



EUROPEAN COMMISSION

Brussels, 5.8.2010
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**Subject: State aid N 200/2009 and N 47/2010 – Lithuania
Lithuanian bank support scheme**

Sir,

I. PROCEDURE

1. On 3 April 2009, Lithuania notified a State aid scheme in support of the Lithuanian banking sector, consisting of three measures, namely State guarantees for bank stability enhancement (hereafter "Guarantee"), Subordinated loans to banks (hereafter "Recapitalisation") and Redemption of bank assets (hereafter "Asset relief").
2. The notification, which was registered under N 200/2009, consisted only of the general provisions enabling the implementation of the measures without specifying their terms and conditions.
3. By letters dated 30 April and 2 June 2009 the Commission services requested the Lithuanian authorities to specify the terms and conditions of the measures. Furthermore, the Commission services noted that the Lithuanian authorities intended to specify the terms and conditions of the Guarantee as a first step.
4. Hence, the scope of the notification registered under N 200/2009 was limited to the Guarantee, whilst Lithuania was invited to notify separately the other measures. Lithuania responded to questions concerning the Guarantee scheme on 8 and 10 February 2010.

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5. On 8 February 2010, Lithuania also notified the implementing provisions for Recapitalisation and Asset relief, registered under N 47/2010. The Commission services requested further information on 9 April, 31 May, 11 June 2010 and 30 July to which Lithuania replied on 1 June, 7 July and 30 July 2010.

II. DESCRIPTION OF THE SCHEME

1. Objective of the measures and legal basis

6. In response to the financial crisis, Lithuania intends to bring forward a scheme consisting of three measures (hereinafter referred to as "the Scheme" or "the measures") designed to create prerequisites for the State to take action for strengthening the stability and robustness of the Lithuanian financial system.
7. The three measures are as follows:
 - A. Asset relief: The Lithuanian Government will take over certain categories of bank assets from beneficiary banks in exchange for cash or government securities. The measure aims at restoring a bank's solvency, fulfilling its risk-limiting standards or otherwise strengthening its stability and credibility.
 - B. Recapitalisation: The Lithuanian Government will participate in the capital of beneficiary banks by providing subordinated loans to them. This measure aims at strengthening the stability and credibility of a bank's activities by increasing its own capital.
 - C. Guarantee: The Lithuanian Government will provide, in return for an appropriate remuneration, a State guarantee for loans and other senior financial liabilities (except interbank deposits). This measure aims at enhancing the liquidity of a bank or otherwise strengthening its stability and credibility.
8. The principles of the proposed measures are laid down in the Law on "Financial Stability" (hereinafter: "the Law") adopted by the Lithuanian Parliament on 22 July 2009 and published in the Lithuanian Official Gazette on 4 August 2009, No. 93-3985.
9. The three measures will be implemented by a government "Resolution on approval of rules on issue, administration and implementation of State guarantees for bank stability enhancement, rules on extension of subordinated loans to banks and supervision thereof and rules on redemption of bank assets" (hereafter "the Rules").
10. The Law and the Rules will be implemented upon approval by the Commission.

2. The Beneficiaries

11. Beneficiaries of the scheme are banks whose financial situation poses a threat to the stability and credibility of the banking system¹, including foreign subsidiaries and branches of foreign banks established in the Republic of Lithuania (hereafter "Bank" or "Banks"). Banks shall apply for the application of the scheme by submitting a duly substantiated request to the

¹ Or the Bank, which in case of its reorganisation or otherwise, takes over the obligations of such a Bank.

Ministry of Finance while simultaneously sending the application material to the Bank of Lithuania for assessment.

12. The Bank of Lithuania will provide its conclusion and proposals on the application to the Ministry of Finance, including:
 - a) information about the financial status of the Bank, forecast of fulfilment of prudential requirements and its financial status, in the absence of State support;
 - b) proposed details and conditions of the support to be provided to the Bank;
 - c) its opinion on the plan submitted by the Bank for ensuring stable and credible activities of the Bank;
 - d) proposal regarding additional requirements to be applied to the Bank as stipulated in the Rules (see paragraph 24 below).
13. Applications for participating in the scheme will be approved by the Government of the Republic of Lithuania.

3. Description of the measures

A. Asset relief

14. Article 2(2) of the Law empowers the Lithuanian State to introduce a mechanism for asset relief for Banks. Asset relief is achieved through the possibility for Banks to transfer bank assets to the State-controlled joint stock company AB Turto bankas² (hereinafter "AB Turto bankas") in exchange for a payment in litas, euros or government securities.
15. The total estimated budget for both asset relief and recapitalisation measures would not exceed LTL 3 billion (EUR 870 million)³.
16. Bank assets to be transferred shall be a wide range of impaired loans and financial assets granted or purchased by the Bank, which includes credits, account credits, discounted bills, debt securities, amounts to be received from operative leasing, deposits, funds on accounts of other banks, re-repurchase agreements, factoring, assets sold by instalments (on loan) and advance payments. Only assets denominated in litas or in euros and held by the Bank at the

² AB Turto bankas was established in 1996. The State holds 100 per cent of AB Turto bankas' capital. The activities of AB Turto bankas initially were concentrated on the financial restoration of the State-controlled banks that failed during the 1995 banking crisis and preparing them for eventual privatization; and the liquidation of failed commercial banks, takeover of their assets with a view to protecting creditors' interests. During the first decade of its operation, AB TURto bankas completed the liquidation of 10 commercial banks and 46 investment stock companies. Since 2000, the activities of AB Turto bankas were extended, i.e. it took over the administration of the loans and guarantees given on behalf of the State and the recovery of debts. At present the main purpose of AB Turto bankas is to organise and coordinate the renewal of State-owned real estate, realize non-performing assets and recover administered loans, State guarantees and other material liabilities. AB Turto bankas is remunerated by the State for the performance of its functions, no commercial funding is provided. AB Turto bankas' remuneration rules are stipulated by Government of the Republic of Lithuania Resolution No. 931 of 29 August 2007 On Approval of the Rules on Calculation of the Remuneration of AB Turto Bankas for Administration of Debts and Organisation and Coordination of the Renewal of the State-Owned Real Estate and the Rules on Use of the Resources which are Residual after the Renewal of the State-Owned Real Estate.

³ The budget for the asset relief measure corresponds to the transfer value of assets to be purchased.

time of the entry into force of the Rules shall be eligible. In addition, the assets eligible will be those entered in the balance sheet of the beneficiary banks before the announcement of the relief measure date of 4 August 2009 (the cut-off date).

17. Banks applying for Asset relief shall present information on the types of impaired assets, criteria based on which the bank assets to be transferred have been established and grounds for choosing those criteria. That information shall also include full disclosure of impairments on the assets.
18. The Bank of Lithuania will verify and assess the information presented by the Bank, including its financial status and activities, its balance sheet and the impairments with a view to assessing the Bank's capital adequacy and the Bank's prospective viability.
19. The Ministry of Finance will examine the documents submitted by the Bank only if the Bank of Lithuania provides the conclusion that the use of Asset relief for strengthening financial stability would enable the fulfilment of prudential requirements, or otherwise strengthen the stability and credibility of the Bank.
20. If the proposal meets all requirements stipulated by the Law and by the Rules, the Ministry of Finance informs AB Turto bankas, which orders the evaluation of the bank assets, selects an appraisal company to perform the evaluation (i.e. to calculate the real economic value of such assets) and approves (and modifies if necessary) the appraisal method proposed by the property appraisal company.
21. In the evaluation of the bank assets, the appraisal company has to involve an auditor selected by AB Turto bankas. The auditor must not be involved in the regular audit of the Bank's financial statements. The evaluation of the bank assets shall be based on the principles set in the Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector⁴ (hereinafter "IAC").
22. The Bank of Lithuania as supervisory authority also assesses the valuation of the bank assets to be transferred.
23. The minimum haircut on the transfer value established by the appraisal company shall be 20 per cent. AB Turto bankas may also set a lower price of the assets transferred taking into consideration:
 - a) the reliability and liquidity of measures securing the transferred bank assets and the range in the projected value of these measures;
 - b) the credibility and creditworthiness of the loan recipient or issuer;
 - c) any other significant factors which may affect the value of the bank assets.
24. The decision to transfer the assets of a specific Bank will be based on objective and non-discriminatory criteria. Upon taking a decision, an individual and publicly available Resolution will be adopted by the Government of the Republic of Lithuania. The Resolution will specify the precise terms and conditions of the Asset relief as well as the consequences for the Bank of non-performance, and may incorporate additional safeguards, including:
 - a) a prohibition on the payment of dividends, tantiems and share buy-backs;

⁴ OJ C 72, 26.3.2009, p.1.

- b) a requirement for maintaining credit to the real economy, for fulfilling relevant prudential requirements and for increasing the bank-authorized capital by additional contributions from shareholders and for limiting certain activities.
25. Transferred assets will be managed separately from the Bank from a functional and organisational perspective by AB Turto Bankas. The Bank of Lithuania will provide the Ministry of Finance with the information received during the supervision of credit institutions on fulfilment of the terms and conditions for the Asset relief and the plan for ensuring stable and credible activities of the bank.

B. Recapitalisation

26. Article 2(3) of the Law empowers the Lithuanian State to participate in the capital of certain Banks. The measure aims at strengthening the stability and credibility of the Bank's activities by increasing its own capital. The decision to grant the measure will be based on objective and non-discriminatory criteria. Article 7(1) of the Law envisages recapitalisation in the form of subordinated loans⁵.
27. The exact detailed arrangements of recapitalisation (e.g. amount, remuneration and term) are to be laid down in an agreement between the credit institution and the Lithuanian State. The Law empowers the Government of the Republic of Lithuania to conclude this agreement and the Rules set out its conditions. However, any such agreement will follow the principles described in this decision.
28. The subordinated loans shall be provided to the Bank in litas or euros.
29. The term of the subordinated loans shall be from 2 to 5 years. Depending on their maturity, the subordinated loans may qualify as Tier 2 (five year term loans) or Tier 3 capital.
30. The interest rate on the subordinated loans should not be lower than the sum of the following:
- The annual interest rate on Government securities calculated as the weighted interest rate on Government securities issued through public placement within the preceding 3 months in the relevant currency and with the relevant maturity taking into consideration the subordinated loan to be provided. If the Government has not made such placement in the given period, it shall be based on the yield of comparable Government securities announced in at least one publicly acknowledged and used information and trade system;
 - The weighted average of the preceding 12 months of the annual rates of 5-year credit default swaps ("CDS") of the Republic of Lithuania announced in at least one publicly acknowledged and used information system;
 - 200 basis points.

⁵ The Law also envisages the possibility for the State to purchase newly issued shares by the bank or existing ones from the bank's shareholders. However, no implementing rules were established for these measures. The latter measures do not enter in the scope of the present decision.

31. The major differences between the above methodology and that of the ECB are as follows:
 - The Lithuanian authorities use the immediate past data while the ECB recommends using the pre-crisis period data;
 - Instead of bank's CDS spread the Lithuanian authorities use sovereign CDS⁶.
32. Lithuania confirmed that, in any case, the remuneration charged for the subordinated loans will not be lower than under the pricing formula recommended by the ECB.
33. By way of example, according to the Lithuanian authorities, as a result of the above methodology, the indicative annual return on subordinated loans provided in litas in April 2010 would have been approximately 10%; those provided in euros would have been approximately 9%.
34. Furthermore, the Government, taking into consideration the bank's risk level, the financial market situation and other circumstances may set a higher annual interest rate. The bank may also be set a gradually increasing interest rate in order to encourage the bank to which the subordinated loan has been granted to repay this loan as soon as possible.
35. The Bank has at any time the possibility to repay the subordinated loan under the conditions and procedure established in the Agreements on Subordinated Loans prior to the term set therein.
36. Further, the Rules provide that in cases where the beneficiary bank does not fulfil its liabilities to the State under the Agreements on Subordinated Loans, the Lithuanian State has the right, amongst others, to rearrange the subordinated loan, to transfer the claim, or to capitalise the subordinated loan.

C. The Guarantee measure

37. Under Article 2(1) of the Law, the Lithuanian State is also empowered to make available a State guarantee to solvent banks covering newly issued senior loans and other senior financial liabilities, excluding interbank deposits (hereafter "debt"). Subordinated loans and capital investment are excluded from the scope of the measure.
38. The budget for the guarantee measure is LTL 3 billion (EUR 870 million).
39. The guarantee is limited in so far as only debt with maturities of up to 3 years but not shorter than 3 months is eligible.
40. The total amount of the Bank's liabilities guaranteed by the State cannot exceed the Bank's own capital or, if liabilities of a foreign bank branch is guaranteed, total amount of such liabilities cannot exceed the size of mandatory reserves calculated for the branch in the current period multiplied by three.
41. The Bank requesting to issue a State guarantee presents to the Ministry of Finance along with other documents, *inter alia*, the list of assets that would secure the fulfilment of the Bank's obligation under the Guarantee. The Ministry of Finance selects the assets from the list

⁶ Certain major banks operating in Lithuania have higher credit rating and CDS than the Lithuanian State. In any case, Lithuania's rating is BBB, whilst according to the ECB recommendations it is sufficient to take into consideration A rating category for lower-rated or unrated banks.

which are most acceptable to it. The value of collateral, in case of assets pledge – the value set by independent assessors, should not be lower than the amount of the requested State guarantee liabilities. The collateral may be real estate, securities and non-impaired loans.

42. The annual State guarantee fee cannot be lower than the weighted average of the preceding 12 months of the annual rates of 5-year CDS of the Republic of Lithuania announced at least in one publicly acknowledged and used information system. The Government considering the riskiness of the bank, the situation in the financial market and other circumstances may determine a higher remuneration. By way of example, according to the Lithuanian authorities, as a result of the above methodology, the indicative annual fee in April 2010 would have been approximately 3.52%.
43. The Lithuanian authorities have also committed that the guarantee fee will be higher than that calculated on the basis of the European Central Bank Recommendations on Government Guarantees on Bank Debt, taking into consideration the new conditions set by the Commission⁷.
44. The exact modalities of the guarantee (e.g. guaranteed debt, guarantee fee) are to be laid down in an agreement between the bank and the Lithuanian State. On the basis of Article 5(4) of the Law, a decision on the provision of State guarantees shall be adopted by the Government upon proposal by the State Loan Commission. The decision to grant the measure will be based on objective and non-discriminatory criteria and will follow the principles described in this decision.
45. In addition, beneficiary banks would not be allowed to follow unfair commercial practice by advertising the State guarantee.

III. POSITION OF LITHUANIA

46. The Lithuanian authorities accept that the scheme contains State aid elements. Lithuania considers that the scheme is compatible with the common market because it is necessary to remedy a serious disturbance in the Lithuanian economy pursuant to Article 107(3)(b) TFEU.
47. By letter of 26 April 2010 the Bank of Lithuania confirms that the notified measures are required to prevent potential harmful spill-over effects of the global financial crisis on the Lithuanian financial system and on the economy as a whole. The measure would enhance the collective resilience of the national financial system against negative changes notwithstanding whether the national economy is in its upswing or recession. It is also designed to reduce the effect of negative events posing a threat to national economic and financial stability, which is difficult to predict and therefore early preparation and the capability to use intervention measures effectively is essential. The Lithuanian authorities consider that the failure to address the issues of potential lack of liquidity and confidence in the banking sector could also have, due to its vital role for the real economy, a systemic effect on the Lithuanian economy as a whole. Therefore, the scheme aims at remedying a serious disturbance in the Lithuanian economy.

⁷ http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf.

48. The increased capital, the temporary guarantee and the asset relief represent, in the view of the Lithuanian authorities, a comprehensive, necessary and proportionate package to maintain the financial stability of and confidence in the Lithuanian economy.
49. The proposed State intervention of a temporary nature is necessary to achieve the predefined goals. The scheme is supplemented by appropriate procedural rules and safeguards. Therefore, the Lithuanian authorities consider that the notified scheme does not involve any unduly adverse spill-over effects on other Member States or undue distortions of competition.
50. The measures are open to all banks whose financial situation poses a threat to the stability and credibility of the banking system authorised to operate in Lithuania (including foreign bank branches), and thus are open and non-discriminatory and do not threaten to distort competition.
51. Lithuania commits to provide restructuring plans for all beneficiaries of the asset relief measure which require in-depth restructuring pursuant to Section 6 of the IAC and viability plans for all others (including information regarding valuation in both cases) within three months from the beneficiary's accession to the scheme and to supplement the restructuring plan or viability reviews by detailed information regarding the assets covered, the valuation, the remuneration as well as the effect of the assets relief on regulatory capital.
52. The Lithuanian authorities also commit that if the Commission upon the review of valuation of assets on case by case basis finds that the transfer value of assets does not cover their real economic value and/or that the remuneration for the relief related thereto is not sufficient, they will amend the valuation methodology of assets or the haircut so that the former requirements of the IAC are complied with. If this is not possible, the Lithuanian authorities will bring in line with point 41 of the IAC the difference between the real economic value and the transfer price would be recovered at a later stage through a claw-back mechanism or by providing for more in-depth restructuring of the beneficiary bank.
53. Further, Lithuania commits to distinguish between fundamentally sound institutions and those in difficulty according to the criteria set out in Annex of the Recapitalisation Communication prior to granting any aid. It further commits to inform the European Commission prior to each recapitalisation about the risk profile of the beneficiary bank and to provide the European Commission with all relevant information in line with criteria set out in the aforementioned Annex and with regard to beneficiary bank's liquidity situation.
54. Further, for the Banks in respect of which the State guarantee is called, a restructuring plan will be notified to the European Commission in accordance with the Banking Communication within 6 months.
55. If the Bank benefitting from Recapitalisation measure does not fulfil its liabilities to the State, the Lithuanian authorities committed to submit to the Commission all relevant information concerning the situation of the failed beneficiary bank as soon as possible, but not later than three months following its failure to fulfil the liabilities. Also, in the event of a second Recapitalisation measure in favour of the same beneficiary bank, the Lithuanian authorities committed to notify the measure separately.

56. For fundamentally sound banks benefiting from the recapitalisation, Lithuania commits to provide the European Commission with a viability plan proving their capability to conduct business on a stand-alone basis after the granting of subordinated loan no later than six months after the capital injection. Where a beneficiary institution cannot be considered as fundamentally sound, Lithuania commits to submit a restructuring plan for that institution no later than six months after the capital injection.
57. As regards monitoring of guarantees, Lithuania commits to submit a report to the Commission every six months and also upon notification of the extension of the scheme, if any, including recent data on the cost of comparable non-guaranteed and guaranteed debt issuances.
58. Lithuania undertakes to present a viability review for every bank that is granted guarantees on new or renewed liabilities and for which at the time of the granting of new guarantees the total outstanding guaranteed liabilities (including the new ones) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. The viability review will be communicated to the Commission within three months of the granting of guarantees and will comply with the principles set out in the Restructuring Communication⁸. In particular, it will cover the solidity of the funding capacity of the bank concerned; where necessary and in any event where requested by the Commission in case of doubt, a liquidity stress test will be carried out. No separate viability review has to be presented for banks that are subject to a pending viability review at the time new guarantees are granted.
59. In addition to other reporting requirements, Lithuania undertakes to submit to the Commission a concise mid-term review on the operation of the guarantee scheme by 15 October 2010 at the latest.
60. As regards recapitalisation measures, the Lithuanian authorities have committed to submit a monitoring report for review by the European Commission within six months from the recapitalisation, containing information provided in paragraph 40 of the Recapitalisation Communication.
61. The Lithuanian authorities submit that all possible measures have been taken in order to ensure that the scheme will not allow the credit institutions to expand their business in an unfair manner. To this end, they have undertaken to impose a number of behavioural conditions.
62. The Lithuanian authorities commit to seek the Commission's approval, should it be considered necessary for the measures to continue beyond the end of 2010.

IV. ASSESSMENT

1. State aid character of the scheme

63. As set out in Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by

⁸ Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.08.2009, p. 9.

favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

64. The Commission agrees with the position of Lithuania that the scheme constitutes aid to the credit institutions concerned, pursuant to Article 107(1) TFEU.
65. The recapitalisation and the guarantee to credit institutions allow their beneficiaries to secure the required capital as well as liquidity on more advantageous conditions than would otherwise be possible in the light of the prevailing conditions in the financial markets. The asset relief measure may enable beneficiaries to avoid potential write-downs and provisioning and may free up capital held due to regulatory requirements. The measures thus give an economic advantage to the beneficiaries and strengthen their position compared to that of their competitors in Lithuania 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.
66. In particular, it should be noted that no market economy investor would have undertaken the recapitalisation, provided the guarantee or bought the assets. Regarding the capitalisation, given the current difficulties on capital markets, the Commission considers that the State is investing because no market economy operator would have been willing to invest on similar terms. Regarding the guarantee, the Commission is convinced that in the current circumstances no market economy investor would have granted such a guarantee on securities or loans to be provided by the participating banks.⁹ Regarding the asset relief, the Commission notes in particular that no market economy investor would enter into an asset transfer under the same conditions in the prevailing market conditions.

2. Compatibility of the Financial Support Measures

a) Application of Article 107(3)(b) TFEU

67. Lithuania intends to provide capital injections, guarantees and asset relief under a scheme to assist credit institutions. Given the present circumstances in the financial market, they invoke Article 107(3)(b) TFEU as a basis for compatibility.
68. Article 107(3)(b) TFEU enables the Commission to declare aid compatible with the internal market if it is necessary "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 107(3)(b) TFEU needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State.¹⁰ The Commission has issued a number of Communications

⁹ See Commission Decision of 10 October 2008 in case NN 51/2008 Guarantee scheme for banks in Denmark, OJ C 273, 28.10.2010 para. 32

¹⁰ See in principle Joined cases T-132/96 and T-143/96 Freistaat Sachsen and Volkswagen AG Commission [1999] ECR II-3663, para. 167. Applied in Commission Decision in case C 47/1996, *Crédit Lyonnais*, OJ L 221, p.28, para. 10.1, Commission Decision in case C 28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, p. 1, para. 153 et seq and Commission Decision in case C50/2006 *BAWAG*, OJ L 83, 26.03.2008, p. 7, para. 166. Also, see Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, OJ C 43, 16.2.2008, p. 1,

setting out its application of state aid rules to financial institutions in the current crisis: the Banking Communication, the Recapitalisation Communication and the IAC.

69. The Commission considers that the present scheme concerns the entire Lithuanian banking industry. The Commission does not dispute the analysis of the Lithuanian authorities that the financial crisis has made access to liquidity more difficult for credit institutions and has eroded confidence in the creditworthiness of counterparties. The Commission also agrees that if the issues of potential lack of liquidity and lack of confidence are not properly dealt with, it may result not only in difficulties for the banking sector but will also have an effect on the Lithuanian economy as a whole. The Commission does not dispute that the present scheme is designed to address these problems that Lithuanian banks may face in the context of the crisis. Therefore, it finds that the scheme aims at remedying a serious disturbance in the Lithuanian economy.

b) Conditions for compatibility under Article 107(3)(b) TFEU

70. In line with the Banking Communication, in order for such aid to be compatible, any aid or aid scheme must comply with the general criteria for compatibility under Article 107(3) of the TFEU. Viewed in the light of the general objectives of the TFEU, this implies that the measures have to be appropriate, necessary and proportionate.
71. The three Communications concerning State aid to banks translate these general principles into specific compatibility conditions depending on the instrument chosen.

c) Assessment of the Asset Relief Measure

Eligibility of assets

72. As regards the eligibility of the assets, section 5.4 of the IAC provides that asset relief requires a clear identification of impaired assets and that certain limitations in relation to eligibility must apply to ensure consistency and prevent undue distortions of competition. Whilst the IAC explicitly refers to US-subprime assets, it also makes clear that an overly narrow relief measure would not be advisable and hence takes a pragmatic approach, extending eligibility to other well-defined categories of assets, in particular to those which are set out in Annex III to the IAC.
73. The Commission notes that the scope of asset relief measures is in line with asset categories set out in Annex III to the IAC and, therefore, is in line with the eligibility criteria of the IAC.

Transparency and disclosure

74. As regards transparency and disclosure the Commission notes that section 5.1 of the IAC requires full ex ante transparency and disclosure by eligible beneficiaries of impairments on the assets which will be covered by the relief measures, based on adequate valuation,

Commission Decision of 30 April 2008 in case NN 25/2008, Rescue aid to WestLB, OJ C 189, 26.7.2008, p. 3, Commission Decision of 4 June 2008 in case C 9/2008 SachsenLB, OJ L 104, 24.4.2009, p. 34.

certified by recognised independent experts and validated by the competent supervisory authority.

75. According to the terms of the Lithuanian scheme, prior to the asset relief measure the real economic value of the assets to be transferred is established by an independent appraisal company, assessed by independent auditors and confirmed by the Bank of Lithuania as competent supervisory authority. Furthermore, for each asset relief measure in respect of each individual bank, a Resolution of the Government of the Republic of Lithuania will be adopted and made public. The Resolution will specify the precise terms and conditions of the asset relief, including the impairments suffered on the assets. Thus, the Commission finds that the IAC's requirements regarding transparency and disclosure are complied with.

Aligning incentives with public policy objectives

76. In order to limit incentives for banks to delay impaired asset relief measures, impaired asset relief programmes should have an enrolment window limited to six months from the launch of the scheme as required by section 5.3 of the IAC. As the scheme expires within 6 months, the Commission notes that incentives for delaying asset relief are limited.
77. Section 5.3 of the IAC further requires appropriate behavioural constraints, including restriction on dividends and on executive remunerations and safeguards against abuse financing growth strategies. According to Article 13 of the Rules on Extension of Subordinated loans to Banks, a number of restrictions may be imposed upon the beneficiary banks taking into account the proposal of the Bank of Lithuania. This includes behavioural constraints such as restrictions on executive remuneration, caps on dividends and coupons, safeguards which ensure aid received is not used to the detriment of competitors and the obligation to provide credit to the real economy. As the Lithuanian authorities have committed to notify either a viability review or a restructuring plan within three months from the beneficiary's accession to the scheme, the Commission considers that the behavioural constraints can be appropriately dealt with by the Commission while assessing notified viability reviews or restructuring plans.
78. The Commission, therefore, concludes that the IAC's requirements for aligning banks incentives with public policy incentives are complied with.

Valuation

79. Section 5.5 of the IAC notes that a correct and consistent approach to valuation is of key importance to prevent undue distortions of competition. The valuation of impaired assets should follow a general methodology established at EU level, which should be closely coordinated ex ante by the Commission and Member States.
80. The asset relief implementing rules require the establishment of the real economic value prior to the execution of the asset relief measure. The implementing provisions provide for compliance of the valuation methodology with the IAC without however defining a specific methodology for valuation. The valuation and methodology can be reassessed by the Commission, when ascertaining viability or restructuring plans to be notified within three months from the beneficiary's accession to the scheme according to Annex V of the IAC.

The Commission, therefore, finds that the valuation principles are in line with the requirements of the IAC.

Burden-sharing

81. As regards burden-sharing, section 5.2 of the IAC states the general principle that beneficiaries ought to bear the losses associated with impaired assets to the maximum possible. In principle, according to the implementing provisions, asset transfers are executed at the real economic value less at least 20%.
82. This implies that a beneficiary should, in principle, bear the difference between the nominal value and the real economic value of the impaired assets ex ante. However, if upon the reassessment of the evaluation of the assets in the context of a viability or restructuring plan (see paragraph 80), the Commission finds that the real economic value of the transferred assets deviates to such an extent that the transfer price is above the real economic value of assets, the Commission is still in the position to ask for a claw-back or more in-depth restructuring in accordance with point 41 of the IAC.
83. As burden-sharing, in principle, will be achieved ex-ante and in any case ex post, the Commission concludes that the IAC's requirements for burden-sharing are met.

Remuneration

84. In order to assess burden-sharing of the costs related to impaired assets, another element to be assessed by the Commission, according to paragraph 21 of the IAC, is remuneration. Pursuant to Annex IV to the IAC "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 the determination of the real economic value.
85. Whilst the Law and the Rules require no separate fee for future losses exceeding those reflected by the real economic value, a haircut of at least 20% to the real economic value will be applied. In principle, this haircut is applied uniformly. However, AB Turto bankas may set an even lower price of the assets on a case-by-case basis depending on considerations such as the reliability and the liquidity of collateral, its value range projections, credibility and creditworthiness of the loan recipient and other important circumstances which may have an effect on the value of the assets transferred.
86. This provision helps to ensure adequate compensation for the risks of future losses exceeding those that are projected in the determination of the real economic value.
87. In principle, the Commission considers that the haircut should adequately capture the risk of unexpected losses. However, if in the context of the individual notifications the Commission finds that the valuation of the real economic value of the transferred assets deviates to such an extent that the remuneration is not sufficient; the Commission is still in the position to ask for a claw-back or more in-depth restructuring in accordance with point 41 of the IAC.

Management of assets

88. As regards the management of assets, section 5.6 of the IAC requires a clear functional and organisational separation between the beneficiary and its assets, notably as to their management, staff and clientele. The Communication states in that respect that this should prevent conflicts of interest.
89. The Lithuanian Authorities provide that assets subject to an asset relief will be managed by a separate and distinct special purpose entity (AB Turto bankas) and hence separately from an organisational and functional perspective from the beneficiary bank. The Commission concludes, therefore, that the arrangements for asset management under the Law and the Rules are in line with the IAC.

Follow-up (Viability review and restructuring plan)

90. As regards the need for an assessment of a beneficiary's balance sheet and activities, section 6 of the IAC states that an application for aid by an individual beneficiary should be followed by a full review of that beneficiary's activities and balance sheet, with a view of assessing capital adequacy and the prospects for future viability (viability review).
91. Annex V to the IAC requires that either a restructuring plan or a viability review for each beneficiary has to be notified to the Commission within three months from its accession to an asset relief programme.
92. Lithuania has made a commitment to provide restructuring plans for all beneficiaries which require in-depth restructuring pursuant to Section 6 of the IAC and viability plans for all others (including information regarding valuation in both cases) within three months from the beneficiary's accession to the scheme and to supplement the restructuring plan or viability reviews by detailed information regarding the assets covered, the valuation, the remuneration as well as the effect of the assets relief on regulatory capital. The Commission, therefore, notes that proper follow-up is ensured.
93. Additionally Lithuania commits to report to the Commission every six months on the functioning of the asset relief measure.

Authorisation of the measure

94. In view of the fact that the intended asset relief measure complies with the criteria of full ex ante transparency and disclosure, eligibility of assets, alignment of incentives to participate with public policy objectives, asset management arrangements, burden-sharing and remuneration, and that proper follow-up is ensured, the Commission can approve the scheme until 31 December 2010.
95. The Commission notes that asset relief under the scheme is subject to the individual notification of a restructuring plan / viability review after three months and is only approved at the level of an individual institution for six months.

d) Assessment of the Recapitalisation Measure

96. The objective of the Recapitalisation is to strengthen the capital of the banking system and to ensure that banks are sufficiently strongly capitalised so as to better withstand potential stress. The Commission has already observed in several cases that recapitalisation is in principle an appropriate mean to strengthen the banks and thus to restore market confidence.¹¹
97. The provision of capital can be seen as a confidence-building measure aimed at restoring the trust of third parties in Lithuanian credit institutions. It is thus intended to prevent enterprises which are solvent from falling into difficulties as a result of the existing ongoing crisis or to support the solvency of banks in difficulty whose financial situation would risk affecting the stability of the Lithuanian banking system. The scope of the recapitalisation scheme therefore seems appropriate to strengthening the Lithuanian banking sector.
98. In addition, the Recapitalisation measures are granted upon the Bank of Lithuania's assessment, which evaluates the financial institutions based on objective criteria, with special regard to a sufficient level of capitalisation and solvency requirements.
99. The Recapitalisation is also limited to the minimum necessary in scope and time. With regard to its temporal scope, the Commission notes positively that Lithuania has limited the window to enter the scheme until 31 December 2010. In reaching its conclusion that the measure is limited in scope, the Commission has also taken into account the type of capital provided and its limited duration (i.e. the term of subordinated loans is fixed ex ante and cannot be longer than five years) as well as the commitment to present either a restructuring or a liquidation plan for banks in difficulty within six months.
100. With regard to the size of the measure, the Commission notes positively that the budget of the recapitalisation together with the asset relief measure is limited to a maximum amount of LTL 3 billion (EUR 870 million).
101. Moreover, capital interventions in credit institutions must be done on terms that minimise the amount of aid. A key element in this respect is an appropriate, market-oriented remuneration for the capital invested.¹²
102. In this context, Lithuania will charge an interest rate consisting of the sum of i) the yield of comparable government bonds; ii) Republic of Lithuania 5 year CDS and iii) an additional 200 basis points. The Commission observes that this calculation method results in an interest rate of about 9% in euros and 10% in litas, taking into consideration the prevailing market rates as of April 2010.
103. The Recapitalisation Communication, which follows the methodology set out in the ECB recommendations on recapitalisation, sets out the Commission's view on how the appropriate remuneration for the Lithuanian Government's capital injection, which is in the form of subordinated loans, should be calculated.

¹¹ Commission Decision of 13 October 2008 in case N507/2008 Guarantee Scheme for banks in the United Kingdom, OJ C 290, 13.11.2008, para. 46 et seq and Commission Decision of 27.10.2008 in case N512/2008 Support measures for financial institutions in Germany, OJ C 293, 15.11.2008, para. 41 et seq.

¹² See in particular the Banking Communication, point 39.

104. The Commission considers that the recapitalisation measures should be priced according to the formula for subordinated debt outlined in section 3 of the ECB recommendations. The formula described in point 102 follows in general the ECB formula. However, the resulting remuneration exceeds the remuneration calculated according to the ECB formula. In addition, Lithuania confirmed that the remuneration charged for the subordinated loans can not be lower than under the pricing formula recommended by the ECB. Therefore, the Commission considers that the expected return can be considered acceptable in the present case.
105. As provided for by the Banking Communication, the aid must be limited to the minimum necessary so as not to allow the beneficiary to engage in aggressive commercial activities that would imply undue distortions of competition. Consequently, the Commission positively views the overall remuneration of the measure, the requirement that institutions refrain from marketing invoking the measure and the requirement to provide a report within six months of the recapitalisation, as required under paragraph 40 of the Recapitalisation Communication. The Commission also observes a number of significant behavioural commitments.
106. The measure described can be granted to both fundamentally sound financial institutions or not. The Commission has set out criteria for determining whether banks are fundamentally sound in the Annex to the Recapitalisation Communication. In this regard, the Lithuanian authorities committed to distinguish between fundamentally sound institutions and those in difficulty according to the criteria set out in Annex to the Recapitalisation Communication and to inform the Commission about the details of their assessment. For banks that are considered not to be fundamentally sound by the Commission, the Lithuanian authorities commit to submit a restructuring plan within six months of the recapitalisation. In this case, the Commission considers that the institutions concerned should pay at least the price for distressed banks indicated in the Recapitalisation Communication, which should in principle be higher than that for fundamentally sound banks¹³. Where the price cannot be set at levels that correspond to the risk profile of the bank, it would need to be close to what would be required for a similar bank under normal market conditions. However, the use of State capital for these banks can only be accepted on the condition of either a bank's winding-up or a thorough and far-reaching restructuring. Moreover, where a bank that was initially considered fundamentally sound falls into difficulties after recapitalisation has taken place, a restructuring plan for that bank must be notified.
107. On the basis of the above, the Lithuanian Recapitalisation measure can be considered compatible with the internal market.

e) Assessment of the Guarantee Scheme

108. The objective of the present guarantee scheme is to provide a safety net to investors that purchase the newly issued debt of, or lend to, 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

¹³ As per point 44 of the Recapitalisation Communication.

interbank lending market. It therefore regards the scheme as an appropriate means to meet the objective.¹⁴

109. In addition, the scheme is targeted at the appropriate beneficiaries which are all Lithuanian banks, including the subsidiaries and branches of foreign banks. Their eligibility is established by the Bank of Lithuania.
110. As regards necessity, the guarantee scheme is limited to the minimum necessary in material scope and time. As regards material scope, the Commission notes positively that Lithuania is limiting the guarantee to short- to medium-term senior liabilities. Thus, capital investments, including subordinated debt, as well as existing debt are excluded from the scope of the Guarantee scheme.
111. Regarding temporal scope, the guarantee applies to newly-issued debt for up to three years. In general, the Commission views favourably if the duration of a guarantee is as short as possible, e.g. does not exceed three years.
112. The Commission notes positively an additional safeguard in the present scheme in so far as it has a limited issuance period, which ends on 31 December 2010, and any prolongation must be re-notified to the Commission. The temporal scope is thus in principle justified.
113. As regards the specific features of the guarantee scheme, the Commission has to balance its positive effects for financial stability with the distortions of competition and the delay in the return to a normal functioning of the financial markets that the measure entails. Guarantee schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States.
114. As regards proportionality, the distortion of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market-orientated premium.
115. The gradual stabilisation of the market situation and the resulting reduction of the risk premium for unguaranteed debt have brought about a first step towards an alignment with market conditions, whilst providing an exit incentive for the sounder institutions. It is necessary to minimise distortions across banks in the internal market and avoid the risk of State aid dependence. There should therefore be an adjustment of the terms on which banks may retain for the time being the possibility of accessing government guarantees schemes.
116. On the basis of these considerations, the prerequisites for the compatibility of guarantee schemes with Article 107(3)(b) TFEU that have been established by the Banking Communication and the Commission's subsequent decisional practice continue to apply but need to be complemented by requirements aimed at achieving two objectives.

¹⁴ See Commission Decision of 10 October 2008 in case NN 51/2008 Guarantee scheme for banks in Denmark, OJ C 273, 28.10.2010, at para. 42, Commission Decision of 13 October 2008 in case N 507/2008 Financial Support Measures to the Banking Industry in the UK, OJ C 290, 13.11.2008, para. 56, and Commission Decision in case NN 48/2008 Guarantee scheme for banks in Ireland, OJ C 312, 06.12.2008, para. 59.

117. First, banks should be incentivised to scale down or terminate their recourse to government guarantees by means of pricing rules that bring the funding costs of beneficiary banks closer to market conditions and thereby reduce distortions of competition. This should be achieved by an increase in the guarantee fee in comparison with the ECB recommendations of October 2008 that amounts at least to 20 basis points for banks with a rating of A+ or A, 30 basis points for banks rated A-, and 40 basis points for banks rated below A-.
118. Second, the use of guarantee schemes should not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments. To this end, the Member State concerned should present a viability review for any bank that requests new guarantees under a scheme which take or keep the total amount of the bank's outstanding guaranteed liabilities above 5% of the bank's total liabilities and above the absolute amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication within three months of the granting of the guarantees. The viability review will either confirm the bank's long-term viability without State support or show that farther-reaching restructuring is required.
119. The Commission considers that the validity of the State guarantee scheme until 31 December 2010 complies with the requirements set out above and is compatible with the internal market. In particular, the Commission notes positively that the Lithuanian authorities provided commitments in line with new pricing conditions and viability review requirements.
120. As regards the combination of this guarantee scheme with other aid measures, as indicated in the Annex to the Restructuring Communication, any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To this end an individual *ex ante* notification is necessary.
121. Furthermore, the Commission recalls that based on point 16 of the Restructuring Communication, if aid not initially foreseen in a notified restructuring plan is necessary for the restoration of viability, this additional aid cannot be granted under an approved scheme but needs to be subject to individual *ex ante* notification and any such further aid will be taken into account in the Commission's final decision on that bank.
122. In addition to the above, Lithuania agrees to provide the Commission with a concise mid-term review of the operation of the scheme by 15 October 2010 in addition to the pre-existing reporting requirements and to complement its future reports on the operation of the scheme with updated available data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances. This will allow the Commission to assess the appropriateness, necessity and proportionality of possible extension of the scheme beyond 31 December 2010 and the conditions for such extensions.

Any further extension will require the Commission's approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness.

123. Finally, the Commission recalls that Lithuania has to provide a restructuring or liquidation plan for any institution that causes the guarantee to be drawn.

124. On the basis of the above, the Lithuanian Guarantee scheme can be considered compatible with the internal market.

V. DECISION

The Commission has accordingly decided to consider the aid to be compatible with the internal market pursuant to Article 107(3)(b) TFEU.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm

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

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-president of the Commission