally, the Authority notes that the CEO and the board members appointed by the former shareholder Milestone were replaced in 2009.
- (109) The Authority considers that the measures outlined above are appropriate to address the failures in corporate governance and risk management that contributed to the financial difficulties of Sjóvá.

### 3.2.3. Assessment of the restructuring measures — profitability measures

- (110) The Authority notes the measures undertaken by Sjóvá to increase its profitability, with regards both to improving margins and to reducing costs. As a result of these measures, Sjóvá has been able to substantially improve its combined ratio and to run its insurance activities profitably. The restructuring plan foresees further improvements in profitability.
- (111) The Authority considers that these measures should enable Sjóvá's insurance business to be run profitably and reduce the reliance on investment returns, thereby enabling Sjóvá to sustain a more prudent investment policy. At the same time, the measures should assist Sjóvá in strengthening its equity, in particular in case of adverse developments, including those simulated in the submitted stress cases.

### 3.2.4. Assessment of the financial projections

- (112) As required in point 13 of the Restructuring Guidelines, the Icelandic authorities have provided financial projections covering both a base case scenario and three stress case scenarios.
- (113) The financial projections provided in the restructuring plan rely in the base case on assumptions that are sufficiently prudent and conservative. In the base case, Sjóvá would generate profits and consolidate its capital base throughout the planning period. In the base case, the projected return on equity of Sjóvá is around [...] % at the end of the restructuring period, which appears in line with the current market requirements for the industry. Furthermore, the projected combined ratio of Sjóvá will remain below 100 %, which shows that the operative insurance business will stay profitable and Sjóvá does not need to rely on an unduly risky investment strategy to create sufficient returns.
- (114) The Authority does not contest that the stress case assumptions contain a sufficient level of stress to assess Sjóvá's ability to remain solvent. According to the resulting financial projections, Sjóvá would remain solvent during the entire planning period under all three stress scenarios. The Authority considers that having provided three different stress scenarios, which even go beyond the restructuring period, strengthens the robustness of the stress testing. In particular, the scenarios cover the case of a protracted economic recession, as well as other stress factors specifically addressing the situation in Iceland (e.g. capital controls). The regulatory solvency requirements would not be breached at any time during the planning period under any of the three stress scenarios.
- (115) In view of the above, the Authority concludes that the financial projections of Sjóvá demonstrate a return to viability of the company as required by the Restructuring Guidelines. The Authority also notes that SF1, a private investor, agreed to purchase a controlling interest in Sjóvá from the Icelandic state. The willingness of a private market participant to make a significant investment in the company further comforts this finding.

### 3.3. Own contribution — burden sharing

- (116) The Restructuring Guidelines indicate that an appropriate contribution by the beneficiary is necessary in order to limit the aid to the minimum and to address distortions of competition and moral hazard. To that end, firstly, the restructuring costs should be limited while, secondly, the aid amount should be limited thanks to a significant own contribution.
- (117) As regards the limitation of the restructuring costs, the Restructuring Guidelines indicate in point 23 that the restructuring aid should be limited to cover the costs that are necessary for the restoration of viability. Furthermore, in order to keep the aid limited to a minimum, financial institutions should first use their own resources to finance the restructuring. Accordingly, the costs associated with the restructuring should not only be borne by the state but also by those who invested in the institution, by absorbing losses with available capital and by paying an adequate remuneration for state interventions.

#### 3.3.1. Limitation of restructuring costs

- (118) The recapitalisation of Sjóvá was limited to what was required to meet the regulatory minimum equity requirements, of which the Icelandic state only contributed the amount that Sjóvá's main creditors Glitnir and Íslandsbanki were unable to provide.
- (119) The transfer of the insurance activities to a new entity ensured that the recapitalisation was limited to what was required for the operative insurance business, and did not cover losses from the legacy investment portfolio.
- (120) Limiting the recapitalisation to the minimum necessary constrained Sjóvá's ability to compete in the market. Furthermore, none of the costs in the restructuring plan aim at entering new markets or expanding Sjóvá's business in any manner.
- (121) For these reasons, the Authority considers that appropriate steps have been undertaken to limit the amount of restructuring aid.

#### 3.3.2. Burden sharing/own contribution

- (122) As set out in point 24 of the Restructuring Guidelines, companies should use their own resources to finance restructuring. In addition, the Authority examines whether the financial position of existing shareholders has been totally or partially diluted as a result of the capital injection.
- (123) The Authority observes that the historic owners of Sjóvá have contributed to the costs of restructuring. In particular, Milestone lost its entire stake in the company without receiving any compensation when Glitnir took over Sjóvá. The winding-down of the legacy investment portfolio now held by SJE will impose further losses on investors. These measures contribute to the burden sharing and reduce the moral hazard resulting from the aid.
- (124) In respect of the contribution to restructuring costs through internal resources generated by Sjóvá, the Authority notes that Sjóvá has implemented both profitability as well as cost-cutting measures. These measures ensure that Sjóvá will create sufficient profits to strengthen the equity base over time. The Authority notes that the restructuring plan does not foresee any dividend payments until 2014.
- (125) Finally, the Icelandic state has been able to sell all its shares in Sjóvá to a private investor within a period of only three years and thereby recover almost two thirds of the funds granted as state aid.
- (126) In view of the measures above, the Authority considers that the restructuring plan provides for sufficient burden sharing and own contribution to the restructuring.

### 3.4. Measure to mitigate distortions of competition

- (127) Point 31 of the Restructuring Guidelines states that when assessing the amount of aid and the resulting distortions of competition, the Authority has to take into account both the absolute and relative amount of the state aid received.

- (128) As set out above, Sjóvá received in total about ISK 12,3 billion (approx. EUR 77 million) in state aid. This represented almost 80 % of the shortfall in equity at the time of the initial recapitalisation. This shows that the amount of aid received by Sjóvá was relatively high. Furthermore, Sjóvá would have exited the market without the state intervention.
- (129) Based on these elements, the Authority first considered structural measures to mitigate distortions of competition. In particular, the Authority assessed the potential divestment of Sjóvá's life insurance business carried out by the subsidiary Sjóvá Life.
- (130) The Icelandic authorities have presented detailed information on the importance of the life insurance business for the viability of Sjóvá. In particular, they highlighted the integration of this business line into the product offering of Sjóvá, customer demand for insurance packages including both non-life and life insurance products, and the ability of the major competitors in the non-life field to meet this demand. On this basis, the Icelandic authorities submitted that the Authority should apply the principle that measures limiting distortions of competition should not compromise the prospects of a return to viability, in line with point 32 of the Restructuring Guidelines.
- (131) Given the above, the Authority concludes that it would not be appropriate to require Sjóvá to divest its life insurance business.
- (132) In the absence of structural measures, the Authority needs to assess behavioural measures.
- (133) The Authority notes that Sjóvá's market share has fallen significantly since the beginning of the financial crisis. The Icelandic authorities have highlighted in particular the effect on market shares of the 30-day 'transfer window' in September 2009, which enabled competitors to approach all Sjóvá customers in the non-life segment with competing offers. The Icelandic authorities argue that this regulatory measure addressed some of the distortions of competition.
- (134) The Authority further notes that the restructuring plan does not foresee any aggressive growth in Sjóvá's market share, and that the new pricing and risk management policies are designed to ensure that Sjóvá only quotes for sufficiently profitable business.
- (135) In addition, the Icelandic authorities and Sjóvá have committed to a pricing restriction in relation to quotes for certain corporate customers for the duration of the restructuring period, reproduced in the Annex. This commitment provides a further safeguard against potential aggressive market behaviour by Sjóvá, and any loss in insurance business due to the commitment will benefit Sjóvá's competitors.
- (136) The Authority notes that this commitment only covers certain types of insurance business. However, given the high concentration levels in the Icelandic insurance market, the Authority considers that a more comprehensive pricing restriction could result in a reduction of effective competition and would therefore be inappropriate.
- (137) The Authority welcomes the Icelandic authorities' commitment to introduce certain regulatory changes to the functioning of the insurance market, as set out in the Annex. In line with points 44-45 of the Restructuring Guidelines, the proposed changes would increase effective competition as well as favour market opening and new entry. In particular, they would facilitate switching by customers and thereby contributing to more competition between the existing players on the market.
- (138) As required in point 40 of the Restructuring Guidelines, Sjóvá commits to an acquisition ban for the duration of the restructuring period, as set out in the Annex. The acquisition ban prevents Sjóvá from acquiring any significant interest in other financial undertakings, whilst allowing Sjóvá to make small-scale investments if required.
- (139) Finally, Sjóvá will not use the received aid or any advantages arising from it for advertising purposes.
- (140) The Authority concludes that the restructuring foresees sufficient measures to mitigate distortions of competition and to ensure that the state aid is not used to the detriment of unaided competitors, in line with point 39 of the Restructuring Guidelines.

## 4. CONCLUSION

- (141) The Authority concludes that the recapitalisation measures in favour of Sjóvá are compatible with the functioning of the EEA Agreement pursuant to Article 61(3)(b) of the EEA Agreement.
- (142) The Authority also concludes that the Icelandic authorities have unlawfully implemented the state aid in question in breach of Article 1(3) of Part I to Protocol 3,

HAS ADOPTED THIS DECISION:

*Article 1*

The recapitalisation measures granted to Sjóvá constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

*Article 2*

The state aid granted to Sjóvá is compatible with the functioning of the EEA Agreement pursuant to Article 61(3)(b) of the EEA Agreement subject to adhering to the commitments as set out in the Annex to this Decision.

*Article 3*

This Decision is addressed to Iceland.

*Article 4*

Only the English language version of this Decision is authentic.

Done at Brussels, 10 July 2013.

*For the EFTA Surveillance Authority*

Oda Helen SLETNES

*President*

Sverrir Haukur GUNNLAUGSSON

*College Member*

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## ANNEX

**Behavioural commitments regarding Sjóvá**

The Icelandic authorities provide the following commitments concerning Sjóvá:

1. Sjóvá commits to restrict its commercial offers by quoting insurance risks in such a way that it will not quote below [...]. Commercial offers are defined as quotations which cover the customer's total insurance account ('Commercial Offers').
  - This commitment applies to Commercial Offers for commercial entities with annual premium turnover exceeding ISK [...].
  - This commitment applies to Commercial Offers where tender documents or other underwriting information include historical loss data showing paid and outstanding losses over a period of no less than [...] years.
  - In evaluation of past loss experience Sjóvá may remove individual losses exceeding [...] the proposed premium bid from its calculation in order to arrive to a more even and more stable statistical loss conclusion.
2. Sjóvá commits to keep the same or higher premium levels at renewal for individual insurance accounts if historical loss experience (calculated technical loss ratio) exceeds [...] % of premiums.
  - This commitment applies to the renewal of corporate accounts, but loss history must exceed [...] years.
  - In evaluation of past loss experience Sjóvá may cap individual losses at [...]. This is to arrive at more even and more stable statistical loss conclusion.
3. Sjóvá will not acquire more than [...] % of the shares of credit institutions, investment firms (as defined in Directive 2004/39/EC of 21 April 2004 on markets in financial instruments), insurance or reinsurance companies. Sjóvá may, after obtaining the Authority's approval, acquire further businesses, in particular where the acquisition is necessary in order to safeguard financial stability or to ensure effective competition.
4. Sjóvá will not use the recapitalisation or any competitive advantages arising in any way from the recapitalisation for advertising purposes.

These commitments shall last until 31 December 2014.

**Regulatory commitment**

In order to improve the mobility of consumers in the Icelandic insurance market, the Icelandic authorities undertake the following commitment:

- The Icelandic Ministry of Finance and Economic Affairs will appoint an expert group with the mandate to review the provisions of Act No 30/2004 on Insurance Contracts that concern customers' mobility, in particular with regard to recent amendments to the Norwegian Act on Insurance Contracts — on which the Icelandic legislation was based — and the Danish Financial Business Act. The expert group shall present its findings no later than 31 December 2013 and shall examine the potential implications of amending the provisions relating to cancellation by individuals of insurance contracts, when transferring their business between insurance companies, in order to facilitate customers' switching and promote competition in the insurance market.
  - Should the expert group's findings be that such provisions would be beneficial to the functioning of the Icelandic insurance market, it shall submit to the Minister of Finance and Economic Affairs an amendment to the Act on Insurance Contracts by way of a draft bill of law. The Ministry is favourably disposed towards promoting a change which would further accommodate customer mobility in the insurance market. Upon receiving the expert group's findings the Minister will, unless otherwise duly justified, present a draft bill to the Icelandic Parliament in the course of 2014 based on the findings of the expert group.
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