

**Felhívás észrevételek benyújtására az EFTA-államok közötti, a Felügyeleti Hatóság és a Bíróság létrehozásáról szóló megállapodás 3. jegyzőkönyve I. része 1. cikkének (2) bekezdése szerint a lakásfinanszírozási alap (Housing Financing Fund) által nyújtott állítólagos támogatással kapcsolatos állami támogatás kérdésében**

(2010/C 277/04)

A 2010. március 10-i 76/10/COL határozattal, amelynek eredeti nyelvű szövege ezen összefoglaló végén található, az EFTA Felügyeleti Hatóság eljárást kezdeményezett az EFTA-államok közötti, a Felügyeleti Hatóság és a Bíróság létrehozásáról szóló megállapodás 3. jegyzőkönyve I. része 1. cikkének (2) bekezdése szerint. Az izlandi hatóságokat a határozat másolatának megküldésével értesítették.

Az EFTA Felügyeleti Hatóság ezúton felkéri az EFTA-államokat, az EU-tagállamokat és az érdekelt feleket, hogy e felhívás közzétételétől számított egy hónapon belül juttassák el észrevételeiket a szóban forgó intézkedéssel kapcsolatban az alábbi címre:

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Az észrevételeket továbbítják az izlandi hatóságoknak. Az észrevételeket benyújtó érdekelt felek kérésüket megindokolva, írásban kérhetik adataik bizalmas kezelését.

#### ÖSSZEFOGLALÁS

##### Az eljárás

2009. május 27-i levelükben az izlandi hatóságok támogatási programot jelentettek be, amelynek értelmében az izlandi lakásfinanszírozási alap (a továbbiakban: HFF) lakóingatlannal fedezett jelzáloghiteleket vásárol különféle pénzügyesektől (a továbbiakban: a jelzáloghitel-program). A Hatóság két alkalommal további tájékoztatást kért az izlandi hatóságoktól.

##### A jelzáloghitel-program értékelése

A jelzáloghitel-program bevezetésére az izlandi pénzügyi piacokon a pénzügyi rendszer összeomlása következtében kialakult likviditáshiány indította az izlandi hatóságokat. A program szerint a HFF jelzáloghiteleket vásárol különféle pénzügyesektől, amelyek azokért cserébe HFF-kötvényeket kapnak. Az ügylet állandó eszköz swap, és a pénzügyesek jogosultak arra, hogy a HFF-kötvényeket fedezetül használják az izlandi központi banktól felvett készpénzkölcsönök támogatására.

A Hatóság véleménye szerint a pénzügyi válság okozta jelenlegi piaci helyzetben egyetlen piaci magánbefektető sem bonyolított volna hasonló eszköz swap ügyletet. Ezért a Hatóság előzetes következtetése értelmében a jelzáloghitel-program állami támogatást foglal magában.

Az intézkedés összeegyeztethetőségének megítélése céljából a Hatóság értékelte a jelzáloghitel-programot a Hatóság értékvesztett eszközökre vonatkozó állami támogatásokról szóló iránymutatásának fényében. A Hatóság több kérdést aggályosnak talált. Ebben a szakaszban, a rendelkezésre álló információk alapján a Hatóságnak az alább felsoroltak tekintetében merültek fel kételyei. A Hatóság

1. nem bizonyos abban, hogy az eszközök – mind a jelzáloghitelek, mind a HFF-kötvények – értékelése a valós gazdasági értéket tükrözi, és megjegyzi, hogy az értékelést nem független szakértő végezte;
2. nem bizonyos abban, hogy az állam számára nyújtott ellentételezés elegendő, valamint
3. aggályosnak tartja, hogy a jelzáloghitel-program határozatlan időre szól.

Fenti szempontokra figyelemmel a Hatóságnak kételyei merültek fel a tekintetben, hogy a jelzáloghitel-program összeegyeztethetőnek tekinthető-e az EGT-megállapodás működésével az értékvesztett eszközökre vonatkozó állami támogatásokról szóló iránymutatás alapján.

A jelzáloghitel-programot már a bejelentése előtt bevezették. A programot legelőször a HFF és a Keflavik takarékalap között 2009. március 23-án aláírt jelzáloghitel-vásárlási szerződéssel összefüggésben alkalmazták. Következésképpen a jelzáloghitel-program jogellenes támogatást foglal magában.

### Következtetés

Fenti megfontolások fényében a Hatóság az EGT-megállapodás 1. cikkének (2) bekezdésével összhangban a hivatalos vizsgálati eljárás megindítása mellett döntött. Felkérjük az érdekelt feleket, hogy az e határozatnak az *Európai Unió Hivatalos Lapjában* való közzétételétől számított egy hónapon belül nyújtsák be észrevételeiket.

## EFTA SURVEILLANCE AUTHORITY DECISION

No 76/10/COL

of 10 March 2010

**to initiate the formal investigation procedure with regard to the transfer of mortgage loans secured against collateral in residential property from financial undertakings to the Housing Financing Fund (Iceland)**

THE EFTA SURVEILLANCE AUTHORITY <sup>(1)</sup>,

Having regard to the Agreement on the European Economic Area <sup>(2)</sup>, in particular to Articles 61 to 63 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 <sup>(3)</sup>, in particular to Article 24 thereof,

Having regard to Article 1(3) of Part I and Article 4(4) and 6 of Part II of Protocol 3 to the Surveillance and Court Agreement <sup>(4)</sup>,

Having regard to the Authority's Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement <sup>(5)</sup>, in particular the chapter on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis and the Chapter on the treatment of impaired assets in the EEA banking sector,

Having regard to the Authority's Decision of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3 <sup>(6)</sup>,

Whereas:

### I. FACTS

#### 1. Procedure

In the context of pre-notification discussions, the Icelandic authorities submitted three letters dated 14 October 2008 (Event No 494902), 3 November 2008 (Event No 496979) and 3 December 2008 (Event No 500670) to the Authority with the intention of introducing a scheme concerning the purchase of mortgage loans (the 'Mortgage Loan Scheme'). The pre-notification discussions formed part of a more general discussion on the financial crisis in Iceland. On 27 May 2009, the Icelandic authorities notified the scheme to the Authority in order to obtain legal certainty (Event No 519720).

<sup>(1)</sup> Hereinafter referred to as the Authority.

<sup>(2)</sup> Hereinafter referred to as the EEA Agreement.

<sup>(3)</sup> Hereinafter referred to as the Surveillance and Court Agreement.

<sup>(4)</sup> Hereinafter referred to as Protocol 3.

<sup>(5)</sup> Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19.1.1994, published in the *Official Journal of the European Union* (hereinafter referred to as OJ L 231, 3.9.1994, p. 1 and EEA Supplement No 32, 3.9.1994, p. 1. Hereinafter referred to as the State Aid Guidelines). The updated version of the State Aid Guidelines is published on the Authority's website (<http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>).

<sup>(6)</sup> Decision No 195/04/COL of 14 July 2004, (published in OJ L 139, 25.5.2006, p. 37 and EEA Supplement No 26, 25.5.2006, p. 1), as amended. A consolidated version of the Decision can be found online (<http://www.eftasurv.int/>).

By letter dated 25 June 2009 (Event No 520515) and e-mail dated 29 June 2009 (Event No 523605), the Authority requested additional information. A reply was provided by the Icelandic authorities on 27 July 2009 (Event No 525671). The information submitted was updated by letter of 28 August 2009 (Event No 528493). The case was also discussed in a conference call between the Authority and the Icelandic authorities on 1 July 2009.

The case was further discussed between the Authority and the Icelandic authorities in the context of the State Aid Package Meeting on 4 November 2009.

By letter dated 16 November 2009 (Event No 536644), the Authority requested follow-up information. A reply was provided by the Icelandic authorities on 25 November 2009 (Event No 538088).

## 2. Description of the measures

### 2.1. Background

The Icelandic authorities have explained that as a result of turmoil in the global financial markets, the Icelandic financial institutions have been faced with a shortage of liquidity and limited supply of credit. In response to this situation, the Icelandic authorities decided to adopt measures aimed at securing the functioning of financial markets. One of such measures consists of authorising the national housing agency, the Housing Financing Fund (the 'HFF'), to purchase mortgage loans from financial undertakings.

The Icelandic authorities have explained that this is the second scheme authorising the HFF to intervene on behalf of the State in the context of the financial crisis. The first scheme was approved by the Authority by means of Decision No 168/09/COL of 27 March 2009 on an additional loan category of the HFF on lending to banks, saving banks and other financial institutions for the purpose of temporarily refinancing mortgage loans <sup>(1)</sup>. The major difference between the scheme already approved by the Authority and the Mortgage Loan Scheme is that the former contained an asset swap of a temporary nature whereas under the Mortgage Loan Scheme the asset swap would be permanent. The schemes do not overlap in the sense that they cover the same portfolio of mortgage loans at the same time, because the portfolio of the mortgage loans subject to the temporary scheme must be returned to the beneficiary undertaking before a purchase agreement is put into effect.

The primary objective of the Mortgage Loan Scheme is to provide liquid funds to financial institutions. The market failure intended to be addressed by the measure is the lack of liquidity due to the collapse of the financial system. As a secondary objective, the Mortgage Loan Scheme aims at ensuring the availability of loans on the residential housing market and to safeguard the interests of the homeowners.

The Mortgage Loan Scheme was originally designed as a financing measure for new mortgage loans to be offered by the financial institutions in order to complement the temporary scheme for the refinancing of financial institutions in respect of mortgage loans already given, which was subject to the Authority's Decision No 168/09/COL. The Mortgage Loan Scheme, like the temporary scheme, is principally aimed at guaranteeing the security and availability of mortgage loans and promoting normal price formation in the real estate market <sup>(2)</sup>.

According to the information provided by the Icelandic authorities, the Mortgage Loan Scheme is directed first and foremost at small savings banks that were dependent on access to liquidity from the domestic operators facing liquidity problems themselves <sup>(3)</sup>. The saving banks mainly provide traditional banking services to the local communities (individuals, corporate customers and local authorities) of which they form an integrated part. In many regional areas, the saving banks are the only financial institutions in operation <sup>(4)</sup>.

<sup>(1)</sup> OJ C 241, 8.10.2009, p. 16 and EEA Supplement No 52, 8.10.2009, p. 1. The non-confidential version of the Decision is available on the Authority's website ([http://www.efasurv.int/fieldswork/fieldstateaid/stateaidregistry/sadecice09/168\\_09\\_col.pdf](http://www.efasurv.int/fieldswork/fieldstateaid/stateaidregistry/sadecice09/168_09_col.pdf)).

<sup>(2)</sup> See Government Declaration of 19.6.2008 concerning measures related to the real estate and financial markets and the Government's press release of 18.7.2008.

<sup>(3)</sup> Before the financial crisis, the Icelandic banking sector consisted largely of two segments: The first one comprising the three former major banks Glitnir, Landsbanki and Kaupthing which had relatively large international exposure. The second comprised small savings banks which traditionally rely on financing from the bigger banks.

<sup>(4)</sup> Decision No 168/09/COL, p. 3.

## 2.2. *The Mortgage Loan Scheme*

On the basis of the Mortgage Loan Scheme, the HFF is authorised to take over mortgage loans from financial undertakings. It is not necessary to seek the permission of the debtor for such a transfer. The transfer is only possible at the initiative of the respective financial undertaking. Following a written application from the financial institution giving information regarding the estimated size of the mortgage loan pool to be transferred, the HFF enters into negotiations on the terms of the transaction.

The Mortgage Loan Scheme takes the form of a permanent asset swap, according to which the financial institution receives HFF's bonds in exchange for mortgage loans which are transferred to the HFF. The bank can then use the HFF bonds as collateral when taking cash loans with the Central Bank of Iceland. According to the first agreement on the purchase of mortgage loans, signed between the HFF and the Keflavik Saving Fund (SPK), from 2010 onwards, the banks are also authorised to lend and sell the HFF bonds on secondary markets.

As a result of the asset swap, the HFF assumes the role of lender vis-à-vis the borrower of the mortgage loan subject to a transfer. It is not clear whether the borrower acquires the same rights and obligations as other parties in lending transactions with the HFF. According to the Icelandic authorities, the terms and conditions of mortgage loans for borrowers remain unchanged following a transfer to HFF. This would for example mean that loans obtained in foreign currency remain to be in foreign currency following a transfer to HFF. However, based on information submitted by the Icelandic authorities, the Authority has understood that following a transfer the general loan conditions of HFF apply.

All banks, saving banks and credit institutions, which have been granted a licence to operate in Iceland in accordance with the provisions of Act No 161/2002 on financial undertakings, are eligible to participate in the Mortgage Loan Scheme. This also includes subsidiaries of foreign banks established in Iceland and branches of foreign companies.

According to the Icelandic authorities, the valuation of mortgage loans shall be in accordance with their market value. As a rule, the value will be calculated on the basis of the book value of the loan, taking into account the prepayment risk, operation costs and other factors. In order to calculate the market value and to minimise the HFF's credit risk, the HFF performs a valuation of each of the mortgage loans offered by the financial undertaking in accordance with objective criteria, such as the payment status of each debtor, loan-to-value (LTV) ratio, the default status of the respective mortgage loans and the terms of the loan and divides them into three categories:

- (a) non-defaulted mortgage loans that meet all of the HFF's general loan requirements;
- (b) other non-defaulted mortgage loans that do not meet the HFF's general loan requirements;
- (c) defaulted mortgage loans.

While the first two categories are eligible for a transfer to HFF, category (c) is only eligible if the mortgage loans are removed from debt collection and all fees and expenses are paid prior to any transfer.

For credit risk evaluation of mortgages and mortgage pools, the international standard Basel II is used for capital risk assessment of financial institutions. Accordingly, in order to assess the credit risk of mortgage loans, the expected loss is calculated by multiplying the following three factors: probability of default, loss given default and exposure at default. Those variables are assessed for each mortgage loan and for each year of the loan period. If no satisfactory agreement in respect of the credit risk can be reached between the HFF and the beneficiary undertaking, the application is refused.

In addition, in case of involvement of assets denominated in foreign currencies in transactions under the Mortgage Loan Scheme, the currency exchange risk of the HFF should be specifically assessed and taken account of in the pricing of the assets. Payment for assets in foreign currency purchased by the HFF takes place in the form of HFF bonds in foreign currency specifically issued for this purpose.

The final value assessment of the mortgage pool is determined by its performance and the expected loss at the final settlement of the transaction. In exchange for the mortgage loans, the HFF hands over the HFF's bonds <sup>(1)</sup>. The yield of the HFF's bond subject to the swap also takes into account the duration and terms of the mortgage loans and is considered on the basis of other factors such as pre-payment risk and operating costs.

<sup>(1)</sup> There might be different forms of compensation, for instance cash payments. However, at present no other type of compensation than the HFF bonds is provided for.

The HFF transfers the HFF bonds in two instalments. At the moment of signature of the agreement between the HFF and the beneficiary financial institution, only up to 80 % of the value of the mortgage loans is due in the HFF bonds, whereas the final settlement takes place 8 to 10 years after the signing of the agreement <sup>(1)</sup>. The percentage of the value of the HFF bonds to be transferred at the time of signing the agreement decreases in proportion to an increased estimated loss. This ensures that the retained portion of the value of the HFF bonds is always higher than the estimated loss on the mortgage loans. At the time of the final settlement, the HFF transfers to the beneficiary undertaking the remainder of the HFF bonds less the depreciation of the mortgage pool that has already taken place and the estimated loss of the pool throughout its duration.

### 2.3. Legal basis

The Mortgage Loan Scheme is based on Chapter V of Act No 125/2008 of 6 October 2008 on the authority for treasury disbursements due to unusual financial market circumstances etc., inter alia amending Act No 44/1998 on housing affairs (the 'Emergency Act') <sup>(2)</sup>. Further details have been specified by means of Regulation No 1081/2008 of 26 November 2008 on the authority of the Housing Financing Fund to purchase bonds secured by mortgages in residential housing and issued by financial undertakings (the 'Regulation'). The Regulation was adopted and entered into force on 24 October 2008. In addition, the Board of the Housing Financing Fund issued Rules regarding the purchase of mortgage loans from financial undertakings (the 'Supplementary Rules'). Following the approval by the Minister of Social Affairs and Social Security, the Rules were published on 15 January 2009 and entered into force on the same day.

The first application under the Mortgage Loan Scheme was a mortgage loan transfer agreement signed on 23 March 2009 between the HFF and the Keflavik Saving Fund for a total value of ISK [...] <sup>(3)</sup>. For the time being, there are three beneficiaries of the Mortgage Loan Scheme. In addition to the Keflavik Savings Bank, the HFF has entered into agreements with BYR Savings Bank <sup>(4)</sup> and Bolungarvik Savings Bank <sup>(5)</sup>. The Icelandic authorities have also informed the Authority about four further applications which have been made under the Mortgage Loan Scheme.

### 2.4. Budget and duration

The Icelandic authorities have so far not been able to provide the Authority with either the foreseen annual or total expenditure of this measure.

The Mortgage Loan Scheme has not been limited in time. The Icelandic authorities refer to the temporary nature of the Mortgage Loan Scheme, since its aim is to address the temporary liquidity crisis of the financial institutions. The total estimated number of beneficiaries has not been specified in the notification.

## 3. Comments by the Icelandic authorities

The Icelandic authorities have argued that the transfer of the mortgage loans under the Mortgage Loan Scheme takes place on market terms, thereby ensuring that no State aid is involved in the transfer of the HFF bonds to the financial institutions. The Icelandic authorities have only notified the measure for legal certainty. In the event, the Authority should, however, find that the Mortgage Loan Scheme involves elements of State aid, the Icelandic authorities argue that the scheme is compatible on the basis of Article 61(3)(b) of the EEA Agreement.

The Icelandic authorities have also argued that although the Mortgage Loan Scheme is not limited in time, the aim of the Mortgage Loan Scheme is to address the temporary liquidity crisis of the financial institutions, and hence the scheme is of a temporary nature.

## II. ASSESSMENT

### 1. The presence of State aid within the meaning of Article 61(1) EEA

Article 61(1) of the EEA Agreement reads as follows:

'Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.'

<sup>(1)</sup> The definite time of the final settlement is normally specified in the agreement.

<sup>(2)</sup> Act No 125/2008 entered into force upon publication.

<sup>(3)</sup> According to the agreement between the parties of the swap, the final price was to be settled on 15.4.2009.

<sup>(4)</sup> Agreement signed on 20.5.2009 for the value of ISK [...].

<sup>(5)</sup> Agreement signed on 3 July and 5 August 2009 for the final value of ISK [...] and ISK [...] respectively.

### 1.1. *Presence of State resources*

The measure must be granted by the State or through State resources.

The Mortgage Loan Scheme has been introduced by the Emergency Act, passed by the Icelandic Parliament. Further details have been specified by means of the Regulation and the Supplementary Rules.

In line with settled case law, aid may be granted directly by the State or by public or private bodies established or appointed by it to administer the aid <sup>(1)</sup>.

In exchange for mortgage loans the applicant financial institutions receive HFF bonds. The HFF was established by the Housing Act No 44/1998 as a State housing agency, wholly owned by the Icelandic State and under administrative surveillance of the Minister of Social Affairs and Social Security. The Minister appoints the five-member Board of directors of the Fund. The tasks of HFF (i.e. to give loans to individuals, municipalities and companies for financing the acquisition or construction of residential housing) are laid down and regulated in statutory rules, namely Act No 44/1998 on Housing Affairs and secondary legislation (such as Regulation No 57/2009 on the loan categories of the HFF).

The present measures are therefore decided by the State and executed through a State agency, the HFF, which is subject to the full control of the State. The actions of HFF are therefore imputable to the State. The transfer of HFF bonds to financial institutions means therefore that State resources are involved.

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

#### 1.2.1. *Economic advantage*

The aid measure must confer on beneficiaries advantages that relieve them of charges that are normally borne from their budgets.

As explained by the Icelandic authorities, the Mortgage Loan Scheme was established in order to enable banks to obtain the necessary financing from other sources than the usual interbank lending, which was drying up as a result of the global difficulties of the financial sector. The Authority considers it unlikely that, in the current financial crisis, financing would have been provided by a market economy investor on a comparable scale and on similar conditions in favour of the participating banks. Furthermore, the scheme does not contain a pricing mechanism to ensure a correct market price. The price obtained for the mortgage loans may therefore be above market value and hence give the undertakings an economic advantage.

The Mortgage Loan Scheme improves the position of the beneficiary banks by increasing the liquidity of banks' assets and removing a source of volatility on the balance sheet. Moreover, since the calculation of the value of the underlying assets does not take into account their real economic value and the actual losses, it cannot be excluded that in individual cases of application of the Mortgage Loan Scheme, the beneficiary bank might enjoy further benefits.

#### 1.2.2. *Selectivity*

To constitute State aid, the measure must favour certain undertakings, the production of certain goods or the provision of certain services. The Mortgage Loan Scheme is selective as it favours only certain financial institutions. The fact that all undertakings in a given sector may benefit from a measure does not lead to the conclusion that the measure is of a general nature. On the contrary, the measure is selective as it only favours one sector of the economy, i.e. financial institutions.

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

The Mortgage Loan Scheme is liable to distort competition and affect trade between the Contracting Parties. The Mortgage Loan Scheme is intended to support small saving banks involved in mortgage loans activities in Iceland and thereby strengthens their position compared to those of their competitors in other EEA countries. Moreover, all banks and financial institutions, in Iceland, whatever their size, are in principle eligible to apply for support under the scheme. The services and products in the banking and financial sectors are traded internationally. The Mortgage Loan Scheme is therefore liable to distort competition and affect trade between the Contracting Parties in the European Economic Area.

<sup>(1)</sup> Case 78/76 *Steinike and Weinlig v Federal Republic of Germany* [1977] ECR 595, para. 21.

## 2. Procedural requirements

Pursuant to Article 1(3) of Part I of Protocol 3, 'the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid (...). The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision'.

The Icelandic authorities notified Mortgage Loan Scheme by letter of 27 May 2009 (Event No 519720). However, the Rules of the Board of the Housing Financing Fund regarding the purchase of mortgage loans from financial undertakings entered into force already on 15 January 2009, and the first agreement on the purchase of mortgage loans was signed on 23 March 2009, i.e. before the Authority had taken a final decision thereon. The Authority therefore concludes that the Icelandic authorities have not respected their obligations pursuant to Article 1(3) of Part I of Protocol 3.

## 3. Compatibility of the aid

Article 61(3)(b) EEA enables the Authority to declare aid compatible with the functioning of the EEA Agreement if it has the effect 'to remedy a serious disturbance in the economy of an EC Member State or an EFTA State'. The Authority recalls that, in line with the case law of the Court of Justice and the decision making practice of the European Commission (hereinafter referred to as the Commission), Article 61(3)(b) needs to be applied restrictively and must tackle a disturbance in the entire national economy<sup>(1)</sup>.

The Authority recognises that the Mortgage Loan Scheme was adopted amid the current international financial crisis. In Iceland, small saving banks faced liquidity problems as a result of financial difficulties of the larger banks, which traditionally provided funding to the saving banks' sector. Unlike the larger financial undertakings, the saving banks did not have direct access to funding by the Central Bank.

In line with the Authority's Guidelines on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, the Authority considers that this measure falls to be assessed under Article 61(3)(b) EEA.

In order to be declared compatible with the EEA Agreement, the aid must be granted on the basis of non-discriminatory criteria, be appropriate in terms of being well targeted to remedy a serious disturbance in the economy and be necessary and proportionate thereto, limiting negative spill-over effects for competitors. The Impaired Assets Guidelines<sup>(2)</sup> (the 'IAG') translates these general principles into conditions specific for impaired asset relief. The Authority considers that the appropriate framework for assessing the compatibility of the measure is the IAG.

The IAG define impaired assets relief as all measures whereby a bank is dispensed from the need for severe downward value adjustments of certain asset classes. This is also the cases for the present measure. Therefore the Mortgage Loan Scheme must fulfil the conditions for the compatibility of assets relief as set out in the IAG.

### 3.1. Eligibility of assets

Section 5.4 of the IAG states that a coordinated approach within the EEA is necessary for purposes of determining the assets which are eligible for State aid under the IAG. To this end, Annex 3 of the IAG contains a list of categories of impaired assets which are considered clearly eligible. This list includes housing mortgages. Since all assets transferred to HFF under the Mortgage Loan Scheme are housing mortgages the Authority considers that the impaired assets under the scheme are eligible for State aid under the IAG.

<sup>(1)</sup> Joined Cases T-132/96 and T-143/96 Freistaat Sachsen and Volkswagen AG v Commission [1999] ECR II-3663, paragraph 167. See Commission's Decision in Case NN 70/07 Northern Rock (OJ C 43, 16.2.2008, p. 1), Commission's Decision in Case NN 25/08 Rescue aid to WestLB (OJ C 189, 26.7.2008, p. 3), Commission's Decision of 4.6.2008 in Case C 9/08 SachsenLB, (OJ C 71, 18.3.2008, p. 14-23). Authority's Decision No 36/09/COL of 30.1.2009 on the Agreement between the Norwegian State and Eksportfinans ASA concerning state funding of Eksportfinans; Decision No 205/09/COL of 8.5.2009 on the scheme for temporary recapitalisation of fundamentally sound banks in order to foster financial stability and lending to the real economy; Decision No 235/09/COL of 20.5.2009 on the Norwegian Temporary Small Aid Scheme; Decision No 168/09/COL of 27.3.2009 on an additional loan category of the Icelandic Housing Financing Fund on lending to banks, saving banks and other financial institutions for the purpose of temporarily refinancing mortgage loans.

<sup>(2)</sup> The updated version of the State Aid Guidelines is published on the Authority's website (<http://www.efasurv.int/state-aid/legal-framework/state-aid-guidelines/>).

### 3.2. *Management of assets*

According to the IAG, it is for the EFTA States to choose the most appropriate model for relieving banks of assets, but irrespective of the model chosen, it is necessary to ensure clear functional and organisational separation between the beneficiary bank and its impaired assets, notably as to their management, staff and clientele.

Under the Mortgage Loan Scheme, the Icelandic State, via HFF, takes full and permanent control of the assets relieved. In the view of the Authority this ensures clear functional and organisational separation between the beneficiary bank and its impaired assets.

### 3.3. *Valuation*

The IAG require that the national authorities use an independent third-party expert opinion for the purpose of valuation of eligible assets. The valuation should be transparent, preferably based on a range of approaches and common criteria to be adopted across EEA States <sup>(1)</sup>.

The Icelandic authorities have explained that the value assessment performed by the HFF used a model designed by KPMG Iceland. The Icelandic authorities have argued that as HFF has used a credit valuation model designed by outside consultants (KPMG Iceland), the valuation of the mortgage loan pool has been performed by an independent expert valuator. However, the Authority considers that, to be in line with the IAG, the valuation has to be designed and performed in full by an independent expert. To the Authority's knowledge, no (other) third-party expert opinions are available in this case.

Moreover, Chapter 5.5 of the IAG sets out a method of valuation of impaired assets in the context of an asset-relief measure. Paragraph 39 and 40 and Annex 3 introduce the concepts of cost, current market value, real economic value and the transfer value.

Cost means the carrying amount or nominal value of the loans minus impairment. Current market value is the market value the impaired assets could have obtained at the market. The real economic value is the underlying long-term economic value of the assets, on the basis of underlying cash flows and broader time horizons. This should be calculated both for a base case scenario and a stress case scenario. The transfer value is the value attributed to impaired assets in the context of an asset-relief program.

Furthermore, as long as the transfer price is higher than the market value, there is aid involved. In order for the aid to be declared compatible, the transfer price should be lower than or equal to the real economic value.

Moreover, the IAG require that adequate remuneration for the State shall be secured. This may be secured by setting the transfer price below the real economic value.

The Icelandic authorities have explained that the value of the mortgage loan pools are based on the book value of each individual mortgage, less expected loss, corrected for accrued interest and indexation. This was done in line with the credit evaluation model, designed by KPMG Iceland, which the Icelandic authorities have presented to the Authority.

In terms of the IAG, this value corresponds to book value less impairment, i.e. cost. The value of the mortgage loans to be transferred to the HFF therefore represents cost. The Icelandic government has therefore failed to show (or calculate) that the transfer value is based on the real economic value.

On the basis of the available information, in line with the considerations of the IAG, the Authority cannot exclude that incompatible State aid is involved in the notified Mortgage Loan Scheme. In order to assess the compatibility of the scheme, a proper evaluation of the real economic value of the mortgage loans has to be carried out.

### 3.4. *Valuation of the HFF bonds*

The HFF will give HFF bonds in return for the impaired assets received. To ensure the compatibility of the swap transaction with the EEA Agreement, it is necessary to calculate the correct value the HFF bond, in the same manner as the impaired assets.

The Icelandic Authorities have explained that they have calculated the value of HFF bonds by matching HFF bonds with the relevant mortgage loan portfolios (nominal value, duration, etc.), discounting with the yield of the mortgage loan portfolios, and subtracting operational costs.

<sup>(1)</sup> Annex 1 IAG.

As regards the methodology, the Authority is of the view that the value of the HFF bonds should have been calculated separately from the valuation of the mortgage loan pools, instead of linking the two. By linking the two valuations, the evaluation of the HFF bonds becomes blurred and non-transparent thereby preventing the Authority from verifying that the correct value is fixed.

In addition, the Authority considers that the value of the HFF bonds should be calculated using the yield of the HFF bonds, i.e. finding the net present value of the future yields of the HFF bonds over their remaining duration. Based on the information provided by the Icelandic authorities, this methodology does not appear to have been applied in the case at hand.

On this basis, the Authority doubts whether the Icelandic authorities have carried out a correct valuation of the HFF bonds, given in exchange for impaired assets, from the financial institutions under the Mortgage Loan Scheme. In order to assess whether the Mortgage Loan Scheme is compatible with the EEA Agreement, the value of the HFF bonds given, in exchange for the mortgages loans, by the Icelandic Authorities would have to be obtained and assessed.

### 3.5. *Burden sharing*

As regards burden sharing, the IAG state in Section 5.2 the general principle that banks ought to bear the losses associated with impaired assets to the maximum extent. That implies first that banks should bear the difference between the nominal value and the real economic value of the impaired assets.

As the Icelandic government has not established the real economic value of the mortgages loan pools, it is difficult to assess to which extent the banks bears the difference between the nominal value and the real economic value of the impaired assets.

Given that the Authority has doubts as regards the correct valuation of the assets prior to government intervention, there are also doubts as regards the necessary degree of burden sharing included in the Mortgage Loan Scheme.

### 3.6. *Remuneration*

The remuneration paid by the banks to HFF, is also an important element of burden sharing. The Authority recalls that, as noted in Annex 4 to the IAG, it is necessary for EFTA States to ensure that 'any pricing of asset relief must include remuneration for the State that adequately takes account of the risks of future losses exceeding those that are projected in determination of the "real economic value" and any additional risk stemming from a transfer value above the real economic value'.

The IAG suggest that such remuneration may be provided by setting the transfer price of assets to a sufficient extent below the 'real economic value' so as to provide for adequate compensation for the risk in the form of a commensurate upside, or by adapting the guarantee fee accordingly. Any pricing system would have to ensure that the overall contribution of beneficiary banks reduces the extent of net State intervention to the minimum necessary (i.e. burden sharing). However, as the Icelandic authorities has provided the Authority neither with an assessment of the real economic value of the mortgage loans pools, nor a real economic value of the HFF bonds used as payment, it is at this stage difficult to assess if the Icelandic authorities have complied with the remuneration requirement.

The IAG further suggest that identifying the necessary target return could be 'inspired' by the remuneration that would have been required for recapitalisation measures. This should be in line with the chapter on recapitalisation of banks of the Authority's State Aid Guidelines, while taking into account the specific features of asset-relief measures and particularly the fact that they may involve higher exposure than capital injections.

The Guidelines refer to the Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations, which prescribes the following:

'As a lower bond, the required rate of return on subordinated debt should be the sum of the government bond yield of the country where the bank is domiciled, the issuing bank's five-year CDS spread on subordinated debt (!), and an add-on fee of 200 basis points per annum to cover operational costs and provide banks with adequate incentives.

As an upper bond, the required rate of return on ordinary shares would be determined as the sum of the government bond yield of the country where the bank is domiciled, an equity risk premium of 500 basis points per annum <sup>(?)</sup>, and an add-on fee of 100 basis points per annum to cover operational costs and provide banks with adequate incentives.

- <sup>(1)</sup> If this is not available one should use 73 bp, which is the median of all A CDS subordinated debt spreads in the euro area (at the time).
- <sup>(2)</sup> This represents a measure of the realised nominal return on euro area banks' ordinary shares in excess of a minimum risk yield over an extended span of time, in order to avoid periods of excessive volatility.'

The Icelandic authorities have argued that 95 basis points (bp) are charged to the beneficiary banks.

According to the information available to the Authority, HFF normally adds a premium of 95 bp to its own cost of capital, to cover operating costs (25 bp), prepayment risk (50 bp) and credit loss (20 bp) when it offers its regular mortgage loans to its customers.

In the Mortgage Loan Scheme, the margin subtracted from the weighted average interest rate of the mortgage loan portfolio, used in the value assessment, resembles the normal HFF customer margin.

The Authority is under the impression that this will reduce the value of the mortgage loan pool, but only with a margin which the mortgage loan takers will pay to the HFF later on. This can therefore not be considered as remuneration paid by the banks to the State for assets relief measures.

Moreover, to date, the Authority has not received any documentary evidence of this premium not being covered by the customers.

Furthermore, even if the Authority was to accept the margin as a price element for the swap, the question still remains whether the level is sufficient to represent an appropriate remuneration.

By reference to the above mentioned principles in the ECB Recommendation, the yield of the HFF bonds could be considered to represent the Government's bonds yield of the country where the bank is domiciled. In addition, the premium should include an add-on between 273 bp to 600 bp. As the measure at hand is a permanent swap, as opposed to a loan or another temporary measure, the add-on should rather be closer to the upper bond, than the lower bond. Therefore, 95 bp which the Icelandic authorities have presented as a price for the swap is far below what could be seen as corresponding to an adequate market premium, which is necessary in order to declare the Mortgage Loan Scheme compatible.

There are therefore doubts as to whether the 95 bp that the HFF charges the beneficiary banks for the swap transactions under the Mortgage Loan Scheme can be accepted as an adequate remuneration.

### 3.7. *Unlimited scope and duration*

The Icelandic authorities have not specified any time limit within which the financial institutions can enter the Mortgage Loan Scheme (so-called entrance window) <sup>(1)</sup>. The IAG state that in order to find asset relief measures compatible their duration must not go beyond the period of the financial crisis <sup>(2)</sup>. Based on the Commission's decision practice, asset relief measures are approved for maximum six months. Every extension (usually for another six months) must be re-notified well in advance and take account of the evolution of the situation on the financial markets. Provided that biyearly reports are submitted, a scheme may be in force for a period of up to two years <sup>(3)</sup>. In other words, the asset relief measures are not approved for an unlimited period of time.

Furthermore, the Icelandic authorities have neither specified the amount of the total budget of the scheme, nor estimated annual expenditure under the Mortgage Loan Scheme. The fact that the Icelandic authorities have not submitted an estimated number of beneficiaries and no limit of the value of assets potentially subject to a swap indicates that the scheme is unlimited in scope. It is therefore not possible for the Authority to determine whether the Mortgage Loan Scheme is proportionate.

<sup>(1)</sup> The argument of the Icelandic authorities that the nature of Act No 125/2008 is temporary and thus schemes implemented on its basis by definition do not have permanent nature cannot be accepted. There is no provision whatsoever in any of the relevant piece of legislation which would prevent the Icelandic authorities from continuing the implementation of the Mortgage Loan Scheme for an indefinite time. This clearly contradicts the general principle of proportionality and necessity which are the core rules of the guidelines for financial crisis. The fact that the Icelandic Parliament intended to review Act No 125/2009 by 1.1.2010 does not change this conclusion. To date, the Icelandic Parliament has not reviewed the act.

<sup>(2)</sup> See paragraph 12 of the Authority's Guidelines on financial institutions.

<sup>(3)</sup> Paragraph 24 of the Authority's Guidelines on financial institutions.

### 3.8. No behavioural commitments

The Icelandic authorities have not suggested imposing any behavioural commitments on the beneficiary banks in order to limit distortions of competition triggered by the Mortgage Loan Scheme. In order to minimise the beneficiary's commercial advantage, usually, such commitments include prohibition of marketing of the State intervention in favour of the bank concerned or a ban on growth. In recapitalisation cases, aggressive commercial conduct or growth of business activities through acquisitions can be prohibited. Therefore, in the context of the formal investigation, the Authority will assess the convenience of imposing such behavioural commitments.

### 3.9. Restructuring or viability plan

The Icelandic authorities have not committed themselves to submitting any restructuring, liquidation or viability plans (or given the Authority an assessment if they are necessary).

The Authority recalls that paragraph 54 of the IAG establishes that a need for in-depth restructuring will be presumed where an appropriate valuation of impaired assets according to the principles set out in Section 5.5 and Annex 4 would lead to negative equity/technical insolvency without State intervention. Repeated requests for aid and departure from the general principles set out in the IAG will normally point to the need for such in-depth restructuring.

Furthermore, paragraph 55 of the IAG establishes that an in-depth restructuring would also be required where the bank has already received State aid in whatever form that either contributes to coverage or avoidance of losses, or altogether exceeds 2 % of the bank's total risk-weighted assets, while taking the specific features of the situation of each beneficiary into due consideration.

Information on the follow-up measures is one of the core principles of the application of the Impaired Assets Guidelines<sup>(1)</sup> and has been consistently applied by the Commission in its decision-making practice. Such plans should be provided in sufficient time for the Authority to evaluate the potential compatibility<sup>(2)</sup>. In order to facilitate the work on the respective plans, the Authority refers to the considerations in the Authority's guidelines on return to viability<sup>(3)</sup> and to Table 2 in Annex III of the Impaired Assets Guidelines<sup>(4)</sup>.

If any restructuring, liquidation or viability plans are deemed necessary, according to the IAG, the Icelandic authorities will have to commit themselves to such plans.

## 4. Conclusion

Based on an assessment of the information submitted by the Icelandic authorities, the Mortgage Loan Scheme appears to constitute State aid within the meaning of Article 61(1) of the EEA Agreement. Furthermore, the Authority doubts that the Mortgage Loan Scheme can be regarded as complying with Article 61(3)(b) of the EEA Agreement, in combination with the requirements laid down in the IAG. The Authority thus doubts that the Mortgage Loan Scheme is compatible with the functioning of the EEA Agreement.

Consequently, and in accordance Article 4(4) of Part II of Protocol 3, the Authority is obliged to open the procedure provided for in Article 1(2) of Part I of Protocol 3. The decision to open proceedings is without prejudice to the final decision of the Authority, which may conclude that the measures in question are compatible with the functioning of the EEA Agreement.

In light of the foregoing considerations, the Authority, acting under the procedure laid down in Article 1(2) of Part I of Protocol 3, invites the Icelandic authorities to submit their comments within one month of the date of receipt of this Decision.

In light of the foregoing considerations, within one month of receipt of this decision, the Authority request the Icelandic authorities to provide all documents, information and data needed for assessment of the compatibility of the transfer of mortgage loans secured against collateral in residential property from financial undertakings to the HFF.

<sup>(1)</sup> See paragraph 48 et seq. of the IAG.

<sup>(2)</sup> In some cases the Commission required the plans to be submitted within three months.

<sup>(3)</sup> See the chapter on 'Return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules', under the State Aid Guidelines on the Authority's home page.

<sup>(4)</sup> This table outlines good practices in presenting information of the bank's activities related to the impaired assets that would feed into the viability review for cases of individual aid granting, but could be applied *per analogy* also to schemes.

The Authority invites Iceland to forward a copy of this decision to any potential aid recipients of the aid immediately.

The Authority would like to remind the Icelandic authorities that, according to the provisions of Protocol 3, any incompatible aid unlawfully put at the disposal of the beneficiaries will have to be recovered, unless this recovery would be contrary to the general principal of law,

HAS ADOPTED THIS DECISION:

*Article 1*

The EFTA Surveillance Authority has decided to initiate the formal investigation procedure provided for in Article 1(2) of Part I of Protocol 3 to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice regarding the scheme on the transfer of mortgage loans secured against collateral in residential property from financial undertakings to the Housing Financing Fund.

*Article 2*

The Icelandic authorities are invited, pursuant to Article 6(1) of Part II of Protocol 3 to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice, to submit their comments on the opening of the formal investigation procedure within one month from the notification of this Decision.

*Article 3*

The Icelandic authorities are requested to provide within one month from notification of this decision, all documents, information and data needed for assessment of the compatibility of the aid measure.

*Article 4*

This Decision is addressed to the Republic of Iceland.

*Article 5*

Only the English version is authentic.

Done at Brussels, 10 March 2010.

*For the EFTA Surveillance Authority*

Per SANDERUD  
*President*

Kurt JÄGER  
*College Member*