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ROUNDTABLE ON EXIT STRATEGIES

-- Note by the Delegation of Denmark --

This note is submitted by the delegation of Denmark to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 June 2010.

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ROUNDTABLE ON EXIT STRATEGIES

-- Note by Denmark --

1. What are the different types of strategies that have been formulated in your country to exit from government actions that were taken to fight the crisis?

1. Denmark has adopted a number of exit incentives in the support schemes to the financial sector in accordance with the EU state aid regulation. Furthermore, Denmark is gradually withdrawing part of the support for the financial sector and is thus already beginning to exit from the government actions taken in response to the crisis.

2. Several different measures have been adopted with regard to ensuring timely exit from government support schemes. The Danish government has adopted an unlimited state guarantee for simple creditors of financial institutions which expires 30. September 2010. The measure was later amended to include the possibility of individual guarantees for financial institutions and a measure concerning state recapitalisation of financial institutions was also adopted.

3. The Danish recapitalisation scheme was contemplated as a temporary transitional measure and was thus adopted in order to ensure that banks had access to the necessary capital to sustain their activities once the guarantee scheme expires. The measure illustrates the Danish state's attempt to take account of the financial sector's situation after the expiry of the general state guarantee and an attempt to provide a smooth foundation upon which banks can return to the market on their own terms and at their own pace.

4. The Danish parliament has also passed a bill concerning the handling of distressed banks which will enter into effect after the expiry of the guarantee. This measure is introduced as a transition from crisis support to normal market conditions. The Danish government will however still be involved in the financial sector with regard to handling of distressed banks and individual guarantees for banks, which can be given for loans of up to three years.

5. With regard to exit-strategies applied to these measures it should first of all be mentioned that government support of the financial sector is temporary and, therefore, limited in time. It has thus been the aim of the Danish government only to give necessary and temporary support to correct the market failures following the systemic financial crisis.

6. Furthermore, the Danish recapitalisation measure has been targeted towards the support of only fundamentally sound banks in accordance with the EU state aid regulation under the temporary framework. The requirement that only fundamentally sound banks would receive government support was to ensure that aid was not given to banks that were poorly managed and to ensure that the state aid had the wanted effect.

7. If support is given to distressed firms during a crisis, competition suffers by supporting firms that have shown incapable of surviving under normal market conditions. Exit of ineffective firms from the market and the threat of new entrants to the market are important drivers in order to achieve efficient markets that promote welfare and innovation.

8. By ensuring that aid is only given to healthy undertakings, the measure supports only the survival of those firms that under normal market conditions would have been able to run an ongoing business without government support.

9. Thirdly, the government has ensured that firms in the financial sector opting for government support pay a sufficiently high price for the support measures. This is done in order to provide firms with the proper incentive to turn to the private financial markets once these are functioning normally again or to refrain from applying for support in the first place. Setting high prices for financial state aid measures also ensures that only firms with a real need actually receive it.

10. The guarantee scheme adopted in Denmark, for example, was designed in such a way that the state guarantee would not be drawn upon before losses surpassed 4,6 billion euros. These first 4,6 billion euros of losses would instead be covered collectively by the participating banks ensuring a strong financial contribution from the participating banks. The private financial contribution was designed in order to minimise the state aid to that which was estimated necessary to reach its goal. In addition, the contributions from private banks give incentives to withdraw collectively from the unlimited guaranty once market conditions have normalised.

11. The government capital injections came at a price set sufficiently high to give firms incentives to either not apply for capital injection or – for firms who did apply for capital injections – to return to the financial markets once these function normally. The pricing mechanism in this aid scheme was designed in accordance with principles used by the European Central Bank and the state aid rules of the Treaty of the Functioning of the European Union.

12. The second largest bank in Denmark, Nordea Bank AB, chose to obtain loan capital from the private equity market instead of obtaining capital injections from the government scheme. This could be an indication that the strategy of high prices for state capital injections was well designed.

13. As the latest development, the Danish government has proposed a bill concerning the handling of distressed banks. The bill is meant to enter into effect when the existing guarantee scheme expires and seeks to handle the distressed banks through a controlled winding-up process in order to optimise the outcome for depositors and investors compared to normal termination through the bankruptcy procedure. At the time of banks' inability to adhere to Danish financial regulation regarding insolvency[1], the banks are given a choice between liquidation in accordance with normal rules concerning bankruptcy and allowing the takeover of assets by a subsidiary of the state owned company set up with the purpose of facilitating the winding-up of insolvent banks.

14. The subsidiary will hereafter instigate a controlled and swift winding-up of the distressed bank. The distressed bank will continue to function until it is liquidated, but may not participate in aggressive marketing of its activities or compete on the market. The subsidiary will see to it that the simple creditors, and to some degree also the stockholders, of the distressed banks minimise their losses in connection with the liquidation of the distressed bank.

15. With the introduction of the measure for the handling of distressed banks, and expiry of the general guarantee scheme, neither the banking sector nor the private depositors benefit from a state guarantee. With the new measure, the Danish state is initiating a withdrawal from the financial crisis regime of government support to a situation whereby the private banking sector almost entirely stands on its own. What remain of government support of the sector are the individual guarantees that can be

[1] Assuming that all attempts of selling the bank have proven unsuccessful.

attached to loans of up to three years and the fact that the handling of distressed banks is under government control to a certain degree. However, the participation in the measure for the handling of distressed banks is entirely voluntary and government takeover of a distressed bank will not be carried out before all possibilities of a private sale have been explored.

16. Denmark has not given direct state aid to specific companies in the real economy during the crisis, although some relief were given in terms of postponement of payment of specific taxes and value added tax.

2. To what extent have you, as a Competition Authority, been involved in the design of those exit strategies? Have you identified some related competition issues? How will they be addressed? In particular, to what extent is your Authority involved in the improvement of financial regulations to ensure that competition concerns are taken into consideration and co-ordinated with financial security objectives?

17. The first government general action taken in response to the crisis was the general guarantee scheme adopted in October 2008. The Competition Authority was represented in the task force created to design the guarantee scheme as well as the credit scheme. Some ideas during the design phase were abandoned as a consequence of competition concerns expressed by the Competition Authority's representative. The Danish Bankers' Association as well as other interested parties were also consulted in the design of the guarantee scheme.

18. The Competition Authority has likewise been involved in giving advice on the design of the subsequent initiatives with respect to conformity with EU state aid rules.

19. Legislation regulating the financial sector is prepared by the Ministry of Economic and Business Affairs and the Financial Supervisory Authority. However, all new regulation is submitted to the Competition Authority in an official hearing for the Authority to give its statement on issues relating to possible anti-competitive effect.

3. Regardless of whether your government has actually implemented any exit strategies yet, in your view, what exit strategies should be adopted to get the best outcome for competition, bearing in mind the constraints of other policy initiatives?

20. Government ownership of commercial enterprises can in and of itself constitute a distortion of competition. The perception of the market, in some cases, is that a firm which is owned by the state will have easier access to capital and a better credit rating than ordinary private firms in a similar legal and factual situation. It is also widely understood, that the state would be reluctant to allow a government owned company to go bankrupt. The threat of failure is therefore minimal for the publicly owned firm in question. Ownership alone may in some situations thus provide a competitive advantage for the companies in question and as a result, distorts competition at the expense of tax payers and society as a whole.

21. Public ownership can constitute interference in the market and should only be applied in matters of sincere general economic interest such as that of natural monopolies and to ensure stability of the financial system. Therefore, any government involvement in the financial sector should subsequently be scrutinised with the purpose of securing timely exit from a situation whereby the sector is dependent on state aid.

22. In addition to this, once the financial markets are normalised, the state should begin its withdrawal from the market. This entails putting a stop to all provision of capital, as well as other means of support, to financial institutions. This may not be possible to implement from one day to the next and it

should be considered whether state guarantees should still be given in order to support confidence in the market while slowly phasing out the level of state aid given to companies while they once again adapt to market conditions. It may also prove necessary, as in the case of Denmark, to provide support to the simple creditors and stock owners of distressed banks in order to provide a more smooth transition back to normal market conditions and to safeguard the asset value of the distressed banks.

23. As contemplated by the Danish government, it is also important to provide incentives for firms to return to normal market conditions at the opportune moment for the individual company. This can be done by setting sufficiently high prices for guarantees and other support measures. This ensures that companies do not linger in a permanent state of government resuscitation, whereby inefficient companies may be sustained at the expense of new, efficient and innovative entrants. It also ensures that companies return to the market when the market is functioning again and is able to supply its products or services at a price below that of the state aid schemes.

24. Setting relatively high prices also ensures that only companies who truly need the aid choose to accept it and that the aid schemes do not provide unnecessary and disproportionate advantages to companies or entire industries. But perhaps more importantly, high prices ensure that individual companies have incentives to improve their risk profiles in order to keep costs down. In regard to this, it is important to set prices individually in accordance with the receiving firm's risk profile and credit rating. Setting a fixed price for the entire sector or industry, promotes risk taking and generally benefits inefficient firms at the expense of more efficient firms.