# POMOC PAŃSTWA – ŁOTWA

## Pomoc państwa C 26/09 (ex N 289/09) – pomoc na restrukturyzację dla JSC Parex Banka

## Zaproszenie do zgłaszania uwag zgodnie z art. 88 ust. 2 Traktatu WE

**(Tekst mający znaczenie dla EOG)**

(2009/C 239/05)

Pismem z dnia 29 lipca 2009 r., zamieszczonym w autentycznej wersji językowej na stronach następujących po niniejszym streszczeniu, Komisja powiadomiła Łotwę o swojej decyzji w sprawie wszczęcia postępowania określonego w art. 88 ust. 2 Traktatu WE dotyczącego wyżej wspomnianego środka pomocy.

Zainteresowane strony mogą zgłaszać uwagi na temat środka pomocy, w odniesieniu do którego Komisja wszczyna postępowanie, w terminie jednego miesiąca od daty publikacji niniejszego streszczenia i następującego po nim pisma. Uwagi należy kierować na następujący adres:

European Commission
Directorate-General for Competition
State aid Greffe
1049 Brussels
BELGIUM

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Otrzymane uwagi zostaną przekazane władzom łotewskim. Zainteresowane strony zgłaszające uwagi mogą wystąpić z odpowiednio uzasadnionym pisemnym wnioskiem o objęcie ich tożsamości klauzulą poufności.

TEKST STRESZCZENIA

### I. **PROCEDURA**

(1) Dnia 24 listopada 2008 r. Komisja zatwierdziła pakiet środków pomocy na rzecz przedsiębiorstwa JSC Parex Banka (zwanego dalej „przedsiębiorstwem Parex" lub „bankiem"). Dnia 11 lutego 2009 r. oraz dnia 11 maja 2009 r. Komisja zatwierdziła zmiany do środków pomocy. Łotwa powiadomiła o planie restrukturyzacji przedsiębiorstwa Parex w terminie, tj. dnia 11 maja 2009 r.

### II. **FAKTY**

(2) Beneficjent pomocy, przedsiębiorstwo Parex, jest pod względem aktywów drugim co do wielkości bankiem na Łotwie. Jest to bank uniwersalny oferujący szeroką gamę produktów bankowych zarówno bezpośrednio, jak i poprzez wyspecjalizowane spółki zależne. Bank ten założono w 1992 r. i zanim państwo łotewskie przejęło w nim udziały, jego większościowymi właścicielami były dwie osoby fizyczne. Parex posiada oddziały w Sztokholmie, Tallinie, Hamburgu i Berlinie oraz 11 przedstawicielstw w 9 innych państwach. Podczas boomu gospodarczego na Łotwie w latach 2004–2008 portfel kredytowy przedsiębiorstwa Parex wzrósł o 28 % skumulowanego rocznego wskaźnika wzrostu (CAGR).

(3) Przedsiębiorstwo Parex znalazło się w trudnej sytuacji w październiku 2008 r., gdy drastycznie pogorszyło się otoczenie finansowe. Jako największy bank łotewski bez silnej zagranicznej spółki dominującej przedsiębiorstwo Parex najbardziej ucierpiało na braku zaufania w łotewskim sektorze finansowym (również zaufania deponentów). Panika bankowa spowodowała dzienne wypływy środków w wysokości 100 milionów EUR, co dało w rezultacie 36-procentowy spadek depozytów w porównaniu z końcem 2007 r. (przede wszystkim z powodu paniki przedsiębiorców-deponentów oraz indywidualnych rezydentów). Wynikający z tego niedobór środków został wyrównany za pomocą państwowych środków na rzecz utrzymania płynności.

(4) Skutki obecnego światowego kryzysu finansowego i ekonomicznego dotknęły przedsiębiorstwo Parex bardziej niż inne banki. Ostatnio prowadziło ono stosunkowo ryzykowną działalność bankową opierającą się na szybko rosnącym bilansie bazującym w znaczącym stopniu na wzroście kredytów w sektorze nieruchomości, dużych pożyczkach i udzielaniu kredytów w krajach WNP. Wynikiem tego była wyższa ogólna ryzykowność portfela kredytowego banku.

(5) Po badaniu due diligence w 2008 r. bank odnotował straty wynoszące 131 milionów LVL (185 milionów EUR) na poziomie grupy w porównaniu z zyskiem 40 milionów LVL (58 milionów EUR) w 2007 r. Przede wszystkim z powodu zwiększonych rezerw na straty z tytułu pożyczek oraz straty z tytułu portfela papierów wartościowych całkowity kapitał udziałowców spadł w 2008 r. o 65 % do poziomu 77 milionów LVL.

(6) W tym kontekście władze łotewskie postanowiły interweniować w przedsiębiorstwie Parex w interesie stabilności finansowej.

(7) Przed zapewnieniem pomocy w zachowaniu płynności i udzieleniem innego wsparcia państwo łotewskie przejęło początkowe 51 % udziałów w banku. Nie udało się jednak odzyskać zaufania, a panika bankowa trwała. Rząd nabył wobec tego pozostałe 34 % udziałów, które należały do założycieli banku. Dnia 11 listopada 2008 r. Skarb Państwa przekazał przedsiębiorstwu Parex 200 milionów LVL, by zapewnić wystarczającą płynność. Całkowita maksymalna kwota instrumentu wsparcia płynności finansowej, którą można udostępnić bankowi, zwiększyła się zatem do 1,5 miliarda LVL. W marcu 2009 r. całkowita kwota krótkoterminowego wsparcia płynności finansowej osiągnęła 873 milionów LVL.

(8) Łotwa zapewniła również gwarancje państwa na istniejące kredyty konsorcjalne. Środek polegający na dokapitalizowaniu, który pozwolił przedsiębiorstwu Parex osiągnąć 11-procentowy współczynnik adekwatności kapitałowej (CAR) i zachować go podczas fazy ratowania polegającej na zastrzyku kapitału od państwa, opierającego się na zakupie akcji zwykłych nowej emisji oraz przyznaniu pożyczki podporządkowanej, został zatwierdzony zgodnie z decyzją Komisji z dnia 11 maja 2009 r.

(9) Przedłożony plan restrukturyzacji przewiduje wdrożenie nowej strategii, która zakłada zorganizowanie działalności banku w trzech głównych segmentach działalności gospodarczej: zarządzanie kapitałem korporacyjnym, detalicznym i prywatnym, które uznaje się za przyszłe główne segmenty działalności przedsiębiorstwa Parex. Plan ten przewiduje wiele środków pomocy restrukturyzacyjnej, takich jak możliwość zapewnienia dodatkowej pomocy w zachowaniu płynności finansowej, dalszych gwarancji państwa, jak również dodatkowych środków polegających na dokapitalizowaniu.

## III. **OCENA**

(10) Komisja proponuje wszcząć postępowanie wyjaśniające dotyczące planu restrukturyzacji przedsiębiorstwa Parex. Uważa ona, że obecny plan nie jest wystarczający w zakresie przywrócenia długoterminowej rentowności, wkładu własnego beneficjenta oraz środków pozwalających na ograniczenie zakłócenia konkurencji. Zachęca ona zainteresowane strony do przedstawienia uwag dotyczących niniejszej decyzji.

(11) Odnośnie do rentowności w planie restrukturyzacji brakuje szczegółowych informacji umożliwiających Komisji uzyskanie pewności co do przywrócenia długoterminowej rentowności. Nie opisano też wystarczająco, jak zaproponowane środki pomocy restrukturyzacyjnej zaradzą problemom banku.

(12) W odniesieniu do wkładu własnego Komisja kwestionuje wystarczający wkład przedsiębiorstwa Parex w koszty jego restrukturyzacji. W szczególności wykorzystanie zbycia lub sprzedaży aktywów w celu pozyskania środków wydaje się być na tym etapie ograniczone. Nie istnieje również przejrzysty plan ani termin zakończenia udzielania środków pomocy państwa oraz przerwania większościowego udziału państwa w banku.

(13) Odnośnie do zakłócenia konkurencji Komisja podkreśla, że przedsiębiorstwo Parex było drugim co do wielkości bankiem na Łotwie i gdy zaczął się kryzys związany z zapewnianiem płynności stosowało ono stosunkowo agresywną strategię prowadzenia działalności. Komisja ma wątpliwości na tym etapie, czy przedsięwzięto wystarczające środki, by zrównoważyć negatywne skutki pomocy. Zgodnie z planem bank otrzyma znaczne kwoty pomocy i przewiduje szybkie odzyskanie straconych udziałów w różnych segmentach rynku oraz wejście do nowych segmentów rynku. Komisja uważa, że klauzula o przywództwie niecenowym oraz możliwe ograniczenia wzrostu w głównych segmentach rynku, dalsze ograniczenie działalności kredytowej banku, w tym redukcja obecnie przewidywanych potrzeb finansowania poprzez depozyty, mogą okazać się konieczne, by złagodzić zakłócenia konkurencji.

TEKST PISMA

„The Commission wishes to inform Latvia that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty.

## 1. **PROCEDURE**

(1) On 10 November 2008 Latvia notified to the Commission a package of measures in favour of JSC Parex Banka (hereinafter "Parex" or "the bank"), designed to support the stability of the financial system, which was approved on 24 November 2008 ([1]) (hereinafter "first Parex decision"). On 26 January 2009, Latvia informed the Commission about several changes to the public support measures to JSC Parex Banka, which were approved on 11 February 2009 ([2]) (hereinafter "second Parex decision"). On 29 March 2009, Latvia notified to the Commission the need for further changes to the recapitalisation measure, which was approved by Commission Decision of 11 May 2009 ([3]) (hereinafter "third Parex decision").

(2) On the final date of the rescue period, which ended on 11 May 2009 ([4]), Latvia notified a restructuring plan for Parex. On 5 June 2009 a request for information was sent to the Latvian authorities. On 15 June 2009 a meeting was held between the Latvian authorities and the Commission. The documents provided by the Latvian authorities during the meeting were registered on 16 June 2009. Latvia replied partially to the above request for information by letter of 7 July 2009, registered on the same day.

## 2. **DESCRIPTION**

### 2.1. **The beneficiary**

(3) The beneficiary, Parex, is a financial institution based in Latvia. It is a universal bank offering the full range of banking products directly and through specialised subsidiaries. Parex is the second largest bank in Latvia in terms of assets ([5]) and considered to be of systemic importance for the Latvian financial system. The bank was particularly active in business with non-resident (and non-OECD, mostly CIS) clients, particularly in the deposits segment.

([1]) See Commission Decision of 24 November 2008 in Case NN 68/08 *Public Support Measures to JSC Parex Banka* (OJ C 147, 27.6.2009, p. 1).

([2]) See Commission Decision of 11 February 2009 in Case NN 3/09 *Modifications to the public support measures to JSC Parex Banka,* 11 (OJ C 147, 27.6.2009, p. 2).

([3]) See Commission Decision of 11 May 2009 in Case N 189/09 *Modifications to the public support measures to JSC Parex Banka* — not yet published.

([4]) The Latvian authorities had committed to submit to the Commission either a restructuring or liquidation plan within 6 months of the granting of the first State aid rescue measure to Parex (see the first Parex decision). Since this had occurred on 11 November 2008, when the State Treasury had deposited LVL 200 million with Parex in order to ensure sufficient liquidity, the end of the 6-month rescue period (and due date for the submission of the restructuring plan) was on 11 May 2009.

([5]) In 2008 the bank had a consolidated balance sheet total of LVL 3,5 billion (EUR 4,9 billion).

(4) The bank was founded in 1992 and was majority owned by two individuals until the current financial crisis, when due to the bank's difficulties the Latvian authorities decided to partly nationalise the bank and to provide public support measures in favour of Parex. Parex was nationalised through acquisition of a 84,83 % stake by the Government of Latvia in November and December 2008. After the recapitalization measure approved as rescue aid, the Latvian State increased its participation in Parex up to about 95 %. The rest of Parex' shares are owned by institutional investors.

(5) Parex is the parent company of the Parex Group and it accounts for 98 % of the group's assets. The Parex Group is currently present in 15 countries through operating subsidiaries or, in certain cases, representative offices. The bank has branches in Stockholm, Tallinn, Hamburg and Berlin and 11 representative offices in 9 other countries. Operations in Sweden and Germany are limited to taking of deposits. The bank owns leasing companies in all three Baltic States since 2003. It has acquired six leasing companies in CIS countries [6] (Russia, Ukraine, Belarus and Azerbaijan) to offer both operating and financial leases to its clients. The group's asset and pension fund management activities are principally carried out through IPAS Parex Asset Management ("PAM"), which provides investment management and advisory services to local and foreign high net worth individuals, corporations, mutual funds, pension funds, insurance companies, foundations and endowments. The Swiss private banking subsidiary AP Anlage & Privatbank AG provides specialised private banking services to Latvian and other international customers.

(6) Parex' loan portfolio grew at a compound annual growth rate (CAGR) of 28 % during Latvia's credit boom (2004-2008). While historically the bank focused on corporate lending, over the last three years it has been expanding the retail book, particularly mortgages. The loan portfolio of the bank is relatively concentrated with the real estate sector representing 26 % of the gross loan portfolio as of year end 2008 (YE 08). In addition, more than half of the retail loans, which amount to 33 % of the portfolio, are mortgage loans. Parex' real estate exposure is in line with the Latvian market where lending growth over the last two years has been in parallel to the real estate boom.

### 2.2. **Financial difficulties of the bank**

(7) Parex ran into difficulties in October 2008, when the financial environment deteriorated dramatically. Parex, as the largest Latvian bank without a strong foreign parent, suffered most from the lack of trust in the Latvian financial sector with a loss in depositor confidence. However, it must be noted that even when the liquidity tensions emerged, the bank continued the dynamic growth of the loan portfolio assuming easy access to wholesale funding. Overall, in the absence of significant long-term funding, the bank's maturity mismatch between assets and liabilities was very significant, as the funds collected on very short-term deposits were lent for mostly real estate related projects. The run on deposits peaked at a daily outflow of EUR 100 million, which resulted in a fall in deposits of 36 % compared to end 2007 (mostly due to a run by corporate depositors and individual residents). The resulting shortfall in funding was replaced by State liquidity measures [7].

(8) Parex sought government assistance in early November 2008 when it faced a severe liquidity crisis. Before providing liquidity and other measures, the Latvian State took over an initial 51 % stake in the bank. However, trust was not restored and the deposit run continued. This forced the government to acquire the remaining 34 % held by the bank's founders. In total, the Latvian State acquired the bank's shares, which represent 84,83 % of the bank's paid-up share capital, at a symbolic total purchase price of LVL 2 (EUR 3). Due to unstopping bank run, limits on deposit withdrawals (partial deposit freeze) were imposed and, as the Commission was initially informed, these restrictions should have been withdrawn by mid 2009. However, from the last submission of 7 July 2009, it can be inferred that they are still in place.

(9) The […] (*) report prepared by an external consultant on 26 January 2009, which was submitted with the restructuring plan, identified the following issues that need to be addressed by the bank:

(a) a risk that customer deposits continue to decline, notably when withdrawal limits, put in place by the regulator, are lifted;

(b) expected further increase in non-performing loans (NPL) due to continuing economic downturn and stress in the real estate markets (NPL percentage has increased from 0,9 % as at year end (YE) 2006 to 4,4 % as at November 2008);

(c) significant level of real estate exposure (44 % of the bank's gross loan portfolio was for lending on real estate projects) combined with past practice of the bank to lend […] [8] as opposed to borrowers' financial fundamentals. The real estate market is still expected to decline. In addition, the consultant noted that a substantial part of the real estate related loans had […] [9]. This is indicative of the substantial risk within the portfolio with respect to real estate, both in terms of […];

[6] Commonwealth of Independent States.

[7] In addition, by the end of 2008 the bank had in its accounts significant balances payable to central banks. The Commission lacks further information on this facility.

(*) Parts of this text have been deleted so as not to divulge confidential information; they are indicated by a series of dots between square brackets or a range providing for a non-confidential approximation of the figure.

[8] The consultant has also noted […].

[9] Moreover, up to December 2008 Parex considered the restructured loans as non-impaired and did not allocate any provisions.

(d) exposure to non-OECD borrowers — 36 % of loans and 44 % of deposits are from non-OECD customers ([10]). Certain of these markets (e.g. Ukraine) have been particularly hard hit by the recent economic crisis;

(e) concentration of loan portfolio. In addition to the real estate exposure, large loans (> LVL 1 million) comprise 65 % of the bank's total portfolio. As a result, the default of any borrower can have a significant effect on loan provisioning. Besides, more than half of Top 50 loans were provided to non-residents, including [between 10 and 18] % in Russia, [between 7 and 12] % in Azerbaijan. Volatility of markets and unpredictability of overall business development in the above countries may result in a higher credit risk attributable to the respective loans. The majority of large loans have maturities of longer than one year ([between 60 and 90] %). Only [between 15 and 20] % have amortising repayment patterns. The remainder have balloon payments at maturity or are linked to specific project completions. Particularly considering that many loans have deferred or capitalised interest periods, there is a limited payment history on which to base a historical default analysis;

(f) potential impairment on held-to-maturity (HTM) portfolio. Similarly to many banks, Parex retroactively transferred a significant amount of the portfolio from available-for-sale (AFS) to HTM in order to avoid the fair market valuation adjustments downward. In spite of the bank management's intention to hold the portfolio to maturity, the consultant considers that it is uncertain whether the bank will be able to hold these securities to maturity. It has to be noted that most of the securities are debt securities since most equity investments (except for the investments in the bank's subsidiaries) have been already sold to avoid further losses;

(g) additional adjustments might be necessary with regard to real estate funds (held-for-trading (HFT) or available-for-sale (AFS)). In addition, until March 2008, the bank was a market-maker for some relatively high-risk CIS securities. A number of those securities were very rarely traded and, as a result of the lack of liquidity, the bank was left with those instruments once the markets dried up. Currently, those securities are part of the investment portfolio. The majority of them are, however, completely illiquid;

(h) exposure to movements in exchange rates (many loans are in foreign currencies and thus a significant weakening of local currencies to EUR or USD may increase distress on borrowers);

(i) depositor concentration. The Top-50 depositors comprise one-third of all non-State deposits.

(j) interest margin may be put under significant pressure in a near term, since market interest rates are decreasing whilst the bank's liquidity concerns do not allow it to reduce interest rate on deposits to a similar extent. Additionally, State deposits as well as the Bank of Latvia Lombard loan bear relatively high interest.

(10) Following a due diligence exercise, the bank booked losses amounting to LVL 131 million (EUR 185 million) in 2008 on group level compared to a profit of LVL 40 million (EUR 58 million) in 2007. As of YE 08 total shareholder's equity fell by 65 % to LVL 77 million mainly because of increased loan loss provisions and losses on the securities portfolio. As of YE 08, Parex' Capital Adequacy Ratio (hereinafter "CAR") and Parex' Group CAR was only 4,1 % and 3,1 % respectively. Therefore, the bank was not fulfilling its regulatory obligations for several months before seeking an amended recapitalisation measure by the State. Provisions as of YE 08 amounted to 6,4 % of gross loan portfolio (GLP), well above the Latvian banking market provisioning of 2,1 % reported by the regulatory authority ([11]). The bank has breached a number of prudential requirements. Whilst some of the breaches were remedied following the recapitalisation by the State, some will still need to be remedied in the restructuring phase, notably, with regard to the foreign currency open positions limits, the liquidity ratio and the mandatory reserve requirements. Due to non-compliance with mandatory reserve requirement, the bank suffers penalty fines which will substantially impact the current year's result.

(11) It has to be noted that the bank had relatively high operational costs. Parex' management historically focused on business expansion and to this end expanded the bank's cost base substantially. This is illustrated by its cost-income ratio when compared to the sector (65 % vs. sector average of 43 % in 2007). Furthermore, high operational costs also resulted from excessive allowances to shareholder managers.

### 2.3. **The emergency aid measures**

(12) The previously approved rescue aid measures for Parex are the following:

(a) on 11 November 2008 the State Treasury deposited LVL 200 million with Parex in order to ensure sufficient liquidity. Thereafter, the overall maximum amount of the liquidity facility was increased to LVL 1,5 billion. As a result, the bank was provided with funds to acquire government debt securities, i.e. liquid collateral to use in operations with the central bank, which it did not have at the time. The remuneration and the initially set amount were revised in the second Parex decision. In March 2009 the total amount of the short-term liquidity support reached LVL 873 million;

([10]) Part of customers residing in CIS countries are high net worth individuals (HNWI) […].

([11]) The figures are based on management, i.e. prior to audited, accounts for 2008.

(b) subordinated loans up to LVL 200 million to address capital needs (the measure was not carried out until the third Parex decision, which restated the recapitalisation measure, see also point (d) below);

(c) guarantees covering two existing syndicated loans in the amount of EUR 775 million and new loans issued to refinance one of the above-mentioned syndicated loans in the amount of EUR 275 million;

(d) a recapitalisation measure, allowing Parex to reach and maintain a Capital Adequacy Ratio (CAR) of 11 % during the rescue phase consisting of a capital injection by the State through a purchase of newly issued ordinary shares and granting of a subordinated loan ([12]).

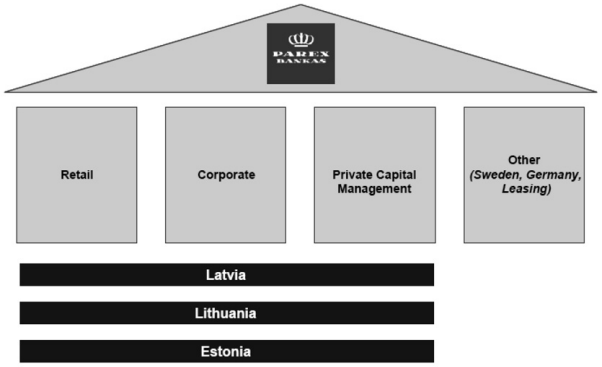
### 2.4. **Restructuring plan**

#### 2.4.1. *Business strategy*

(13) The submitted restructuring plan covers a period from 2009 to 2013. It foresees the implementation of a new strategy with the bank aiming to become a leading pan-Baltic bank. Its operations will be organised in the three main business segments: corporate, retail and private capital management, deemed to be the future core segments of Parex.

(14) The bank defines the three Baltic markets as its domestic market places and plans to take advantage of their similarities, in spite of limited market presence to date, in particular in Estonia, where it only held a 0,5 % share in terms of total assets. In the Baltic market, Parex aims to be the nearest, most easily accessible, local bank, focusing on the retail business with private and corporate clients, especially targeting the SME sector. The bank will use its existing branch network to implement its strategy of localness. Attractive rates and […] marketing strategy ([13]) shall support the growth path of Parex.

(15) The bank's future core business activities are shown in the figure below.




(16) However, by letter of 7 July 2009 Latvia informed the Commission of the planned change in Parex' business strategy that consists in focusing of Parex lending activities to the strategic sectors of the Latvian economy, State and government institutions as well as companies that would be co-financed by the European structural funds. It is envisaged that Latvia would issue State guarantees to the bank, providing financing for implementation of the State aid loan programmes.

(17) Parex considers all other international activities, such as its Western European operations, the private capital management in CIS and the leasing subsidiaries in CIS as non-core activities. Parex is currently in the process of identifying assets that can be segregated as non-core or legacy and eventually run-off ([14]) or sold (see section 2.4.6. below). Given the current market environment, wherein the bank does not see possibilities for imminent sale of assets, the restructuring plan foresees sustaining the value of these operations in order for them to be spun off at a later, yet unspecified, date. Before that, these international activities are stated to be necessary for a successful restructuring of the bank mainly due to the funding gap resulting from the run on the bank.

(18) In this regard, the Latvian authorities consider that in the near term the bank could not dispose of any deposit taking operation. Notably, some of the current exposure to Russia and other CIS lending markets should be retained for loan portfolio diversification reasons. The bank also seeks opportunities to attract retail funding from the Western European subsidiaries by offering competitive interest rates. As regards CIS clients' retail deposits, they are regarded as vital for the bank in the short to medium term to achieve the funding targets of the restructuring plan. In the long run, however, the bank will implement a new business model as regards CIS clients based on targeting higher value-added customers to whom products and services with a higher profit margin can be sold. Moreover, new loans to CIS based customers […].

(19) To focus on its new core business, Parex plans to retain its current footprint in the loans market but to restrict its new lending to its core client segments. Loan books to the sectors or geographies where the bank is over-exposed

([12]) The amounts estimated at the time: LVL 140,75 million in the form of ordinary shares, qualifying as Tier 1 capital, and LVL 50,27 million in the form of subordinated term debt, qualifying as Tier 2 capital. If further capital injections are necessary to preserve CAR of 11 % during the rescue phase due to the currently unexpected further provisioning, the same proportion between both capital forms maximising the amount of Tier 2 capital in respect of Tier 1 will have to be preserved.

([13]) As regards the private capital management segment, the bank is clearly positioning itself against […] competitors ([…]), which are said to be its closest competitors for non-resident clients. These banks seem to have been benefitting from some clients that fled Parex and Parex, according to the notified plan, aims to quickly regain its previous position as the preferred Baltic financial institution for CIS-based clients. As regards lending more generally, Parex aims at "cherry-picking of assets in an environment of restrictive lending by competitors" throughout the period of economic downturn, […] (see p. 35 of the notified restructuring plan as of 11 May 2009).

([14]) A significant part of the loans is expected to be run-off based on their maturities.

are planned to be decreased, notably in the real estate and construction sectors and CIS (according to the latest submission, it is planned to reduce CIS loans and leasing portfolio by LVL [between 150 and 250] million and LVL [between 100 and 200] million respectively by 2013). However pursuant to the notified restructuring plan, under the *base* scenario, the bank is planning to achieve a larger net volume of loans both in total and in each of the three above-mentioned segments by 2013. The balance sheet would contract slightly only due to a decrease in the securities' portfolio. Under a *negative* scenario, the bank would slightly contract its retail and corporate loans' portfolio by 2013. Moreover, maintaining and improving the liquidity and reducing the bank's over-reliance on short term funding, as well as a reduction of operating costs and an improvement of risk management are said to be a top priority for the bank during the restructuring phase. To regain the lost deposit base the bank envisages pursuing […] pricing strategy, especially in relation to the top corporate clients who are a substantial source of the bank's funds. Under the *base* scenario Parex plans to achieve in 2013 a larger deposits volume than in the pre-crisis year of 2007.

(20) Nonetheless, the future private capital management activity will have no geographical focus, even if in the long term the Latvian home market is regarded as priority area. The restructuring strategy of this business segment foresees the broadening of the existing product range to increase the fee generation […]. Initially, Parex will offer its Private Capital Management services for […] low prices […] ([15]).

(21) Another corner stone of the restructuring process is […] and notably to achieve the goals that are set by the retail segment. […] aim to keep existing customers and to attract new customers to widen the bank's deposit base. The bank thus intends to signal to the market a fundamental change of Parex. Nevertheless, in this regard no clear decision seems to have been taken yet and the work seems only to be starting.

(22) Finally, the bank's operational processes are to be evaluated and optimized to utilise possible synergies.

2.4.2. *Restructuring aid measures*

(23) Taking into account the risk of negative developments, the Latvian authorities consider that **liquidity support** up to LVL 1,5 billion may need to be provided to the bank. Under the *base scenario*, the expected outstanding amount at the end of the forecast period in 2013 is planned at LVL 305 million. On the basis of the provided information it is not clear when this support would be entirely repaid. In the *negative scenario*, it is assumed that the repayment of the funding could be delayed or the bank would require additional funding. Nonetheless, the Latvian authorities envisage that under the *negative scenario* the State liquidity measures would amount to a smaller amount of LVL 217 million in YE 2013. In the *alternative, i.e. optimistic* scenario (hereinafter "optimistic"), the liquidity support will end in 2012.

(24) The Latvian authorities plan to roll over the liquidity support in the form of short-term deposits which have been provided in the rescue phase (indicatively, the maturity will be in the range of three months to one year). In order to reflect normal market conditions and the bank's risk profile, the Latvian authorities intend to adjust the remuneration mechanism for renewed deposits. In this regard, the Latvian authorities use as a benchmark the interest rate obtained under the renegotiated syndicated loan agreements, which are State guaranteed. The interest rate is a sum of a short-term floating base rate (currently 1 month EURIBOR) and 3 % fixed spread.

(25) The interest rate for liquidity measures in EUR will be set, by analogy to the abovementioned interest rate, as the sum of the following components: (i) short term floating base rate EURIBOR ([16]); (ii) 3 % fixed spread; (iii) 44,8 bps (the same as for A-rated fundamentally sound banks) and (iv) 50 bps add-on fee. As a result, the remuneration as set in the rescue phase increases by around 180 bps, since the previous element of remuneration representing credit spread for Latvia over EUR mid-swaps, then at 120 bps, is replaced by the above-mentioned fixed spread of 3 %. However, if the fixed spread of 3 % is eventually lower than the credit risk spread over benchmark EURIBOR/mid-swap rate for further public borrowings, the fixed spread will be accordingly adjusted upward to the higher credit risk spread in order to reflect the Latvian government's actual funding costs. In any case, the interest rate for deposits will not fall below the interest rate applied for the last received tranche of the loan to Latvia under the Economic Stabilisation and Growth Programme.

(26) The interest rate for liquidity measures in LVL will remain unchanged as set in the rescue phase. It amounts to the sum of: (i) an annual yield of the most recently issued domestic T-bills; (ii) 44.8 bps; and (iii) 50 bps add-on fee.

(27) All State liquidity measures in Parex are guaranteed by good quality loans, i.e. standard loans paid back without any delay as well as supervised loans repayment of which can be delayed in principle no more than 30 days (90 days, if the secondary source of loan repayment is reliable). The proportion between a pledge and deposits should not be less than […] ([17]). In case of some impairment, amendments in the pledge agreement are to be made.

([15]) "Initial pricing of Private Capital Management products will be […] low aiming to […]." (see paragraph 3 on p. 44 of the notified restructuring plan as of 11 May 2009).

([16]) The EURIBOR maturity used for establishing the interest rate is aligned to the maturity of the State short-term liquidity measures, which are rolled over in the medium-term.

([17]) E.g., as on 1 July 2009 the total amount of liquidity measures of LVL 646,3 million were secured by the pledged assets amounting to LVL […] million.

(28) As regards State **guarantees**, in both the *base* and the *negative* scenario they are envisaged to be terminated by YE 2011. Based on the *base* scenario of the notified restructuring plan, the bank may, however, require additional State guarantees in respect of the outstanding Eurobonds, amounting to LVL 89 million. Moreover, in the *optimistic* scenario, the restructuring plan envisages more significant State guarantees to be provided in respect of funding to be obtained from international financial institutions including, amongst others, the European Investment Bank. In this scenario it is planned that the State guarantees would remain beyond the end of the forecast period and at YE 2013 the State guarantees would amount to LVL 200 million.

(29) The remuneration for new or renewed guarantees has not been specified explicitly. As for existing guarantees, no adjustment of the pricing methodology applied under the rescue phase is foreseen ([18]).

*Table 1*

**State liquidity measures and guaranteed loans (the balances at the year end)**

| LVL'000 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| Base Scenario | | | | | |
| State liquidity measures | 600 814 | 575 814 | 525 814 | 472 475 | 305 121 |
| State guaranteed loans | 470 271 | 252 402 | — | — | — |
| Negative Scenario | | | | | |
| State liquidity measures | 625 814 | 625 814 | 625 814 | 489 334 | 216 702 |
| State guaranteed loans | 381 271 | 163 402 | — | — | — |
| Optimistic Scenario | | | | | |
| State liquidity measures | 600 814 | 575 814 | 384 439 | 203 397 | — |
| State guaranteed loans | 381 271 | 263 402 | 200 000 | 200 000 | 200 000 |

(30) As regards additional **recapitalisation measures**, the restructuring plan envisages that by the end of 2009 Parex will receive additional LVL 24 million of share capital. According to the *negative* scenario, the bank may need additional share capital in the amount of up to LVL 25 million to ensure a Capital Adequacy Ratio (CAR) of 9 % for the bank and additional LVL 32 million to ensure a CAR of 11 %. This is, however, not in line with the stress testing exercise of the supervisory authority, as orally presented in the meeting with the Latvian authorities of 15 June 2009, which shows higher capital needs ([19]).

(31) Furthermore, the restructuring plan assumes that Parex will receive also additional LVL 12 million in subordinated loans ([20]). To date the remuneration for the additional capital has not been specified.

([18]) The restructuring plan refers to the guarantee scheme for banks in Latvia approved by Commission Decision of 22 December 2008 in State aid case N 638/08 (OJ C 46, 25.2.2009), the prolongation of which until 31 December 2009 was subsequently approved by Commission Decision of 30 June 2009 in State aid case N 326/09 — not yet published. However, the scheme excludes the possibility of guarantees being granted to Parex.

([19]) Under the restructuring plan the overall amount of the capital to be injected into Parex is not clear. The restructuring plan (part 2) suggests that in the negative scenario Parex will receive LVL 49 million (LVL 24 million plus LVL 25 million) in total. The descriptive part of the financial projections for the base scenario indicates that Parex will be provided with LVL 42 million of the share capital. The summary of the financial projections states that depending on the scenario, additional share capital in the range of LVL 27-57 million could be necessary. However, the tables on solvency included in the financial projections show that the expected capital injection would sum up only to around LVL 24 million.

([20]) The descriptive part of the financial projections for the base scenario indicates that Parex will be provided with LVL 17 million of subordinated loans.

2.4.3. *Financial projections*

(32) The financial projections comprise bottom-up forecasts of business volumes by customer segments (the latest submission refers to volumes for the following business segments: retail banking, corporate banking and private capital management, split according to geographical segments, currencies, standard vs. credit card loans). The Latvian authorities state that business managers of respective units have forecasted loans and deposits in these segments under three different scenarios based on the bank's strategy of restoring lost market share ([21]).

(33) On the basis of the information provided by Latvia, the *base* scenario relies on the following assumption:

— increase to a pre-crisis level of the current base of customer deposits by […] (implying a compound annual growth rate (CAGR) of [between 11 and 17] %),

— net loans and receivables' growth at CAGR of [between 2 and 5] %,

— running-off the securities portfolio from (between 800 000 and 1 000 000) at YE 2008 to (between 170 000 and 220 000) by YE 2013,

— sale of assets is not included, except for the disposal of several corporate loans in 2009 (amounting to in total LVL (between 40 and 50) million),

— net interest income volume growth at CAGR of [between 20 and 30] %,

— limited growth in funding from other financial institutions up to LVL (between 40 and 70) million until 2013,

— syndicated loans and Eurobond repaid on their maturity by year end 2011 and 2011 respectively.

(34) As provided by Latvia, the *negative* scenario and the *optimistic* scenario rely on the following assumptions as compared to the *base* case:

The *negative* case

— provisioning level is increased by 30 % vs. current level,

— deposit growth is reduced by 30 % if compared to a growth level in the *base* case,

— [between – 1 and 2] % loan growth post 2009 (except for corporate CIS loan portfolio which is reduced in line with base case ([22])),

— Eurobond repaid by year end […].

The *optimistic* scenario

— raising LVL [between 170 and 220] million financing from international financial organizations (with a State guarantee though, see above),

— increase in inter-bank balances to LVL [between 50 and 90] million (in line with […] levels),

— net loans at YE […] and YE […] are comparable.

(35) According to the *base* scenario and *negative* scenario the main indicators of Parex will develop as shown in the table below.

*Table 2*

**Financial Projections**

| LVL'000 | Base case | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Total Balance sheet | 3 418 039 | [2 600 000-3 100 000] | [2 600 000-2 900 000] | [2 000 000-2 800 000] | [2 000 000-2 800 000] | [2 100 000-3 000 000] |
| Net loans and receivables | 1 680 051 | [1 400 000-1 700 000] | [1 200 000-1 500 000] | [1 000 000-1 600 000] | [1 100 000-1 700 000] | [1 200 000-1 800 000] |
| Net profit/loss | (124 008) | [loss] | [loss] | [profit] | [profit] | [profit] |
| Net interest margin | 2,6 % | [0,9-1,4] % | [0,2-1,4] % | [0,5-2,7] % | [2,0-3,3] % | [3,0-3,9] % |

([21]) The provided financial projections are unconsolidated and in principle do not include the Parex' Group.

([22]) The plan does not provide explanation on the means by which the CIS loan portfolio is decreasing as information provided is not detailed enough (see the assessment part)).

| LVL'000 | Base case | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Return on average equity (ROAE) | nm | nm | nm | […] % | [> 15] % | [> 20] % |
| Cost/income ratio | 85,7 % | [80,0-85,0] % | [70,0-78,0] % | [50,0-57,0] % | [43,0-51,0] % | [37,0-45,0] % |
| Loans growth rate | (3,4 %) | [negative] | [negative] | [- 6,0-5,0] % | [> 1] % | [> 5] % |
| Customer deposits growth rate | (36,2 %) | [negative] % | [> 10] % | [> 9] % | [> 10] % | [> 10] % |
| CAR ([1]) | 4,10 % | [>= 8] % | [> 9] % | [> 11] % | [> 12] % | [> 11] % |

([1]) The ratio provided is on a standalone basis.

| LVL'000 | Negative case | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Total Balance sheet | 3 418 039 | [2 600 000-2 800 000] | [2 350 000-2 700 000] | [2 000 000-2 500 000] | [2 000 000-2 500 000] | [2 100 000-2 500 000] |
| Net loans and receivables | 1 680 051 | [1 300 000-1 700 000] | [1 200 000-1 600 000] | [1 300 000-1 600 000] | [1 200 000-1 500 000] | [1 100 000-1 500 000] |
| Net profit/loss | (124 008) | [loss] | [loss] | […] | [profit] | [profit] |
| Net interest margin | 2,6 % | [1-1,4] % | [0,1-1,2] % | [0,2-2,5] % | [1,8-3] % | [2,5-3,7] % |
| Return on average equity (ROAE) | nm | nm | nm | […] % | [> 10] % | [> 20] % |
| Cost/income ratio | 85,7 % | [82,8-94] % | [79-99] % | [59-78] % | [47,1-57,3] % | [40-50] % |
| Loans growth rate | (3,4%) | […] % | […] % | […] % | […] % | […] % |
| Customer deposits growth rate | (36,2 %) | [< - 4] % | [> 6] % | [> 8] % | [> 10] % | [> 8] % |
| CAR | 4,10 % | [> 8] % | […] % | [> 9] % | [> 10] % | [> 15] % |

(36) The restructuring plan does not include a stress test carried out by the supervisory authority, which would reflect, in particular, all exposures, macroeconomic risks, the exit of the State aid and other market risks for the whole length of the restructuring period ([23]).

(37) Parex' business strategy is not based upon market studies developed by an independent expert. According to Latvia, in the current economic circumstances, it is highly unlikely that any reliable institution will publish forecasts for more than the next two years. The same stands for the more detailed projections related to the banking sector. Since Parex' operations in other countries are not significant and are irrelevant in terms of market shares, Latvia states that it is unreasonable to commission external studies. Instead, the Latvian authorities intend, in cooperation with an investment bank (acting as Parex' consultant) to build a reasonable set of independent projections and, using Parex' historic data on market shares, develop future market shares forecasts.

([23]) In this context, it should be noted that the Latvian State is subject to a balance of payment financial assistance facility which is conditional on the implementation of a strict programme of economic and budgetary adjustment (see Commission press release IP/09/323 of 25 February 2009).

2.4.4. *Exit strategy*

(38) In April 2009, the Latvian authorities signed an agreement to sell 25 % plus one share of the bank's equity to the EBRD. The EBRD intends to be a long-term investor and participate in the development of the Bank and ultimately return it to the private sector. Based on the information provided, the deal has not yet been completed ([24]).

([24]) Subject to the conclusion of legal documentation, the EBRD package would include the acquisition of 25 percent plus 1 of ordinary shares of Parex Bank for LVL 59,5 million (EUR 84,2 million) and a subordinated loan of EUR 22 million qualifying as Tier 2 capital. Following its capital injection the EBRD will be represented at Parex Bank's supervisory board with a nominee director.

(39) In the context of the third Parex decision, the Latvian authorities stated that it is their intention that the State would sell Parex' shares as soon as possible once the exit price is reasonable and achievable, but not later than after a period of three years since the first rescue measures were provided to Parex. To this end, an investment bank has been entrusted to support this process. The Latvian authorities and the investment bank declare that they will use best efforts to run an efficient process that should allow the closing of the transaction by the end of 2009. The investment bank will contact a wide list of potential investors. This will include Western European banks who have a presence in Eastern Europe, Eastern European banks looking to expand in the region, the larger Russian banks as well as private equity investors who are targeting financial services. Ahead of the process the investment bank will remain open to receiving pro-active approaches and determine jointly with the Latvian authorities whether to consider initiating any bilateral discussions before September. However, in its latest submission of 7 July 2009, Latvia expressed certain doubts as for the possibility of Parex' quick privatisation related, among others, to Latvia's and the world economic situation and short term challenges such as potential deposit outflows […] and closing of the EBRD's investment.

2.4.5. *Burden sharing*

(40) The restructuring plan does not identify restructuring costs and does not explain in detail how these costs are to be covered. It assumes the EBRD's capital investment in Parex and ultimately also its return to the private sector. The potential private buyer will supposedly replace the granted State aid with its own funds. However, according to the Latvian authorities, it cannot be excluded that some State aid measures will be retained even after the privatisation.

2.4.6. *Measures to limit the distortions of competition*

(41) As mentioned above, Parex is currently in the process of identifying assets that can be segregated as non-core or legacy and eventually run-off or sold. According to the latest submission of the Latvian authorities of 7 July 2009, the legacy and non-core assets initially intended for the run-off or sale amount to LVL [between 650 and 950] million. According to the Latvian authorities, however, the restructuring plan does not provide any reserves for spin-offs that decrease capital, therefore any spin-off under that plan should be done in a "capital-neutral" manner. None of the buyers approached to date were willing to continue negotiating based on the terms offered by the bank and expressed the need for […], which was considered not feasible by the bank taking into account its capital position. Among the assets Parex plans to include are c. LVL [between 150 and 250] million of CIS loans in addition to the complete CIS leasing portfolio (LVL [between 100 and 200] million) and a significant proportion of the securities portfolio (LVL [between 90 and 400] million). LVL [between 650 and 900] million represents ~ […] % of Parex' assets as of March 2009. The timeline for this disposal was not specified by the Latvian authorities to date.

(42) In addition, it has to be noted that the notified restructuring plan submitted by the Latvian authorities provides that the business synergies between private capital management and other divisions are […]. Therefore, according to the Latvian authorities, the spin-off of the private capital management division could be potentially envisaged. The Latvian authorities also noted that this business segment does not constitute part of the future activities of Parex as envisaged by the EBRD.

(43) As for the behavioural constraints Latvia undertakes that Parex will not invoke State support as a source of competitive advantage when marketing its financial offer.

(44) Latvia also indicates in the latest submission of 7 July 2009 that Parex will not be an overall price leader in its core markets. Latvia submits that this does not exclude the bank providing attractive terms to its customers for a limited period of time and for specific products increasing overall profitability of the specific client or client group. This statement, however, would seem to be in contradiction to the basic assumption of Parex's restructuring plan and its current operation ([25]).

(45) Regarding an adequate remuneration, the Latvian authorities propose the adjusted methodology for pricing the liquidity support. However, the Latvian position on the remuneration of other State measures envisaged in the restructuring plan is not clear (see section 2.4.2 above).

## 3. **ASSESSMENT OF THE AID**

### 3.1. **Existence of aid**

(46) As stated in Article 87(1) EC, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market, save as otherwise provided in the Treaty.

(47) The Commission notes that Parex is involved in cross-border and international activities, so that any advantage from State resources would affect competition in the banking sector and have an impact on intra-Community trade.

(48) In line with the assessment of the rescue measures granted to Parex (see decision of 24 November 2008 ([26])), which are to be maintained during the restructuring phase, the Commission agrees with the position of Latvia that the State measures provided and to be provided to Parex in

([25]) The currently offered interest rates by Parex seem to be much higher than those of its main competitors in all three Baltic States for most of the maturities and currencies.

([26]) As amended by the second Parex decision and the third Parex decision).

the context of its restructuring in the form of State guarantee, liquidity measures and capital injection constitute State aid pursuant to Article 87(1) EC.

### 3.2. **Compatibility of aid**

(49) As regards the consideration of the Latvian authorities that all additional State guarantees for Parex will be provided under the State guarantee scheme approved by the Commission on 22 December 2008 ([27]), the Commission considers that this is not covered by the approved Latvian guarantee scheme. The Latvian guarantee scheme applies to emergency aid measures. However, further State guarantees as well as the maintenance of the State guarantees granted in the rescue phase are beyond the initial 6 months' rescue period, which ended with the submission of the restructuring plan for Parex by the Latvian authorities on 11 May 2009. Thus, these measures do not constitute an emergency measure but a measure that is part of the restructuring. The State guarantees therefore have to be assessed as ad hoc aid in the context of the present restructuring.

#### 3.2.1. *Application of Article 87(3)(b) EC*

(50) Latvia claims that the aid should be assessed on the basis of Article (87)(3)(b) EC. Latvia considers that Parex is a bank with systemic relevance since it is the second largest bank in Latvia in terms of assets. In addition, the Latvian authorities underline that Parex is the main bank involved in non-resident deposit business, which is of significant importance for the Latvian economy (40 % of total deposits are non-domestic, mostly from CIS). The support measures were necessary in order to remedy a serious disturbance of the Latvian economy.

(51) Article 87(3)(b) EC enables the Commission to declare aid compatible with the Common market, if it is aimed at remedying "a serious disturbance in the economy of a Member State". The Commission recalls that the Court of First Instance has stressed that Article 87(3)(b) EC needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State ([28]).

(52) On 13 October 2008 the Commission adopted a 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 ("Banking Communication") ([29]). In the Banking Communication the Commission acknowledges that, in light of the severity of the current crisis in the financial markets and of its possible impact on the overall economy of Member States, Article 87(3)(b) EC is, in the present circumstances, available as a legal basis for aid measures undertaken to address this systemic crisis.

(53) In addition, in its decisions approving the Latvian guarantee scheme and the rescue aid in favour of Parex the Commission considered that Article 87(3)(b) applies.

(54) The Commission assumes therefore, due to the systemic relevance of Parex, that not granting State aid to Parex would have led to a serious disturbance in the Latvian economy. On the basis of the above, the Commission concludes that Article 87(3)(b) EC can be applied in the case at stake and that the notified aid measures should be assessed on this basis.

#### 3.2.2. *Compatibility under Article 87(3)(b) EC*

(55) As the Commission has set out in the three Communications adopted in the context of the current financial crisis ([30]), aid measures granted to banks in the context of the ongoing financial crisis should be assessed in line with the principles of the rescue and restructuring aid Guidelines, while taking into consideration the particular features of the systemic crisis in the financial markets ([31]). That means that the principles of the rescue and restructuring aid Guidelines may have to be adapted when applied to the restructuring of Parex in the present crisis, which is assessed on the basis of Article 87(3)(b) EC. Within this context attention should be given to the rules set out in the rescue and restructuring aid Guidelines for own contribution. Given the fact that the external financing for Parex has dried up and that the 50 % requirement set in rescue and restructuring aid Guidelines appears unfeasible in the current economic setting, the Commission accepts that during the crisis in the financial markets it may not be appropriate to request that the own contribution represents a predefined proportion of the

([27]) See reference in footnote 18.

([28]) Cf. See, in principle, Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, paragraph 167. Followed in Commission Decision in Case C 47/96, *Crédit Lyonnais*, point 10.1 (OJ L 221, 8.8.1998, p. 28), Commission Decision in Case C 28/02 *Bankgesellschaft Berlin*, points 153 et seq., (OJ L 116, 4.5.2005, p. 1), and Commission Decision in Case C 50/06 *BAWAG*, not yet published, point 166. See Commission Decision of 5 December 2007 in Case NN 70/07, *Northern Rock* (OJ C 43, 16.2.2008, p. 1), Commission Decision of 30 April 2008 in Case NN 25/08, *Rescue aid to WestLB* (OJ C 189, 26.7.2008, p. 3), Commission Decision of 4 June 2008 in Case C 9/08 *SachsenLB*, not yet published.

([29]) Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", adopted on 13 October 2008 (OJ C 270, 25.10.2008, p. 8).

([30]) Communication from the Commission — Application of the State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, points 10, 32, 42 (OJ C 270, 25.10.2008, p. 8); Communication from the Commission — Recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, point 44 (OJ C 10, 15.1.2009, p. 2). Communication from the Commission on the Treatment of Impaired Assets in the Community banking sector, point 17 and 58 et seq. (OJ C 72, 26.3.2009, p. 1).

([31]) See explicitly the Banking Communication — Application of the State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, point 42 (OJ C 270, 25.10.2008, p. 8).

costs of restructuring. Furthermore, the design and implementation of measures to limit distortion of competition may also need to be reconsidered in so far as Parex may need more time for their implementation due to the current market circumstances.

(56) As the Commission has indicated in previous guidance, the depth of restructuring required to return to viability is likely to be in direct proportion, on the one hand, to the scope and volume of the aid provided to Parex and, on the other, to the fragility of its business model ([32]).

3.2.3. *Restoration of long-term viability*

(57) The restructuring plan must provide a credible basis on which it can be expected that the viability of the company will be restored within a reasonable time span. In other words, it must enable the bank to "stand on its own feet", without continued State support. At this stage the Commission is unable to conclude that it is likely that this will be ascertained.

(58) More specifically, the Commission's doubts on the restoration of viability are based on the following elements.

(59) First, the Commission invites the Latvian authorities to clarify how and when the bank would re-establish compliance with relevant regulatory requirements (see paragraph (10) above).

(60) Second, the Commission considers that the restructuring plan needs to address more thoroughly the risk factors identified in the […] report drawn up by the external consultant (see paragraph (9) above). The notified restructuring plan does not seem to clarify how these issues will be addressed during the restructuring phase. Hence, the Commission invites the Latvian authorities to comprehensively address all the above-mentioned risk factors. Notably, with respect to non-OECD loans, large loans and real estate related loans, the Commission would like to obtain from the Latvian authorities further information on performance of these sub-segments of loans to date as well as their forecasted net growth, repayment and provisioning levels during the restructuring period. At this stage, the Commission agrees with the external consultant's considerations that the Probability of default (PD) and Loss-given-default (LGD) ratios should not be more optimistic than the respective average ratios in the banking sector in Central and Eastern Europe.

([32]) See paragraph 44 of the Communication from the Commission — Recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition.

(61) Third, the Commission has doubts on how the bank will manage the lifting of deposit withdrawal restrictions. It observes that the previously estimated end date for such restrictions seems to be postponed and invites the Latvian authorities to provide a strategy in this regard.

(62) Fourth, the notified restructuring plan does not have a clear focus and in the *base* scenario seems to be built on an expanding business strategy for all lending segments with the exception of […] as illustrated by the financial projections with regard to the net loans and receivables over the restructuring period. At this stage the Commission observes that the restructuring plan does not provide for abandoning or significant reduction of all more risky activities, such as lending to high net worth individuals in CIS countries, either. Due to the lack of detailed projections, the Commission cannot assess at this stage whether the exposure to the mortgage lending business or lending to other sectors currently experiencing particular difficulties will be decreased during the restructuring exercise (see paragraphs (66) et seq. below). For instance, the bottom-up financial projections provided as on 7 July 2009 show a growth in lending to CIS clients in the private capital management segment in spite of the general indication in the restructuring plan that […]. Furthermore, the Commission doubts that the liquidity constraints are duly reflected in the bank's restructuring strategy with regard to new lending. Notably, given the fact that the restructuring plan aims to restore the previous size of the gross loan portfolio, Parex needs significant funds, which could only be achieved through a slower reduction of the State funding and/or by assuming a rapid restoration of lost deposit volumes. As a result, the Commission at this stage considers that a smaller scale and more focused bank might provide a less costly and/or less distortive alternative solution whilst preserving financial stability.

(63) To address funding concerns, the deposits volumes are forecasted to increase for all sub-segments. In particular, a twofold increase is envisaged for the largest private capital management deposits sub-segment by YE 2013 as compared to YE 2009. The Commission doubts whether this is realistic and whether this can be achieved only through "service and innovation". Furthermore, the Commission observes that the bank seems to expand all deposit raising activities, including through its Western European subsidiaries. At this stage, the Commission doubts whether this is cost efficient. Therefore, the plan seems to be depending on rather optimistic assumptions as to future operating conditions. As a consequence, the Commission invites the Latvian authorities to reconsider the restructuring plan for the bank in this regard and to justify all substantial increases of assets and funding categories.

(64) In relation to the above, the Commission has doubts on the assumptions on the bank's penetration in different market segments and would seek further information on this aspect.

(65) Fifth, given the significant maturity mismatch of the bank's assets and liabilities to date, the Commission doubts whether the reliance on deposits alone can provide for a sustainable long-term solution for the bank. It seems that the bank would also need more long-term and stable means of financing. In this context, the Commission considers that the restructured bank should be able to compete in the marketplace for capital and/or long-term debt funding on its own merits.

(66) Finally, the financial projections comprise bottom-up forecasts of business volumes by customer segments. Due to the use of such approach, it is unclear to the Commission what underlying assumptions were used with regard to gross and net new lending, provisioning levels, and macroeconomic assumptions, notably with regard to real estate market developments. The separation between previously dominating large loans and currently targeted SME loans is not visible either. The impact of the interest rate margin on net income and the assumptions related to the increase of commission income are not comprehensible either. In other words, the Commission does not see the link between the assumptions provided in the notified plan and the resulting financial forecasts for the whole bank during the restructuring period. Furthermore, some of the assumptions, i.e. concerning the interest rates on different loans and deposits, provide for swings over the restructuring period, which are not explained in the plan.

(67) In the light of the above, the Commission is not able at this stage to ascertain how the increases in different segments of loans and income may be explained. Notably, the Commission has not been made aware of how the significant exposure to the real estate sector in the context of the ongoing economic crisis, the projected low price strategy and relatively expensive funding costs would impact the financial projections of the bank. In this respect, the Commission notes that a high price strategy in funding is likely to have a negative effect on the bank's margin and has doubts whether this has been duly reflected in the bank's restructuring strategy.

(68) In addition, the Commission has not been provided with the results of the stress testing by the Regulator. The Commission has not been provided with the full list of assumptions underlying the base case, the negative case and the optimistic case either (notably, macroeconomic assumptions on projected development of the real estate sector, loss provisions by subcategory of loans, other factors explaining substantial increases in fee income or substantial decreases in expenses). In this regard, in view of the severe nature of the present economic crisis in Latvia with a contraction of the economy of 4,6 % in 2008 and a predicted contraction of 15 % in 2009 ([33]), the Commission needs to underline the importance of adequate stress testing. The Commission's assessment will take into account the uncertainties of the underlying assumptions about the further macroeconomic development in general, including the real estate sector. The Commission invites the Latvian authorities to clarify why the *negative* case provides for less State aid than the *base* case (see table 1 above which shows that: (a) for the whole period, the amount of State guaranteed loans is less in the *negative* scenario than in the *base* one; and (b) for 2013, the amount of State liquidity measures is lower in the *negative* scenario than in the *base* one).

(69) As regards the portfolio of securities, which is envisaged to decrease substantially under all three scenarios, the Commission observes that the majority were reclassified to held-to-maturity (HTM). Therefore, it is not clear whether securities are projected to mature or to be sold and invites the Latvian authorities to provide information on this issue.

(70) At this stage, the Commission has therefore not been able to assess in sufficient detail the restructuring plan and to verify whether it was made on the basis of realistic assumptions as to future operating conditions. The Commission observes that even the partially revised and more segregated financial projections submitted by the Latvian authorities on 7 July 2009 are not detailed enough. Therefore, the Commission invites the Latvian authorities to submit the financial projections wherein all the relevant and significant segments would be visible also including deposits from institutional customers (municipalities, public sector enterprises and State institutions).

3.2.4. *Avoidance of undue distortions of competition*

(71) Measures to limit distortions of competition in banking restructuring cases must be in proportion to the distortive effects of the aid. In particular, the nature and form of these measures need to reflect the amount of the aid and the conditions and circumstances under which it was granted and, second, the characteristics of the market or markets on which the beneficiary bank will operate, including the bank's relative importance on these markets.

(72) In this regard, the Commission observes that the bank was the second largest bank in Latvia. In contrast to other major banks ([34]) operating in the Baltic States, Parex is not owned by larger banks of other Member States or third countries. Parex continued the growth of the loan portfolio when the liquidity crisis emerged ([35]). In the light of the envisaged business expansion strategy, the Commission needs to investigate in more detail whether the implementation of the envisaged restructuring, as notified on 11 May 2009, may not lead to undue distortions of competition. In particular, the Commission observes that

([33]) The forecasted GDP is taken as from the notified restructuring plan (p. 24).

([34]) It has to be noted though that there are smaller players in the market, which are also "domestic" (e.g. Rietumu banka and Aizkraukles banka in Latvia, see p. 35 of the plan).

([35]) See paragraph (7).

the plan seems to rely on an […] pricing and marketing policy ([36]), e.g. Parex might use its competitive advantage due to the secured refinancing by the State to the detriment of competitors. Moreover, under the plan the bank will receive significant amounts of aid and envisages a rapid regaining of its lost market shares in different market segments, whilst also entering a new market segment of lending to […].

(73) The Commission doubts that sufficient measures are taken to offset the negative effects of the aid. As regards the envisaged spin-offs or divestitures, they seem, at least partly, necessary for the restoration of viability. The Commission has doubts whether these measures offset specific market distortions. Furthermore, it is not clear how the disposals will be achieved given the aim to execute them only in a "capital friendly manner". The Commission preliminarily considers that it cannot be excluded that at least for part of the disposable assets the underlying economic value may prove to be below book value and hence in the medium term perspective the bank may need to provide some further discount in order to be able to sell them. As regards the behavioural commitments provided by the Latvian authorities, at this stage the Commission considers them to be insufficient. Indeed, they should be designed in a way as to prevent the bank from using […] pricing to regain lost market shares which would unduly distort competition.

(74) In view of the above, the Commission at this stage considers that the currently envisaged measures to limit distortions of competition are insufficient. In particular, a non-price leadership clause and possible growth limitations in core market segments, the further shrinkage of the bank's lending activities and hence reduction of its currently envisaged funding needs through deposits might be needed to mitigate competition distortions.

(75) As regards the apparent reliance of Parex on operating State aid schemes (as referred to in point 16) in its future business, the Commission at this stage doubts whether the direct entrustment of Parex does not include further aid elements to the bank. Furthermore, the Commission recalls that the bank's viability should derive mainly from internal measures as opposed to future reliance on the State. It needs to be noted that it seems, at this stage, open whether and how this task should be assigned to Parex and how the remuneration for this potential assignment should be fixed. At this stage, it is also unclear how the separation between Parex' purely commercial activities and the State assigned ones, in terms of financial and organizational structure, would be ensured. In this regard, the Latvian authorities are invited to clarify to what extent the bank would lend on the basis of a State guarantee in relation to, inter alia, SME State aid schemes.

(76) The Commission invites the interested parties to comment on all the above issues and to indicate what other measures might be needed to prevent undue distortions of competition caused by the aid at issue.

([36]) Settlement cards electronic funds transfer point of sale (EFTPOS) terminal […] (see paragraphs 3 and 4 on p. 40 of the notified restructuring plan as of 11 May 2009).
Initial pricing of Private Capital Management products will be […] low aiming to […] (see paragraph 3 on p. 44 of the plan). In addition, see also footnotes 13 and 15 above.

3.2.5. *Aid limited to the minimum necessary/own contribution*

(77) The Commission does not yet have clear information on the whole amount of own contribution. On this basis the Commission has no indication that the own contribution to the restructuring would be sufficient.

(78) In the case at hand, the Commission doubts whether the restructuring plan is focussed so as to provide the bank with the minimum State aid necessary to enable it to restore its long-term viability and to be able to compete on its own merits in a medium term. In this context, the Commission invites the Latvian authorities to specify in detail the State measures envisaged for the bank's restructuring under all three scenarios. Notably the Latvian authorities are requested to clarify the maximum amounts that they intend to provide to Parex.

(79) As regard the aid being limited to the minimum necessary, little information has been submitted so far by the Latvian authorities.

(80) First, the Commission observes that under all three scenarios even by the "end" of the restructuring period, i.e. by YE 2013, the bank remains dependent on the State liquidity facilities or State guarantees (see table 1 above). In this regard, the Commission considers that the bank should be able to obtain funding and to refinance its operations without State support in the form of State guarantees or loans in order to be considered viable on a standalone basis. The Commission preliminarily considers that this should be possible within a maximum period of 5 years. To this end, the Commission observes that the *negative* case, which assumes [between - 1 and 2] % loan growth post 2009, provides for less State support as at YE 2013 than the *base case*. By analogy, the Commission preliminarily considers that lower growth of the loan portfolio could reduce the outstanding State aid amounts in the form of liquidity measures.

(81) Furthermore, the Commission needs to investigate to what extent Parex' funding needs could be reduced by a greater focus on core activities and an overall further reduction of the bank's size. As regards the optimistic scenario, the Commission observes that attracting funds from international financial institutions would require additional State guarantees. However, a viable business should be able to finance itself in the medium term without any State guarantees. The fact that it is not projected even in a more optimistic scenario to attract funding from the markets without State guarantee raises further doubts on whether the envisaged restructuring plan is capable of restoring the bank's long-term viability. Therefore, the Commission invites the Latvian authorities to reconsider the minimum aid necessary to restore the viability of the bank.

(82) Second, the Commission doubts whether the currently envisaged remuneration for the State measures liquidity measures can be considered as sufficient even when taking into account the collateral provided by the bank. Thus, at this stage it cannot exclude that the remuneration may need to be revised upward to adequately reflect the risk profile of the bank. In addition, it invites the Latvian authorities to clarify the remuneration of all aid measures and to possibly envisage step up clauses that would incentivise the bank to repay the aid as soon as possible.

(83) Third, the Commission recalls that a clear and timed exit commitment by the Latvian State and its implementation would be a strong signal for the belief of the market in the long-term viability of Parex.

(84) Fourth, the Commission cannot exclude at this stage that Parex may use the State aid to pursue […] price strategy ([37]) negatively reflecting on its margins. In the Commission's view this seems to indicate that the aid might not be limited to the minimum necessary. The Latvian authorities are thus invited to reconsider the overall amounts of aid in connection with the revised business strategy for the bank in light of viability concerns and limiting the aid to the minimum. Third parties are also invited to comment on the above issues.

### 3.3. **Conclusion**

(85) On the basis of the above the Commission comes to the preliminary conclusion that the notified restructuring measures consisting of the prolongation of State guarantees, potential new State guarantees to ensure further funding needs of the bank, liquidity measures and capital injections constitute State aid. The Commission has at this stage doubts that such aid can be found to be compatible with the common market.

## 4. **DECISION**

In the light of the foregoing considerations, the Commission has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty and requires Latvia to provide in addition to all documents already received, information and data needed for the assessment of the compatibility of the aid within one month of the date of receipt of this letter.

In particular, the Commission would wish to receive comments on the points on which it raised doubts.

Latvia is requested to forward a copy of this letter to the recipient of the aid immediately.

The Commission wishes to remind Latvia that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Latvia that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publishing a notice in the EEA Supplement to the *Official Journal of the European Union*, and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication."

([37]) See footnotes 13, 15 and 36 above.