EUROPEAN COMMISSION

Brussels, 25.04.2012
C(2012) 2872 final

Subject: **State aid n° SA.34423 (2012/N) – Denmark**
Rescue decision for the merger of Vestjysk Bank and Aarhus Lokalbank

Sir,

1. PROCEDURE

(1) On 28 February 2012 Denmark informed the Commission that two Danish banks, Vestjysk Bank A/S and Aarhus Lokalbank A/S, are about to merge, as they both face an increased risk of becoming a distressed bank on stand-alone basis.

(2) The Danish authorities submitted further information and updates on 9, 17, 26 and 30 March and 12 April 2012. A meeting between the Commission services and the Danish authorities was held on 27 March 2012.

(3) Denmark notified the measures covered by this decision to the Commission on 13 April 2012.

(4) Denmark has exceptionally agreed that the authentic language for this decision should be English.

2. DESCRIPTION OF THE BENEFICIARY

(5) Vestjysk Bank was formed in 1874 and is currently one of Denmark's largest regional banks with 20 branches in Jutland and on Funen. As at the end of 2011, Vestjysk Bank

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had a balance sheet of DKK 29.28 billion (EUR 3.94 billion[1]).

(6) Aarhus Lokalbank started operating in 1908 and as at the end of 2011 had a balance sheet of DKK 4.47 billion (EUR 600 million).

(7) Both banks are [...][*] as they both face an increased risk of [...].

(8) The Danish State is a major shareholder in both banks (it has a stake of 53.1% in Vestjysk Bank and 45.2% in Aarhus Lokalbank) following a recapitalisation under the recapitalisation scheme in 2009 and a conversion of the capital injection into share capital on 20 February 2012[2].

(9) Vestjysk Bank and Aarhus Lokalbank (hereafter, collectively, "the banks") are set to merge. The **continuing bank**, after the merger, will be Vestjysk Bank. Aarhus Lokalbank will cease to exist after the merger, as its assets and liabilities are transferred to Vestjysk Bank in connection with the merger. Following the merger, the Danish State will be a major shareholder in the continuing bank (52.1 %).

(10) The merger is intended to counter the funding challenges of the continuing bank and improve the basis for a future phase-out of the State-guaranteed loans by […]. Furthermore, the merger of the banks will create the basis for a capital plan whose implementation will strengthen the continuing bank's long-term capital base. Denmark has indicated that a more passive strategy of wait-and-see would [...], which would increase the risk of renewed uncertainty in the financial sector.

(11) The merger strengthens the position of Vestjysk Bank as a regional bank of central and western Jutland. The continuing bank's main activities will be focused on corporate and retail banking operations.

(12) As at the end of 2011, the continuing bank had total loans for an amount of DKK 29.7 billion (EUR 4 billion), of which corporate customers accounted for 77.1%, private customers 22.7% and public authorities 0.1%.

(13) In terms of industry segments, lending provided to real estate represented the largest exposure, accounting for 18.7% of loans. That exposure includes customers from inside and outside the continuing bank's main geographical market. The exposure to

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1 With the exchange rates of 10 April 2012 (EUR 1 = DKK 7.4395).

* Business secret

2 **Vestjysk Bank** raised State hybrid core capital with an original principal of DKK 1.44 billion (EUR 194 million), of which DKK 287.6 million (EUR 39 million) plus accrued interest of approximately DKK 8.7 million (EUR 1.2 million) was converted into shares in Vestjysk Bank. In the period 2009 - 2011 Vestjysk Bank has paid coupons amounting to a total of DKK 312.8 million (EUR 42 million) to the Danish State. The coupon interest rates were set at 9.69 and 10.19 per cent p.a., depending on whether they included the conversion option fee.

Aarhus Lokalbank has raised State hybrid core capital with an original principal of DKK 177.8 million (EUR 24 million), of which DKK 142.2 million (EUR 19 million) plus accrued interest totalling DKK 47.3 million (EUR 20 million) was subsequently converted into shares in Aarhus Lokalbank. In the period 2009 - 2011 Aarhus Lokalbank paid coupons amounting to a total of DKK 25.9 million (EUR 3.5 million) to the Danish State. The coupon interest rates were set at 10.92 and 11.42 per cent p.a., depending on whether they included the conversion option fee.

real estate is primarily made up of properties in Denmark and, to a certain extent, of investments made by Danish customers in properties in Germany. In addition to the loans provided by the continuing bank to customers in the property industry, the continuing bank is also indirectly exposed to real estate, as customers of other industry segments may also hold investments in real estate, either as part of their operations or for investment purposes.

(14) Loans for agriculture, hunting, forestry and fisheries represent 17.4% of total loans and guarantees and are primarily related to customers in the continuing bank's main geographical area.

(15) The shares of both Vestjysk Bank and Aarhus Lokalbank are listed on the Copenhagen stock exchange.

3. DESCRIPTION OF THE MEASURES

(16) On 17 February 2012 the Commission approved a Danish scheme which allows for the provision of guarantees to banks that are merging ("SA.34227(2012/N) - Guarantees for merging banks")[3]. The scheme allows guarantees to be provided to merged entities with a balance sheet of up to EUR 3 billion. That merger scheme only allows State guarantees on banks' liabilities.

(17) As the merged entity is to have a balance sheet of around DKK 35.2 billion (EUR 4.7 billion), the Danish authorities pre-notified the measures covered by the present Decision.

(18) In connection with the merger, the continuing bank is to implement a "capital plan" to improve its position. That capital plan consists of the following measures:

1. Completion of a capital raise by the continuing bank with *net proceeds* of between DKK 250 and 300 million (EUR 34-40 million);

2. Raising of new subordinated loan capital with a principal of DKK 200 million (EUR 27 million) financed entirely by the private sector;

3. Sale of a minority shareholding in the amount of DKK 175 million (EUR 24 million) that the continuing bank owns in a Danish mortgage credit institution to the Danish Central Bank;

4. Individual State guarantees for new bonds for up to DKK 8.6 billion (EUR 1.2 billion).

(19) Measures 2, 3 and 4 are conditional on the implementation of measure 1 with a minimum of DKK 250 million of capital raised, and are also inter-dependent. In other words, none of measures 2, 3 and 4 will be taken unless measure 1 is implemented and the other two measures are implemented. The implementation of measure 1 is

[3] Commission decision of 17 February 2012 (C(2012) 1081 final), not yet published.

independent of the implementation of measures 2, 3 and 4.

(20) In order to enable the Danish State to participate in the capital raise, a portion of the convertible hybrid capital instruments obtained by the State as part of the 2009 recapitalisation have been converted into ordinary shares. The conversion was implemented on 20 February 2012 at the initiative of the banks, in line with the rules set in the Danish recapitalisation scheme approved by the Commission[4]. The continuing bank shall assist the Danish State if it wishes to dispose of the shares acquired.[5]

(21) The Danish FSA considers that the merger of the banks will lead to a more viable bank.

<u>Measure 1 – capital increase in the continuing bank</u>

(22) The capital increase will be carried out as a rights offering with preferential subscription rights for existing shareholders. Accordingly, all shareholders will receive subscription rights for each share they own.

(23) The capital raise is not underwritten by the Danish State. The State participates *pro rata* in the capital increase corresponding to the State's direct ownership of 52.1% in the merged entity and at the same conditions as the private investors.

(24) The bank expects *gross proceeds* of DKK 270-320 million, and must realize *net proceeds* of at least DKK 250 million to comply with the conditions for obtaining the other elements of the capital plan.[6]

(25) The State, as a starting point, must be able to utilize all the allocated subscription rights and subscribe for new shares of up to DKK 166.7 million (EUR 22.4 million). The remaining amount is expected to be subscribed by current or new private shareholders.

(26) If the private participation is less than expected, the pro rata condition implies that the State participation is reduced correspondingly.

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4 Commission Decision in case N31a/2009, *Danish bank recapitalisation scheme and guarantee scheme on new debt*, OJ C 50, 3.3.2009, p. 3 as prolonged and amended by the Commission Decision in case N415/2009 and NN 46/2009, *Prolongation and amendment of the recapitalisation scheme and prolongation of the guarantee scheme*, OJ C 277, 22.9.2009, p. 2 and Commission Decision in case N628/2009, *Second prolongation of the recapitalisation scheme*, OJ C 33, 10.2.2010, p. 4.

5 The continuing bank shall notify the Danish State if the continuing bank becomes aware of an impending breach or anticipatory breach of the agreement on State capital injection or that a payment under the agreement cannot or will not be made. The continuing bank shall furthermore immediately notify the Danish State in writing if, under the provisions on mandatory conversion, the continuing bank is ordered to convert into shares any part of the State capital injection which is subject to provisions on mandatory conversion. The continuing bank shall present a statement on its lending activities to the Danish State twice a year.

6 Issuance expenses are estimated to be DKK 20 million.

(27) According to the information submitted by Denmark, the subscription rate will be set at DKK [...], entailing a discount of [...] from a stock price in the beginning of 2012 and [...] of the theoretical ex-rights price ("TERP"). Since the current stock price is around DKK [...] the bank is expected to offer a discount that exceeds both these levels (discounts from the stock price in the beginning of 2012 and from the TERP) in order to achieve a subscription from private investors of at least DKK [...] million.

Measure 2 – raising of a subordinated loan

(28) The subordinated loan capital will be funded entirely by private investors.

Measure 3 – sale of a minority shareholding to the Danish Central Bank

(29) Vestjysk Bank as the continuing bank has obtained a conditional commitment from the Central Bank of Denmark for the purchase of Vestjysk Bank's shares in Dansk Landbrugs Realkreditfond ("DLR"), a Danish mortgage credit institution. Vestjysk Bank has a minority shareholding (>10%) in DLR. Pursuant to accounting rules on minority shareholdings, Vestjysk Bank has to consolidate the risk-weighed assets linked to that minority participation when calculating its capital needs. Accordingly, the sum of non-significant holdings in other financial institutions in excess of 10% of the financial institution's own funds have to be deducted from its own funds. The sale of the minority shareholding would therefore improve Vestjysk Bank's capital position and its regulatory capital by around 60 basis points.

(30) DLR is owned jointly by a number of banks. DLR's shareholders' agreement lays down that the price of DLR's shares is calculated based on 100% distributable and on 57.56% non-distributable reserves. That formula is intended to ensure that DLR's shares are traded at a price below the book value of equity.[7] Owner banks apply the same price mechanism for their accounting purposes.

(31) Denmark submits that holdings of unlisted shares are included in the accounts of a bank at fair prices. In that regard, Vestjysk Bank has included its DLR shares in its account at the market price and will incur neither losses nor profits resulting from the sale of those shares.

Measure 4 – issuance of new State-guaranteed debt

(32) The two banks involved in the merger each hold individual State guarantees on liabilities under the Danish guarantee scheme. Following the merger, they intend to replace the existing State guarantees with new individual State guarantees. The

[7] According to the information submitted by Denmark, the market price of the DLR shares on 11 April 2012 was DKK 14.03 (EUR 1.89), whereas the book value of equity of a DLR share was DKK 16.14 (EUR 2.17).

continuing bank will after the completion of the merger have a total of DKK 9.4 billion (EUR 1.3 billion) of guaranteed liabilities. The outstanding guaranteed loans will mature by 16 July 2013.

(33) As part of the capital plan the merged bank will in 2012 be obliged to reduce the total guarantee to DKK 8.4 billion. That reduction of the amounts guaranteed by DKK 1 billion (EUR 134 million) has been stipulated by the Financial Stability Company ("FSC")[8], as one of the conditions for the issue of the new State guarantees. The FSC has given a conditional commitment on the new individual State guarantees for liabilities totalling up to DKK 8.6 billion (EUR 1.2 billion). It is expected that the continuing bank will start reducing the outstanding balance of the new guarantees as of February 2014 with the final repayment being effected in June 2016.

(34) Pursuant to the submissions from Denmark, the following general terms will apply to the new individual State guarantees:

(i) A new individual State guarantee on new debt issued in connection with a merger may have a term of up to five years, but shall not last longer than until 31 December 2016, and only one-third of the guarantee may have a term of more than three years.

(ii) The guarantees on new debt are scheduled to be issued between May 2013 and July 2013.

(iii) The continuing bank shall pay a risk-based guarantee commission for the State guarantee. The basis for determining the guarantee commission is set at 1.35%, to which should be added an incremental additional guarantee charge of 0.65% in the first year, 0.75% in the second and 0.90% in the third year and onwards for the duration of the guarantee. If the European Commission were to seek a higher guarantee commission in the course of its monitoring of the guarantee schemes implemented by the Member States, the guarantee fee will be increased to that level.[9]

(iv) Bonds issued with a new individual State guarantee must be pledged with Danmarks Nationalbank and may not be sold to any third party.

(35) Furthermore, the FSC has defined the following terms to be satisfied by the continuing bank for as long as the individual State guarantees are outstanding:

(i) The continuing bank may only pay dividends if [...].

(ii) No capital reductions whereby the amount is disbursed to shareholders may be implemented by the continuing bank, no new programmes to buy back treasury

[8] FSC is the State-owned entity established to take care of the State aid measures that are being introduced in the context of the financial crisis.

[9] The minimum level for the guarantee fee will be determined according to method described in the Annex of the 2012 Prolongation Communication – Commission Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

shares may be initiated, bonus shares may not be issued at a discount and no other similar favourable programmes may be applied. However, that limitation shall not apply, in whole or in part, to any buy-back of shares held by the Danish State as part of a phase-out of the State capital injections.

(iii) New share option programmes or similar programmes for the executive board may not be launched, and existing programmes and other similar programmes may not be extended or renewed.

4. DENMARK'S POSITION

(36) The Danish authorities argue that out of measures 1 to 4, the only measure entailing the use of State aid is the new guarantees issued for the continuing bank's debt (measure 4).

(37) Measure 1 – capital increase. Denmark argues that, given that the State will participate on a *pari passu* basis with private investors at the same terms and proportionally to its current share in the merged entity[10], the participation is done at market terms, ensuring that the State acts as a private market investor.

(38) Furthermore, Denmark submits that the intention of the State in the long run is not to remain a shareholder in Danish financial institutions. In that context, the State may sell shares as well as subscription rights in the merged bank during the subscription period at market price.

(39) On that basis, Denmark considers that there is no aid in relation to the capital increase.

(40) Measure 2 – subordinated loan. Denmark submits that the subordinated loan capital is raised entirely from a number of private investors. Therefore it does not entail any usage of State resource and therefore does not qualify as State aid.

(41) Measure 3 – sale of a minority shareholding to the Danish Central Bank. Denmark submits that the Danish Central Bank owns shares in a number of entities that are jointly owned by commercial banks and mortgage credit institutions. Denmark argues that the Danish Central Bank has offered to buy Vestjysk Bank's minority shareholding in DLR in relation to the merger, and as the Danish Central Bank saw the planned strengthening of the capital base of the continuing bank as satisfactory, the Central Bank decided to give a conditional commitment to buy those shares at the current market price.

(42) Denmark submits that the purchase of the DLR shares by the Danish Central Bank will improve the capital position of the continuing bank.

(43) The Danish Central Bank also submits that it assesses on a general basis requests by

[10] Denmark argues that condition implies that the State will only call all of its subscription rights if the current or new private shareholders call all of their subscription rights. Similarly, the State will only call half of its subscription rights if the private shareholders only call half of their subscription rights.

banks for the purchase at market value of shares in jointly-owned corporations to improve the liquidity position of banks.

(44) Finally, Denmark argues that measure 3 does not entail any usage of State resources.

(45) Measure 4 – Issuance of new guaranteed debt. Denmark submits that the banks hold individual State guarantees and as part of the merger the plan is to replace the existing individual State guarantees with new individual State guarantees. In that context Denmark submits that the new guarantees entail State aid.

(46) Denmark argues that the merger plan was individually notified to the Commission only because the continuing bank's balance sheet is to exceed the eligibility criteria set up for the merger scheme. However, Denmark argues that the merger and the replacement of State guarantees will respect the principles laid down in the merger scheme, with the exception that the merged entity will continue to be [...].[11]

5. ASSESSMENT

A. Existence of aid and potential beneficiaries

(47) The present decision assesses whether the package of measures to Vestjysk Bank following its merger with Aarhus Lokalbank contains State aid.

(48) According to Article 107(1) TFEU, State aid is any aid granted by a Member State 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, in so far as it affects trade between Member States.

1. State resources

(49) Several measures in the package contain State resources as they are financed by the State and its bodies. Specifically, State resources are present in the State participation in the capital raise[12], the purchase of Vestjysk's DLR stake by the Danish Central Bank and the guarantees provided by FSC, a State-owned company responsible for providing guarantees to Danish banks (measures 1, 3 and 4).[13]

(50) Regarding the subordinated loan capital (measure 2), it can be concluded that no State resources are involved as the loans are provided by private market participants.

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11 […].

12 In that context it is observed that as regards the conversion of part of the convertible hybrid capital instruments received by the State as part of the 2009 capital injection into Vestjysk, the State's involvement does not bring new capital to the bank, but only changes the form of its shareholding. As a result of the exercise, the State's convertible hybrid core capital instruments have been converted into ordinary shares. The principal value of those shares has already been considered in full as State aid for Vestjysk Bank and Aarhus Lokalbank by virtue of the Commission's decision approving the Danish capital injection scheme.

13 The measures provided by the FSC were found imputable to the Danish State in the Commission Decision NN51/2008 of 10 October 2008 ("Guarantee scheme for banks in Denmark") (OJ C 273, 28.10.2008, p. 2).

(51) Based on the foregoing, it is concluded that measure 2 does not contain any State resources. Therefore the remainder of the State aid analysis should deal only with measures 1, 3 and 4.

2. Existence of an advantage

(52) Measures 1, 3 and 4 in favour of the continuing bank provide the continuing bank with an advantage as they will enable the continuing bank to raise the capital required to continue activities of the merged entity and provide it with sufficient liquidity.

(53) The State participation in the capital raise will ensure that 52.1% of the amount of total ordinary shares issued to investors is taken up by the State, thus providing a significant part of the capital required. Although the State does not underwrite the transaction, it [...] that it will participate to the right issue [...]. It can therefore not be excluded that the knowledge that the State is participating will encourage private investors to take up shares in Vestjysk Bank, which could increase take-up and thus make the capital raise more successful.

(54) In addition, the purchase of the DLR minority stake by the Central Bank will generate a capital release effect which will allow Vestjysk Bank to derecognise the risk-weighted assets on its balance sheet related to that stake. That measure thus enables Vestjysk Bank to complete the capital plan. Without the sale of the DLR stake, the capital raised through the capital plan would be incomplete, thus requiring Vestjysk Bank to find other sources of capital which might not be available.

(55) As regards the guarantees provided to the continuing bank, they will allow Vestjysk Bank to access the necessary liquidity to finance its activities. Given that without the guarantee, the continuing bank would have difficulty to obtain funding in the financial markets, it provides an advantage.

3. Selectivity

(56) The use of measures 1, 3 and 4 would concern only the continuing bank and are therefore selective.

4. Distortion of competition and effect on trade between Member States

(57) The advantage procured by the measures will strengthen the positions of the continuing bank as regards capital and liquidity compared to those of its competitors who will not benefit from similar measures. The measures will furthermore facilitate the merger of Vestjysk Bank and Aarhus Lokalbank and therefore enable the merged entity to improve its market position. The measures therefore can lead to a distortion of competition.

(58) Given the integration of the banking market at European level, the advantage provided to the continuing bank is felt by competitors both in Denmark (where banks from other Member States operate) and in other Member States. The measures must therefore be regarded as potentially affecting trade between Member States.

5. Applicability of the market investor principle

(59) The Danish authorities have argued that measures 1 and 3 respect the market investor principle as the Danish State participates in the capital raise on a pro rata basis at the same terms as private investors and the Central Bank will purchase the DLR stake at market price.

(60) In its judgment in Case T-11/95 *BP Chemicals* v *Commission*[14] the Court of First Instance held that in the case of several recapitalisations for an undertaking by the same public investor over a period of several years which brought no return, the Commission had to determine whether a further capital injection could reasonably be severed from the previous injections and classed, for the purposes of the private investor test, as an independent investment.

(61) The Commission recalls that, the participation by the Danish State in the capital raise is possible because of an earlier capital injections implemented in 2009 under the Danish recapitalisation scheme. The Commission observes that measures 1 to 4 are all part of a single package that has been created by the Danish authorities. In the light of *BP Chemicals*, it has to be noted that a series of consecutive measures do not automatically have to be considered together. Relevant considerations in this case are the chronology of events, the purpose of the measures and the situation of the beneficiary at the time of the decision to make the investment by the State. In that context it is noted that construction of the package does not allow the bundled measures to be assessed separately from each other. Without measure 1 being completed, the other measures will not be executed. There is therefore a clear chronological link in place between the various measures in the package.

(62) It is noted that the purpose of measures 1, 3 and 4 is the same, namely to strengthen the viability of the continuing bank by facilitating the merger of two banks that are experiencing some difficulties and [...]. The merger together with the package furthermore are intended to improve the access of the continuing bank to funding and its viability by ensuring it has sufficient capital and liquidity. It is noted that both banks were experiencing problems in 2009, which lead to them being aided through capital injections under the Danish capital injection scheme.

(63) With regard to measure 1, it is furthermore doubtful that a private investor would have announced in advance of the rights issue that it would participate to the capital increase [...] where there was no obligation for it to do so.

(64) Concerning measure 3, the Danish Central Bank will purchase DLR shares at market price (in line with the shareholders' agreement setting the price of DLR shares). However, the Danish Central Bank has indicated that the rationale behind that investment is to sustain the viability and solvency of the continuing bank. Therefore the investment is conducted in the context of obligations which the Danish Central Bank bears as a public authority. As a result it is questionable whether the market economy investor principle could apply to that particular measure. It is furthermore questionable whether a private market investor would assist a recapitalisation of a bank

[14] Case T-11/95 *BP Chemicals* v *Commission* [1998] ECR II-3235, paragraphs 170 and 171.

by purchasing a minority shareholding that bank holds in another institution at market price without a discount, in particular in view of the low liquidity of the shares purchased (DLR is not traded).

(65) The guarantees provided by the FSC to the continuing bank (measure 4) to enable it to access funding would not be provided by a private market guarantor as such an operator would not be able to guarantee the considerable amount necessary for the continuing bank to finance its operations (DKK 8.6 billion) given the current shortage of liquidity on the financial markets.

(66) For those reasons, it is found that the market economy investor principle does not apply to the package proposed by the Danish authorities and more specifically measures 1, 3 and 4, which cannot be viewed in isolation and are part of a package designed by the Danish State. In any event, even if that principle was applicable, the design of the measures does not appear to be in line with the conduct of a private market operator with similar characteristics.

Conclusion

(67) As a result, the Commission concludes that measures 1, 3 and 4 constitute State aid within the meaning of Article 107(1) TFEU.

B. Compatibility of the aid

1. Legal basis for the compatibility assessment

(68) Article 107(3)(b) TFEU provides that State aid may be considered to be compatible with the internal market where it is intended to "remedy a serious disturbance in the economy of a Member State".

(69) Given the present circumstances in the financial markets, the Commission considers that measures 1, 3 and 4 may be examined under that provision.

(70) The Commission accepts that the financial crisis has created exceptional circumstances in which the bankruptcy of one bank may undermine trust in the financial system at large, both at national and international level. That may be the case even for a bank of small size which is not in immediate difficulty but [...] by the Financial Regulator, such as Vestjysk Bank and Aarhus Lokalbank. In those cases, early intervention to avoid the institutions concerned becoming unstable can be necessary to avoid threats to financial stability. It is particularly so in the case of a small economy such as Denmark where counterparts may tend not to distinguish between individual banks, thus extending the lack of confidence generated by the failure of one bank to the whole sector.

(71) Given the great uncertainty due to the financial crisis and the necessity of external funding for the Danish banking sector, a lack of confidence in the Danish financial system could severely affect the whole Danish economy.[15]

(72) The general principles applicable for State aid granted to financial institutions are set out in point 15 of the Banking Communication[16]. Those principles have been further elaborated in the Recapitalisation Communication[17]. Both Communications were subsequently amended by the 2010 Prolongation Communication[18] and the 2011 Prolongation Communication[19].

(73) Furthermore, certain principles of the Restructuring Communication[20] have to be respected in the present case. According to the Restructuring Communication, in order to be compatible with Article 107(3)(b) TFEU, the restructuring of a financial institution in the context of the current financial crisis, in particular, has to lead to a restoration of the viability of the bank or a demonstration of how it can be wound-up in an orderly fashion. Whilst viability considerations play a role in the assessment of the measures, due to the specificities of the case, this decision does not prejudge the full assessment which will be undertaken in a future restructuring decision.

2. Compatibility assessment

(74) In order to determine the compatibility of measures 1, 3 and 4 with the internal market, they will be analysed under the different guidelines provided by the Commission in the context of the financial crisis. Accordingly, they will be analysed on the basis of the Banking Communication and the Communications that have further elaborated on or amended the Banking Communication. These include the 2011 Prolongation Communication for measures 1, 3 and 4 and the 2010 Prolongation Communication for measure 4.

(75) According to the Banking Communication, the aid has to be:

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15 Denmark has introduced several schemes introducing measures for tackling that risk. Those schemes have ranged from resolution frameworks of failing banks to a merger scheme aiming at keeping banks on the market by means of a market-based solution. See Decision N 407/2010 of 30.09.2010 (OJ C 312, 17.11.2010, p. 7); Decision SA.31938 (N 537/2010) of 7 December 2010 (OJ C 117, 15.2.2011, p. 2); Decision SA.33001 (2011/N) – Part A of 28.06.2011 (OJ C 237, 13.8.2011, p. 2); Decision SA.33001 (2011/N) – Part B of 01.08.2011 (OJ C 271, 14.9.2011, p. 4); Decision SA.33757 (2011/N) of 9.12.2011 (OJ C 22, 27.1.2012, p. 5); and Decision SA.34227(2012/N) of 17 February 2012 (C(2012) 1081 final), not yet published; as well as Decision "SA.33639 (2011/N) – Rescue Aid for Max Bank" of 7 October 2011(OJ C 343, 23.11.2011, p. 13).

16 Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8.

17 Commission Communication on the Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

18 Commission Communication on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

19 Commission Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

20 Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.08.2009, p. 9.

– well-targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy;

– proportionate to the challenge faced, not going beyond what is required to attain that effect, and

– designed in such a way as to minimize negative spill-over effects on competitors, other sectors and other Member States.

2.1 The aid is well-targeted

(76) The financial crisis has created exceptional circumstances in which the bankruptcy of one bank may undermine trust in the financial system at large, both at national and international level. That may be the case even for banks of small sizes, such as Vestjysk Bank and Aarhus Lokalbank.

(77) Given the great uncertainty due to the financial crisis and the necessity of external funding for the Danish banking sector, in the case of a small economy such as Denmark, the lack of confidence generated by the failure of one bank may extend to cover the entire financial sector, which could severely affect the whole Danish economy.

(78) In fact, the Danish FSA considers that both of the banks are [...], as a result of not being able to obtain funding from the open markets. The merger is intended to counter challenges to both the funding and the solvency of the continuing bank. In particular, measures 1, 3 and 4 are to improve the basis for a future phase-out of the State-guaranteed loans for the purpose of ensuring that the continuing bank will not require any State guarantees after […], as well as to improve the capital ratio of the continuing bank to meet new capital requirements.

(79) The Commission throughout the financial crisis has consistently held that guarantees on newly issued debt are appropriate to ensure sufficient funding to allow banks to operate in an environment where wholesale funding from the financial markets is increasingly difficult to access. The same applies to the provision of capital by the State in order to ensure that the continuing bank is sufficiently solvent after the merger.

(80) In that respect, measures 1, 3 and 4 are a well-targeted and efficient means of remedying a serious disturbance in the Danish economy, as they are appropriate instruments and will eliminate the threat to the stability of the Danish economy that the failure of Vestjysk Bank and Aarhus Lokalbank could have entailed.

2.2 The aid is proportionate and limited to the minimum

(81) As set out in the Banking Communication, the aid should be proportionate and restricted to the minimum necessary. It implies that the amount of aid is appropriate to address the difficulties of the bank and that it is adequately remunerated.

Measure 1

(82) It is observed that in measure 1, the Danish State will participate in the capital raise on the basis of its stake in both banks. As a result the State will provide 52.1% of any capital that will be injected in the continuing bank provided private parties will also invest. By definition, that feature of the measure limits the amount of aid the State will provide.

(83) As regards remuneration to the State for its participation in the capital raise, it is noted that the 2011 Prolongation Communication provides guidance on the conditions for State recapitalisations in the form of ordinary shares. According to that Communication, the remuneration for such recapitalisations should be assessed on the basis of the discount to the share price adjusted for the dilution effect or the TERP immediately prior to the announcement of the capital injection.

(84) It is noted that the subscription rate of the rights issue in which State participates will be set at DKK [...]. That subscription rate entails a discount of [...] from a stock price of DKK [...] in the beginning of 2012, representing a TERP of [...]. The discount is expected to increase prior to the launch of the capital raise as the current stock price is around DKK [...], meaning the bank is expected to offer a discount in excess of that level in order to achieve the envisaged subscription from private investors of at least DKK [...] million.

(85) The Commission notes that the discount to the TERP[21] would be around 25%, which is lower than is currently being carried out in the open markets. However, the Commission observes that the Danish State is not underwriting the issuance but is acting on *pari passu* basis with private investors and is only subscribing in proportion to its current ownership to the rights offering.

(86) The discount foreseen in measure 1 ensures that the State will receive an adequate remuneration for its participation in the capital raise. The measure therefore fulfils the requirements of the 2011 Prolongation Communication.

(87) For those reasons, the Commission considers that the aid in relation to measure 1 is to be proportionate and limited to the minimum necessary.

Measure 3

(88) The purchase of the DLR stake of Vestjysk Bank by the Danish Central Bank will result in a capital release in favour of that bank. The measure in question does not appear to relate to monetary policy operations of the Danish Central Bank.

(89) Together with the capital raise in which the State will participate, measure 3 will ensure that Vestjysk Bank will generate sufficient capital to maintain its solvency after the merger. Without the purchase of the DLR shares, Vestjysk Bank would have had to find other sources of capital in order to achieve the target amount of capital that need to be raised. As the transaction releases capital and helps to ensure the necessary capital target is met, it can be considered as proportionate to the challenge faced.

[21] See footnote 9 of the 2011 Prolongation Communication.

(90) It is observed that the DLR stake is being purchased at a market price that is determined by the shareholders' agreement. There is no discount foreseen in the price that will be paid to Vestjysk Bank for the DLR shares.

(91) In that context it should be recalled that the capital release which is caused by the sale of the DLR stake by Vestjysk Bank reduces the amount of capital Vestjysk Bank has to hold against the risk-weighted assets in its balance-sheet. That capital release effect is comparable to a recapitalisation and should therefore be remunerated as such. As the DLR stake is made up of instruments equivalent to ordinary shares, it is appropriate that the principles of the 2011 Prolongation Communication are applied.

(92) Since a market price is paid for the DLR stake to Vestjysk Bank and no discount has been envisaged, the remuneration for the capital release resulting from the sale of that stake is insufficient.

(93) According to the 2010 Prolongation Communication, banks that receive a recapitalisation from 1 January 2011 onwards have to submit a restructuring plan to the Commission that fulfils the criteria of the Restructuring Communication. As both measures 1 and 3 are recapitalisations that have been qualified as aid, that obligation also applies in the present case. Furthermore, the Recapitalisation Communication stipulates that insufficient remuneration should increase the extent of restructuring required.

(94) The Commission will therefore take into account the lack of remuneration for measure 3 when determining the depth of the restructuring of Vestjysk Bank. Nevertheless, the Commission will also take into account the following mitigating factors: the nature of the measure, the fact that the remuneration received for the guarantee exceeds Commission requirements for compatibility of guarantees with the internal market and the limited distortion of competition caused by the aid.

<u>Measure 4</u>

(95) It is considered that the guarantee on new liabilities is both proportionate and limited to the minimum.

(96) The Commission considers the fee paid for the guarantee by the continuing bank to be sufficient, as the fees for the guarantee exceed the minimum levels set by the Commission in its 2011 Prolongation Communication, and, in any case, Denmark has committed to apply that minimum level for the fees if the method used by Denmark were to give rise to a lower fee.

(97) The Commission welcomes the fact that the FSC has capped the new individual State guarantees for loans and that the FSC has stipulated as one of the conditions for the issue of the new State guarantees a prepayment of DKK 1 billion (EUR 134 million) of the existing guarantees. Those elements will limit the amount of aid required.

(98) It follows from the conditions laid down by the FSC that the aggregate amount of senior loans outstanding benefitting from the existing and the new guarantees may not at any point in time exceed an amount of DKK 8.6 billion, thus further limiting the aid.

(99) In that context the Commission notes that the State guarantees would exceed 5% of the total liabilities of the continuing bank. In line with the 2010 Prolongation Communication, that relative amount of aid would in principle trigger the requirement to provide a viability review of the continuing bank. However, the Commission will not request a viability review since the continuing bank will have to submit a restructuring plan, which by definition requires a set of measures that go further than a viability review.

2.3 Measures limiting distortion of competition

(100) The Commission notes that as a contribution to limiting distortions of competition the continuing bank's balance sheet is to be reduced by [10-20] % in the context of the merger.

(101) Denmark has further committed to introduce an acquisition ban.

(102) In addition, it is observed that the aid provided by way of recapitalisation is relatively small, estimated at a maximum of EUR 64 million compared to a total balance sheet of the continuing bank of around EUR 4.7 billion. Furthermore, the fees paid by the continuing bank for the guarantee on its liabilities exceed the minimum required by the 2011 Prolongation Communication and are sufficiently expensive to encourage the bank to exit from the State aid regime as soon as possible.

(103) The balance sheet reduction to be implemented by the continuing bank after the merger will limit its activities, while the acquisition ban ensures that it cannot engage in any aggressive commercial behaviour.

(104) The Commission notes that the notified guarantees are a part of a merger plan that is to be considered as a proactive initiative to find solutions to the challenges for the two banks. A more passive strategy of wait-and-see would [...] for the two banks, which could have the effect of creating renewed uncertainty in the financial sector.

(105) In that regard, it also has to be taken into consideration that Denmark has introduced several schemes entailing contribution of shareholders to the burden-sharing of failing banks.[22] Whilst those schemes therefore pursue the goal of resolving failing banks, the merger scheme aims at keeping banks on the market by means of a market-based solution.

(106) Accordingly, the Commission considers that the State aid measures provided to the continuing bank are designed in such a way as to minimize negative spill-over effects on competitors, as without them both banks would face problems with their refinancing needs and would be in danger of becoming distressed, which could create renewed uncertainty in the financial sector.

[22] See Decision N 407/2010 of 30.09.2010 (OJ C 312, 17.11.2010, p. 7); Decision SA.31938 (N 537/2010) of 7 December 2010 (OJ C 117, 15.2.2011, p. 2); Decision SA.33001 (2011/N) – Part A of 28.06.2011 (OJ C 237, 13.8.2011, p. 2); Decision SA.33001 (2011/N) – Part B of 01.08.2011 (OJ C 271, 14.9.2011, p. 4); Decision SA.33757 (2011/N) of 9.12.2011 (OJ C 22, 27.1.2012, p. 5); and Decision SA.34227(2012/N) of 17 February 2012 (C(2012) 1081 final), not yet published.

Conclusion

(107) The Commission concludes that the rescue aid measures provided for Vestjysk Bank and Aarhus Lokalbank are in line with the conditions of the Banking Communication, the 2010 and 2011 Prolongation Communications, and the Restructuring Communication because: (i) the aid is appropriate and well-targeted; (ii) the aid is limited to the minimum necessary; and (iii) there are sufficient measures limiting the negative spill-over effects for other competitors.

6. DECISION

The Commission finds that measures 1, 3 and 4 in favour of Vestjysk Bank and Aarhus Lokalbank constitute State aid within the meaning of Article 107(1) TFEU. However, on the basis of the foregoing assessment, those measures are found to be temporarily compatible with the internal market for reasons of financial stability. The measures are accordingly approved for six months or, if Denmark submits an in-depth restructuring plan within six months from the date of this Decision, until the Commission has adopted a final decision on that restructuring plan.

Denmark accepts exceptionally that the adoption of the decision be in the English language.

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Your request should be sent by registered letter or fax to:

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Yours faithfully
For the Commission

Joaquín ALMUNIA
Vice-President