III

(Other acts)

EUROPEAN ECONOMIC AREA

EFTA SURVEILLANCE AUTHORITY DECISION

No 204/16/COL

of 23 November 2016

concerning alleged unlawful state aid granted to Íslandsbanki hf. and Arion Bank hf. through loan agreements on allegedly preferential terms (Iceland) [2017/1950]

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 thereof,

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

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

HAVING called on interested parties to submit their comments and having regard to their comments,

Whereas:

I. FACTS

1. *PROCEDURE*

(1) On 23 September 2013, the Authority received a complaint alleging that Íslandsbanki hf. ('ISB') and Arion Bank hf. ('Arion') had been granted unlawful state aid through long-term funding at favourable interest rates by the Central Bank of Iceland ('CBI') ([1]).

(2) By letter dated 23 October 2013, the Authority sent a request for information to the Icelandic authorities ([2]), to which the Icelandic authorities replied on 17 January 2014 ([3]). The case was subsequently discussed at a meeting between representatives of the Authority and of the Icelandic authorities in Reykjavík in May 2014. The discussions were followed up with a letter dated 5 June 2014 ([4]). The case was again discussed at a meeting between representatives of the Authority and of the Icelandic authorities, including a representative from the CBI, in Reykjavík in February 2015. These discussions were followed up with a letter dated 24 February 2015 ([5]), to which the Icelandic authorities replied on 1 April 2015 ([6]).

([1]) Document No 684053.
([2]) Document No 685741.
([3]) The reply from the Icelandic authorities contained letters from the CBI (Document No 696093), ISB (Document No 696092) and Arion (Document No 696089).
([4]) Document No 709261.
([5]) Document No 745267.
([6]) The reply from the Icelandic authorities contained letters from the CBI (Document No 753104) and Arion (Document No 753101).

(3) By Decision No 208/15/COL of 20 May 2015, the Authority initiated the formal investigation procedure into alleged unlawful state aid granted to ISB and Arion through loan conversion agreements on allegedly preferential terms. By letter dated 28 August 2015 ([1]), the Icelandic authorities commented on the Authority's decision. On the same date, the Authority also received comments from one of the two alleged beneficiaries, *i.e.* Arion ([2]).

(4) On 24 September 2015, the decision to initiate the formal investigation procedure was published in the *Official Journal of the European Union* and in the EEA Supplement to it ([3]). By letter dated 5 October 2015, the CBI submitted comments to the opening decision ([4]).

(5) By letter dated 14 June 2016, the Authority requested additional information from the CBI, ISB and Arion ([5]). The Icelandic authorities provided the requested information by letter dated 20 September 2016 ([6]).

2. *DESCRIPTION OF THE MEASURES*

2.1. BACKGROUND

(6) The measures in question are linked to the CBI's collateral and securities lending. As part of its role as a central bank and lender of last resort, and in line with the monetary policy of other central banks, the CBI provides short-term credit facilities to financial undertakings in the form of collateral loans, in accordance with the provisions of CBI rules pertaining thereto. Financial institutions have the option of requesting overnight loans or seven-day loans against collateral considered to be eligible by the CBI.

(7) In 2007 and 2008, collateral lending increased steadily, and the CBI became a major source of liquidity for financial undertakings. Collateral loans peaked on 1 October 2008, just before the collapse of the banks, when the CBI had loaned ISK 520 billion to financial institutions. Thus, at the time of the collapse of the three commercial banks (Landsbankinn, Glitnir and Kaupthing) in October 2008, the CBI had acquired considerable claims against these domestic financial undertakings, which were backed by collateral of various types. At that time, nearly 42 % of the collateral for CBI loan facilities took the form of Treasury guaranteed securities or asset-backed securities, while some 58 % of the underlying collateral consisted of bonds issued by Glitnir, Kaupthing, and Landsbankinn ([7]).

2.2. LOAN AGREEMENT CONCLUDED WITH ISB

(8) With the collapse of Glitnir in 2008, the CBI's claims became due and payable, thus making the CBI a creditor of the failed bank. By decision of the Financial Supervisory Authority ('FME') in October 2008, in principle all domestic assets and liabilities (save for some excluded assets and liabilities) of Glitnir's were transferred to ISB, including Glitnir's outstanding liabilities to the CBI, which amounted to approximately ISK 55,6 billion, as well as indirectly the ownership of the underlying collateral (the mortgage loan portfolio) ([8]).

([1]) Document No 771173.
([2]) Document No 771174.
([3]) EFTA Surveillance Authority Decision No 208/15/COL of 20 May 2015 concerning alleged unlawful state aid granted to Íslandsbanki hf. and Arion banki hf. through loan conversion agreements on allegedly preferential terms ('Decision No 208/15/COL') (OJ C 316, 24.9.2015, p. 6, and EEA Supplement No 57, 24.9.2015, p. 1). Available at: http://www.eftasurv.int/media/esa-docs/physical/208-15-COL.pdf.
([4]) Document No 775870.
([5]) Document No 808042.
([6]) Documents No 819287, 819289, 819291, 819293 and 819295.
([7]) For an overview of developments in collateral loans, see the CBI's Annual Report 2008, p. 9-11, available at http://www.sedlabanki.is/lisalib/getfile.aspx?itemid=7076
([8]) Glitnir had set up a covered bond programme, according to which a mortgage loan portfolio was sold into the Glitni banka (GLB) Fund which in turn guaranteed the Notes (Glitnir's obligations) issued under the covered bond programme. The covered bonds were not sold to investors but used as collateral in repurchase transactions with the CBI. By decision of the FME on 14 October 2008, among other things, all unit shares in the Fund were transferred to ISB. Outstanding covered bonds were held by the CBI as collateral for Glitnir's outstanding debt with the CBI, now appropriated to ISB and amounting to approximately 55 billion ISK at the time of the FME's decision. ISB had to operate the Fund and honor all payments on the original debt in order to protect the assets (the mortgage loan portfolio) and pay fees to all relevant parties to the original debt programme. As there were foreseeable costs and complications involved in operating the Fund and servicing the loans through the Fund, ISB sought to renegotiate the debt with the CBI in order to seek, inter alia, to extend the term of the debt.

(9) As the debt with the CBI consisted of short-term collateralised lending, instant repayment would have had a serious impact on ISB's liquidity position and could have jeopardised the restructuring of the bank. According to the CBI, the alternative would have been for the CBI to collect the debt, which would have left the CBI with the mortgage loan portfolio. This would have been difficult for a central bank to manage. Selling the mortgage loan portfolio at the time was also not considered an option, taking into account the financial crisis and the very few potential purchasers on the market.

(10) Therefore, ISB sought to renegotiate the debt with the CBI, in order to convert it into a long-term debt with a reasonable amortisation profile, to avoid a further negative impact on ISB's liquidity position. Following negotiations between ISB and the CBI, an agreement was reached on 11 September 2009, resulting in ISB issuing a stand-alone bond to the CBI in the amount of ISK 55,6 billion. The bond was asset-backed with the same, or similar, mortgage loan portfolio as the covered bonds that were issued by Glitnir in the past. The bond is over-collateralised with a loan-to-value ('LTV') ratio of 70 % ([1]). The bond's maturity is 10 years, with an interest rate of 4,5 %, CPI linked (*i.e.* consumer price-indexed).

2.3. LOAN AGREEMENT CONCLUDED WITH ARION

(11) In October 2008, it was clear that Kaupthing could no longer be saved and the FME therefore took over the operations of the bank. In line with the Act No 125/2008 on the Authority for Treasury disbursements due to Unusual Financial Market Circumstances etc. (the 'Emergency Act'), which was passed on 6 October 2008, the FME decided to split Kaupthing into an old and a new bank. The new bank, which later became Arion, in principle took over most domestic assets and liabilities. However, the secured liabilities towards the CBI and the respective collateral, including the housing loan portfolio, were not transferred ([2]). The old bank was placed under the supervision of a resolution committee and later became subject to winding-up procedures, with the aim of eventually closing all operations.

(12) Kaupthing, the Government and Arion reached an agreement on 3 September 2009 regarding the capitalisation of Arion and the basis for compensation from Kaupthing to Arion (the 'Kaupthing capitalisation agreement'). According to this agreement, Kaupthing had the option of acquiring control of Arion by subscribing to new share capital and was to pay for the new share capital with the old bank's own assets (*i.e.* the assets that had not been transferred pursuant to the FME decision as described above).

(13) Before Kaupthing could decide whether it would acquire a majority stake in Arion, an agreement needed to be reached with the CBI on the settlement of the outstanding claims as some of the assets it would need to pay for the new share capital had been placed as collateral against loans provided by the CBI to Kaupthing, including the housing loan portfolio. Therefore, on 30 November 2009, the Ministry of Finance, the CBI and the Kaupthing Resolution Committee entered into an agreement on the settlement of the CBI's claims against Kaupthing (the 'settlement agreement'). The settlement of overnight loans was the subject of Article 3 of the settlement agreement and there the parties agreed that Arion Bank would assume Kaupthing's debt towards the CBI by issuing a bond in the amount of approximately ISK […] (*) billion, in a specific form attached to the agreement as Appendix II, with the CBI in turn assigning the housing loan portfolio to Arion.

(14) On 22 January 2010, Arion and the CBI concluded a loan agreement, which, according to the CBI and Arion, represented the formal completion of Article 3 of the settlement agreement and the capitalisation agreement, i.e. when the creditors of Kaupthing became owners of Arion. The loan agreement replaced the aforementioned bond. The loan agreement essentially reflected the terms of the bond, except that the principal amount of the loan agreement was denominated in EUR, USD and CHF instead of ISK. This change in currency denomination was in line with the terms of the settlement agreement which provided that, despite the denomination of the principal, Arion should pay interest and instalments in foreign currencies to the extent the bank was able to. The settlement agreement also stipulated that if Arion was not able to pay in foreign currencies, and wished instead to pay in ISK, it had to submit a written reasoned application to the CBI.

([1]) The loan-to-value ratio is a financial term used by lenders to express the ratio of a loan to the value of an asset purchased.
([2]) See the Minister of Finance's Report on the restructuring of the commercial banks, pages 13-17. Available online at: http://www.althingi.is/altext/pdf/139/s/1213.pdf.
(*) The information in square brackets is covered by the obligation of professional secrecy.

(15) The loan agreement provided for a seven-year loan, extendable by two three-year terms, for an amount of EUR […] million, USD […] million and CHF […] million. Arion was permitted to change the combination of the currencies in which the loan was to be repaid. The interest payable was EURIBOR/LIBOR + 300 bps. The housing loan portfolio of Arion served as collateral to the CBI.

3. *THE COMPLAINT*

(16) According to the complainant, the loan agreements between ISB, Arion and the CBI were not assessed in the Authority's decisions approving restructuring aid to ISB and Arion ([1]). Since the measures were not addressed in these cases, the complainant considers it important to obtain the opinion of the Authority on (i) the compatibility of these additional alleged aid measures with the EEA Agreement, and (ii) the consequences of the failure by the Icelandic authorities to notify these measures.

(17) The complainant alleges that, at the time the CBI entered into the loan agreements with Arion and ISB, other banks in Iceland were not given the opportunity to receive such financing from the CBI or other government agencies. The complainant therefore argues that the aid was selective as it was granted exclusively to certain financial institutions competing on the Icelandic banking market. According to the complainant, by granting a loan to ISB, the bank was granted aid to avoid enforcement by the CBI on the covered bond issue; and in Arion's case, the loan was granted to secure an appropriate balance on the bank's currency risk. The complainant argues that other financial institutions, which did not receive such aid, were forced to sell off assets in markets that favoured buyers.

(18) According to the complainant, the loan agreements gave ISB and Arion a clear advantage in the form of long-term funding with favourable interest rates below market rates and which were not available to other market participants. According to the complainant, no private investor would have entered into such agreements at this turbulent time on the financial markets. In order to substantiate its claim that the interest rates were below market rates at the time, the complainant submitted credit default swap ('CDS') spreads of the Icelandic government in 2009 and interest rates in 2009 on bond issues HFF150224 and HFF150434 by the Icelandic Housing Financing Fund ('HFF'). The complaint maintains that the measures strengthened ISB and Arion on the banking market and therefore affected the position of other market participants.

(19) Finally, the complainant argues that the restructuring plans of ISB and Arion, implemented by the Icelandic government and which the Authority found compatible aid pursuant to Article 61(3)(b) of the EEA Agreement, were sufficient to remedy the disturbance in the Icelandic economy. According to the complainant, the additional aid measures implemented by way of the abovementioned agreements were not necessary, appropriate or proportionate to restore the Icelandic banking system and therefore entail incompatible state aid.

4. *GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE*

(20) In Decision No 208/15/COL, the Authority preliminarily assessed whether the short-term credit facilities provided by the CBI to Glitnir and Kaupthing, as well as the loan agreements concluded between the CBI and both Arion and ISB, could constitute state aid within the meaning of Article 61(1) of the EEA Agreement; and, if so, whether the state aid could be considered compatible with the functioning of the EEA Agreement.

(21) With regard to CBI's short-term collateral lending to banks and other financial institutions, the Authority found that the conditions set out in the Banking Guidelines ([2]) concerning liquidity assistance and central bank facilities were fulfilled. Accordingly, the Authority concluded that the short-term credit facilities provided by the CBI to Glitnir and Kaupthing did not involve state aid.

([1]) Public version of EFTA Surveillance Authority Decision No 244/12/COL of 27 June 2012 on restructuring aid granted to Íslandsbanki ('ISB restructuring aid decision') (OJ L 144, 15.5.2014, p. 70 and EEA Supplement No 28, 15.5.2014, p. 1); and Public version of EFTA Surveillance Authority Decision No 291/12/COL of 11 July 2012 on restructuring aid to Arion Bank ('Arion restructuring aid decision') (OJ L 144, 15.5.2014, p. 169 and EEA Supplement No 28, 15.5.2014, p. 89), paragraphs 86, 149, 168 and 238.

([2]) Guidelines on the application, from 1 December 2013, of state aid rules to support measures in favour of banks in the context of the financial crisis ('2013 Banking Guidelines') (OJ L 264, 4.9.2014, p. 6 and EEA Supplement No 50, 4.9.2014, p. 1), paragraph 62, which replaced the Guidelines on the application of state aid rules to measures taken in relation to financial institutions ('the 2008 Banking Guidelines') (OJ L 17, 20.1.2011, p. 1 and EEA Supplement No 3, 20.1.2011, p. 1), paragraph 51.

(22) However, with respect to the loan agreements between the CBI and both Arion and ISB on allegedly favourable terms, the Authority came to the preliminary conclusion that it could not be excluded that these constitute state aid within the meaning of Article 61(1) of the EEA Agreement. The following aspects were identified in Decision No 208/15/COL:

(i) The Authority noted that public support granted by a central bank could be regarded as attributable to the State and thus constitutes a transfer of state resources.

(ii) The Authority expressed doubts as to whether the measures under assessment were consistent with the conduct of a private creditor finding himself in a comparable legal and factual situation. Hence, the preliminary assessment of the Authority showed that an economic advantage in favour of ISB and Arion could not be excluded.

(iii) Since no evidence had been provided demonstrating that the allegedly favourable loan agreements were made available to all undertakings in a comparable factual and legal situation as ISB and Arion, it was the Authority's preliminary view that the measures appeared to be selective.

(iv) Finally, the Authority noted that although ISB and Arion today operate mostly on the Icelandic market, they are nevertheless engaged in the provision of financial services, which are fully open to competition and trade within the EEA. Therefore, in the preliminary view of the Authority, the measure was liable to distort competition and affect trade within the EEA.

(23) According to the Authority, further evidence needed to be provided in order to be able to determine whether the lending terms could be regarded as compatible with the functioning of the EEA Agreement.

(24) Consequently, following its preliminary assessment, the Authority had doubts whether the measures in question and the lending terms in particular constituted state aid, and if so, whether they could be found to be compatible with the functioning of the EEA Agreement.

5. *COMMENTS FROM THE CBI*

5.1. GENERAL

(25) The CBI notes that the restructuring of the Icelandic financial system, its legal foundation, and the government's execution of it, have been previously addressed by the Authority, inter alia, in the ISB and Arion restructuring aid decisions. According to the CBI, it is not logical to take the measures under investigation in this case out of their context and to assess them as stand-alone instruments.

(26) According to the CBI, it is unrealistic for a central bank to enforce collateral like the one in question in the case of Kaupthing (Arion) and ISB. In appropriating such collateral, the CBI would have taken on the role of a commercial bank with one of the largest household loan portfolios in Iceland. This would have been inconsistent with its role as a central bank. There was also an important risk of destabilising the operations of Arion and ISB, which would have jeopardised financial stability. The Authority must bear in mind that the CBI has a legal obligation to promote financial stability. If the CBI had collected the claim on ISB, ISB's liquidity would have been rendered too weak to operate as a healthy bank and consequently the CBI would not have been in a position to collect all of its claim.

(27) The CBI notes that the Banking Guidelines unfortunately do not address what happens when claims stemming from monetary policy operations fall into default and a central bank is forced to take steps to collect claims and appropriate collateral assets. The CBI argues that the conversion of the CBI's claims into loan agreements should be considered as a normal continuation of creditors' measures aiming to maximise recoveries of claims stemming from short-term credit facilities and not as new funding provided to Arion and ISB.

5.2. THE PRESENCE OF STATE AID

(28) With respect to whether the loan agreements conferred an advantage on the banks, the CBI first argues that the initial delay in payments did not involve state aid, given the exceptional circumstances prevailing in Iceland after the collapse of the banking system in October 2008. The settlement of payments with ISB in September 2009 and with Kaupthing in November 2009 cannot be considered a delay, according to the CBI, as Iceland was undergoing a comprehensive bank restructuring with the assistance of the IMF and there was a high degree of uncertainty about the valuation of the banks' assets.

(29) The CBI highlights that is has the legal obligation to preserve financial stability and to supervise credit institutions' foreign exchange balances. Therefore, the CBI had a legal obligation to address the severe situation prevailing at the time. Concluding the loan agreements was the best rational economic decision under these circumstances. The CBI points out that not only would it have been inconsistent with the role as a central bank to appropriate the collateral, but it would also ultimately have resulted in the CBI recovering less of the short-term debt.

(30) In addition, according to the CBI, the terms of the loan agreements, *i.e.* the interest rates and collateral, were favourable to the CBI. The CBI refers to available information on issued instruments worldwide and also to the terms of other instruments entered into by the parties at that time (Arion, ISB, the CBI, other domestic financial institutions, and the State) ([1]). Therefore, according to the CBI, the terms of the loan agreements were in both cases fully consistent with normal market terms at the time, and therefore fully in line with the market economy investor principle.

(31) With respect to whether these loan agreements were selective, the CBI argues that all undertakings in a comparable legal and factual situation were treated equally. In this regard, the CBI notes that Straumur, a private Icelandic investment bank, also concluded an agreement with the CBI on the settlement of its short-term debt ([2]). Moreover, according to the CBI, MP Bank was not in a similar factual or legal situation as its short-term debts were not secured with assets comparable to the housing loan portfolio but with public securities such as Treasury instruments and similar secure instruments, *i.e.* easily tradable assets with a set value and no costs involved or associated with appropriation. Therefore, the CBI rejects the assertion that other banks in Iceland were not given the opportunity to receive such financing from the CBI or other government agencies.

(32) Finally, the CBI notes that the Authority must consider that during the period when the loan agreements were concluded, there was *de facto* no competition between Icelandic financial undertakings and other financial undertakings in the EEA. In November 2008, the Icelandic Parliament adopted Act No 134/2008, amending the Foreign Exchange Act No 87/1992, which imposed restrictions on cross-border capital movements and foreign exchange transactions related thereto, thus making it impossible for foreign financial entities to compete on the Icelandic market ([3]). Therefore, the CBI argues that the measures were not liable to distort competition and affect trade between the Contracting Parties to the EEA Agreement.

(33) On the basis of the above, the CBI argues that the conclusion of the loan agreements cannot constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

5.3. COMPATIBILITY

(34) Should the Authority nevertheless consider the measures to constitute state aid, the CBI argues that the measures must be considered compatible with the EEA Agreement on the basis of its Article 61(3)(b), as they formed an integral part of the measures that were necessary, proportionate and appropriate to remedy a serious disturbance in the Icelandic economy and thus were directly linked to the restructuring aid measures approved by the Authority in its Arion and ISB restructuring aid decisions.

6. *COMMENTS BY ARION*

6.1. GENERAL

(35) Arion also argues that the measures under investigation in this case cannot be taken out of their context and assessed as stand-alone instruments. Arion suggests that the Authority has already investigated and approved the restructuring and capitalisation of Arion in its Arion restructuring aid decision.

(36) Arion notes that denominating the loan in foreign currencies instead of ISK was in line with the terms of the settlement agreement, which provided that Arion should pay interest and instalments in foreign currencies to the extent the bank was able to and that it was only allowed to pay in ISK in exceptional circumstances. Arion also notes that Article 4 of the settlement agreement provided that the borrower may, with the permission of the

([1]) Document No 819287.
([2]) See: http://www.almchf.com/new-and-events/nr/121.
([3]) Case E-03/11 *Pálmi Sigmarsson* v *Seðlabanki Íslands* [2011] EFTA Ct. Rep. 430.

lender, change the denomination of the debt in part or full. The terms of the loan agreement are therefore fully in accordance with the terms of the settlement agreement. Arion highlights that the Authority already reviewed and approved the terms of the settlement agreement in its Arion restructuring aid decision ([1]).

(37) According to Arion, the Authority's description in Decision No 208/15/COL that without the housing loan portfolio Arion's position would have been 'slim', is incorrect. According to Arion, the housing loan portfolio was indeed a valued asset as it included loans of some of Arion's core clientele and had also been serviced by Arion. Pursuant to the settlement agreement (and not the FME's decision), Kaupthing was able to transfer the housing loan portfolio to Arion as part of Arion's capitalisation. In the absence of Article 3 of the settlement agreement (and thus in the absence of the transfer of the housing loan portfolio), however, other assets would have replaced the housing loan portfolio in order to fulfil the requirements of capitalisation and restructuring of Arion.

6.2. THE PRESENCE OF STATE AID

(38) According to Arion, the position of the CBI could be qualified as that of a private creditor enforcing claims against Kaupthing, as detailed in the settlement agreement, in accordance with the applicable rules governing winding-up procedures ([2]). The assignment of the housing portfolio pursuant to the settlement agreement and the conclusion of the loan agreement were carried out on terms fully consistent with normal market terms at the time. Consequently, the conduct of the CBI meets the requirements of the private creditor test. The CBI therefore did not confer upon Arion any advantage that could in any way be considered state aid.

(39) According to Arion, the main points that should be taken into consideration when assessing whether a hypothetical private creditor would have entered into the settlement agreement and the loan agreement can be summarised as follows:

(i) It was economically and functionally the only sensible option for the CBI. Appropriating the housing loan portfolio would have resulted in the CBI recovering a lower amount of the short-term debt in the end.

(ii) The CBI as a secured creditor had exhausted all other available options at the time.

(iii) The debtor, Kaupthing, had been put in winding-up proceedings and the short-term debt therefore had to be concluded in accordance with Act No 21/1991 on Bankruptcy Proceedings.

(iv) The measures were in line with the goal of the government to move the domestic part of the old banks to the new banks.

(v) The restructuring and capitalisation of Arion was part of the overall restructuring of the financial sector.

(vi) The terms of the loan agreement, *i.e.* interest rates and security, were favourable to the CBI. This is evident from the available information on issued instruments worldwide but also from the terms of other instruments entered into by the parties at that time (*i.e.* by Arion, the CBI and other domestic financial institution and the State).

(40) Since the Authority, in Decision No 208/15/COL, considered it difficult to determine the appropriate benchmarks for interest rates during the financial crisis, Arion has provided information on covered bond and senior unsecured bond issuances by banks in Europe during the period in question. Since the loan provided by the CBI is secured primarily with mortgages, Arion argues that it is comparable to covered bonds that were issued by European banks during 2009 using residential mortgages as security. According to Arion, the dataset it provided ([3]) demonstrates that funding spreads European banks were paying ranged between 0,1 % and 1,90 % over interbank rates, with a median spread of 0,72 %. The highest rates for covered bonds were paid by the Bank of Ireland in September 2009 (1,9 % over interbank rates) and EBS Mortgage finance from Ireland (1,75 % over

([1]) Arion restructuring aid decision, paragraphs 86, 149, 168 and 238.

([2]) That the financial reorganisation and insolvency of credit institutions, such as Kaupthing, is regulated by the provisions of the Act on Financial Undertakings No 161/2002 which contains a specific set of insolvency rules supplemented by the general provisions of the Bankruptcy Act No 21/1991 applicable to all insolvency cases in Iceland. Winding-up proceedings are in many respects similar to that of bankruptcy proceedings, and in fact many of the provisions of the Bankruptcy Act are incorporated into the former by reference, such as the processing of claims as well as other provisions ensuring equal treatment of creditors.

([3]) See schedules 1 to 3, attached to Arion's letter of 31 March 2015 (Document No 753101).

interbank rates) in November 2009. According to Arion, it is difficult to see how a debt instrument secured with mortgages and other high quality assets, and bearing an interest rate of LIBOR + 3,00 %, could be seen as state aid, while at the same time the highest funding costs of a European bank with mortgage collateral was interbank rates + 1,9 %.

(41) According to Arion, the change made in the loan agreement from the terms of the settlement agreement relating to the denomination of the principal in EUR, USD and CHF, instead of ISK, was favourable to the CBI. Arion notes that stringent limitations on cross-border movement of capital and related foreign exchange transactions were imposed in Iceland since the banking system collapsed in the autumn of 2008. Applying the private creditor test in these circumstances can only result in the conclusion that a private creditor would have preferred a denomination in foreign currencies rather than in ISK. Such a change in denomination would therefore be to the advantage of the creditor, not the debtor.

(42) Arion also draws a comparison with a settlement agreement ('the LBI agreement') that was concluded between the 'new' Landsbankinn ('NBI'), and the 'old' Landsbankinn ('LBI') in December 2009. The LBI agreement entailed the issue of a senior secured bond, denominated in EUR, GBP and USD, in the amount of ISK 247 billion in foreign currency for a term of 10 years by NBI to LBI. In addition, a contingent bond of ISK 92 billion in foreign currency was issued early in 2013. These senior secured bonds were a consideration for the assets and liabilities transferred from LBI on 9 October 2008 with the decision of the FME on the disposal of assets and liabilities from LBI to NBI. These senior secured bonds mature in October 2018 and do not have instalment payments during the first five years. The interest rates are EURIBOR/LIBOR + 175 bps for the first five years and EURIBOR/LIBOR + 290 bps for the remaining five years. They are secured by pools of loans to customers of Landsbankinn ([1]).

(43) According to Arion, the terms of the LBI agreement can be viewed as directly comparable to the terms in the loan agreement. The differences can be summarised as follows:

(i) A margin of 175 bps/290 bps from a private party lender compared to a 300 bps from the CBI under the loan agreement.

(ii) A principal of close to the equivalent of ISK 350 billion from a private party lender compared to ISK […] billion from the CBI under the loan agreement.

(iii) A collateral pool of loans to customers to a private party lender compared to a diversified pool of domestic exposures on sovereign, municipalities and residential mortgages to the CBI under the loan agreement.

(44) The above differences between these two cases are, according to Arion, all favourable to the loan agreement and the CBI, *i.e.* higher interest rate, lower principal amount and stronger collateral pool, in spite of the fact that the lender in this case is a private party. This indicates that the terms of the funding provided to Arion under the loan agreement are in line with prevalent market terms at the time.

(45) In summary, Arion thus argues that the conclusion of the loan agreement between the CBI and Arion cannot constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

6.3. COMPATIBILITY

(46) Should the Authority, despite the arguments presented above, consider that the measures constitute state aid, Arion argues that these measures are compatible with the EEA Agreement on the basis of its Article 61(3)(b).

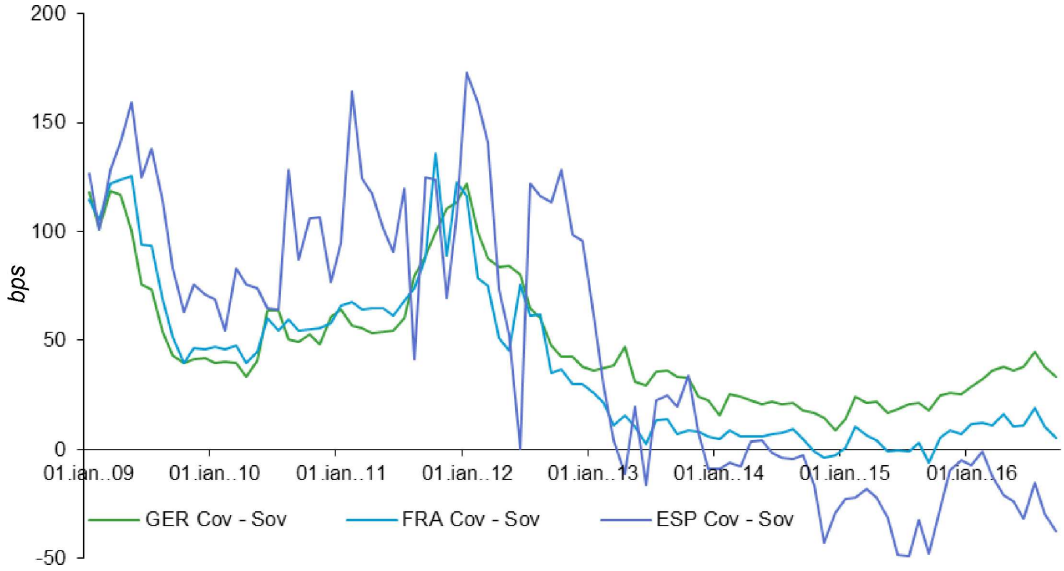
(47) As the measures in question formed an inseparable part of the final capitalisation of Arion and the restructuring plan of Arion submitted to the Authority, Arion argues that these measures cannot be separated from the overall assessment made by the Authority in that case. They are therefore covered by the Authority's Arion restructuring aid decision.

([1]) Document No 696088.

(48) Arion is also of the opinion that, if the Authority considers it possible to revisit a specific part of a transaction that has already been reviewed and approved by the Authority in the Arion restructuring aid decision, then the Authority should take into consideration the full factual and legal situation. The Authority's assessment on the compatibility of the measures in question should thus be in line with the assessment in the Arion restructuring aid decision, and in particular on whether the criteria of the applicable state aid guidelines were met.

7. *COMMENTS BY ISB*

(49) ISB provided information concerning the conditions of similar asset-backed bonds in Europe at the time of the conclusion of the agreement with the CBI. According to ISB, similar asset-backed bonds in Europe were trading at a 40–80 bps premium to state guaranteed papers at the time. ISB provided a graph which shows data from 2009 for three countries, *i.e.* France, Germany and Spain, on the spread difference between covered bond spreads and sovereign spreads. The iBoxx ([1]) covered spreads are a weighted average of all outstanding covered bonds from those respective countries with an average duration of the indices in the range of five to seven years.



(50) As can be seen from the graph, the spread has fluctuated substantially during this period and is *e.g.* currently negative in the case of Spain. In 2009, the spread difference for these three countries was in the range of 40–160 bps.

II. **ASSESSMENT**

1. *THE PRESENCE OF STATE AID*

(51) In the following chapters, the Authority will assess whether the loan agreements concluded between the CBI and both ISB and Arion involve state aid within the meaning of Article 61(1) of the EEA Agreement.

(52) A measure constitutes state aid within the meaning of Article 61(1) of the EEA Agreement if the following conditions are cumulatively fulfilled: the measure (i) is granted by the State or through State resources; (ii) confers an economic advantage on an undertaking; (iii) is selective; and (iv) is liable to distort competition and affect trade between Contracting Parties.

(53) As a preliminary point, it should be reminded that there is no blanket exemption of monetary policy from the application of the state aid rules ([2]). Indeed, the exclusion of liquidity assistance from the application of state aid law, as mentioned in paragraph 21 above, is limited to measures fulfilling the conditions enumerated in paragraph 51 of the Authority's 2008 Banking Guidelines and paragraph 62 of the Authority's 2013 Banking Guidelines ([3]). This does not imply that all actions by central banks are excluded from the application of the state

([1]) The iBoxx bond market indices are benchmarks for professional use and comprise liquid investment grade bond issues.
([2]) See judgment in *Hellenic Republic* v *Commission*, C-57/86, EU:C:1988:284, paragraph 9.
([3]) Although the 2008 Banking Guidelines are no longer in effect, they were at the time the contested measures were adopted and therefore the Authority must apply them in this case.

aid rules. In the present case, the Authority considers that the provision of long-term loans by the CBI does not comply with the conditions set out in the aforementioned paragraphs of the 2008 and 2013 Banking Guidelines, since the measures were connected to the restructuring measures provided to the two banks. Therefore, the Authority must assess the measures on the basis of the conditions set out in Article 61(1) of the EEA Agreement.

1.1. PRESENCE OF STATE RESOURCES

(54) According to Article 61(1) of the EEA Agreement, a measure must be granted by the State or through State resources in order to constitute state aid.

(55) The State, for the purpose of Article 61(1) of the EEA Agreement, covers all bodies of the public administration, from the central government to the city level or the lowest administrative level as well as public undertakings and bodies ([1]).

(56) The measures under examination take the form of loan agreements between the CBI and Arion and ISB on allegedly favourable terms.

(57) In order to determine whether the provision of long-term loans by the CBI involves state resources, it needs to be assessed whether measures taken by a central bank can be regarded as imputable to the State. Central banks are in general independent from the central government. However, it is irrelevant whether or not an institution within the public sector is autonomous ([2]). Moreover, it is generally accepted that central banks do perform a public task. The Authority notes that there is well-established case law that financial support provided by an institution serving a public purpose can result in the granting of state aid ([3]). The public support granted by a central bank can thus also be regarded as being imputable to the State and thus qualify as state aid ([4]). Indeed, according to the 2013 Banking Guidelines, funds provided by a central bank to specific credit institutions generally imply the transfer of State resources ([5]).

(58) However, beyond these remarks, the question of whether the loan agreements in question were granted by the State or through state resources can be left open, given the conclusion reached in the following section that the measures did not confer an economic advantage on the banks.

1.2. ADVANTAGE

(59) In order to constitute state aid within the meaning of Article 61(1) of the EEA Agreement, the measures must confer an advantage upon an undertaking.

(60) An advantage, within the meaning of Article 61(1) of the EEA Agreement, is any economic benefit which an undertaking would not have obtained under normal market conditions, thus placing it in a more favourable position than its competitors. Only the effect of the measure on the undertaking is relevant, and not the cause or objective of the State intervention ([6]). For it to constitute aid, the measure can take the form of a positive economic advantage as well as a relief of economic burdens. The latter is a broad category comprising any measure mitigating the charges that would normally be borne from the undertaking's budget. The question of whether the conclusion of the loan agreements could be regarded as granting ISB and Arion an advantage will ultimately depend on whether a private creditor of a comparable size to that of the public body, operating in the same market conditions, would have granted a similar loan on similar conditions.

(61) In order to determine whether a public body has acted like any market economy operator in a similar situation, only the benefits and obligations linked to the role of the State or public body as an economic operator — to the

([1]) Judgment in *Germany* v *Commission*, C-248/84, EU:C:1987:437, paragraph 17.
([2]) Judgment in *Air France* v *Commission*, T-358/94, EU:T:1996:194, paragraphs 58 to 62.
([3]) Judgments in *Italy* v *Commission*, C-173/73, EU:C:1974:71, paragraph 16; *Steinicke and Weinling* v *Germany*, C-78/76, EU:C:1977:52.
([4]) See Commission Decision 2000/600/EC of 10 November 1999 conditionally approving the aid granted by Italy to the public banks *Banco di Sicilia* and *Sicilcassa* (OJ L 256, 10.10.2000, p. 21) at paragraphs 48 and 49, where it is accepted with no further discussion that advances granted by the Banca d'Italia to distressed banks constitute financial assistance provided by the State.
([5]) 2013 Banking Guidelines, paragraph 62.
([6]) Judgment in *Italy* v *Commission*, C-173/73, EU:C:1974:71, paragraph 13.

exclusion of those linked to its role as a public authority — are to be taken into account ([1]). Moreover, in order to determine whether a state intervention is in line with market conditions, it must be examined on an *ex ante* basis, only taking into account the information available at the time the intervention was decided upon. In addition, in the absence of specific market information on a given debt transaction, the debt instrument's compliance with market conditions may be established on the basis of a comparison with comparable market transactions, that is to say through benchmarking.

(62) The private creditor test, developed and refined by the courts of the European Union ([2]), serves to establish whether the conditions under which a public creditor's claim is to be repaid, possibly by rescheduling payments, constitutes state aid. When the State is in the position, not as an investor or a promoter of a project, but as a creditor trying to maximise the recovery of an outstanding debt, lenient treatment alone, in the form of deferral of payment, may not be sufficient to presume favourable treatment in the sense of state aid. In such circumstances the conduct of the public creditor is to be compared with that of a hypothetical private creditor in a comparable factual and legal situation. The crucial question is whether a private creditor would have granted similar treatment to a debtor in similar circumstances.

(63) Prior to assessing the loan agreements, the question arises as to whether the initial delay in settling payments, which is understood to have lasted from around October 2008 until late 2009, may involve state aid. In general, decisions by public bodies to tolerate late payments on a loan may entail an advantage to the debtor and involve state aid. While a temporary deferral of payment would probably correspond to the conduct of a private creditor and thus not involve state aid, such conduct, initially consistent with market conditions, could turn into state aid in cases of protracted delays in payment ([3]).

(64) From the point of view of a private creditor, enforcement of a claim that has become due is the self-evident norm. This also applies if the debtor undertaking is in financial difficulties, as well as in the case of insolvency. Private creditors will not normally be willing in such circumstances to accept further deferral of payment if this does not bring them any clear advantage. On the contrary, once a debtor runs into financial difficulty, further loans would only be granted to the debtor under stricter terms, *e.g.* at a higher interest rate or with more comprehensive securities, as repayment is endangered. Exceptions may be justifiable in individual cases where non-enforcement seems to be the economically more sensible alternative. This would be the case when non-enforcement offers clearly improved prospects of collecting a substantially higher proportion of the claims in comparison with other possible alternatives or if even greater consequential losses can be averted in this way. It can be in the interest of a private creditor to keep the business of the debtor company running instead of liquidating its assets and thus, under certain circumstances, only collecting a part of the debt. When a private creditor accepts to refrain from enforcing his claim in full, he will normally require the debtor to provide additional securities. When this is not possible, for instance in cases of debtors in financial difficulty, the private creditor will seek assurances of maximum compensation should the financial condition of the debtor later improve. If insufficient securities or commitments are made by the debtor, a private creditor would generally not accept to conclude debt rescheduling agreements or provide the debtor with additional loans.

(65) With respect to the initial delay in settling payments, the CBI argues that settling payments with ISB in September 2009 and with Kaupthing in November 2009 cannot be considered a delay given the exceptional circumstances prevailing in Iceland after the collapse of the banking system in October 2008. During the period from the collapse until the settlement of the claims, Iceland was undergoing a comprehensive bank restructuring with the assistance of the IMF and there was considerable uncertainty about the fair valuation of the banks' assets.

([1]) Judgments in *Commission* v *EDF*, C-124/10 P, EU:C:2012:318, paragraphs 79 to 81; *Belgium* v *Commission*, C-234/84, EU:C:1986:302, paragraph 14; *Belgium* v *Commission*, C-40/85, EU:C:1986:305, paragraph 13; *Spain* v *Commission*, Joined Cases C-278/92 to C-280/92, EU:C:1994:325, paragraph 22; and *Germany* v *Commission*, C-334/99, EU:C:2003:55, paragraph 134.

([2]) See judgments in *Spain* v *Commission*, C-342/96, EU:C:1999:210, paragraphs 46 *et seq.*; *SIC* v *Commission*, T-46/97, EU:T:2000:123, paragraph 98 *et seq.*; *DM Transport*, C-256/97, EU:C:1999:332, paragraphs 19 *et seq.*; *Spain* v *Commission*, C-480/98, EU:C:2000:559, paragraphs 19 *et seq.*; *HAMSA* v *Commission*, T-152/99, EU:T:2002:188, paragraph 167; *Spain* v *Commission*,C-276/02, EU:C:2004:521, paragraphs 31 *et seq.*; *Lenzig* v *Commission*, T-36/99, EU:T:2004:312, paragraphs 134 *et seq.*; *Technische Glaswerke Ilmenau* v *Commission*, T-198/01, EU:T:2004:222, paragraphs 97 *et seq.*; *Spain* v *Commission*, C-525/04 P, EU:C:2007:698, paragraphs 43 *et seq.*; *Olympiaki Aeroporia Ypiresies* v *Commission*, T-68/03, EU:T:2007:253; and *Buzek Automotive* v *Commission*, T-1/08, EU:T:2011:216, paragraphs 65 *et seq.*

([3]) See Opinion of Advocate General Jacobs in *DM Transport*, C-256/97, EU:C:1998:436, paragraph 38.

Therefore, the CBI as the creditor of the banks needed time to properly evaluate the assets that served as collateral. The Authority has assessed these arguments and considers that the CBI acted in line with the private creditor test concerning the initial delay.

(66) Further, the Authority needs to assess whether a private creditor holding similar short-term claims on the defaulting banks would have agreed to the transfer of the housing loan portfolios under the conditions set out above and to the subsequent conclusion of loan agreements with the new banks according to the same conditions.

(67) The Authority notes that in the wake of Glitnir's and Kaupthing's collapse in the autumn of 2008, the CBI found itself in a position where it was unrealistic to expect to enforce collateral like the ones in question in the case of Arion and ISB. Taking into account that the loan portfolios constituted a large share of Arion's and ISB's customer base, appropriating such collateral could have jeopardised the financial stability of Arion and ISB and driven these financial undertakings into bankruptcy. Enforcing the collateral would have also entailed additional administrative expenses for the CBI. Moreover, if the loan portfolios had been offered for sale, the CBI would also have had no assurance of acceptable recovery, and it was highly unlikely that investors with sufficient capital strength would have been available to buy the portfolios, given the market situation in Iceland at the time. Therefore, appropriating the housing loan portfolios — either by enforcing the collateral or following bankruptcy — would have resulted in the CBI recovering a lower amount of the short-term debt in the end.

(68) Faced with this situation, the CBI therefore chose to enter into the loan agreements to ensure full payment of its claims, with interest and without having to incur administrative expenses. The loan agreements were thus entered into to achieve maximum possible recovery at that time.

(69) Based on these elements, the Authority considers that the CBI endeavoured to maximise the recovery of its claims when entering into the loan agreements.

(70) The Authority also must assess whether the conditions attached to the loan agreements, and in particular the applicable interest rates, would have been sufficiently valuable to a private creditor to meet the requirement of the private creditor test.

(71) In Decision No 208/15/COL, the Authority noted that it was difficult to determine the appropriate benchmarks for interest rates during the financial crisis. In response to this, ISB, Arion and the CBI have submitted additional information and comments.

(72) ISB argues that the interest rates are in line with the interest rates of similar asset-backed bonds at the time. The ISB bond's maturity is 10 years, with an interest rate of 4,5 %, CPI linked (consumer price-indexed), and is over-collateralised with a LTV ratio of 70 %. The interest rate was set at about 50 bps on top of the state-guaranteed HFF bonds on the date of issue. In comparison, common rates in Europe at the time for similar asset-backed securities were at 40–80 bps above state-guaranteed papers. ISB also provided a graph which shows that the spread differences for France, Germany and Spain were in the range of 40–160 bps in 2009.

(73) Similarly, Arion argues that its loan agreement with the CBI was concluded on market terms. Arion compares it, inter alia, to a comparable agreement concluded between NBI and LBI. Both agreements were concluded around the same time, *i.e.* end of 2009 and the beginning of 2010, and involved similar settlements of claims. The comparison shows that the terms of Arion's loan agreement were more stringent than those in the LBI agreement, involving a private lender. Indeed, it appears that the LBI agreement required lower interest rates, involved a higher principal amount and had weaker and less diversified collateral than the Arion loan agreement.

(74) In its letter of 31 March 2015 ([1]), Arion provided additional information on covered bond and senior unsecured bond issuances by banks in Europe during the period of 1 January 2009 until 31 December 2010. Taking into account that the loan provided by the CBI is primarily secured with mortgages, Arion argues that it is comparable to covered bonds issued by European banks during 2009 using residential mortgages as security. As

([1]) Document No 753101.

mentioned above, according to the dataset provided by Arion, funding spreads European banks were paying ranged from 0,1 % to 1,90 % over interbank rates, with a median spread of 0,72 %. The highest rates for covered bonds were paid by Bank of Ireland in September 2009 (1,9 % over interbank rates) and EBS Mortgage from Ireland (1,75 % over interbank rates) in November 2009.

(75) The CBI also argues that the terms of the loan agreements, *i.e.* the interest rates and collateral, were favourable to the CBI. According to the CBI, this is evident from the available information on issued instruments worldwide (as documented by Arion, see above) and also from the terms of other instruments entered into at the time, including the LBI agreement.

(76) The Authority notes that the loan agreements concluded between the CBI and the banks bear an interest rate of LIBOR + 3,00 % and are collateralised with mortgages and other assets. As the information provided by ISB and Arion shows, this interest rate is well above the average interest rates for comparable debt instruments concluded at the time, and even exceed the highest funding cost of any other European banks at the time that had mortgages as collateral (*i.e.* Bank of Ireland, interbank rates + 1,9 %). The Authority considers that the information concerning comparable debt instruments provided by the banks is reliable and that it presents and accurate picture of market conditions at the time the loan agreements were concluded. Moreover, since these interest rates were agreed to by private parties, the Authority considers that they represent a more appropriate benchmark for determining market rates at the time than the CDS spreads and interest rates on HFF bonds cited by the complainant.

(77) Concerning the loan agreement concluded with Arion, the Authority notes that the loan was denominated in foreign currencies instead of ISK. However, as noted by Arion, this change of denomination was in line with the terms of the settlement agreement, which provided that Arion should pay interest and instalments in foreign currencies to the extent the bank was able to and that Arion could, with the permission of the lender, change the denomination of the debt in part or full. As previously noted, the Authority has already reviewed and approved the terms of the settlement agreement in the Arion restructuring aid decision. Moreover, as noted by Arion, due to the stringent limitations in Iceland on cross-border movement of capital and related foreign exchange transactions, a private creditor would in all likelihood have preferred a denomination in foreign currencies rather than in ISK. Such a change in denomination would therefore be to the advantage of the creditor, not the debtor.

(78) Considering the market parameters at the time and the evidence presented, the Authority concludes that the lending terms in general, and the interest rates in particular, of the loan agreements would have been equally acceptable to a private creditor finding himself in a comparable factual and legal situation.

(79) In light of the above, the Authority concludes that the loan agreements between the CBI and, respectively, ISB and Arion did not confer an economic advantage upon ISB and Arion.

1.3. SELECTIVITY, DISTORTION OF COMPETITION AND EFFECT ON TRADE BETWEEN CONTRACTING PARTIES

(80) In order to qualify as state aid within the meaning of Article 61(1) of the EEA Agreement, the measure must be selective as well as liable to distort competition and affect trade between the Contracting Parties to the Agreement. However, given that the Authority concludes that no economic advantage was granted in the present case, and as the cumulative conditions for the existence of state aid are therefore not fulfilled, the Authority does not have to make any further assessment in this regard.

2. *CONCLUSION*

(81) On the basis of the foregoing assessment, the Authority considers that the loan agreements the CBI concluded with ISB and Arion do not constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

HAS ADOPTED THIS DECISION:

Article 1

The loan agreements concluded between the CBI and, respectively, Íslandsbanki hf. and Arion banki hf. do not constitute state aid within the meaning of Article 61(1) of the EEA Agreement. The formal investigation is hereby closed.

Article 2

This Decision is addressed to Iceland.

Article 3

Only the English language version of this decision is authentic.

Done in Brussels, 23 November 2016.

For the EFTA Surveillance Authority

Sven Erik SVEDMAN
President

Helga JÓNSDÓTTIR
College Member