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C (2013) 5258 final

<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>		<p>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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Subject: State Aid SA.36248 (2013/NN) – Lithuania
Liquidation aid for the resolution of AB Utkio Bankas

Sir,

1. PROCEDURE

- (1) Lithuania informed the Commission about its planned intervention in the liquidation of AB Utkio Bankas (hereafter '**Utkio bank**' or '**the bank**') by electronic mail dated 20 February 2013. Complementary information was submitted by Lithuania on 1 and 7 March, 16 May, 5 and 28 June and 5 and 26 July 2013.
- (2) On the basis of the initial discussions, Lithuania notified the intervention on 29 May 2013.
- (3) The intervention was put into effect on 23 February 2013.
- (4) Lithuania accepts that exceptionally the decision is adopted in English.

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2. DESCRIPTION OF THE MEASURE

2.1 The beneficiary

- (5) Established in 1989, Ukio bank was a small commercial bank providing banking, financial, investment, life-insurance and leasing services to individuals and companies. It operated mostly in Lithuania but had also three representation offices in Ukraine, Russia and Kazakhstan.
- (6) As of 12 February 2013, the bank had 12 branches, 49 client service departments and 841 employees. Its total assets amounted to approximately LTL [2,000–3,000] billion (EUR [...] million¹). Its market share was 7.28% in deposits and 3.16% in loans at national level. Table 1 provides Ukio bank's main financial figures.
- (7) Ukio bank's ordinary shares were traded on the NASDAQ OMX Vilnius Stock Exchange since June 1998 and on the Official List since 13 July 2006. The bank has more than 100 000 shareholders. Apart from 25.61% free float the two main shareholders of the bank were Vladimir Romanov (64.92%) and First Partneriai UAB (9.47%).

Table 1: Ukio bank's main financial figures

	31.12.2012	12.02.2013 (moratorium)
Loans to customers (million LTL)	1,924.5	[1,000-2,000]
Investment securities (million LTL)	748.6	[500-600]
Total assets (million LTL)	3,917.8	[2,000-3,000]
Retail deposits (million LTL)	2,613.4	[2,000-3,000]
Total wholesale funds - including central banks (million LTL)	21.9	[10-20]
Due to customers (million LTL)	3,441.7	[3,000-4,000]
Total liabilities (million LTL)	3,577.7	[3,000-4,000]
Employees Total Group	843	841
Number of branches	12	12
National market share in deposits	7.28%	-
National market share in loans	3.16%	-

¹ All the conversion in the decision are made at an exchange rate as of 11.07.2013 of EUR 1 = LTL 3.4528.

2.2 The events triggering the measures for Ukio bank

- (8) Ukio bank was characterised by a non-transparent decision-making mechanism, inappropriate recording of transactions, a weak risk management system, insufficient internal audit control as well as a strong informal impact of the persons close to the main shareholder (members of the Supervisory Board) on decision-making. As a result, the bank was heavily involved with persons related to the main shareholder² without rational credit assessment, proper collateral valuation or credit structuring (e.g. unjustified rolling-over loans, accruing due interests or servicing interests through newly granted loans). In addition, after 2008, the quality of the bank's loan portfolio worsened as a result of increased systemic risk.
- (9) The Bank of Lithuania identified operational deficiencies of the bank and violations of legislation during its inspections. The bank was sanctioned and operating restrictions were applied to it. The Bank of Lithuania, having observed that the bank did not solve those problems, drafted a specific schedule for repayment of problematic loans. The bank failed to implement both that schedule and its own alternative loan restructuring plan under which the main shareholder would have made a significant contribution.
- (10) Between December 2012 and January 2013, the Bank of Lithuania conducted another inspection. Following an assessment of the collected data, the Bank of Lithuania decided that after forming the required provisions for loans and properly evaluating other assets, the net value of assets of Ukio bank would be significantly lower than its liabilities (*de facto* insolvency). Ukio bank would not meet the requirement for capital adequacy and hence violate Article 48(1) of the Law on Banks of the Republic of Lithuania (“Law on Banks”) and Rules for the Calculation of Capital Adequacy approved by the Board of the Bank of Lithuania on 9 November 2006. Moreover, on 12 February 2013, the bank did not meet national liquidity requirements.
- (11) As a consequence, on 12 February 2013, the Board of the Bank of Lithuania adopted a Resolution on the Moratorium of Ukio bank restricting its activities, and appointed a temporary administrator.
- (12) Based on the assessment of the temporary administrator, on 18 February 2013, the Board of the Bank of Lithuania declared Ukio bank insolvent and revoked its license. In addition, it agreed to the proposal of the temporary administrator to apply Article 76-1 of the Law on Banks, which provides for the possibility to transfer assets, rights, transactions and liabilities of a bank under the moratorium to another bank³ and authorized the temporary administrator to begin negotiations with AB Siauliu Bankas as an acquiring bank.

² E.g. an alumina plant in Bosnia, real estate investments in Moscow, an acquisition of real estate in Scotland, financing football clubs in Scotland, Belarus and Lithuania as well as a basketball team.

³ Article 76 of the Law on Banks provides that the assets, rights, transactions and liabilities of a bank whose activities are subject to a moratorium and to which a temporary administrator is appointed, may be transferred to another bank if: i) there is a real threat that the net value of assets of the bank subject to administration will fall below the bank's liabilities or that the bank will meet other conditions for recognising the bank as insolvent, or it is established that the bank already meets the conditions for recognising the bank as insolvent, and ii) the transfer of assets, rights, transactions and liabilities of the bank subject to administration to another bank would allow to maintain the trust of depositors in the stability and soundness of the banking system and otherwise protect public interest, while liquidation of the bank subject to administration due to bankruptcy would not protect such interest to the same extent.

- (13) On 2 May 2013, Kaunas Regional Court started bankruptcy proceedings against the remaining part of Ukio bank. The company UAB "Valnetas" has been nominated as bankruptcy administrator of Ukio bank.

2.3 The sale of parts of Ukio bank through a competitive process

- (14) In order to allow the transfer of assets, rights, transactions and liabilities of Ukio bank under the moratorium to another bank, in line with the Law on Banks, the temporary administrator conducted a competitive tender to select a buyer.
- (15) On 12 February 2013, AB Siauliu Bankas expressed its interest to the temporary administrator to look into possible acquisition of Ukio bank's assets and liabilities.
- (16) On 14 February 2013, the temporary administrator of Ukio bank approached all commercial banks active in Lithuania⁴ including branches of foreign banks and invited them in writing to express their interest with a view to taking over the assets and liabilities of Ukio bank. The letter from the temporary administrator expressly mentioned that the administrator had already received an expression of interest from AB Siauliu Bankas. AB Siauliu Bankas was also informed about the fact that the temporary administrator had contacted all commercial banks active in Lithuania. The Bank of Lithuania ensured that all commercial banks active in Lithuania would be put on the level playing field in relation to the possible takeover of assets and liabilities of Ukio bank. [...] banks replied to the invitation ([...]).[...] of those banks were willing to participate in further talks.
- (17) On 15 February 2013, a meeting with the [...] interested banks ([...]) took place. During the meeting the parties have discussed all of the major issues related to the taking over of part of the assets and liabilities of Ukio bank.
- (18) [...] subsequently did not submit proposals.
- (19) [...] expressed its interest in taking over part of Ukio bank's business related to [...]. Because the interest expressed by [...] did not cover the entire scope of assets and liabilities proposed by AB Siauliu Bankas, the temporary administrator asked the Bank of Lithuania whether it should start negotiations with [...]. On 16 February 2013, the Board of the Bank of Lithuania concluded that the offer of [...] did not comply with clause 5 of Article 76-1 of the Law on Banks⁵ and recommended not to enter into further negotiations.
- (20) As a result, AB Siauliu Bankas remained the only bank interested in taking over Ukio bank's assets and liabilities.

⁴ Swedbank AB, AB SEB bank, AB DNB bank, Danske Bank A/S, Nordea Bank Finland Plc, AB Citadele bank, UAB Medicinos bankas, AB bank Finasta, AS SMP Bank, AS Unicredit bank, BIGBANK AS, Pohjola Bank plc, Svenska Handelsbanken, Scania Finans Aktiebolag.

⁵ Clause 5 of Article 76-1 of the Law on Banks requires that, as a minimum, a bank wishing to take over the assets and liabilities of a failed bank must take over the liabilities related to insured deposits. [...] expressed its interest in taking over part of the Ukio bank's business which, however, only related to [...].

2.4 The buyer

- (21) AB Siauliu Bankas (hereafter '**Siauliu bank**' or '**the buyer**') is a Lithuanian credit institution with LTL 2 931 million (EUR 848.9 million) in total assets as of December 2012. It has 162 000 customers, 14 branches, 42 client service units and 481 employees. Its market share is 4.99% in deposits and 3.88% in loans at national level.
- (22) As at 31 December 2012, the biggest shareholder of Siauliu bank was the European Bank for Reconstruction and Development (EBRD) with a stake of 19.57%.
- (23) In 2012, Siauliu bank showed resilient income in line with the level of the previous year, despite the general negative economic backdrop in Europe. As of December 2012, its core capital ratio under Basel II rules was 12.62%, while its total Basel II capital ratio was 12.81%.

2.5 The alternative to the sale of parts of Ukio bank

- (24) Apart from the sale of parts of assets and liabilities of Ukio bank, two other options were presented by the temporary administrator to the Bank of Lithuania. They were: i) bankruptcy of Ukio bank and ii) an establishment of a temporary State-owned bridge bank for the transfer of liabilities and performing assets.
- (25) In case of bankruptcy the payment of compensations to insured depositors would have amounted to LTL [1-5] billion (EUR [...] million) which would be paid out by the Deposit Guarantee Fund ('**the Fund**')⁶. The establishment of a temporary State-owned bridge bank would have resulted in total estimated costs of up to LTL [1-5] billion, out of which LTL [0-5] billion would have been contributed by the Fund and up to LTL [0-5] billion contributed by the State to the capital of the bridge bank. Consequently, according to the Lithuanian authorities both options were deemed to be not only more costly but also less effective than the transfer of assets, rights and liabilities to another bank conducting its activities in Lithuania.
- (26) Moreover, because Ukio bank was already the second bank which had stopped its operations in Lithuania⁷ due to financial difficulties, the Lithuanian authorities preferred the sale of parts of assets and liabilities as a more expedient solution so that deposit holders in the Lithuanian banking system would retain trust, as well as better securing the general interest of the public and financial stability in the banking sector.

2.6 The measure

- (27) On the basis of the Law on Banks, the Lithuanian authorities decided to transfer parts of assets and liabilities of Ukio bank ('**the Transfer Package**') to another

⁶ Deposits at Ukio bank were insured by the State Enterprise "Deposit and Investment Insurance" up to the amount of EUR 100 000. The Fund is administered by that State Enterprise.

⁷ On 24 November 2011, another Lithuanian bank, Bankas Snoras AB, went bankrupt.

bank while maintaining the remaining part in special administration and liquidation.

- (28) Overall, LTL 1 921.3 million or approximately 80% of Ukio bank's assets and LTL 2 720.5 million or approximately 80%⁸ of its liabilities was transferred to Siauliu bank. Because the liabilities in the Transfer Package exceeded the assets, in order to allow for its sale the assets had to be supplemented by cash from the Fund in order to match the assets and the liabilities. The gap was estimated at LTL 799 155 000 (EUR 231.4 million).
- (29) The Transfer Package contained the following assets and liabilities:

Assets (at book value)

- (i) Loan portfolio of LTL [900-1000] million,
- (ii) Cash and cash equivalents of LTL [300-400] million,
- (iii) Debt securities of LTL [400-500] million,
- (iv) Other securities of LTL [100-200] million,
- (v) Other assets of LTL [60-70] million,
- (vi) Premises of [20-30] client service units of Ukio bank,

Liabilities

[...]

- (30) Where a depositor with respect to an insured deposit is also a debtor with respect to claim rights under loans which were taken over by Siauliu bank, such claim rights have been transferred to Siauliu bank to the extent the claim rights exceeded the insured deposit.
- (31) The agreement for transfer of assets and liabilities was made on the basis of preliminary evaluation of the assets. In order to secure the rights of the creditors of Ukio bank, that agreement foresees the following safeguards in relation to the assets transferred to Siauliu bank:
- a) KPMG will complete a comprehensive assessment and evaluation of Ukio bank's assets and liabilities (**'final valuation'**) by mid-August 2013. Following the final valuation, the initial consideration paid by the Fund will be revised and the adjusted consideration is to be calculated as the difference between the finally evaluated value of assets and liabilities assumed by Siauliu bank. If the initial consideration is higher than the adjusted consideration, Siauliu bank will pay to Ukio bank the difference in cash. If the adjusted consideration is higher than the LTL 799 million, Siauliu bank may select any additional assets of Ukio bank which Ukio bank will be obliged to transfer to Siauliu bank at a fair market value. If the value of assets acquired by Siauliu bank is not sufficient to cover the difference, and Siauliu bank, Ukio bank and the Fund fail to agree on another solution, both the Fund and Siauliu bank may terminate the agreement for the transfer of assets and liabilities, in which case a full restitution will be effected;

⁸ Both percentages as referred to amounts as of the date of moratorium (12.02.2013).

- b) The creditors (acting through the bankruptcy administrator) of Ukio bank may within nine months sell four different portfolios of assets which have been transferred to Siauliu bank:
- (i) all immovable property transferred to Siauliu bank;
 - (ii) shares in the subsidiaries of Ukio bank transferred to Siauliu bank;
 - (iii) loans which at the time of transfer were non-performing with payments overdue for more than 60 days.; and
 - (iv) shares and bonds in UAB Ūkio banko lizingas and Gyvybės draudimo UAB "BONUM PUBLICUM";

If any of those portfolios are sold at a price higher than their final valuation, the difference in the price will be paid to Ukio bank, and will be distributed to the creditors of Ukio bank upon liquidation;

- c) If within a period of two years the assets transferred from Ukio bank to Siauliu are sold by Siauliu bank at a higher price than the acquisition price, Siauliu bank will repay 60% of the difference to Ukio bank.

2.7 The Rump Ukio

- (32) The unsold assets and liabilities remaining under the legal entity of AB Ukio Bankas ('**the Rump Ukio**') have been placed in the bankruptcy administration. Those assets amount to LTL [300-400] million (EUR [...] million) and include i) investments of Ukio bank outside Lithuania, ii) loans issued to shareholders of the bank and persons associated with the shareholders of the bank, iii) certain non-performing loans, and iv) certain movable assets which are not related to the transferred assets and liabilities of Ukio bank to Siauliu bank. The remaining liabilities mostly relate to obligations towards the Fund in the amount of LTL 799 million and the deposits exceeding the insured amount of EUR 100 000⁹.
- (33) The Rump Ukio is being wound-down by the bankruptcy administrator with a view to collect-out or sell the remaining assets at a maximum price for the benefit of the creditors of Ukio bank.
- (34) As it is under bankruptcy proceedings, the Rump Ukio no longer has a banking license and as such cannot provide financial services. It therefore no longer undertakes any new economic activities in the market. It may carry out certain limited activities in relation to loans, such as extension of repayment terms, restructuring of loans, realising certain securities etc. to secure the value of assets. However, it may not issue additional loans or provide drawdowns from existing facilities.
- (35) According to the provisions of the Law on Banks, the Fund is entitled to claim reimbursement of the LTL 799 million against the Rump Ukio in the bankruptcy.

⁹ No full view of the creditors is currently available, as each creditor must submit its claim within the bankruptcy procedure and they must in turn be approved by the court. The creditors were allowed to submit their claims to Ukio bank until 8 July 2013.

3.1 Siaulių bank's absorption of acquired assets and liabilities

- (36) Siaulių bank made a preliminary analysis of taking over part of assets and liabilities of Ukio bank, based on the available information and certain assumptions. The Lithuanian authorities' preliminary evaluation assessed the impact that the assets and liabilities of Ukio bank could have on the results of the Siaulių bank. [...]. The forecasted results should be achieved due to an increase in the number of bank customers [...] and expansion of the network of operations of Siaulių bank [...].
- (37) Taking over the assets and liabilities of Ukio bank will not materially alter the business focus of Siaulių bank on the market segment of small and medium-sized corporate clients, [...].
- (38) According to the Lithuanian authorities, the management team of Siaulių bank, which was substantially strengthened and increased in 2011, can successfully operate a much larger bank than Siaulių bank had previously been. As a result, the growth of Siaulių bank shall not require substantial investments in human resources at a managerial level. The increased number of clients will be served by approximately [...] new employees. More than [...] additional employees will be employed at the headquarters of Siaulių bank to ensure the management and expansion of its information systems and processes, assortment of services as well as quality control.
- (39) [...].
- (40) Even though the assets and liabilities of Siaulių bank have almost doubled following the takeover of assets and liabilities from Ukio bank, the former has no reservations about its ability to ensure the viability of business of the combined banks. The transferred assets are dominated by liquid assets, which do not present any management issues to Siaulių bank. The loan portfolio taken over from Ukio bank amounts to less than [40-50]% of the loan portfolio of Siaulių bank before the transfer of assets and liabilities of Ukio bank. The loan portfolio has been evaluated conservatively and all required provisions for those loans have been made. The liabilities of Ukio bank transferred to Siaulių bank are dominated by fixed-term deposits from Lithuanian citizens. [...].
- (41) At the same time, Siaulių bank notes that it understands that increase of its market share presents it with new challenges and requires even more responsibility. The largest shareholder of Siaulių bank, the EBRD, supports it in pursuing an increase in its market share and has agreed to strengthen its capital basis by granting it a EUR 20 million subordinated loan on 23 February 2013. Close co-operation with the EBRD will be continued. Among other things, the EBRD has been granted a right to appoint a second representative to the supervisory board of Siaulių bank. According to the Lithuanian authorities, alongside other steps they will ensure that the management of the combined entity is improved and its financial situation strengthened.

4 POSITION OF LITHUANIA

- (42) Originally, the position of the Lithuanian authorities was that the measure does not constitute State aid. Therefore it was implemented without prior notification to the Commission.

- (43) After consultation with the Commission services, the Lithuanian authorities submitted a notification in which they recognise that the intervention of the Fund in Ukio bank may involve State aid but consider that such aid would be compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("the Treaty"), as the intervention was necessary to remedy a serious disturbance in the Lithuanian economy.

5 ASSESSMENT OF THE MEASURES

5.1 Existence of State Aid

- (44) According to Article 107(1) of the Treaty, State aid is any aid granted by a Member State or through State resources in any form whatsoever which distorts, or threatens to distort, competition by favouring certain undertakings, in so far as it affects trade between Member States.
- (45) The qualification of a measure as State aid within the meaning of the provision therefore requires the following cumulative conditions to be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage on its recipient; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and have the potential to affect trade between Member States.

5.1.1 Identification of beneficiaries

- (46) With regard to Siauliu bank, the Commission needs to assess whether it benefits from an aid measure as a purchaser of the Ukio bank's assets and liabilities. According to point 49 of the Banking Communication, in order to ensure that no aid is granted to the buyer of a financial institution or parts of it, it is important that certain requirements are met, and in particular that i) the sale process is open and non-discriminatory; ii) the sale takes place on market terms; and iii) the State maximises the sale price for the assets and liabilities involved.
- (47) In addition to the sale of parts of assets and liabilities of Ukio bank which was carried out, two other options were presented by the temporary administrator to the Bank of Lithuania namely: i) bankruptcy of Ukio bank and ii) an establishment of the temporary State-owned bridge bank for the transfer of liabilities and performing assets.
- (48) If Ukio bank had been made bankrupt the payment of compensation to insured depositors would have amounted to LTL [1-5] billion (EUR [...] million) as a payment by the Fund. The establishment of the temporary State-owned bridge bank would have resulted in a total estimated cost of up to LTL [1-5] billion, out of which LTL [0-5] billion contributed by the Fund and up to LTL [0-5] billion contributed by the State to the capital of the bridge bank. Consequently, the Commission concludes that both those options are more costly than the present transfer of assets, rights and liabilities to another bank conducting its activities in Lithuania.
- (49) On the basis of the information provided by Lithuania, the Commission considers that the Tender Procedure described in section 2.4 qualifies as a competitive process in line with business practices, in which a number of potentially interested

buyers were contacted and which resulted in the best bid winning. No other participant made an offer requesting less public support. Therefore, the transaction seems to be aligned with market practice and Siauliu bank has not received any undue advantage.

- (50) With regards to the Rump Ukio, that entity is under bankruptcy proceedings. As it no longer holds a banking license and cannot provide financial services, it no longer conducts economic activities in the market. Also, it cannot re-enter the market. It can therefore be concluded that Ukio bank is not a beneficiary under the present decision.
- (51) Finally, with regard to the transferred assets and liabilities, the Transfer Package accounts for a substantial part of Ukio bank's balance sheet (80%). It is made of both assets and liabilities and, more specifically, of a portfolio of customers which are incorporated into the buyer's business plan. Moreover, the buyer is also taking part of the bank's infrastructure (some client service units). The transferred business will therefore be allowed to continue providing the same range of banking and financial services to its customers as Ukio bank did before the sale ("the legacy business") and will clearly continue to carry out economic activity within the combined entity.
- (52) The Commission will therefore only consider the legacy business when it examines if the measure described in section 2.6 constitutes State aid.

5.1.2 *State resources and imputability*

- (53) It is clear from established case-law¹⁰ that State resources may be present whether the aid is granted directly by the State or by public or private bodies established or appointed by that State (such as the Fund).
- (54) For advantages to be capable of being categorised as aid within the meaning of Article 107(1) TFEU, they must, first, be granted directly or indirectly through State resources and, second, be imputable to the State¹¹. State resources are involved where funds come from contributions made compulsory by State legislation and are managed and apportioned in accordance with that legislation, even if they are administered by institutions separate from the State¹².
- (55) Even though the Fund is financed by contributions from private member banks, according to settled case-law all the financial means by which the public sector may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector, fall under Article 107(1) of the Treaty if they constantly remain under public control and therefore available to the competent national authorities. Since all banks and credit unions in Lithuania are obliged to contribute to the Fund based on national legislation, the means by which the compensation is funded can be considered as being under public control and hence are State resources.
- (56) The Court of Justice has clarified that imputability to the State of an aid measure taken by a *prima facie* independent body (for instance, a public undertaking) can be inferred from a set of indicators arising from the circumstances of the case, such as

¹⁰ See Case C-345/02 *Pearle and others* [2004] ECR I-7139, at paragraphs 34 and 35 and the judgments referred to therein.

¹¹ *Idem*.

¹² See Case 173/73 *Italy v Commission* [1974] ECR 709, at paragraph 16.

the fact that the body in question cannot take the contested decision without taking into account the requirements of the public authorities, or the fact that, apart from factors of an organic nature which link it to the State, it has to take into account the directives issued by the State before taking the decision allegedly involving State aid¹³. Other indicators might, in certain circumstances, be relevant in concluding that an aid measure taken by a public undertaking is imputable to the State. Similarly, the fact that private persons participate in the running of an entity is not sufficient to exclude imputability to the State of the measure at issue.

- (57) As the Fund operates based on the Law on Insurance of Deposits and Liabilities to Investors, the Ministry of Finance of the Republic of Lithuania exercises the rights of owner of the insurance undertaking administering the Fund and together with Bank of Lithuania appoints the council of the Fund the use of whose means are imputable to the State.
- (58) In light of the above, the measure includes State resources and is imputable to the Member State for the purposes of Article 107(1) of the Treaty.

5.1.3 *Advantage*

- (59) The measure constitutes a clear advantage to the legacy business which will continue within Siauliau bank and would have not continued under normal market conditions.

5.1.4 *Selectivity*

- (60) Since the measure is exclusively addressed to Ukio bank, it should be considered selective in nature.

5.1.5 *Distortion of competition and effect on trade between Member States*

- (61) The Commission considers the measure to distort competition since it enables the legacy business to survive within another legal entity while it would have otherwise disappeared without public support.
- (62) The Commission also considers that the measure is likely to affect trade between Member States since the legacy business continues – within Siauliau bank – to compete on the Lithuanian banking market in which some competitors are subsidiaries and branches of foreign banks.

5.2 **Legal basis for the compatibility of the aid**

- (63) Article 107(3)(b) of the Treaty empowers the Commission to find that aid is compatible with the internal market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy

¹³ See Case C-482/99 *France v Commission ("Stardust Marine")* [2002] ECR I-4397, at paragraph 55. See also Case C-303/88 *Italy v Commission* [1991] ECR I-1433, at paragraphs 11 to 13.

that disturbance¹⁴. The Commission confirmed that view by adopting the 2013 Banking Communication¹⁵.

- (64) In respect of the Lithuanian economy that assessment has been confirmed in the Commission's various approvals of the measures undertaken by the Lithuanian authorities to combat the financial crisis¹⁶. In addition, a disorderly liquidation of Ukio bank's business would create a serious disturbance for the Lithuanian economy.
- (65) Therefore, the legal basis for the assessment of the measures is Article 107(3)(b) of the Treaty.

5.3 Compatibility

Compatibility of measure with the Restructuring Communication

- (66) The Restructuring Communication sets out the State aid rules applicable to the restructuring and winding-up of financial institutions in the current financial crisis. According to the Restructuring Communication, in order to be compatible with the internal market under Article 107(3)(b) of the Treaty, the restructuring of a financial institution in the context of the current financial crisis must (i) lead to a restoration of the viability of the bank, or to the orderly winding-up thereof; (ii) ensure that the aid is limited to the minimum necessary and include sufficient own contribution by the beneficiary (burden-sharing); and (iii) contain sufficient measures limiting the distortion of competition.

5.3.1 Restoration of viability within Siauliu bank

- (67) In the present case, the Lithuanian authorities have chosen to sell selected assets and liabilities of Ukio bank via a competitive tender procedure and to resolve the remaining activities of Ukio bank. The Commission, therefore, has to assess whether the integration into Siauliu bank will enable long-term viability to be restored to the legacy business. Long-term viability is achieved when a bank is able to compete in the marketplace for capital on its own merits in compliance with the relevant regulatory requirements. For a bank to do so, it must be able to cover all its costs and provide an appropriate return on equity, taking into account the risk profile of the bank. Where a financial institution cannot be restored to viability, the restructuring plan should indicate how it can be wound up in an orderly fashion. The plan should, furthermore, also identify the causes of the difficulties faced by a

¹⁴ This has been confirmed in the Banking Communication (Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8), the Recapitalisation Communication (Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2), the Impaired Asset Communication and the Restructuring Communication (Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9).

¹⁵ Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ("Banking Communication"), OJ C 216, 30.7.2013, p. 1, point 6.

¹⁶ See e.g. Fifth prolongation of the Lithuanian bank support scheme – H1 2013 SA.36047 (2013/N), OJ C132/2013 of 9.05.2013.

financial institution and provide a business model that restores the bank's long-term viability.

- (68) According to point 17 of the Restructuring Communication, the sale of a financial institution to a viable third party with sufficient financial means and the capacity to absorb that institution can help to restore its long-term viability.
- (69) In the present case, that requirement is met by Siauliu bank, a banking group incorporated in Šiauliai, with 14 branches, 42 client services, 481 employees, a total balance sheet of LTL 2.9 billion, and a consolidated net profit of LTL 14.8 million as of December 2012.
- (70) First, given the relatively small size of Siauliu bank, although its size in terms of balance sheet will double as a result of transfer, [...].
- (71) Second, as regards viability, Siauliu bank complies and will continue to comply with legal solvency requirements after the integration of the legacy business.
- (72) Third, Siauliu bank's liquidity position is comfortably able to absorb the legacy business. In fact, the transfer improved its liquidity. As of March 2013, the liquidity ratio of the combined entity stood at [50-60]% as compared to the minimum liquidity ratio set by the Bank of Lithuania of 30%.
- (73) Fourth, the quality of Siauliu bank's credit portfolio presents a level of non-performing loans which is in line with the sector's average.
- (74) Fifth, according to the integration plan the combined entity will reap the benefits of synergies resulting in improved profitability. It will also comply with the relevant regulatory requirements throughout the whole projection period (2013 until 2015).
- (75) Sixth, the primary causes of the Ukio bank's difficulties were inextricably linked to the non-transparent decision-making mechanism, inappropriate recording of transactions, a weak risk management system, insufficient internal audit control as well as a strong informal impact of the persons close to the shareholder. The sale of the legacy business to a buyer with a strong track record in that respect and a proper corporate governance structure underpinned by a main shareholder, the EBRD, will contribute to remedy the causes of the bank's difficulties and set it back on the path to a long-term viability.
- (76) It can thus be concluded that Siauliu bank has the capacity to own and manage the legacy business in compliance with regulatory and prudential requirements.
- (77) In light of the above, it is concluded that the integration into Siauliu bank adequately ensures the long-term viability of the legacy business.

Liquidation of Ukio bank

- (78) While selected assets and liabilities will be transferred to Siauliu bank, the remainder of Ukio bank being under bankruptcy proceedings will be resolved and cease to exist. It is envisaged that the winding down of Ukio bank will be completed within [...] years¹⁷. The bank will not pursue any new business. The restructuring of loans will take place only when it leads to a meaningful increase of the net present value of the loan.

¹⁷

The usual timeframe to conclude liquidation in Lithuania is two to three years. However, given that most of the remaining assets which secure the obligations of remaining debtors of Ukio bank are located outside Lithuania and considering the disputes which have already arisen and are likely to arise in the future, the procedure in this case is expected to take longer.

5.3.2 *Own contribution and burden-sharing*

- (79) The Restructuring Communication indicates that an appropriate contribution by the beneficiary is necessary in order to limit the aid to a minimum and to address distortions of competition and moral hazard. To that end, it provides that (i) both the restructuring costs and the amount of aid should be limited and (ii) a significant own contribution is necessary.
- (80) Point 23 of the Restructuring Communication provides that restructuring aid should be limited to the amount necessary to cover the costs which are necessary for the restoration of viability.
- (81) The Restructuring Communication further provides that, in order to keep the aid limited to a minimum, banks should first use their own resources to finance the restructuring. The costs associated with the restructuring should not only be borne by the State but also by those who invested in the bank. That objective is achieved in particular by absorbing losses with available capital.
- (82) In that regard, although the shareholders of Ukio bank do not cease to be its owners they will participate in the restructuring costs. First, they contributed to the costs of the restructuring by absorbing the bank's losses. Second, in view of the capital gap it is not expected that either the shareholders or subordinated loans holders will receive any compensation as a result of the bankruptcy proceedings.
- (83) It is also clear that the bank itself is contributing to the cost of restructuring by transferring a very substantial proportion of its assets to Siauliu bank.
- (84) With regard to the limitation of aid to the minimum, first, the sale to Siauliu bank is the result of a competitive process. The transaction seems to be aligned with market practice and Siauliu bank has not received any undue advantage.
- (85) Second, several bidders expressed their interest in the first phase and only one of them submitted an offer fulfilling criteria under the Law on Banks (see section 2.3).
- (86) Comparing the cash injection necessary to match the gap between the transferred assets and liabilities with the alternative scenario shows that the cost for the State of selling Ukio bank in parts and liquidating the remainder is lower than the costs arising from a liquidation of the whole bank or an establishment of the temporary State-owned bridge bank for the transfer of liabilities and performing assets.
- (87) The Commission thus concludes that the amount of aid can be deemed limited to the minimum necessary.

5.3.3 *Limiting distortion of competition*

- (88) Finally, section 4 of the Restructuring Communication requires that the restructuring plan contains measures limiting distortions of competition. Such measures should be tailor-made to address the distortions on the markets where the beneficiary bank operates post-restructuring. The nature and form of such measures depend on two criteria: first, the amount of the aid and the conditions and circumstances under which it was granted and, second, the characteristics of the markets on which the beneficiary will operate. Furthermore, the Commission must

take into account the extent of the Ukio bank's own contribution and burden-sharing over the restructuring period.

- (89) The Commission recalls that the legacy business has received State aid in amount of LTL 799 million. It is equivalent to 71% of the risk weighted assets of the legacy business¹⁸. Although, the amount of aid relative to the size of the beneficiary is considerable and adequate remuneration is excluded, the nominal amount of the aid remains moderate.
- (90) The Commission notes that the transfer of the legacy business and the liquidation of the remainder results both in no compensation to the former share- and hybrid capital holders of the bank and in its disappearance a standalone entity. The Commission considers that the exit of a failed institution which engaged in excessive risk-taking is a clear indication that moral hazard is addressed. As a result, potential distortions of competition resulting from the State aid are likely to be greatly reduced.
- (91) In addition, the Commission notes that the sale of the legacy business was undertaken through an adequately competitive tender procedure that can be considered as a sufficient proxy for the establishment of the market price for the assets and liabilities taken over by the purchaser.
- (92) As regards the transfer of the legacy business, it is necessary to assess whether the measures to limit the distortion of competition are sufficient in light of the characteristics of the market on which the beneficiary will operate.
- (93) It should be noted in particular that through the transfer the balance sheet of Ukio bank was reduced by 80%. Moreover, the distortions of competition due to the legacy business' continued market presence are limited. Ukio bank was a very small operator with a very limited market presence on the national Lithuanian market. The market share of the transferred assets amounts to merely 3% of the total Lithuanian banking sector assets.
- (94) In light of the above, it can be concluded that the distortions of competition created by the aid are minimised.

5.4 Monitoring

- (95) The Lithuanian authorities will provide a report on final division of assets between Siaulių bank and Ukio bank three months after performing the final valuation of assets and liabilities by KPMG.

5.5 Conclusions on the existence of aid and compatibility with the internal market

- (96) The Commission concludes that the notified measure, namely the cash injection, constitutes State aid in favour of the legacy business pursuant to Article 107(1) of the Treaty.

¹⁸ RWA as of the relevant reference date when the aid measure was granted.

(97) The Commission finds that the restructuring aid in favour of the legacy business is compatible with the internal market for reasons of financial stability on the basis of Article 107(3) (b) of the Treaty.

6 CONCLUSION

The Commission notes that Lithuania put the State aid measure into effect, in breach of Article 108(3) of the Treaty. However, on the basis of the foregoing assessment, the aid measures are found compatible with the internal market pursuant to Article 107(3)(b) of the Treaty. The Commission therefore does not raise any objection against the State aid.

Lithuania exceptionally accepts that the present decision be adopted in the English language, for reasons of urgency.

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
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