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Finland Prolongation of the Guarantee Scheme for Banks' Funding

European Union: European Commission

EUROPEAN COMMISSION

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Subject: State Aid N239 /2009 – Finland
Prolongation of the Guarantee Scheme for Banks´ Funding in Finland

Sir,

I. PROCEDURE

1. On 17 April 2009 Finland notified a request to prolong and amend its guarantee scheme for banks´ funding. The original measure, notified on 11 November 2008, was approved on 13 November 2008 in State aid case N567/2008[1] (hereafter "the original decision"). On 28 January 2009 Finland notified changes to the scheme, which were approved by the Commission on 5 February 2009 (State aid case N44/2009)[2].

II. DESCRIPTION

1. The objective of the Scheme

2. In response to the exceptional turbulence in global financial markets, Finland brought forward a guarantee scheme (hereinafter referred to as "the Scheme") designed to restore stability of the financial system and to remedy a serious disturbance in the economy of Finland. The scheme had as its objective to support the short and medium term financing needs of banks and mortgage institutions.
3. The measure consisted of a State guarantee for the issuance of new and medium term debts in exchange for a fee.

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1 OJ C/309/2008, p. 5
2 Public version not yet available.

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2. Description of the Scheme (Commission Decision of 13 October 2008)

4. Eligible institutions for the State guarantee are all Finnish deposit banks and mortgage banks, including the Finnish subsidiaries of foreign financial institutions, which are considered as solvent by the Finnish authorities. A solvent bank is a bank, whose amount of own funds fulfil the requirements of the Finnish Act on Credit Institutions.

5. Instruments covered by the guarantee are certificates of deposits, unsecured bonds and mortgage-backed bonds issued by mortgage banks (and other non-subordinated debt instruments which have a maturity longer than 90 days but less three years, or five years for covered bonds.) The scheme is not subject to any currency restrictions.

6. The State guarantees up to EUR 50 billion of debt instruments. For each financial institution there are two separate maximum limits for the guarantee. For short term debt (maturity up to 12 months) the limit is the total nominal value of such short term issued debt on 17 October 2008. The monthly maximum covered by a state guarantee is the total nominal value of the debt that matures during the given month. For medium term debt (maturity over 1 year; up to 3 years, or 5 years for covered bonds) the limit is the total nominal value of the bonds that mature between 17 October 2008 and 31 December 2009.

7. The beneficiary must pay a fee on the guarantee based on the recommendations of the European Central Bank[3].

3. The modification to the Scheme (Commission Decision of 5 February 2009)

8. The modification to the Credit Guarantee Scheme affected the following elements:

9. Firstly, Finland introduced a limited possibility to roll over short term debt (maturity from 90 days up to 12 months) to medium term debt (unsecured bonds with a maturity up to 3 years). This means that the participating banks can renew the previously guaranteed short-term debt as medium term debt and still retain the same State guarantee (hereafter the "extension facility"). For each credit institution there will be a maximum limit available under the extension facility. The maximum for each credit institution is its share of the total lending of all eligible banks as of 31 December 2008. There is also a monthly maximum per bank which corresponds to the amount of the short term debt that matures during the given month.

10. Secondly, the requirement that the balance sheet growth of participating institutions be limited to certain thresholds[4], no longer applies to the participating banks.

11. Thirdly, the conditions on management wages and other remuneration were changed. Since the modification the participating banks have to follow the principles of the competitive remuneration system for state-owned and associated companies.

12. Fourthly, in the original scheme under point 16, the participating banks were not allowed to buy or otherwise acquire against payment their own shares. Since the modification the condition is not applicable anymore.

4. Operation of the Scheme up to April 2009

13. Up to 17 April 2009, no bank applied for a guarantee under the Scheme. According to the Finnish authorities, this is due to the following reasons:

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

[4] As set out in paragraph 14 of the original decision.

a) As the Scheme was only implemented on 12 February 2009, the application time was relatively short. The banks in Finland indicate that they are currently in the process of evaluating the possibilities to issue bonds with State guarantee (e.g. legal issues, credit rating). In addition, the issuance of the bond has to take place within the entry window, i.e. until 30.04.2009, which is a relatively short time frame to prepare the issuance of bonds.

b) The instruments with a maturity of up to 3 years under the Scheme are perceived by the banks as having too short maturity. Therefore, among other reasons, banks have not applied for the Scheme.

c) Currently, banks can get short term funding from the national central bank and from the ECB at better remuneration conditions.

d) Mortgage banks have not been able to apply for guarantees under the scheme due to the requirement that the mortgages be transferred to the State if the guarantee is triggered.

5. Description of the proposed modifications to the Scheme

14. With the notification of 17 April 2009, Finland notified the following changes to the Scheme:

15. Firstly, according to the current Finnish regulation, instruments guaranteed under the Scheme may only be issued until 30 April 2009. However, Finland does not expect that the markets will have returned to normal functioning by the end of April. Therefore, in order to restore the functioning of financial markets, and hence, restoring confidence, Finland considers that the measure should stay in place as long as the disturbances in the financial markets remain.

16. Consequently, Finland intends to extend the temporal scope of the Scheme so that guarantees can cover instruments issued until 31 December 2009 included, the date on which the scheme will come to the end. At the same time, Finland commits to introduce to the Scheme, possibly before 31 December 2009, the amendments that may be proposed by the Commission as the result of its ongoing monitoring and assessment of existing schemes.

17. Secondly, Finland intends to broaden the material scope of the Scheme so that guarantees can cover any form of eligible instrument with a maturity of more than 90 days and up to five years (as opposed to a maximum of three years, which is the present maximum maturity for all instruments except for covered bonds[5]). The same provision applies to the extension facility, i.e. the possibility to grant State guarantee for medium term debt (unsecured bonds with a maturity up to 5 years) issued by a bank instead of maturing short term debt (maturity from 90 days up to 12 months). A maximum of € 16.66 billion of guaranteed instruments with terms over three years and up to five years will be allowed, i.e. a third of the total amount of the budget of the Scheme.

18. Finally, the requirement that the mortgages be transferred to the State in case the guarantee has been triggered will be deleted. As a result, the State would be in equal position with other bond holders. Furthermore, the change is necessary as otherwise the

[5] Paragraph 5 of the original decision.

State guarantee cannot be used for covered bonds, which have collateral of a pool of mortgages.[6]

19. All the other conditions of the original scheme (as modified with the notification of 28 January 2009) remain unchanged.

20. Eligible institutions for the State guarantee will be - as defined in the original decision - all Finnish deposit banks and mortgage banks, including the Finnish subsidiaries of foreign financial institutions, which are considered as solvent by the Finnish authorities. Currently, all banks in Finland have a tier 1 capital ratio of at least 8.5%.

III. POSITION OF FINLAND

21. In line with the original decision, the Finnish authorities accept that the amended scheme contains State aid elements.

22. Finnish authorities note that the banks' access to market funding is still severely affected by the international financial crisis and that it is thus necessary to prolong the scheme with the above-mentioned modifications. Difficulties in banks' access to market funding have already caused repercussions for households' and firms' ability to refinance their own obligations. In order to avoid strengthening the negative feedback loop between the real economy and the financial sector, it is imperative that the Scheme will be prolonged, as endorsed by the Bank of Finland.

23. The Finnish authorities submit that their guarantee needs to include medium-term funding with maturity up to 5 years, instead of the current maximum maturity of 3 years. In general, the loan-periods for lending of the banks in Finland are typically from 10 to 25 years. On the funding side the Finnish banks usually use instruments with five years maturity. Therefore, banks which want use the state guarantee have to change their funding structure, i.e. using the short term funding, which could affect financial stability. In the situation, where companies and enterprises increasingly turn to banks for loans as they do not get funding from capital and securities markets, there is a discrepancy if banks cannot grant longer term loans to their customers if the banks' own funding is based on short term debt.

24. In addition, the Finnish authorities claim that it has become more difficult to get funding with three-year maturity. Maintaining the current limitation of three-year maturity would also lead to higher costs for funding which in turn would mean more expensive borrowing for the customers. This kind of outcome would be extremely harmful in the current economic situation.

IV. ASSESSMENT

1. State aid character of the prolonged Guarantee Scheme

25. 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

[6] The mortgage bonds covered by the scheme are special kind of mortgage bonds issued by mortgage banks which are special credit institutes regulated by Finnish Act on mortgage credit banks (1240/1999). The Act provides a presumption that the mortgages, which collateralise the issued bonds, are equal collateral for all creditors that are bond holders. This means that a requirement to transfer the mortgages, in case the State have paid out the creditors of a covered bond (i.e. the guarantee has been triggered), can be fulfilled only in cases where the mortgages collateralise an individual bond.

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.

26. Similar to the original scheme, the Commission agrees with the position of Finland that the prolonged scheme for eligible institutions constitutes aid to the institutions concerned pursuant to Article 87 (1) EC.

27. The guarantee on the newly 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 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.

2. Compatibility of the Prolonged Guarantee Scheme

a) Application of Article 87(3)(b) EC

29. The Commission acknowledges that the global financial crisis is still ongoing and accepts that the functioning of the Finnish financial system remains seriously upset. The Commission further accepts that this is likely to cause a serious disturbance in the Finnish economy and that the Scheme is necessary to remedy this situation.

30. For the reasons indicated in the original decision and the previously approved amendments, the Commission found the Scheme to be compatible with the common market under Article 87(3)(b) of the Treaty, as the Scheme met the criteria of appropriateness, necessity and proportionality laid down in the Banking Communication[7]. Given that the notified amendments would make only minor changes to the Scheme, and that the situation on the financial markets has not improved, it is only necessary to assess whether the finding of compatibility holds true also in view of the notified amendments.

b) Assessment of the Proposed Modifications to the Scheme

31. Since the objective of the measure is to address the current problems of lack of liquidity and lack of confidence, it is important to ensure the availability of the scheme as long as the global financial crisis remains. As the markets are likely not to have returned to normal functioning by the end of April, the Commission considers that the prolongation of the entry window from 1 May 2009 to 31 December 2009 is appropriate and necessary to remedy the disturbance of the Finnish economy.

32. Furthermore, the Commission notes that the extension is limited in time which will limit the potential distortion of competition. The Commission notes that Finland has committed to introduce to the Scheme, before 31 December 2009 if necessary, the amendments that may be proposed by the Commission as the result of its ongoing

[7] Communication from the Commission "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis" (OJ 270, 25.10.2008, p. 8).

monitoring and assessment of existing schemes. This change is therefore proportionate to the purpose of the Scheme.

33. With the proposed amendment, the Scheme would also cover uncollateralized instruments with a term of up to five years, whereas it previously covered only maturities of up to three years (with the exception of covered bonds, see paragraph 5 of the original decision).

34. This increase in scope does not affect the Scheme's appropriateness as a tool to remedy the serious disturbance in the Finnish economy. However, by potentially increasing maturity of guaranteed debt and hence the time such instruments will remain in the market, the notified extension may increase the distortion of competition that the Scheme is likely to generate. The Commission therefore needs to assess the proportionality of this new measure.

35. According to the Finnish authorities the total amount of funding (excluding the deposits) of the major Finnish banks is € 56 billion as of 28 February 2009. The instruments with a maturity over 2 years and up to 5 years amount to 8% of the sum[8]. Before the crisis as of 30 June 2007 the equivalent percentage was 17%. During the same time period short term funding (maturity under 1 year) has increased from 66 % to 80 %. Therefore, these figures, together with the maximum limits per institution described above (at paragraph 6) give reasonable assurance that the proposed extension of the scope of the guarantee would not open the way to a disproportionate shift towards longer-term funding under the scheme, which in turn reduces the risks for a disproportionate distortion of competition.

36. In this respect, the Commission notes that the amount of debt with maturities exceeding three years and up to five years (made possible by this measure) is limited to an aggregate maximum of one third of the total budget that can be guaranteed under the Scheme.

37. In view of the above, and in line with earlier decisions[9], the Commission considers that this limitation provides a sufficient safeguard that any distortion of competition that the extension may generate will remain proportionate to its purpose. The Commission can therefore agree to the notified amendment.

38. Concerning the deletion of the requirement that the mortgages be transferred to the State in case the guarantee has been triggered, the change is necessary as otherwise the State guarantee cannot be used for covered bonds which have collateral of a pool of mortgages. It should be noted that the inclusion of covered bonds in the scheme was approved in the original decision. As a result of the deletion, if the guarantee is triggered, the State would be in equal position with other bond holders with the same collateral. The Commission can therefore agree to the notified amendment.

39. On the basis of the above, the amended scheme of Finland can be considered compatible with the Common market.

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8 There is no statistics available for the instruments over 3 years and up to 5 years.

9 See Commission Decision of 12 December 2008 in case N 531/2008 *Guarantee scheme for credit institutions in Slovenia* and of 12 February 2009 in state aid N 664/2008 *Support measures for the baking industry in Hungary*.

V. DECISION

The Commission concludes that notified amended scheme is compatible with the Common market and has accordingly decided not to raise objections against it, since it fulfils the conditions to be considered compatible with the EC Treaty.

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Yours faithfully,

For the Commission

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Member of the Commission