Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

EliScholar – A Digital Platform for Scholarly Publishing at Yale

YPFS Resource Library

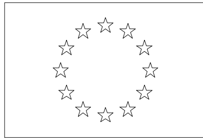
11-13-2008

Guarantee Scheme for Banks' Funding in Finland

European Union: European Commission

https://elischolar.library.yale.edu/ypfs-documents/725

This resource is brought to you for free and open access by the Yale Program on Financial Stability and EliScholar, a digital platform for scholarly publishing provided by Yale University Library. For more information, please contact ypfs@yale.edu.



EUROPEAN COMMISSION

Brussels, 13.XI.2008
C(2008) 6986

Subject: **State Aid N 567/2008 – Finland**
Guarantee scheme for banks' funding in Finland

Sir,

I. PROCEDURE

1. On the 11th of November 2008 Finland notified a guarantee scheme for banks' funding in Finland.

II. DESCRIPTION

1. The objective

2. The measure "Finnish Guarantee Scheme for banks' funding" (hereafter the "guarantee scheme") seeks to respond to the present financial crisis with a guarantee scheme in order to support the short and medium term financing needs of banks and mortgage institutions.

2. Beneficiaries

3. Eligible institutions for the State guarantee will be all Finnish deposit banks and mortgage banks, including the Finnish subsidiaries of foreign financial institutions, which are considered as solvent by the Finnish authorities. The beneficiary may be a deposit bank or its parent undertaking. In case of a group the beneficiary may be one bank or an undertaking in the group.

3. Form and amount of aid

4. Finland will make available a state guarantee for the issuance of new short and medium term debts. Under this scheme, institutions will have the option to enter into an agreement

Ulkoministeri Alexander STUBB
Merikasarmi
PL 176,
FIN - 00161 Helsinki

with the state which in turn would guarantee the institutions' new issuance of debt instruments in exchange for a fee.

5. Instruments covered by the guarantee are certificates of deposits, unsecured bonds and other non-subordinated debt instruments which have a maturity longer that 90 days but less than 3 years. Covered (mortgage backed) bonds, which can have a maturity of up to 5 years, are the only instruments that can be covered for more than 3 years.. The scheme is not subject to any currency restrictions.
6. Instruments guaranteed under this scheme may be issued within a period of six months (i.e. until 30.04.2009). The Finnish authorities have committed that they will renotify any extension of the entry window into the scheme to the Commission. They currently consider that the scheme could be extended up to 31 December 2009.
7. The State will initially guarantee up to EUR 50 billion of debt instruments. For each financial institution there will be two separate maximum limits for the guarantee.

   a) For short term debt (maturity up to 12 months) the limit will be the total nominal value of such short term issued debt on 17 October 2008.

   There will be also a monthly limit in addition to the overall limit for short term debt. The monthly maximum covered by a state guarantee will be the total nominal value of the debt that matures during the given month.

   b) For medium term debt (maturity over 1 year; up to 5 years) the limit will be the total nominal value of the bonds that mature between 17 October 2008 and 31 December 2009.

4. Conditions for granting the aid

8. Participation into the scheme is voluntary. All solvent banks are eligible to apply for the guarantee. A solvent bank is a bank, whose amount of own funds fulfil the requirements of Finnish Act on Credit Institutions.[1] Presently, all Finnish banks have a tier 1 capital ratio of at least 7%.
9. The beneficiary must pay a fee on the guarantee based on the recommendations of the European Central Bank[2].
10. The fee for short term debt (maturity up to 12 months) is equal to 50 basis points (bps) on an annual basis.
11. The basic fee for medium term debt (maturity over 1 year) consists of the two following components: (1) a fee based on the banks' Credit Default Swap (CDS) spreads and (2) an add-on fee of 50 bps (hereafter the "add-on fee").

    a) For banks with CDS data, the price should equal (1) the median value of 5 year CDS spreads over the period 1 January 2007 to 31 August 2008 plus (2) the add-on fee of 50 bps on an annual basis.

---

[1] The bank has to have at minimum the amount of own funds required to cover the risks as stipulated in Section 55(1) of Act on Credit Institutions. Section 55(1) of the Act covers credit risk, operational risk, foreign-exchange and commodity risks and also trading book risk, and has a reference to the Sections in the Act, which stipulates the calculation of the required minimum of own funds to cover each risk. This specification of a solvent bank is in paragraph 4, point 2 of the draft of the Government decision. In addition, the draft Government decision requires that Treasury asks for the opinion of the Finnish Financial Supervisory Authority on the applicants' solvency.

[2] Recommendations on Government Guarantees on Bank Debt of the European Central Bank of 20 October 2008.

b) For banks without CDS data, or representative CDS data, but with a credit rating, an equivalent CDS spread should be derived from (1) the median value of 5 year CDS spreads during the above mentioned period for the rating category of the banks concerned, based on a representative sample of euro area large banks plus (2) the add-on fee of 50 bps on an annual basis.

c) For banks without CDS data and without a credit rating, an equivalent CDS spread should be derived from (1) the median value of 5 year CDS spreads over the same period for the lowest rating category plus (2) the add-on fee of 50 bps on an annual basis.

d) For guarantees for covered bonds the fee consists of (1) the institution's CDS spreads plus (2) the lowered add-on fee of 25 bps on an annual basis.

12. In case the Tier 1 capital ratio of the bank falls under 7%, the add-on fee payable for the bank would be 5 bps higher. These would apply for all the fees, concerning the fees for short term debt, uncovered and mortgage-backed medium term debt.
13. The pricing will be constant until the 30th April 2009, but could be revised if the guarantee period is prolonged, to reflect changes in market conditions
14. Finland imposes certain conditions on institutions benefitting from the state guarantee, aimed at eliminating or minimising any spill over effects which may distort competition.

a) At an aggregate-level the Finnish authorities undertake to monitor and review the expansion of the activities of the banks that are participating in the guarantee scheme in order to ensure that their aggregate growth in balance sheet volume does not exceed:

- the annual rate of growth of Finnish nominal GDP in the preceding year,
- the average historical growth of balance sheets in the Finnish banking sector during the period 1987- 2008 (Quarter 3), or
- the average growth rate of the balance sheet volumes in the banking sector in the EU in the preceding six months

whichever is higher.

15. The Finnish Financial Supervisory Authority will be responsible for monitoring the growth of balance sheet volume in participating banks and report back to the government on a regular basis. If the activities of the participating banks in total exceed the above thresholds, the Finnish Financial Supervisory Authority will examine the reasons for such growth. Unless there is evidence that the thresholds are exceeded for reasons unrelated to the guarantee scheme, the Finnish Financial Supervisory Authority will as a matter of urgency take measures to adjust the guarantee scheme in order to re-establish the discipline.
16. In addition the following constraints will be included in the bylaw for participating banks:

- Restrictions on mass marketing of the guarantee, except when required by law or other regulations, for example rules relating to offering documents,
- A commitment not to undertake a significant expansion of activities which would not have taken place in absence of the guarantee scheme, and

- Prohibition of buy-back programs, meaning that a bank with shares, which has been granted a state guarantee, is not allowed to buy or otherwise acquire against payment its own shares. Savings banks are not allowed to buy or otherwise acquire against payment their basic funds shares. Cooperative banks are not allowed to refund cooperative capital, additional cooperative capital or cooperative investment capital for any other reason than termination of membership in the cooperative.
- Restrictions with respect to wage increases, bonus payments, increases in board remuneration and bank executives´ severance packages during the guarantee period.

III. POSITION OF FINLAND

17. The Finnish authorities accept that the guarantee scheme contains State aid elements.

18. The Finnish authorities seek urgent authorisation for the guarantee scheme. According to the Finnish authorities the international financial crisis has affected financial markets in Finland, frozen the money market and severely impeded the access to liquidity for many banks. The situation is regarded with concern given the international market-failure where even healthy banks are having trouble getting access to liquidity. This threatens financial stability in Finland and if left unaddressed may cause significant disruptions to firms and households.

19. The Finnish authorities claim that the measure is compatible with the with the common market because it is necessary to remedy a serious disturbance in the Finnish economy pursuant to Article 87(3)(b) of the EC Treaty.

20. A letter sent by the Suomen Pankki (Bank of Finland) dated 31 October 2008 confirms that the notified measures isurgently required to prevent harmful spillover effects on the entire Finnish financial system and on the economy as a whole.

21. The Finnish authorities declare that the notified scheme does not involve any unduly adverse spillover effects on other Member States or undue distortions of competition. The measures are not limited to purely Finnish companies and therefore are open and non-discriminatory and do not threaten to distort competition.

22. The Finnish authorities submit that all possible measures have been taken in order to ensure the Commission that the scheme will not allow the banks to expand their capacity. In this respect several safeguards have been included in the scheme (see details above points14 and16).

23. The Finnish authorities submit that their guarantee needs to include covered bonds[3] because the experience in Denmark, where they were excluded, has shown that in their view this market would dry up without the guarantee. In particular, a well functioning mortgage bonds market, which consists to a large extent of fixed rate loans with a maturity of five years, is crucial to the whole financial industry in Finland. The exclusion of such covered bonds would severely distort the mortgage loan market, as the mortgage banks would not be able to refinance their business. This would endanger the functioning of the mortgage market and negatively impact the housing market in Finland. To limit distortions from this longer guarantee period, Finland commits to limit the guarantee on debt with a maturity of between three and five years to covered bonds only and to a

[3] Covered Bonds are issued not just against the balance sheet of a bank but also against collateral, in particular mortgages.

maximum amount of EUR 250 million. As an additional safeguard for mortgage-backed debt only debt that matures during 2009 will be eligible for guarantee.

24. The Finnish authorities undertake to present every six months reports on the operation of the scheme containing the information specified in the relevant rules on standardised reports.[4] The six months reports will also include a list of all beneficiary companies indicating for each of them the necessary data to understand the full scope of the support measures.

25. In addition, the Finnish authorities commit to file individual restructuring/liquidation plans, within 6 months, for banks that default on their liabilities and which cause the guarantee to be called upon. [5]

IV. ASSESSMENT

1. State aid character of the scheme

26. As set out in Article 87(1) EC, 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 shall, in so far as it affects trade between Member States, be incompatible with the common market.

27. The guarantee on the new issued debt allows the beneficiaries to refinance at advantageous conditions. This gives an economic advantage to the beneficiaries and strengthens the position of these beneficiaries compared to that of their competitors in Finland and other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. The advantage is selective since it only benefits the beneficiaries of the scheme and is provided through State resources.

28. In particular, the Commission is convinced that in the current circumstances of financial crisis no private investor would have granted such a significant guarantee on the senior debt of the participating banks.[6].

29. The measures therefore constitute State aid within the meaning of Article 87(1) of the EC Treaty. This was not disputed by Finland.

---

[4] Annex III. A and B (standardised reporting format for existing State aid) to Commission Regulation (EC) No 749/2004 of 21 April 2004 adopting provisions for the implementation of council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 140, 30.4.2004, p. 1).

[5] The notified scheme does not contain any provision on restructuring plans of banks in difficulty. However, the Finnish Financial Supervisory Authority has according to the Act on Credit Institutions (121/2007) powers to require restructuring plans; The Ministry of Finance in Finland has such powers according to Act on Temporary Interruption of the Operations of the Credit Institution (1509/2001).

[6] Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 32. Commission decision of 21 October 2008 in case C 10/2008 *IKB,* not yet published, at point 74.

2. Compatibility of the scheme

Application of Article 87(3)(b) EC

30. Finland intends to provide aid under a guarantee scheme by assisting banks, which have problems accessing liquidity. Given the present circumstances in the financial market, the Commission considers that it may be acceptable to examine this measure directly under the Treaty rules and in particular under Article 87 (3) (b) EC.

31. Article 87 (3) (b) EC enables the Commission to declare aid compatible with the Common Market if it is "to remedy a serious disturbance in the economy of a Member State". The Commission recalls that the Court of First Instance has stressed that Article 87 (3) (b) EC needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State.[7]

32. The Commission notes that the present scheme concerns the entire Finnish banking sector. The current global financial crisis has made access to liquidity more difficult for financial institutions across the board and has also eroded confidence in the creditworthiness of counterparties. In these circumstances, even fundamentally sound financial institutions are facing the prospect of going out of business. The Commission considers that if the issues of lack of liquidity and lack of confidence are not addressed, it will result not only in difficulties for the banking sector but, due to that sector's essential role in providing financing to the rest of the economy, will also have a systemic effect on the Finnish economy as a whole. The Commission does not dispute that the present scheme is designed to address the problems of the lack of liquidity and lack of confidence that are currently striking Finnish banks. Therefore it finds that the scheme aims at remedying a serious disturbance in Finnish economy.

Conditions for compatibility under Article 87 (3) (b)

33. In line with the Commission 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", in order for an aid or aid scheme to be compatible under Article 87(3)(b) of the EC Treaty, it must comply with general criteria for compatibility under Article 87(3) of the EC Treaty, viewed in the light of the general objectives of the Treaty and in particular Articles 3(1)(g) and 4(2), which imply compliance with the following conditions[8]:

    a. *Appropriateness*: The aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the disturbance would also disappear in the absence of the measure or if the measure is not appropriate to remedy the disturbance.

---

[7] Cf. in principle case Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Confirmed in Commission Decision in case C 47/1996, *Crédit Lyonnais*, OJ 1998 L 221/28, point 10.1, Commission Decision in Case C28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, page 1, points 153 *et seq* and Commission Decision in Case C50/2006 *BAWAG*, not yet published, points 166. See Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, OJ C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, *Rescue aid to WestLB*, OJ C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

[8] Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 41.

b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g. a guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.[9]

c. *Proportionality*: The positive effects of the measures must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measures' objectives. This follows from Article 3 (1) g EC and Article 4 (1) and (2) EC, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87 (1) EC prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87(3)(b) of the EC Treaty which authorises State aid must ensure that such aid must be limited to what is necessary to achieve its stated objective.

Application of the criteria to the guarantee scheme

34. As regards appropriateness, the objective of the present guarantee scheme is to provide a safety net to investors in newly issued debt of the participating credit institutions, so that these institutions can have sufficient access to liquidity. This is a reaction to the international market failure where even healthy banks are facing difficulties in fulfilling their central role in financial intermediation. The Commission considers that such guarantee schemes should help to overcome this market failure, by establishing the conditions for the revival of the interbank lending market and regards it therefore as an appropriate means.[10]

35. In addition, the scheme is targeted at the appropriate beneficiaries as the eligibility of participating firms is limited in principle to solvent companies. The scheme comprises all the banks in Finland, including the subsidiaries of foreign banks.

36. As regards necessity, the guarantee scheme, whereby required to restore confidence and exchange of liquidity in the interbank market, is limited to the minimum necessary in material scope and time.

37. As regards material scope, the Commission does not dispute that the guarantee scheme is needed to restore confidence of lenders.[11] A guarantee on retail deposits would not be sufficient as it would only avoid bank runs but not restore confidence of institutional lenders. Moreover, the Commission notes positively that Finland is in principle limiting

---

9 Cf. Case 730/79, *Philip Morris* [1980] ECR 2671. This line of authority has recently been reaffirmed by the Court of Justice in. Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive* of 15 April 2008, where the Court held that, "As is clear from Case 730/79 […], aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market […]."

10 See Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 42, Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet published, at point 56, and Commission decision of 13 October 2008 in case NN 48/2008 *Guarantee scheme for banks in Ireland*, not yet published, at point 59.

11 See the above mentioned Commission Decisions in cases NN 51/2008 (at point 47) ,N 507/08 (at point 59) and N533/08.

the guarantee to the forms of financing that are considered a specific source of difficulties, i.e. short to medium term interbank lending. The scheme firstly excludes from its scope subordinated debt. Secondly, existing debt is not covered but only newly issued debt and only such debt that is short and medium term.

38. The Commission does not consider it problematic that the scheme also comprises covered bonds[12], because the fact that a premium is charged will ensure that such bonds will only be included against a significant and deterrent surcharge and thus only if absolutely necessary. Finland justifies the necessity to include by reference to the Danish experience, where in their view the exclusion of covered bonds from the guarantee led to a loss of confidence and to the drying up of the market. Similar considerations ware also taken into account in the assessment of the Swedish scheme.[13]

39. As regards temporal scope, the guarantee applies to the newly issued debt for up to three years, and only in justified cases up to five years. In general, the Commission is of the view that the duration of a guarantee should be as short as possible. In this regard, the Commission notes positively an additional safeguard in the present scheme in so far as it has a limited issuance period of six months. The temporal scope is thus in principle justified.

40. The Commission notes however that covered bonds shall be covered for a period for up to 5 years. However in this context it accepts the Finnish submission that covered bonds should normally not even need a guarantee given that they are already sufficiently collateralised, but, in the context of the current market failure, any debt that is not covered by the guarantee risks being shunned by excessively risk averse investors. Second, Finland has sufficiently explained that covered bonds are an integral part of their financial system which can not be excluded from the system without creating major distortions. Thus, given that the guarantee systems are aimed at stabilisation and not at creating additional distortions, an exceptional coverage of long term covered bonds up to 5 years can be sufficiently justified. Moreover, the Commission notes that Finland has limited the guarantee on covered bonds to a maximum amount of EUR 250 million. Given this context, and within this limitation the exception can for now be accepted, but may be reviewed after six months.

41. As regards proportionality, the distortions of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market orientated premium. It can be estimated that in this way the banks pay on average an adequate premium. The banks will pay in a base case a premium of 50 bps plus the median of the 5-year CDS spread over the 20 months period ending on 31 August 2008 for each institution. This can be considered proportionate and consistent with the recent practice of the Commission.[14] In addition, the Commission notes that this is also in line with the recommendations of

---

[12] A different system was the basis of the Danish scheme (Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published) where the guarantee would if applicable to covered bonds have included them automatically. A similar approach is taken in Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, not yet published.

[13] Commission decision of 29.10.2008 in case N 533/2008 – Support measures for the banking industry in Sweden (see recitals 42-44).

[14] A similar approach is taken in Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, not yet published. Point 66. ==and in the Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet published, point 61.

the ECB, which also aim at the establishment of an appropriate framework for premiums on guarantees issued in the Euro zone.

42. Also the fact that for covered bonds the add-on is lowered is in line with the ECB as it allows for a lower add on in cases where the guaranteed debt is collateralised. The reduction of 50 % in the add-on fee seems at this stage reasonable.

43. Given that these recommendations are themselves building upon the Commissions decision in particular in cases N 507/2008 and N 533/08, it is appropriate to apply the ECB criteria in parallel with the behavioural constraints that were established in this decision.

44. Indeed, the scheme includes several strong behavioural constraints which help to ensure that the participating banks do not expand their activities under the scheme and thus do not receive more support than necessary for re-establishing their long term viability.[15] This concerns a limitation of the expansion of activities on an aggregate level of all participating banks against clear benchmarks as well as strong individual behavioural commitments.

45. Furthermore, the Commission acknowledges that Finland has committed to provide a restructuring or liquidation plan, within six months, for any institution that causes the guarantee be drawn.[16]

46. Finally, the Commission would like to reiterate that the window to avail of financial support measures is limited by the Finnish law to a period ending on 30 April 2009. Should Finland wish to extend the application of this scheme, it needs to notify this to the Commission as new state aid under Article 88(3) of the EC Treaty, in due time before that date.

47. On the basis of the above, the guarantee scheme can be considered compatible with the Common market.

V. DECISION

48. The Commission has accordingly decided not to raise objections against the notified scheme, since it fulfils the conditions to be considered compatible with the EC Treaty.

Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission

---

[15] A similar principle is imposed by point 44 of the rescue and restructuring guidelines.

[16] Such plans are the cornerstone of the Community Guidelines on State aid for Rescuing and Restructuring Firms in Difficulty, see OJ 2004 C 244, p. 2,