POMOC PAŃSTWA – ŁOTWA

Pomoc państwa SA.30704 (12/C) (ex NN 53/10) – Dodatkowe środki pomocy dla łotewskiego banku hipotecznego i ziemi

Zaproszenie do zgłaszania uwag zgodnie z art. 108 ust. 2 TFUE

(Tekst mający znaczenie dla EOG)

(2012/C 130/03)

Pismem z dnia 26 stycznia 2012 r., zamieszczonym w języku autentycznym na stronach następujących po niniejszym streszczeniu, Komisja powiadomiła Łotwę o swojej decyzji w sprawie wszczęcia postępowania określonego w art. 108 ust. 2 Traktatu o funkcjonowaniu Unii Europejskiej dotyczącego wyżej wspomnianego środka pomocy.

Zainteresowane strony mogą zgłaszać uwagi na temat środków pomocy, w odniesieniu do których Komisja wszczyna postępowanie, w terminie jednego miesiąca od daty publikacji niniejszego streszczenia i następującego po nim pisma. Uwagi należy kierować do Kancelarii ds. Pomocy Państwa w Dyrekcji Generalnej ds. Konkurencji Komisji Europejskiej na następujący adres lub numer faksu:

European Commission
Directorate-General for Competition
State aid Greffe
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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.

STRESZCZENIE

I. PROCEDURA

(1) Dnia 19 listopada 2009 r. Komisja zatwierdziła dwa środki służące dokapitalizowaniu na rzecz łotewskiego banku hipotecznego i ziemi (zwanego dalej MLB lub „bankiem"). W dniu 6 kwietnia 2010 r. Łotwa poinformowała o trzecim środku służącym dokapitalizowaniu, który został zrealizowany dnia 23 marca 2010 r. W dniu 15 kwietnia 2011 r. Łotwa przekazała plan restrukturyzacji, oparty na planie politycznym, przewidujący przekształcenie banku w bank rozwoju poprzez sprzedaż jego pozostałych aktywów komercyjnych do dnia 31 grudnia 2011 r. Plan wiązał się z kolejnymi środkami pomocy na rzecz grupy MLB.

(2) Dnia 23 sierpnia 2011 r. Komisja została poinformowana, że według szacunków cały proces sprzedaży części komercyjnej zostanie skutecznie zakończony nie wcześniej niż w sierpniu 2012 r. Oznaczało to opóźnienie w stosunku do wcześniejszych zobowiązań zakończenia sprzedaży do 31 grudnia 2011 r. W dniu 2 listopada 2011 r., zgodnie z decyzją łotewskiego rządu z dnia 1 listopada 2011 r., Łotwa oficjalnie przekazała strategię sprzedaży w celu stopniowego zakończenia (sprzedaży lub ograniczenia w zależności od rodzaju działalności) działalności komercyjnej banku oraz (osobnym pismem) wniosła o tymczasowe zatwierdzenie dodatkowych środków pomocy przewidzianych w podstawowym scenariuszu w strategii sprzedaży. W pismach z dnia 8 i 9 grudnia 2011 r. władze łotewskie przedstawiły dalsze informacje o dodatkowych planowanych środkach, w tym podział kwot między pionem komercyjnym i pionem rozwoju MLB, harmonogram realizacji środków oraz zapewnienie, że do środków przyznanych po dniu 1 stycznia 2012 r. zastosowany zostanie komunikat Komisji w sprawie stosowania od dnia 1 stycznia 2012 r. reguł pomocy państwa w odniesieniu do środków wsparcia na rzecz banków w kontekście kryzysu finansowego ([1]).

II. FAKTY

(3) Beneficjent pomocy, bank MLB, został założony przez rząd łotewski dnia 19 marca 1993 r. jako bank państwowy. Łotewskie Ministerstwo Finansów posiada 100% udziałów banku. Na dzień 30 czerwca 2011 r. bank posiadał 10 oddziałów i 24 pododdziały. Pod względem aktywów był to ósmy największy bank na Łotwie, a jego udział w rynku wynosił 3,6%. Pod względem wartości portfela kredytowego był to siódmy co do wielkości bank z udziałem w rynku w wysokości 4,2%. Pod względem wartości depozytów bank plasował się na dziesiątym miejscu z udziałem w rynku równym 4,2%.

(4) MLB ma dwojaką rolę - działa zarówno jako bank rozwoju, jak i bank komercyjny. Jednak w ostatnich latach bank stał się głównym kanałem wspieranych przez państwo programów kredytowych dla małych i średnich przedsiębiorstw, nowo powstających przedsiębiorstw, obszarów rolniczych i wiejskich oraz działalności gospodarczej słabszych społecznie grup ludności. Obecnie bank jest w trakcie procesu restrukturyzacji, tj. stopniowo stanie się wyłącznie bankiem rozwoju, równocześnie wycofując się z działalności komercyjnej, którą zakończy całkowicie najpóźniej do grudnia 2013 r.

(5) W czerwcu 2009 r. agencja Moody's obniżyła ranking siły finansowej banku do E+ (tj. bardzo niewielka wewnętrzna siła finansowa, z wyższym prawdopodobieństwem okresowego wsparcia zewnętrznego); ranking ten pozostał taki sam zgodnie z najnowszym sprawozdaniem MLB z 22 czerwca 2011 r.

([1]) Dz.U. C 356 z 6.12.2011, s. 7

(6) W tym kontekście władze łotewskie postanowiły interweniować w MLB w interesie stabilności finansowej. Dzięki temu MLB skorzystał z dwóch środków służących dokapitalizowaniu o łącznej wysokości 102,48 mln EUR, które zostały zatwierdzone przez Komisję dnia 19 listopada 2009 r. W dniu 23 marca 2010 r. Łotwa wdrożyła trzeci środek służący dokapitalizowaniu w wysokości 100 mln EUR. W przeciwieństwie do zatwierdzonych środków służących dokapitalizowaniu, które zostały przyznane na działalność banku związaną z rozwojem i miały korzystny uboczny wpływ na działalność komercyjną, wyżej wymieniony środek ma na celu wzmocnienie kapitału własnego działalności komercyjnej banku.

(7) W dniu 20 lipca 2010 r. podpisano trzeci uzupełniający protokół ustaleń między UE a Łotwą, aby udostępnić Łotwie średnioterminową pomoc finansową. Oprócz innych kwestii, opracowanie i wdrożenie procesu restrukturyzacji i sprzedaży komercyjnej części banku MLB jest uznawane za jeden z jego szczególnych warunków.

(8) Zgodnie z uzupełniającym protokołem ustaleń opracowanie planu przekształcenia banku powierzono niezależnemu doradcy, który otrzymał instrukcje, aby przygotować scenariusze przekształcenia banku pozwalające rozdzielić aktywa i pasywa związane z finansowaniem rozwoju, umożliwiając prywatyzację działalności komercyjnej banku lub ewentualnie przekształcenie banku w taki sposób, aby działalność komercyjna mogła zostać wystawiona na sprzedaż niezależnie od pionu rozwoju. W dniu 13 kwietnia 2011 r. rząd łotewski podjął decyzję o zatwierdzeniu przekształcenia MLB w oparciu o scenariusz zakładający „sprzedaż aktywów", co oznaczało albo sprzedaż zintegrowanej puli aktywów i pasywów komercyjnych w dużym portfelu lub w osobnych mniejszych pakietach do końca 2011 r.

(9) Dnia 2 listopada 2011 r. Łotwa oficjalnie przekazała Komisji strategię sprzedaży służącą stopniowemu zakończeniu (sprzedaży lub ograniczeniu w zależności od rodzaju działalności) działalności komercyjnej banku. Łotwa poprosiła również o tymczasowe zatwierdzenie następujących dodatkowych środków pomocy:

— rezerwowy instrument wsparcia płynności w wysokości do 250 mln LVL, który miałby zostać udostępniony od 1 stycznia 2012 r. do zakończenia procesu [2] (obecnie spodziewanego w sierpniu 2012 r.), przyznawany w formie depozytów - wymaganych w przypadku nagłych problemów z płynnością;

— gwarancje w wysokości do 32 mln LVL dla pionu komercyjnego do czasu zakończenia procesu;

— środek wsparcia płynności w wysokości do [30-75] (*) mln LVL zostanie przekształcony w kapitał i udostępniony pionowi komercyjnemu banku jeszcze w 2011 r.

— zastrzyk kapitałowy do kapitału MLB w wysokości 25 mln LVL – potrzebny do pokrycia części strat ze sprzedaży aktywów, oparty na szacowanych teoretycznych obniżkach, w celu zapewniania minimalnego wymaganego współczynnika adekwatności kapitałowej – którego przyznanie przewiduje się na początku 2012 r.;

— 60 mln LVL na wsparcie płynności podmiotu państwowego („agencja prywatyzacyjna" JSC) nabywającego pakiet aktywów o obniżonej jakości, wymagane w przypadku, gdyby pakiet nie został sprzedany; ich przyznanie przewiduje się począwszy od sierpnia 2012 r.

III. **OCENA**

(10) Oceniając, czy środki stanowią pomoc państwa, Komisja dokonała rozróżnienia pomiędzy dwoma różnymi rodzajami działalności MLB: obecną i przyszłą działalnością MLB w ramach jego publicznych zadań jako banku rozwoju, a z drugiej strony pozostałą działalnością komercyjną prowadzoną przez MLB w okresie przejściowym (w okresie stopniowego zakończenia działalności).

(11) Jeśli chodzi o pion rozwoju MLB, uprasza się Łotwę o przekazanie dodatkowych informacji co do tego, w jaki sposób w praktyce zagwarantowana zostanie zgodność działalności rozwojowej MLB z zasadami pomocy państwa. W szczególności władze Łotwy proszone są o przekazanie informacji dotyczących procedur stosowanych przez bank podczas przyznawania pożyczek uprzywilejowanych/wspieranych przez państwo beneficjentom końcowym, które gwarantują, że bank nie będzie udzielać pożyczek, które mogłyby zostać przyznane również przez banki komercyjne.

(12) Jeśli chodzi o pion komercyjny MLB, Komisja uważa, że pomoc państwa na rzecz MLB, składająca się z dokapitalizowania w wysokości 70,2 mln LVL przyznanego w kwietniu 2010 r., środków służących dokapitalizowaniu planowanych na przełomie 2011 r. i 2012 r. (m.in. zamiana długu na kapitał własny w wysokości do [30-75] mln LVL oraz zastrzyk kapitałowy w wysokości do 25 mln LVL), rezerwowego instrumentu wsparcia płynności w wysokości do 250 mln LVL, gwarancji na rzecz pionu komercyjnego MLB w wysokości do 32 mln LVL oraz wsparcia płynności w wysokości 60 mln LVL na likwidację aktywów o obniżonej jakości w ramach HipoNIA, została tymczasowo zatwierdzona do czasu podjęcia ostatecznej decyzji, a wszystkie te środki zostały uznane za tymczasowo zgodne z rynkiem wewnętrznym w myśl art. 107 ust. 3 lit. b) TFUE.

(13) Obecnie Komisja nie posiada wystarczających informacji, aby stwierdzić zgodność pomocy na rzecz zakończenia komercyjnej działalności MLB. W szczególności Komisja potrzebuje większej pewności co do celów pośrednich przewidzianych w procesie sprzedaży działalności, jak również dalszych informacji dotyczących likwidacji działalności, która nie może zostać sprzedana w perspektywie

[2] Wsparcie płynności w wysokości do 125 mln LVL planowane jest dla banku rozwoju począwszy od stycznia 2012 r., jako rekompensata za wcześniejszy kredyt udzielony przez pion komercyjny banku pionowi rozwoju.

(*) Fragmenty tekstu zostały zastąpione jawnymi przybliżonymi zakresami wartości, aby nie ujawniać poufnych informacji.

krótkoterminowej (tzw. alternatywny scenariusz w strategii sprzedaży). Łotwa proszona jest o przekazanie dodatkowych informacji i zobowiązań w tym względzie.

(14) Ponadto Komisja wątpi, czy plan przekształcenia spełnia wszystkie warunki określone w komunikacie o restrukturyzacji. W szczególności na podstawie otrzymanych informacji Komisja nie może stwierdzić, czy działalność gospodarcza prowadzona nadal po sprzedaży będzie rentowna i wzywa Łotwę do dostarczenia odpowiednich dowodów. Ponadto Komisja zwraca się do Łotwy z prośbą o przekazanie dodatkowych informacji dotyczących środków podjętych w celu uniknięcia nieuzasadnionych zakłóceń konkurencji w odniesieniu do sprzedaży, jak również likwidacji niesprzedanej działalności komercyjnej. Komisja stwierdza jednak wstępnie, że środki wyrównawcze wydają się być odpowiednie w odniesieniu do Hipolizings i Hipo Fondi.

(15) Podsumowując, na obecnym etapie Komisja musi dokładniej zbadać warunki planu przekształcenia oraz procesu sprzedaży pionu komercyjnego, aby zapewnić ich zgodność z rynkiem wewnętrznym.

(16) Komisja wzywa zainteresowane strony do przedstawienia swoich uwag odnośnie do niniejszej decyzji.

TEKST PISMA

„The Commission wishes to inform Latvia that, having examined the information supplied by your authorities on the additional aid measures in favour of 'The Mortgage and Land Bank of Latvia (MLB)', it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union (TFEU).

1. **PROCEDURE**

(1) On 19 November 2009, the Commission approved two recapitalisation measures in favour of "The Mortgage and Land Bank of Latvia" [3] ("MLB" or "the bank") in the total amount of LVL 72,79 million (EUR 102,48 million), granted to the bank in January and November 2009 [4] ("the November 2009 decision").

(2) On 6 April 2010, the Latvian authorities officially notified a further recapitalisation in the amount of LVL 70,2 million (EUR 100 million). The measure had been implemented on 23 March 2010.

(3) On 29 April 2010, the Commission sent a request for additional information. The outstanding information was further discussed during a meeting between the Latvian authorities and the Commission services held on 6 May 2010.

(4) On 9 June 2010, the Commission requested further information. On 15 June 2010, the Latvian authorities sent partial replies to the Commission requests. In the same letter, the Latvian authorities informed the Commission that, during the review mission of the International Monetary Fund and the European Commission, the transformation plan of the MLB was also discussed. As a result of those discussions it was agreed among the parties that the further work on the plan was needed.

(5) On 20 July 2010, the third Supplemental Memorandum of Understanding (the "SMoU") was signed between the EU and Latvia so as to make available to Latvia medium-term financial assistance of up to EUR 3,1 billion [5]. In the SMoU Latvia undertook to appoint an independent consultant to advise the government in preparing a comprehensive transformation plan for MLB, to be submitted to the Commission by 30 September 2010 and to develop proposals for optimisation of the system of development financial institutions and integrate, as appropriate, different development institutions operating on behalf of the government with advice from an independent consultant, by 31 December 2010. In that context, Latvia also stated its intent to work with the Commission on improving the framework for development lending in Latvia, specifying that the development bank should preferably lend on concessional funds using commercial banks as intermediaries, and clarify instances when it should lend directly to clients.

(6) In September 2010, Latvia informed the Commission that the elaboration of the MLB transformation plan was assigned to an independent external advisor. The advisor was instructed to prepare possible scenarios on transforming the bank in order to allow for splitting off assets and liabilities related to development financing and

(3) In Latvian, Latvijas Hipoteku un zemes bankas.

(4) Commission Decision in State aid case NN 60/09 - Recapitalisation of "The Mortgage and Land Bank of Latvia" of 19 November 2009 (OJ C 323, 31.12 2009, p. 5).

(5) Council Decision 2009/290/EC provides for EU medium-term financial assistance for Latvia of up to EUR 3,1 billion in the form of a loan under the facility which was established by Regulation (EC) No 332/2002. The EU assistance was provided in conjunction with a loan from the International Monetary Fund ("IMF") under an IMF Stand-by arrangement approved on 23 December 2008.
Article 3(4) of Council Decision 2009/290/EC stipulates that, the Commission shall decide on the release of the instalments on the basis of the fulfilment of the specific economic policy conditions, as laid down in the Memorandum of Understanding and its addendums.
The EU financial assistance was to be disbursed in six instalments. The amount of the first instalment was released on 25 February 2009 after signature of the Memorandum of Understanding ("the Memorandum"), while a second instalment of EUR 1,2 billion was released on 27 July 2009 after completion of the first review mission and the broad fulfilment of the economic policy criteria laid down in the Memorandum. The third and fourth instalments of EUR 0,5 and EUR 0,2 billion were released on 11 March 2010 and 21 October 2010, respectively, following completion of the second and third review missions, and broad fulfilment of the economic policy criteria, as laid down in the first and second SMoU. The fifth instalment of EUR 0,1 billion was not requested by the authorities, following signature of the fourth SMoU.

allowing for privatisation of the bank with its commercial activities or alternatively transforming the bank so that commercial activities could be put for sale leaving the development institution behind.

(7) In October 2010, the Latvian authorities submitted different versions of the possible scenarios on transforming the bank which were discussed between the Latvian authorities, the Commission and the IMF in meetings and conference calls. Latvia was informed about the Commission's preference for the "asset sale" scenario (preferably a sale of assets in bundles).

(8) On 11 December 2010, Latvia submitted a draft transformation plan, based on that preferred scenario. According to that plan, the integrated pools of commercial assets and liabilities in bundles were envisaged to be sold by 31 December 2011. On 20 December 2010, the Commission requested further information regarding the plan.

(9) On 4 February 2011, the Commission was informed by the Latvian authorities that a final decision on the transformation scenario for MLB had not been taken by the government and thus the previously submitted plan could not serve as a politically agreed basis for further discussion. That information was confirmed by Latvia during a conference call on 14 March 2011 between the Latvian authorities, the IMF and the Commission services.

(10) On 11 February 2011 the Latvian authorities submitted to the Commission a draft report to be regarded as a draft proposal on the optimization of the system of development financial institutions in Latvia as prepared by an independent advisor.

(11) On 30 March 2011, the Latvian authorities were requested by the Commission to submit a politically agreed transformation plan by, at the latest, the middle of April 2011.

(12) On 13 April 2011, the Latvian authorities informed the Commission that the Latvian government had taken a decision on the MLB transformation as prepared by an external consultant, based on the "asset sale" scenario. They also decided to engage an independent sales consultant to carry out market prospecting, in particular with respect to the sales price that could be achieved, and to prepare a sales strategy by 31 May 2011.

(13) On 15 April 2011, the Latvian government submitted a politically backed transformation plan for MLB to the Commission ("April 2011 plan"). Latvia committed itself politically to the implementation of the transformation scenario (i.e. sales of commercial assets) as well as to the adherence to a time limit for the sale of the commercial segment by 31 December 2011.

(14) On 12 August 2011, Latvia provided additional information regarding the bank's subsidiary HipoNIA and the valuation of assets transferred from the bank to the subsidiary.

(15) Latvia also communicated a deadline for the submission of a politically agreed asset sales strategy to the Commission initially set at 30 June 2011. The sales strategy was to be prepared by a team of external consultants. On 19 August 2011, the Commission received a version of the sales strategy which was not yet politically agreed. According to the Latvian authorities that version of the strategy could still be significantly modified.

(16) On 23 August 2011, during a high-level conference call, the Latvian authorities indicated to the representatives of the IMF and the Commission that the sales strategy was still under political discussion and could thus not be considered as final. Unlike the political commitment submitted by Latvia on 15 April 2011, that draft provided for the finalisation of the sale of the commercial segment in the first half of 2012.

(17) On 18 October 2011, the Latvian authorities submitted another draft version of the sales strategy, not yet backed by the Latvian government. On 24 October 2011, the Latvian authorities submitted additional information, in particular with respect to the current accounts held by the development segment clients and the treatment of the cross-collateralised loans during the restructuring.

(18) On 28 October 2011, the Latvian authorities informed the Commission that they exceptionally accept that this Decision be adopted in the English language.

(19) On 2 November 2011, in accordance with the Latvian government decision of 1 November 2011, Latvia officially submitted to the Commission the sales strategy for phasing out (selling or running down, depending on activity) the commercial activities of the bank. By a separate letter sent on the same day, the Latvian authorities requested a temporary approval of additional aid measures envisaged in the sale strategy in addition to the recapitalisation measure notified on 6 April 2010.

(20) On 11 November 2011, the Latvian authorities submitted to the Commission the minutes of the Latvian government meeting regarding the restructuring of MLB. By the same letter, the Latvian authorities complemented the submission dated 24 October 2011. On 24 November 2011, Latvia submitted additional information regarding the relations between MLB and its subsidiaries Hipolizings and Hipo Fondi.

(21) By letters of 8, 9 and 22 December 2011 and of 19 January 2012, the Latvian authorities provided further details on the additional measures to be granted, including the split of the amounts between commercial and development segments of MLB, the timing of and remuneration for the measures and an assurance that for the measures granted after 1 January 2012, the Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis [6] will be applied.

[6] OJ C 356, 6.12.2011, p. 7.

2. DESCRIPTION

2.1. The beneficiary

(22) On 19 March 1993, MLB was established by the Latvian government as a State-owned bank. The Ministry of Finance of the Republic of Latvia is the holder of 100 % of the bank's shares.

(23) The bank group currently includes the following subsidiaries:

— SIA "Hipolizings" ("Hipolizings"), which provides leasing services, primarily vehicle leases, with a market share of 5 % as of 30 June 2011, financed exclusively by MLB through a loan facility of LVL 49 million;

— SIA "Hipoteku bankas nekustama ipasuma agentura" ("HipoNIA"), which is a non-performing asset [7] management company managing an asset portfolio, financed exclusively by MLB;

— SIA "Riska investiciju sabiedriba", a special purpose vehicle ("RIS");

— IPS "Hipo Fondi" [8] ("Hipo Fondi"), which is asset management company that manages a State-compulsory funded-pension scheme (second pillar) funds with LVL 34 million under management (approximately 4 % market share), 51 % owned by the bank's subsidiary RIS; Hipo Fondi is operated as a standalone entity, but benefits from MLB's branch network, sales force and IT support;

— SIA "Rigas centra namu parvalde", which is small building maintenance service provider, with less than 1 % of the real estate managing and maintenance market in Riga, 100 %-owned by the bank's subsidiary RIS;

— Other: Cord (currently in the process of liquidation, 51 % owned by the bank's subsidiary RIS), Varmes rapsis and Tilzas rapsis (small agriculture companies, with more than 50 % shares owned by the bank's subsidiary HipoNIA).

(24) MLB is a medium-sized bank in Latvia offering retail bank services, with two separate banking operations, a development bank ("the development segment" or "DB") and a commercial bank ("the commercial segment" or "CB"). All of the bank's subsidiaries are involved in activities of commercial nature.

(25) The history of MLB dates back to 1993, and since then MLB has had considerable structural changes. Initially, the bank focused on lending to small and medium-sized enterprises and mortgage lending. Funding for those activities was market-based, i.e. attracted from the deposit market and by issuing mortgage bonds.

(26) Since 2006, MLB has been in the process of transformation from a commercial bank providing regular retail banking services to a national development bank, servicing the under-banked market segments and being subsidised by the State:

— The concept approved by the Cabinet of Ministers on 1 November 2006 "On Development of the State Joint-Stock Company Lavijas Hipoteku un zemes banka for Years 2007-2013" foresees gradual transformation of MLB into a development bank by 2013;

— In December 2009, that concept was substituted by the adoption of "Transformation of the State Joint-Stock Company Mortgage and Land bank of Latvia into a development bank". The new concept laid out the goals of reducing commercial and increasing development activities for MLB;

— In a Letter of Intent and Technical Memorandum of Understanding with the IMF of 9 May 2011 ("the LoI"), which includes commitments regarding the restructuring of MLB, Latvia communicated its intention to (i) divest the commercial part (the commercial assets and liabilities) of MLB by 31 December 2011; (ii) to coordinate the sale process with the IMF; (iii) to restructure the remaining development bank.

(27) Loans within the development segment comprise loans granted according to priorities defined by the Latvian government or within the scope of EU development programmes. MLB is the main operator of State aid schemes involving loan mechanisms. Since 1999, MLB had been implementing a number of lending programmes supported by the Government ("State-supported lending programs" or "development programmes"), e.g. agricultural lending, rural lending, SME lending, housing loans, rural non-agricultural lending, and risk and mezzanine loans.

(28) Banking services in Latvia are provided by 21 banks (the largest of which are subsidiaries of banks with parent companies in other Member States) and 9 foreign bank branches. As of 30 June 2011, MLB was the eighth-largest bank in Latvia by its volume of assets (market share – 3,6 %, total assets LVL 660,6 million, EUR 936,4 million). With LVL 566 million of loans, it is the seventh-largest bank by the volume of loan portfolio (4,2 % market share). With LVL 368 million of deposits [9], it is the tenth-largest bank by the volume of deposits (4,2 % market share). The bank primarily deals with Latvian residents as customers. It has a [5-10] (*) % market share in the resident deposits segment. At 30 June 2011, the bank had 10 branches and 24 sub-branches. The client base of MLB is sizable, while the average client size is relatively small. It had 90 000 active clients (of which, 11 000 legal entities) and 5 000 credit cards issued (of which 1 300 to legal entities).

(7) They primarily consist of loans and real estate.

(8) Hipo Fondi is a standalone asset management company with independent accounting and management. The company currently is responsible for MLB liquid asset portfolio management. A sizable share of the company (42 %) belongs to active shareholders.

(9) The volumes of deposits as of 30 June 2011 reported on pages 11, 114 and 120 of the sales strategy derive from management accounts which differ from audited accounts (see reconciliation on pages 127-131 of the sales strategy).

(*) 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.

(29) The evolution of the market shares and position of MLB is reported in the table below.

Table 1

Market share and position of MLB

Market share, %	2006	2007	2008	2009	2010	2011Q2
Assets	4,3 %	4,2 %	4,1 %	4,5 %	3,7 %	3,6 %
Loans	4,5 %	4,4 %	4,4 %	4,6 %	4,1 %	4,2 %
Deposits	3,5 %	2,7 %	3,1 %	3,4 %	3,9 %	4,2 %

Market position	2006	2007	2008	2009	2010	2011Q2
Assets	#8	#8	#7	#7	#8	#8
Loans	#7	#7	#5	#5	#7	#7
Deposits	#8	#11	#9	#9	#10	#10

(30) The table below contains information on the key financial data of MLB and its commercial and development segments in 2009, 2010 and for the first half of 2011.

Table 2

MLB Group's key financial data in 2009-1H2011, in thousands of LVL

	31.12.2009			31.12.2010			30.6.2011		
	Commercial segment	Development segment	Combined accounts	Commercial (1)	Development	Combined	Commercial (1)	Development	Combined
Total assets (2)	685,537	247,072	**884,231**	615,146	221,272	**706,053**	588,054	201,510	**660,605**
Net loans	392,688	246,813	**639,501**	289,647	202,094	**491,741**	274,230 (3)	200,396	**474,626**
Total senior liabilities (2)	629,984	193,282	**775,262**	558,856	158,827	**589,229**	528,425	138,263	**540,422**
Deposits	324,811	—	**324,811**	334,957	26,206	**361,163**	356,999	25,983	**381,025**
Subordinated liabilities	31,089	—	**31,089**	31,089	—	**31,089**	31,089	—	**31,089**
Equity (2)	24,464	53,790	**78,254**	23,290	62,445	**85,735**	28,540	63,247	**89,094**
Capital Adequacy Ratio	N/A	N/A	**12,8 %**	N/A	N/A	**17,4 %**	N/A	N/A	**16,3 %** (4)
Net interest margin	1,9 %	3,8 %	**2,6 %**	(3,1) % (5)	6,3 %	**1,4 %**	N/A	N/A	**N/A**
Net profit (loss) (2)	(29,592)	(25,512)	**(54,051)**	(44,452)	(21,723)	**(66,208)**	(24,019)	(15,575)	**(39,302)**
ROE (6)	(121) %	(47) %	**(69) %**	(191) %	(35) %	**(77) %**	(84) %	(25) %	**(44) %**

Source: the transformation plan submitted in April 2011 and the financial reports (available at http://www.hipo.lv/en/investor_relations/financial_information).

(1) That heading includes both the commercial segment within the bank and the so-called commercial services, which in practice cover the companies associated to MLB.

(2) The amounts reported for the commercial and development segments do not always sum up to the amounts reported for the combined accounts, due to the relations between the two business segments that are difficult to separate in view of the limited information provided.

(3) Since the 1H2011 financial report (unlike that of 2010) did not show separately the amounts due to or by other segments, the reconciliation amount was deducted from the commercial segment to allow for comparability.

(4) Here a ratio for the bank rather than the group is provided, since the ratio for the group was not reported.

(5) Negative amounts are reported in brackets.

(6) ROE is calculated as net profit (loss) divided by equity.

(31) Table 2 shows that, contrary to the commitments recorded in the November 2009 decision, in the reported period commercial deposits have increased. As per the annual financial accounts, in 2010 deposits have grown by LVL 36,9 million or 11,3 % reaching LVL 363,6 million and a market share of 4,1 %. The increase of deposits continued into the first half of 2011. Loan balances have decreased for the combined bank, but also individually for the commercial and development segments.

2.2. **The operations of the development segment of MLB**

(32) After Latvia's accession to the European Union, in January 2005 a special unit - Promotional Programs Office ALTUM (hereinafter "ALTUM") - was created within MLB in order to separate public service activities from the bank's commercial activities. ALTUM does not have the status of a separate legal entity. Nevertheless, its activities are to some extent segregated from the commercial activities pursued by MLB. ALTUM has taken over the bank's ongoing State aid programmes, and has started a number of new State aid programmes and instruments in co-operation with the ministries.

(33) To comply with the provisions of Directive 2006/111, [10] the bank keeps separate accounting for its commercial and development segments. The capital is allocated to both segments so as to maintain sufficient capital adequacy ratio for each of them.

(34) As demonstrated by the financial accounts of the distinct segments, there are a number of services and financial flows between the two segments, as well as between the bank and its commercial subsidiaries, priced at internal transfer prices to ensure the separation of accounts.

(35) As described in the November 2009 decision [11], the Latvian authorities had confirmed that the State Programmes are notified to the Commission, where appropriate, in accordance with the State aid rules. Furthermore, the Latvian authorities undertook that no State aid programme implemented by MLB would be financed through deposits or other market-based funding.

(36) According to the information from the Latvian authorities, some Latvian State aid schemes are tendered out to commercial banks and some more complex ones are assigned to MLB while, however, providing the possibility to the commercial banks to participate in the financing of the supported projects. In that context, the Latvian authorities pointed out that the commercial banks would normally not be interested in participating in State-supported lending programmes as they would involve many specific requirements and conditions, e.g. limits for working capital loans taking into account State aid de minimis rules, 25 % co-financing requirement from the State aid loan recipient taking into account the requirements under the Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Article 107 and 108 TFEU (General block exemption Regulation) [12], etc.

(37) In practice, however, MLB usually offers its loan programmes (i.e. providing State guarantee on loans or subsidizing the interest rate) directly to its customers. Only in exceptional cases does it operate via indirect channels, i.e. through commercial banks, leasing companies and credit unions. [13]

(38) At present, the bank is running the following State-supported lending programmes [14]: loans for improvement of the competitiveness of businesses (most significant programme, with a loan balance of 66,7 million LVL, thus representing 27 % of total outstanding loan balance and 72 % of all new programmes), micro-credits programme, working capital (current assets) loans for agriculture, support to business start-ups and long-term investments to agriculture.

2.3. **Difficulties of the bank**

(39) […]. MLB's overall profitability weakened considerably, with loan loss provisions growing nearly four-fold. At the end of 2008 the bank had low loan loss reserves. [15] At the same time, the bank has reported a rapid increase in problem loans, which accounted for 8,6 % of gross loans at the end of 2008 compared with 2,7 % at the end of 2007. As a result, in June 2009, Moody's downgraded the bank's financial strength rating to E+ [16]. In the most recent available report of 22 June 2011, the rating is still at E+.

(40) To keep pace with the requirements for loan loss provisioning, the bank needed capital injections from the State (see section 2.4 below). A big part of injected equity has been already lost in terms of book value. As shown in Table 1, the bank recorded substantial losses in 2009 - first half of 2012. In particular, at the end of 2010, the bank had accumulated losses amounting to LVL 110 million at the level of the bank (and LVL 108,8 million at the level of the group) against LVL 191,6 million of share capital, resulting in total shareholder's equity attributable to shareholders of the bank amounting to only LVL 83,7 million, less than what Latvia injected in the bank in 2009 (the emergency support measures, approved in the November 2009 decision, see below) and 2010 (in total, the injections of 2009 and 2010 amounted to LVL 143 million) [17].

(41) Further, a prolonged transformation process of the bank, whilst maintaining its dual role added significant complexity to the management of the bank.

(42) Based on the information submitted to the Commission, a due diligence report was being prepared by an external consultant. That report has not yet been submitted to the Commission.

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(10) Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (OJ L 318, 17.11.2006, p. 17).

(11) See footnote 4.

(12) OJ L 214, 9.8.2008, p. 3.

(13) *Source:* 'Final report on elaboration of concept for optimisation of development finance institutions in Latvia' of 10.2.2011 prepared by PricewaterhouseCoopers SIA.

(14) *Source:* 'Final report on elaboration of concept for optimisation of development finance institutions in Latvia' of 10.2.2011 prepared by PricewaterhouseCoopers SIA.

(15) Moody's estimated that should the bank have provided a 50 % loan loss reserve coverage against problem loans in 2008, the bank would have needed to increase loan loss provisions by more than four fold, thus turning loss making.

(16) Meaning very modest intrinsic financial strength, with a higher likelihood of periodic outside support.

(17) *Source:* 'MLB- Annual Report for the year ended 31 December 2010', available at: http://www.hipo.lv/ufiles/File/parskati/ENG/2010_gada_parskats_auditets_ENG.pdf

2.4. **The emergency support measures, approved in the November 2009 decision**

(43) In the November 2009 decision, the Commission concluded that insofar as the two recapitalisation measures - i.e. an increase of the bank's capital carried out in January 2009 by the amount of LVL 29,5 million and a second one by LVL 43,29 million in autumn 2009 - supported the continuation of MLB's development activities, they do not constitute State aid within the meaning of Article 107(1) TFEU. As regards the bank's residual commercial activities, the Commission found that, as there is no legal separation between the commercial and development activities, the recapitalisation measures may also benefit the bank's commercial business, i.e. would involve State aid.

(44) On the basis of the following considerations and commitments by Latvia, the Commission found the aid measures to constitute compatible aid:

— The capital was - according to Latvia - attributed solely to the development activities, hence, due to the separation of the accounts between the two segments, minimizing the benefit accruing to the commercial segment of the bank.

— Latvia undertook to phase out the commercial activities by 31 December 2013 at the latest. In particular, the phasing out of the loan portfolio had to be gradual and the market-based funding (including retail deposits) of those activities had to be reduced in parallel to the commercial loans portfolio.

— New lending was terminated immediately, i.e. as from 31 October 2009 except for the funds that had been already committed by the bank and for the restructuring of existing loans of the existing commercial clients with respect to the same client and to the same loan amount.

— Latvia undertook to notify the Commission if further State support for commercial activities would be needed in the future, i.e. to absorb expected potential losses on the outstanding commercial loans, or if commercial activities were to be resumed.

2.5. **The Transformation plan**

2.5.1. ***Alienation by MLB of its commercial activities***

(45) In line with the July 2010 SMoU, the elaboration of the MLB transformation plan had been assigned to an independent advisor. That advisor was instructed to prepare scenarios on transforming the bank in order to allow for splitting off assets and liabilities related to development financing and allowing for privatisation of the bank with its commercial activities or alternatively transforming the bank in a way that commercial activities can be put for sale leaving the development segment behind.

(46) After having analysed the financial situation of the bank, in the April 2011 transformation plan it was concluded that the best scenario would be to sell MLB's commercial assets in bundles in a timely manner.

(47) To further detail the plan, notably by testing the market interest in such assets, reviewing the bundles and detailing other assumptions, a sale strategy was prepared by an external consultant.

(48) Originally due by 30 June 2011, the sales strategy was delayed due to late hiring of the sales consultant, the unanticipated parliamentary elections, and difficulties in forging a political consensus.

(49) In its decision of 1 November 2011, the Latvian government endorsed the sale strategy recommended by the consultant that stipulates alienation of MLB's commercial segment in six bundles in accordance with the base scenario base asset valuation. In line with the recommendations of the consultant, the government decided to launch the sale process immediately.

(50) In this decision, the Commission takes into consideration and makes its assessment of the restructuring/termination of the commercial activities of MLB on the basis of the information contained in the sales strategy submitted by Latvia on 2 November 2011, which was endorsed by the Latvian government in its decision of 1 November 2011. The Commission understands that the sales strategy further specifies or replaces the previously submitted information contained in the transformation plan submitted to the Commission on 15 April 2011 and in the minutes of the Latvian government decision of 15 April 2011.

(51) As of 31 August 2011, the assets and liabilities of MLB's commercial segment to be sold in the market included:

— Commercial loan portfolio and shares in subsidiaries (HipoNIA, Hipolizings, and Hipo Fondi) of LVL 283,8 million;

— Deposits amounting to LVL 356,1 million.

(52) Overall, four alternative sale strategies were considered: (i) sale of all commercial assets and liabilities in one bundle; (ii) use of proceeds from the sale of commercial assets to pay down deposits; (iii) upfront repayment of deposits and runoff of commercial loan portfolio; (iv) sale of bundles consisting of performing loans (retail and corporate) and deposits.

Bundles

(53) The recommended and endorsed sales strategy is to segment MLB's assets and liabilities into the following six separate bundles, in accordance with tested market interest:

1) **Retail and small corporate** performing loans, excluding exposure to real estate developers and construction, of approximately LVL 94,6 million in terms of net book value together with all retail and small corporate term and demand deposits of LVL 244 million (**Bundle 1**);

2) **Large corporate** performing loans, excluding exposure to real estate developers and construction, of approximately LVL 27,4 million in terms of net book value with all large corporate term and demand deposits of LVL 103 million (**Bundle 2**);

3) Corporate performing **loans related to real estate developers and construction** of approximately LVL 39,7 million in terms of net book value (**Bundle 3**);

4) **HipoNIA:** shares and intra-group loan from MLB to HipoNIA of LVL 41,3 million; upon the sale, the assets of HipoNIA will include non-performing loans ("NPLs") yet to be transferred to HipoNIA by the date of the transaction (**Bundle 4**);

5) **Hipolizings** (shares and intra-group loan from MLB to Hipolizings of LVL 47,3 million) (**Bundle 5**);

6) **Hipo Fondi** (shares) (**Bundle 6**) ([18]).

(54) Certain other assets (primarily branch network fixed assets) will be offered together with the bundles.

(55) In the case of the first two bundles, the deposits to be transferred are higher than the assets to be transferred. The resulting gap is expected to be covered from three sources:

— Sale of other bundles and transfer of the cash received to the potential buyers of the first two bundles;

— Reduction in liquid assets of MLB and transfer of cash to the potential buyers;

— Liquidity support from the State Treasury to MLB and transfer of cash to the potential buyers.

(56) Deposit balances to be transferred to the development segment of MLB, rather than sold in the expected transaction, include:

— Development segment client account balances of LVL 9,4 million;

— Deposits used as a collateral LVL 0,7 million.

Valuation of the bundles

(57) According to the sales strategy, the net book value of assets ("NAV") of different loan bundles as provided by MLB was taken as a starting point for the bundle valuation exercise. At a later stage, once the vendor due diligence ("VDD") process is complete, any VDD adjustments will be incorporated into the valuation of the bundles. Next, the consultant performed a run-off valuation by discounting cash flows (loan repayments and pre-tax interest income) to arrive at a present value for the particular portfolio. The discount rate used was based on a combined cost of debt/required return for such cash flows. Finally, the consultant employed an internal rate of return ("IRR") valuation to determine a theoretical entry price based on future cash flows, leverage and investor target IRR. Based on the valuation methodologies, the consultant arrived at a following possible theoretical range of values for the six bundles as of 31 August 2011 in a base case, of low valuation and high valuation.

(58) The resulting estimated values of (parts of) the bundles in the base and a low valuation cases are provided in Table 3.

Table 3

Overview of valuation of bundles to be sold as of 31 August 2011, in thousands of LVL

Name of bundle	Net book value	BASE CASE		LOW VALUATION	
		Value	Discount	Value	Discount
Bundle 1 "Retail + Small Corporate" (Loans)	94,622	[…]	[…] %	[…]	[…] %
Bundle 2 "Large Corporate" (Loans)	27,395	[…]	[…] %	[…]	[…] %
Bundle 3 "Corporate Real Estate" (Loans)	39,662	[…]	[…] %	[…]	[…] %
Bundle 4 "HipoNIA": — equity investment, — intra-group loan, — loans	 18 41,311 32,697	 […] […] […]	 […] % […] % […] %	 […] […] […]	 […] % […] % […] %
Bundle 5 "Hipolizings": — equity investment, — intra-group loan	 300 47,310 (1)	 […] […]	 […] % […] %	 […] […]	 […] % […] %
Bundle 6 "Hipo Fondi" (equity investment)	500	[…]	[…] %	[…]	[…] %
Total	**283,814**	**[…]**	**[…] %**	**[…]**	**[…] %**
Loss from sale		**[…]**		**[…]**	

(1) Gross value of the loan was LVL 53 million, accumulated provisions amounted to LVL 2 million.

([18]) It is noteworthy that Hipo Fondi (Bundle 6) currently has LVL 8,8 million of deposits allocated with MLB. As opposed to Bundles 1 and 2, those deposits are expected to be transferred to the buyer of Hipo Fondi shares or another bank indicated by the buyer rather than sold.

(59) Overall the loss from the sale of assets is assumed to reach approximately LVL […] million in the base case scenario.

Sale process

(60) The sale process of Bundles 1-6 is to be organized by the consultant and is assumed to be closed by 31 August 2012, while the sale process of other commercial segment assets (real estate, fixed assets of sub-branches, automated teller machines ("ATMs") and points-of-sale ("POSs")) is to be handled by MLB's management in the period after the transaction.

(61) More specifically, in accordance with the fifth SMoU ([19]), Latvia will aim to sign final sales agreements by 31 March 2012

(62) All bundles are to be offered in the market. However, Bundle 4 is expected to face significant difficulties in attracting buyer interest without deep discounts. Therefore, it is expected that it may remain in State ownership in the work-out mode, but its management would be separated from MLB. A similar decision may have to be made in respect of other loans, which will attract no market interest or whose sale would result in unacceptable upfront discount levels, […].

(63) In the base case scenario as set out in the sales strategy, all bundles except Bundle 4, related to HipoNIA, are expected to be sold.

(64) […] investors will be given clear instructions that the bids are to be provided for specific bundles as they are, […] All […] unsold commercial loans are expected to be transferred to […].

(65) In its decision of 1 November 2011, the Latvian government decided that the part of MLB's commercial segment intended for sale, but inalienable in the sale process, would be sold to the State-owned JSC "Privatisation Agency". Notably, 100 % of HipoNIA shares and MLB's loan to HipoNIA (Bundle 4) would be sold to it, should they not be sold to third-party investors.

(66) In that context, the government recognised that the assumptions for base assessment of the base scenario regarding asset bundle 4 (HipoNIA) as set out in the sales strategy are only indicative. It also agreed that such bundles (assets) should be sold "at a regular value in functioning market as established by an independent appraiser" (i.e. at a price reflecting their long-term economic value).

(67) The Latvian authorities have already publicly announced their plan to sell the commercial part of MLB. The initial bids have already been received. As set out in the fifth SMoU, the final sales agreements are expected to be signed by 31 March 2012.

(68) While the Latvian government is committed to sell all assets of the commercial segment, it reserves the right to decide not to sell some commercial assets if it considers bids to be below the value it can obtain by recovering them itself. Such assets will be carved out of the remaining development bank and placed in JSC "Privatisation Agency" for a more gradual workout (managed by Parex), but only if the government is certain that it will maximize value to the State and can demonstrate it.

(69) If the assets that accompany the deposits in bundles 1 and 2 are not sold, the Latvian government will implement a contingency plan (including effective communication strategy) for the orderly divestiture of deposits to limit risks to financial stability.

2.5.2. *Management of non-performing loans: transfer to HipoNIA and its resolution*

(70) Originally HipoNIA was set up to assist MLB in its lending activities. However, the functions of HipoNIA have since changed and expanded. Essentially, HipoNIA started to act as a non-performing loan work-out unit of MLB. Its current functions comprise three areas:

— evaluation, acquisition and management of MLB's non-performing loan portfolio;

— securing collateral (mainly real estate) that is tendered as a result of forfeiture under HipoNIA and MLB loans;

— managing and disposing of such collateral in the market.

(71) The operations of HipoNIA are 100 % financed through a credit-line facility from MLB, as of 31 August 2011 at LVL 45,4 million (LVL 41,3 million net book value). Additional loans are being transferred to HipoNIA on a regular basis. Full transfer is expected to be complete around closing of the sale of the other bundles. It is expected that upon the sale of HipoNIA, all NPLs […] are transferred to HipoNIA. The loans managed by HipoNIA include also NPLs from development segment (totalling LVL 6,9 million).

(72) As 31 December 2011, the total assets of HipoNIA are projected to amount to LVL 76,5 million, whist its equity was to be […].

(73) The bank itself has estimated that the operations of HipoNIA are expected to be terminated upon work-out of all loans and the sale of assets by 31 December 2016. Future performance of HipoNIA after the loan work-out is expected to […].

(74) Receivables of MLB originating from the loans issued by MLB have been assigned to HipoNIA according to a framework assignment agreement. According to the

([19]) The Commission services carried out the fifth review mission in cooperation with the IMF staff from 28 October - 10 November 2011 to assess progress made with respect to the specific conditions of the EU financial assistance, as laid down in the fourth SMoU. Based on the findings of the mission, a Compliance Note sent by the authorities on 24 October 2011 and the fifth SMoU was signed. See also note 3.

Latvian Civil Law, as a result of assignment only the receivable and related rights are assigned to the assignee. The contractual relationship between the assignor and debtor remains unchanged, i.e. even though the receivables have been transferred to HipoNIA, MLB still has a contractual relationship with the persons who received loans with the resulting risk of possible litigation of debtors with MLB.

(75) However, upon the intended sale/transfer of MLB, the acquirer of Bundle 4 will have both the receivables resulting from the particular loan agreement and the contractual relationship resulting from the particular loan agreement (i.e. the acquirer will have the "entire" agreement). MLB will cease to be a party to the respective loan agreements. As a result, the administrative burden of MLB as well as the risks of debtors bringing claims against MLB will be considerably reduced.

(76) **Asset pricing calculation** is performed according to internal procedures of the bank. The bank has relied on assistance from KPMG in preparing the methodology for transfer value. The bank has adopted Regulations for valuation of loans to be transferred to HipoNIA, dated 16 November 2010. They outline a methodology for loan pricing and transfer. The methodology is based on discounted cash flow.

(77) Main components and assumptions used in the asset pricing model are:

— positive cash flows from loan repayment and sale of collateral;

— negative cash flows from costs related to repossession and holding of collateral;

— estimate of length of possible loan repayment and collateral repossession process;

— estimate of realistic sale value and sale period of collateral (value appreciation over time).

(78) The discount rate is calculated as cost of capital and cost of loan servicing.

(79) The final decision regarding transfer of particular assets (loans and repossessed collateral) is taken by the management board of the bank and HipoNIA, and subsequent negotiations between the parties.

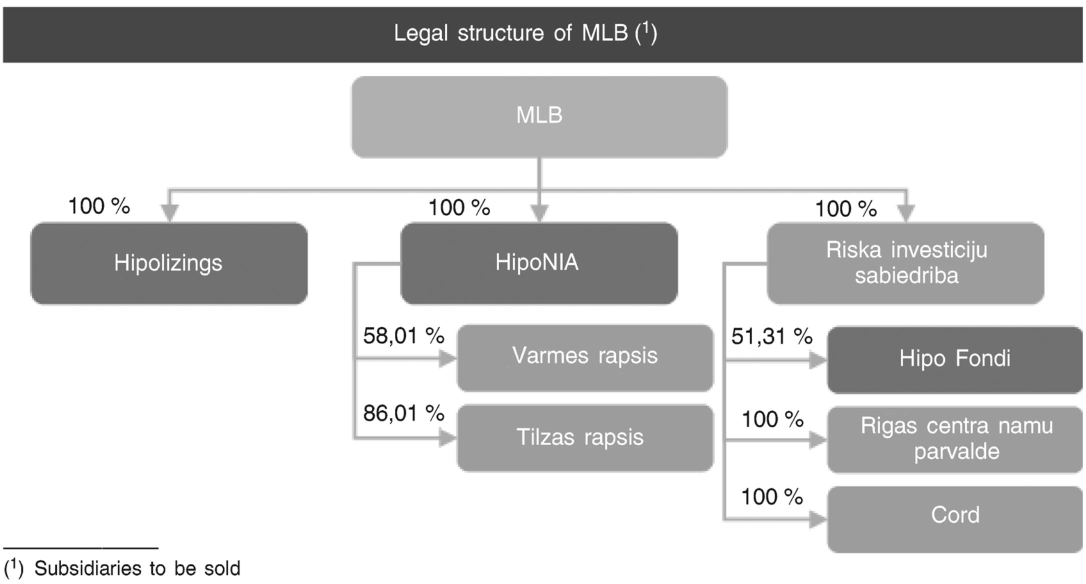
(80) Globally, by 30 June 2011, the non-performing loans were transferred with a […] discount to their book value [20].

2.5.3. ***Financial projections for the commercial activities of MLB group expected to be sold as legal entities***

(81) The entities belonging to the MLB group that are expected to be sold by means of a share deal as legal entities are shown in Chart 1.

Chart 1

Overview of legal entities to be sold by MLB group [21]



[20] According to the data submitted by Latvia on 12 August 2011.

[21] Only subsidiaries with more than 50 % share are shown. Additionally, Hipo Fondi owns 1,8 % in BaltCap Latvia Venture Capital Fund and 100 % in Hipo Adrosinasana, and HipoNIA owns 7,02 % in BRC Novateka, 26,27 % in Priekulu rapsis and 33,46 % in CATRI LL.

(82) **Hipolizings** depends on MLB for all of its funding and also relies on the branch network for product distribution. [22] Hipolizings has independent general management, accounting and sales team. MLB currently holds 100 % of the company.

(83) It has recorded losses in 2009 in the region of LVL 0.26 million (with ROE of −51 %). Starting from 2010 the operations are profitable and are expected to remain so in the future. Hipolizings holds approximately 5 % of the Latvian leasing market as of 30 June 2011.

(84) The operations of Hipolizings are 100 % financed through a number of facilities from MLB totalling LVL 49,3 million as of 31 August 11 (LVL 47,3 million net). They are assumed to increase to LVL 52,9 million (gross) by the end of 2011.

(85) For the base case valuation, the main change in the business is expected through separation from the bank and start of operations without being part of any banking group. The underlying changes in business operations are:

— No outside support in sales

— Limited/no support in administrative area

— Financing available only on market terms.

(86) Additional equity of LVL 5 million has to be invested by the new owner to have adequate Debt/Equity ratios. The remuneration rates are expected to be comparable to those available to other large corporate customers (approximately […] % above EURIBOR).

(87) The business is expected to grow during the forecast period at rates above […] annually.

(88) It is expected that the buyer of Hipolizings will be one of the local credit institutions that would be able to cooperate with Hipolizings on comparable terms to those offered by MLB to date. If a buyer of Hipolizings is a local bank, it should be easier for it to replicate the supporting infrastructure and funding as compared to other potential investors. On that basis it is expected that Hipolizings' performance under new owners should resemble that of its historic results.

(89) Average ROE during 2006-2010 of 30 % should be sufficient for most of the buyers to recognize the investment as adequate. If the best price offer will be received from a non-bank investor, a separate business plan would have to be developed to show the viability of the business under the new owners.

(90) **Hipo Fondi** manages portfolios for pension funds and private investors as well as securities portfolio for MLB.

(91) MLB currently holds 51,31 % stake in Hipo Fondi through its 100 % subsidiary RIS. The shareholding of MLB was diluted from 83 % to 51,31 % in September 2010, following the prohibition to continuously remain involved in the commercial activities.

(92) Hipo Fondi holds approximately 4 % of the Latvian second pillar pension fund management market. Hipo Fondi is operated as a standalone entity, but benefits from MLB's branch network, sales force and IT support.

(93) According to the sales strategy, it is expected that the buyer of Hipo Fondi will be one of the local credit institutions that would be able to cooperate with Hipo Fondi on comparable terms to those offered by MLB to date. If a buyer of Hipo Fondi is a local bank, it should be easier for it to replicate the supporting infrastructure as compared to other potential investors. On that basis it is expected that Hipo Fondi's performance under new owners should resemble that of its historic results.

(94) Average ROE during 2006-2010 of 14 % should be sufficient for most of the buyers to recognize the investment as adequate. Its more recent performance has been above historic as the company was bought by MLB in 2008. Hipo Fondi was profitable both in 2009 and 2010 with ROE of 31-32 %. No projections were provide for the operations of Hipo Fondi in 2011 and thereafter.

(95) If the best price offer will be received from a non-bank investor a separate business plan would have to be developed to show the viability of the business under the new owners.

2.5.4. ***Reorganisation of the development operations***

(96) As regards the reorganisation of the development segment of MLB, the currently ongoing preparation of the reform of all the development institutions operating in Latvia needs to be taken into account, as it also covers MLB.

(97) Latvia assigned an independent external advisor for the preparation of a concept for development institutions in Latvia. On 11 February 2011, the first draft "Report on Optimization of the System of Development Financial Institutions in Latvia" was submitted to the Commission and the IMF.

(98) Inter alia, that draft report recommends the creation of a single development institution while recognizing the need for ensuring its independence through establishing it by a special law and by creating independent decision-making bodies. In that context, the draft report identifies the need for designing the functional structure of the new institution from scratch, based on the full review of existing programmes and their functional and staffing needs, in particular risk assessment and management functions.

(99) Further, it emphasises the need of State interventions through indirect instruments (individual and portfolio guarantees, venture capital and mezzanine funds etc),

[22] According to the submission of Latvia of 11 November 2011, Hipolizings primarily relies at present on direct contact with customers.

while moving away from large direct lending and leaving direct interventions only as an option for few very specific and justified cases (micro-lending, farmers, etc.).

(100) According to the draft report, indirect channelling of State-supported lending would provide for a larger access to the potential beneficiaries of such programmes (optimize outreach) and allow to improve distribution cost efficiency and cooperation with the commercial banking sector. The draft report points out that the coordination and cooperation with the borrower's bank, which is an indispensable partner to supply short-term financing, is impaired by the image of a competitor created by MLB's past commercial activities. Also, under the frame of agreements, legally binding the partners, the aspects related to good governance could be improved.

(101) […] MLB's forecasts include an assumption by the management of MLB that total liquid assets in the amount of LVL 80 million as of 31 December 2011 will be sufficient to ensure continuity of development programs. […]

(102) As after the sale, at 31 August 2012, MLB is expected to consist of solely development activities. It will hold assets of approximately LVL 285 million. The balances remaining after the sale are expected to be transferred to the development segment: amongst others, liquid assets of LVL […] million; demand deposits of LVL 9 million and term deposits of LVL 1 million; long-term liabilities of LVL 32 million, subordinated loans of LVL 31 million; outstanding equity of LVL […] million.

(103) In the fifth SMoU, Latvia provided the following commitments to the EU and the IMF.

(104) After divesting the commercial assets, Latvia intends to merge the development part of MLB with other State institutions to create a single development institution. In particular, by 30 June 2012, based on external consultant's recommendations, Latvia will approve the action plan – with a view to implement it by 31 December 2012 - for optimization of the system of development financial institutions and integration, as appropriate, of different development institutions operating on behalf of the government (i.e., merging development part of MLB with other State institutions to create one development institution); The new institution will not be permitted to attract private deposits. It will avoid direct lending, except where concessional programmes are already approved, or in instances where the lending is: (i) associated with the delivery of products not offered by the commercial banks or non-bank financial institutions; (ii) dependent on highly specialized knowledge that commercial banks or non-bank financial institutions do not possess; or (iii) of too small volume or too risky to be of interest to commercial banks or non-bank financial institutions.

(105) MLB will not start any new direct loan programmes until the action plan for the new development institution is approved; all funding that MLB has been allocated for the implementation of national financial engineering instruments has to be safeguarded and transferred fully to the development institution once it is set up. To improve professional monitoring and transparency once the development institution is set up, a Consultative Council chaired by the Ministry of Finance and comprised of members from key ministries and social partners, the Association of Commercial Banks, as well as renowned international financial institutions with expertise in development activities will be established.

(106) Once the commercial parts of MLB have been sold or transferred to the Latvian Privatization Agency, the bank will not be allowed to attract any new private deposits (except for current accounts directly related to the disbursement or repayment of development loans). The Latvian supervisor, the Financial and Capital Market Commission ("FCMC") will ensure compliance with that commitment.

2.6. **The notified March 2010 recapitalisation measure**

(107) On 23 March 2010, Latvia granted a recapitalisation measure of LVL 70.2 million (EUR 100 million). It was officially notified to the Commission only after it was granted, on 6 April 2010.

(108) In contrast to the recapitalisation measures approved in the November 2009 decision which were mainly attributed to the development part of the bank's activities with a beneficial side-effect on the commercial activities, the notified measure aims at strengthening the capital base of the remaining commercial activities ([23]).

(109) The capitalisation of 23 March 2010 alone would amount to 10,2 % of risk weighted assets (RWA). Taken together with the recapitalisations approved in the November 2009 decision, the figure would be 20,76 % of RWA.

(110) The measure aims to facilitate the phasing out of the commercial activities of the bank.

2.7. **The additional measures to be granted in the context of restructuring**

(111) By letter of 2 November 2011, Latvia sought from the Commission a temporary approval of the additional aid measures needed for the transformation of MLB into a development bank and, in particular, for the bank's alienation of its commercial activities. In accordance with the submission of the Latvian authorities of 22 December 2011 and the decision of the Latvian government of 20 December 2011, the measures were specified and quantified based on […].

([23]) The capital was initially allocated to the development segment, whilst the commercial segment was charged a fee of 5 % to compensate the commercial part's under-capitalization. In December 2010, the capital was reallocated to the commercial segment of the bank.

(112) The following measures are required:

— A standby liquidity facility up to LVL 250 million to be made available as from 1 January 2012 until the completion of the process [24] (currently expected in August 2012), to be granted in the form of deposits - required in case of emergency liquidity events;

— Guarantees to […] of MLB up to LVL 49 million – required to ensure that […] do not require the pre-payment of loans to MLB as the sale of the commercial segment and transformation of MLB into a development bank can be considered as a default event, according to the existing agreements.

Only part of the guarantees (LVL 32 million) is required by the commercial segment of the bank. The State aid to the commercial segment of the bank in the form of guarantees is expected to be granted in the beginning of 2012 and to terminate after the sale. In particular, in July 2012, after the majority of assets and liabilities of the commercial segment are sold, the commercial segment is to be liquidated, but loans from […] to the commercial segment are to be transferred to the development segment and used there as a source of financing. According to Latvia, it means that effectively the guarantee support of LVL 32 million is related to the commercial segment solely in the period January-July 2012.

— A liquidity support measure of LVL [30-75]million granted at the end of 2011 is to be converted into capital in 2012 and applied to the commercial segment of the bank. The capitalisation is needed to cover part of the losses from the sale of assets so as to ensure that minimum regulatory capital adequacy ratios are met, […].

— Up to LVL 60 million of liquidity support to the State-owned entity (JSC "Privatisation Agency") acquiring bundle 4 with the bad assets – required, if the bundle is not sold (expected to be granted as from August 2012).

(113) Latvia undertook to apply a pricing mechanism in accordance with the Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis ("the 2011 Prolongation Communication") [25] for guarantees and liquidity measures in the form of loans or deposits.

(114) In particular, the remuneration mechanism for loans and deposits in set out in Table 4.

Table 4

The structure of the pricing of liquidity measures

<table>
<tr><th>Liquidity deposits</th><th>Loan</th></tr>
<tr><td colspan="2">Interest rate applicable for the state aid consists from:</td></tr>
<tr><td colspan="2">1. Funding costs</td></tr>
<tr><td colspan="2">LVL:
— For instruments with a maturity of up to one year – a yield of the most recently issued domestic Treasury bills, if the yield is not lower than respective maturity RIGIBOR or MLB’s funding cost at the money and capital market if such is available - whichever is higher.
— For longer maturity instruments – a yield of the most recently issued Treasury bonds or MLB’s funding costs at the money and capital market if such is available – whichever is higher.
EUR:
— base rate that corresponds to the relevant term EURIBOR/EUR mid-SWAP rate and fixed spread, which is calculated as average weighted credit risk spread over benchmark EURIBOR/EUR mid-swap rate for the Treasury’s borrowings over the previous calendar half-year that represents the central government’s actual funding costs or MLB’s funding costs at the money and capital market if such is available – whichever is higher.</td></tr>
<tr><td>2. Servicing fee:</td><td></td></tr>
<tr><td>Not applicable</td><td>0,5 %</td></tr>
<tr><td>3. Add-on fee:</td><td></td></tr>
<tr><td colspan="2">— 90 basis points ("bp") [1] for liquidity measures with a maturity of less than one year;
— Remuneration resulting from the application of the guarantee fee formula as applicable for banks belonging to the “BBB- rating or below bucket” – for liquidity measures with a maturity equal to or longer than one year.</td></tr>
</table>

[1] One basis point is equivalent to 0,01 %.

[24] Liquidity support of up to LVL 125 million is planned to the development bank starting from January 2012 to compensate previous inter-segment loan (provided by the commercial to the development segment).

[25] OJ C 356, 6.12.2011, p. 7.

(115) For guarantees for underlying instruments with a maturity of less than one year a fee, the remuneration will the sum of a base fee of 90 bp and a servicing fee of 10 bp. For guarantees for underlying instruments with a maturity equal to or longer than one year, the set remuneration will be the sum of a base fee resulting from the application of the fee formula for banks belonging to the "BBB- rating or below bucket" and a servicing fee of 10 bp.

3. **POSITION OF THE LATVIAN AUTHORITIES**

(116) Following the external consultant's recommendation, the Latvian authorities submitted on 2 November 2011 a politically agreed sales strategy which entails segmenting the bank's commercial assets and liabilities into six separate bundles to comply with stakeholder views and concerns and to most effectively attract investor interest. Latvia believes that the strategy would have the best chance of facilitating the sale of MLB's commercial assets and liabilities at maximized valuation levels in an open and transparent process, while minimizing, to the extent possible, the funding gap and a run on deposits.

(117) Latvia further considers the sale strategy (including additional State aid for the controlled winding-up of the commercial activities of MLB through their sale to the third parties and the liquidation of the remaining assets, if any) compatible with State aid rules.

(118) The legal entity MLB will ensure burden-sharing through suffering a direct loss as a result of the sale of assets and far-reaching restructuring of MLB. The sale process will be open and non-discriminatory, on market terms and with the aim to maximize the price for specific bundles.

(119) The intended process will ensure that MLB maximizes value from its asset base thus effectively ensuring that only the necessary minimum of State aid is required. Alternative options have also been analyzed.

(120) The Latvian authorities argue that the majority of the commercial assets and liabilities of MLB will be wound up in an orderly fashion upon the completion of a proper sale process in 2012. The remaining commercial assets […] will be transferred to […]. It is estimated that the work-out for most of the assets will be completed by 31 December 2016.

(121) Latvia considers that the potential buyers will not benefit from the break-up because they are primarily taking over distinct sets of assets and liabilities and not a business (economic activity). Thus, Latvia claims that the buyers will not benefit from the aid.

(122) To assess whether a sale of a bundle results in a continuation of an economic activity under the State aid rules, Latvia used the following criteria:

- Are assets and/or liabilities transferred with a purpose to be operated independently as a business (whether it is a going concern or sale of distinct assets and/or liabilities);
- Whether the infrastructure is necessary to operate a banking business transferred to the buyer (IT, branch network, property, employees etc.).

(123) The majority of the commercial asset bundles have been structured in a way to ensure that there is no continuation of economic activity. That analysis applies for bundle 1, 2, 3, and partially also for bundle 4. That last bundle, effectively representing the equity of HipoNIA (i.e. to be transferred by a share deal) is considered to contain assets in run-down mode and will operate only for a limited time. Thus, there would be no continuation of an economic activity also upon the sale of bundle 4.

(124) According to Latvia, sale of each particular bundle (1, 2 and 3) is a break-up asset sale. Banking infrastructure such as branches, IT, property or other fixed assets are not sold as a part of the bundles and neither are employees transferred together with the bundles. Those bundles have to be treated as a distinct set of assets and liabilities (except for bundle 3 consisting of assets only) and not as a business and will be integrated in a buyers' existing structures. Thus, Latvia argues that they will not constitute an undertaking within the meaning of Article 107(1) of the TFEU.

(125) As for bundles 5 and 6, Latvia considers that economic activity is continued, since both companies are sold as businesses (by means of a share deal). Viability of the subsidiaries will be reached through the sale. Viability assessment of the buyer or its ability to integrate the sold business will be presented.

(126) Since economic activities of bundles 5 and 6 are not primary activities of MLB and they have a very limited market presence, the sales strategy provides that those entities are sold as they are rather than in asset bundles.

(127) Further, Latvia argued that no aid was channelled to the subsidiaries to be sold as bundles 5 and 6. First, most of the arrangements between Hipolizings and its parent company, MLB, (i.e. funding facilities and shared services) are comparable to what a similar leasing company would expect to receive should it be part of other banking group in Latvia. The funding rates are comparable or worse than for majority of other leasing companies that operate in Latvia. Second, the brand name will be changed after completion of the intended sale. Third, only 15-20 % of new agreements (Hipolizings' agreements with the customers) are sold through MLB's branches. Hipolizings pays a commission for each sale. Fourth, as regards a guarantee agreement entered in 2009, whereby MLB undertakes to cover Hipolizings' losses in exchange for a fixed annual payment, similar guarantee/swap arrangement has been used also by a number of other private banks in Latvia and the guarantee agreement was terminated in September 2011. Fifth, since the initial acquisition of Hipo Fondi by MLB, the former has paid various service fees for services provided by MLB.

(128) According to Latvia, there is no State aid granted to MLB when the so called "bad" assets (and assets with little or no interest) are transferred to its subsidiary HipoNIA.

(129) Firstly, they consider that there is no intervention by the State as the transaction takes place within the group (transfer to subsidiary). Secondly, considering its internal nature, all the potential losses (if any) are assumed by MLB itself. Those losses correspond with the provisioning level made by MLB. By transferring certain assets to HipoNIA, MLB is not relieved from the loss (if any).

(130) In addition it argues that as HipoNIA is a subsidiary of MLB, all the losses from the operation are indirectly absorbed by MLB (in terms of limited recovery of loan to HipoNIA). Also, a far-reaching transformation of MLB is carried out. The commercial activities will be completely phased out and will not remain in the market.

(131) Even if it were found that the transfer of bad quality assets to HipoNIA constituted an asset relief measure, Latvia argues that it would be in compliance with the Commission's Impaired Asset Communication [26] ("IAC").

(132) First, ex-ante identification of assets will be possible not sooner than after receipt of indicative offers and their analysis.

(133) Second, HipoNIA is expected to pay for the State guarantee appropriate fees and operate all loans assigned to it exclusively in a run-down mode. MLB will also provide appropriate remuneration for State aid (if any) arising from transfer of HipoNIA to the state owned entity (the difference between the market value and long term economic value will be recognised as State aid). If any burden-sharing measures have to be taken, that aim will be reached through the means of mitigating competition distortions. Namely, by terminating MLB's commercial activities whereby MBL will not be competing in the commercial banking market after the transformation process.

(134) Third, the management of assets will be separate from former MLB as they will be transferred into a distinct entity, organizationally independent of MLB.

(135) Fourth, the share transfer will be evaluated by a certified valuator as required by the Credit Institutions Law of Latvia. Based on the law, the valuation cannot be more than 30 days old and therefore has to be performed as close to the date of transfer as practicable. An international auditing company in co-operation with the FCMC will develop the exact methodology of valuation. In the sales strategy, it was expected that the transfer value of shares of HipoNIA […].

(136) As regards the valuation of the assets to be transferred to HipoNIA, Latvia submitted that internal valuation is performed for such assets. Assets are evaluated and transferred based on long-term economic value (methodology in line with the best practice incorporating all estimated costs related to recovery of the loan).

(137) According to Latvia, it is planned that MLB will not benefit from the asset transfer as assets will not be transferred above market value. Thus, there is no need for additional remuneration for the State beyond the fees paid for the guarantee by HipoNIA. However, in case HipoNIA is transferred to the State-owned entity (JSC "Privatisation Agency") above market value, the difference between the market value and the long-term economic value will be recognized as State aid and MLB will bear losses for the difference between the book value and the long-term economic value.

(138) As for guarantees and liquidity granted to the development segment, the Latvian authorities hold the view that those support measures will not constitute State aid as far as they benefit the development segment and thus will be compatible with the State aid rules.

4. ASSESSMENT OF THE MEASURES

4.1. Existence of aid

(139) As stated 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 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.

(140) In the context of the transformation of the bank, MLB has benefitted and will benefit from several financial support measures from the Latvian State.

Beneficiaries of potential aid

(141) The MLB group (i.e. the parent company together with its subsidiaries) is the main beneficiary of the measures granted to date.

(142) It has to be noted that part of the restructuring measures will benefit the commercial segment and the development segment of the bank.

(143) When assessing the measures in order to determine whether they constitute State aid, the Commission considers it necessary to make a distinction between the two different types of activities of MLB: the present and future activities of MLB in the execution of its public tasks as development bank, on the one hand, and the residual commercial activities pursued by MLB during the transition (phasing-out) period, on the other hand.

(144) As regards the measures benefitting the development activities of the bank, first the criteria distinguishing them from the commercial ones have to be defined.

[26] Communication from the Commission on the treatment of impaired assets in the Community banking sector (OJ C 72, 26.3.2009, p. 1).

(145) In order to be identified as a development activity, as opposed to a commercial one, such activity has to be justified by the proven existence of market failure. In other words, it must be demonstrated that the markets cannot provide a solution to address the relevant financing needs on a constant basis. Unless proved otherwise, market failures are presumed to be temporary and/or partial.

(146) In that respect, two levels have to be distinguished: of the final beneficiaries targeted by the development activity (SMEs, entrepreneurs etc.) and the financial intermediaries. As regards any potential advantage to the final beneficiaries, the Commission recalls the confirmation of the Latvian authorities that the State programmes are notified to the Commission, where appropriate, in accordance with the State aid rules. However, the assessment of granting of such measures to the final beneficiaries under the State aid rules does not enter into the scope of the present decision.

(147) As regards a role of a development financial institution acting as a financial intermediary, in case of proven and persistent market failure there is scope for the State or a development financial institution acting on its behalf to intervene so as to complement the private sector in eliminating or reducing the market failures. However, the intervention of a development bank should complement rather than substitute entirely private operators. State-supported development activities should not crowd out private initiatives.

(148) To the extent that a development bank does not carry out economic activities and is a mere pass-through vehicle, any support measures provided to it may not constitute aid.

(149) In line with the November 2009 decision, the Commission considers that the development segment of MLB does not benefit of aid to the extent that its activities are limited to the development activities as defined above for the following reasons. First, according to Latvia, its lending activities are limited to those that the commercial banks would not be willing to undertake. Second, in accordance with the commitments provided by Latvia to the EU and the IMF, MLB will not start any new direct loan programmes until action plan for the new development institution is approved. Third, all funding that MLB has been allocated for the implementation of national financial engineering instruments has to be safeguarded and transferred fully to the development institution once it is set up.

(150) Moreover, it is noted that MLB is expected to carry out the development activities only for a limited duration, until a single (merged) development institution is set up, not expected to extend beyond 31 December 2012 (see recitals (103)-(106)). In particular, Latvia intends to approve an action plan for the creation of a single development lending institution by mid-2012, with a view to implement it by the end of 2012.

(151) Notwithstanding the above, Latvia is invited to submit further information illustrating how it is ensured in practice that the MLB's development activities are limited to those as defined in recitals (145)-(147) above. In particular, the Latvian authorities are invited to submit information regarding the procedures the bank follows, when granting soft/State-supported [27] loans to the final beneficiaries (or other intermediaries as the case may be), that would ensure that the bank does not provide lending that could be obtained from the commercial banks.

(152) Moreover, Latvia is invited to provide further elements to justify the deposits that the development bank is expected to hold after the sale, if any, as well as to clarify the ancillary activities that the bank may continue to operate after the sale.

(153) As regards, the measures benefitting the commercial segment of the bank, the Commission has to assess, whether upon the sale the economic activity is continued or dissolved.

(154) On the one hand, the Commission considers that the sale in bundles as described above effectively contributes to the liquidation of the commercial activities of MLB.

(155) On the other hand, according to the sales strategy, Hipolizings and Hipo Fondi are expected to be sold as legal entities. The Commission agrees with Latvia that a sale of a legal entity is likely to lead to a continuation of the economic activity. However, it has yet to be established, if any aid was channelled to those entities and, if so, in which form. At present, such aid cannot be excluded. In particular, the Commission notes that according to the base case valuation the loan provided to Hipolizings is expected to be taken over by a potential buyer […] (see Table 3 above), which already includes some provisioning.

(156) As regards HipoNIA, the Commission notes that it contains assets in run-down mode and will operate only for a limited time. However, in line with the established case practice, the measures aimed at winding down the commercial activities may still constitute aid [28].

(157) As regards the potential buyers, the Commission notes that, as submitted by Latvia, the sale process will be open and non-discriminatory, on market terms and with the aim to maximize the price for specific bundles. On that basis, it considers that no aid would be granted to the buyers MLB's commercial assets and liabilities. However, the Commission reserves the right to review the terms of the sale in the framework of the final decision.

[27] Meaning, by the Latvian State or other international development institutions.

[28] See, for instance, Commission decisions of 25 October 2010 in case N 560/09 Aid for the liquidation of Fionia Bank (OJ C 76, 10.3.2011), of 23 April 2010 in case N 194/09 Liquidation aid to Bradford & Bingley (OJ C 143, 2.6.2010 p. 22) and of 5 November 2008 in case NN 39/08 Liquidation aid to Roskilde bank (OJ C 12, 17.1.2009, p. 3).

(158) As regards the Latvian Privatisation Agency, the Commission preliminarily considers that it does not carry out any economic activities. Hence, it cannot be a beneficiary of the aid.

(159) In conclusion, until the sale the measures benefit the commercial activities of MLB. After the sale, the measures may possibly benefit part of the commercial activities of MLB, which are continued after the sale by Hipolizings and Hipo Fondi. Latvia and interested parties are invited to comment on that preliminary conclusion and the issues set out above.

Recapitalisation notified in April 2010

(160) In contrast to the recapitalisation measures of 2009, the notified measure is aimed at strengthening the capital base of the commercial activities of the bank. According to the Latvian authorities, that urgent need for further support was mainly due to the rapid growth of the proportion of impaired loans of the commercial activities of the bank.

(161) The criteria to qualify that measure as aid would be met. The measure was granted by the public authorities, i.e. from State resources, conferred an economic selective advantage to MLB and strengthened its position compared to that of competitors in Latvia and other Member States. In particular, a market economy investor would not have granted such capital to a company in difficulties as those faced by MLB and not granting any new loans. The losses suffered by the bank were sizeable, whilst its return to long-term viability was doubtful.

(162) In line with the established case practice, the measures aimed at winding down the commercial activities may still constitute aid ([29]). In particular, MLB remains to be active in the financial sector, which is open to intense international competition. MLB still conducts economic activities even though they are somewhat limited in scope at the level of the bank due to the previously provided commitment by Latvia to terminate new lending by MLB and, given the Latvian government commitment to sell, in time. Further, the activities of the affiliated companies are not restrained and the channelling of the advantage thereto cannot be excluded at this stage. Therefore, any advantage from State resources granted to MLB would have the potential to affect intra-Union trade and to distort competition. The measure must therefore be regarded as distorting competition and affecting trade between Member States. Hence, the notified recapitalisation measure in favour of MLB constitutes State aid pursuant to Article 107(1) TFEU.

Transfer of assets to HipoNIA

(163) The IAC provides guidance on the treatment under Article 107(3)(b) TFEU of asset relief measures by Member States, including in particular bad bank solutions as indicated in Annex II to the IAC.

(164) In the present case, it has to be assessed whether the transfer of assets to HipoNIA and its subsequent sale to the State-owned entity to be wound up constitutes an aid measure to any of the above-mentioned potential aid beneficiaries.

(165) Until the sale, the measure does not confer an advantage to the commercial activities of MLB, since it remains within the commercial activities and any losses related to the transferred assets continue to be borne by those activities.

(166) The Commission was not made aware that any of the assets of Hipolizings or Hipo Fondi would be transferred to HipoNIA. Those activities which were legally separated from other commercial activities of MLB. Hence, the Commission preliminarily considers that the measure does not confer any advantage to Hipolizings and Hipo Fondi.

(167) Therefore, it is preliminarily considered that the transfer of assets to HipoNIA would not involve aid that would need to be assessed under the IAC.

(168) The Commission invites Latvia and interested parties to further comment on the State aid assessment of that measure.

The additional measures granted in the context of restructuring

(169) Given the set-up of the sale and the distinction between the commercial and the development segments of the bank (see recitals (141)-(159)), the additional State measures which confer a selective advantage to the commercial activities of MLB are the following:

— A standby liquidity facility up to LVL 250 million to be made available as from 1 January 2012 until the completion of the process ([30]) (currently expected in August 2012), to be granted in the form of deposits - required in case of emergency liquidity events;

— Guarantees to […] of MLB up to LVL 32 million benefitting the commercial segment until the completion of the sales process;

— A liquidity support measure of LVL [30-75] million granted at the end of 2011 to be converted into capital in 2012 and applied to the commercial segment of the bank. The capitalisation is needed to cover part of the losses from the sale of assets so as to ensure minimum regulatory capital adequacy ratios are met, based on discounts estimated on the basis of the indicative non-binding offers;

— Up to LVL 60 million of liquidity support to the State-owned entity (JSC "Privatisation Agency") acquiring the bundle with the bad assets (bundle 4), required if the bundle is not sold; expected to be granted starting from August 2012.

([29]) Ibid note 28.

([30]) Liquidity support of up to LVL 125 million is planned to the development bank starting from January 2012 to compensate previous inter-segment loan (provided by the commercial to the development segment).

(170) In particular, those measures allow MLB […].

(171) A liquidity support to be granted in 2011 and to be converted into capital is considered to be a recapitalisation measure and must be assessed as such. It is the effect of the measure rather than its form that has to be taken into account.

(172) A standby liquidity facility and State guarantees are expected to be terminated/repaid upon the completion of the sale, whilst the liquidity support enabling a solvent liquidation of HipoNIA would be terminated upon full liquidation of the assets transferred to it. Notwithstanding the limited duration of the measures, they satisfy the criteria to qualify them as aid. The measures are granted by the public authorities, i.e. from State resources, confer a selective advantage to the commercial activities of MLB and may be regarded as distorting competition and affecting trade between Member States. For the reasons set out in recital (162) above, the measures in favour of MLB before the sale have the potential to affect intra-Union trade and to distort competition.

(173) As regards the measures to be granted to allow solvent wind-down of the bad assets, it is noteworthy that an entity holding such assets (HipoNIA) would be deemed to conduct economic activities even though they are limited both in scope and in time. It will manage its debt portfolio through activities that include, among others, granting further advances to existing customers. Given that activity is still facing international competition, the Commission considers that those measures have the potential to distort competition and thus affect trade between the Member States ([31]).

(174) Hence, also the above-mentioned additional measures constitute State aid pursuant to Article 107(1) TFEU.

4.2. **Compatibility of aid**

Application of Article 107(3)(b) TFEU to the aid granted to the commercial activities

(175) Article 107(3)(b) TFEU enables the Commission to declare aid compatible with the internal 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 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 ([32]).

(176) Already in the November 2009 decision it was recognized that a failure of MLB would have posed a threat to financial stability. Indeed, MLB has a sizeable market share and is the main operator of the State-supported development programmes in Latvia. The Latvian economy suffered a significant downturn due to the crisis and remains fragile. Hence, the Commission agrees with Latvia that MLB is a bank of systemic importance to the Latvian economy. Therefore, in line with its findings in the November 2009 decision, the Commission considers that the aid measures benefiting the commercial activities of MLB are to be assessed under Article 107(3)(b) TFEU.

Compatibility under Article 107(3)(b) TFEU

(177) The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks may be apt to remedy that disturbance. That analysis has been confirmed in the Commission's 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") ([33]), its Recapitalisation Communication ([34]), the IAC and its Restructuring Communication ([35]).

(178) As the present decision aims at assessing the aid received by MLB and required for the phasing out of its commercial activities and its transformation plan (as laid down in the sales strategy), the Commission finds it appropriate to base its assessment on those communications and, in particular, as regards the assessment of the transformation plan with respect to the commercial activities, on the Restructuring Communication.

Temporary compatibility of the measures as rescue aid

(179) In order to be temporarily compatible rescue aid must first be appropriate. The aim of the aid measures – the recapitalisation measures of 23 March 2010 and those of the end of 2011 (i.e. debt-to-equity conversion of up to LVL [30-75] million), the standby liquidity facility, the guarantees and the liquidity support to the State-owned entity acquiring the bundle with the bad assets – must be to eliminate the threat to the stability of the Latvian economy stemming from the problems of MLB. Given the objective of the phasing-out of the commercial activities of MLB, the Commission considers that those measures as chosen by the Latvian authorities are appropriate means to address MLB problems to be expected in the course of the sale process. In particular, the measures facilitate a timely resolution of the commercial activities of MLB. […].

([31]) See, for instance, Commission decision of 23 April 2010 in case N 194/09 Liquidation aid to Bradford & Bingley (OJ C 143, 2.6.2010 p. 22).

([32]) Cf. in principle, Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, paragraph 167. Confirmed in the Commission's decisional practice as indicated, inter alia, in Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock* (OJ C 43, 16.2.2008, p. 1).

([33]) 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 (OJ C 270, 25.10.2008, p. 8).

([34]) Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (OJ C 10, 15.1.2009, p. 2).

([35]) 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, 19.8.2009, p. 9).

(180) Secondly, the Commission considers that the recapitalisation measures, guarantees and liquidity measures are necessary to enable the facilitation of the sale of the commercial activities of the bank. The Commission finds that the scenario chosen to resolve the commercial activities of the bank (as set out in the sales strategy), namely a timely sale of the commercial activities in six bundles as set out in Section 2.5.1 above, offers the best value option for the Latvian government to phase out the commercial activities of the bank, whilst taking into account State aid considerations.

(181) Finally, to ascertain that the aid is proportionate, the Commission must assess whether the remuneration for the aid is adequate to limit the distortions of competition to the minimum.

(182) The Commission considers that the Recapitalisation Communication provides the appropriate framework for the assessment of the remuneration of the recapitalisation measures granted on 23 March 2010 and at the end of 2011.

(183) As regards the recapitalisation measures granted on 23 March 2010 and at the end of 2011, the Commission recalls that, in principle, the Recapitalisation Communication requires remuneration of at least around 10 % p.a. for such measures. The Commission considers that the remuneration for the recapitalisation measures does not seem to comply with the benchmark of 10 % for capital. In particular, even the principal of the capital is not expected to be recovered.

(184) However, the Commission recalls that point 15 of the Recapitalisation Communication accepts that in duly justified cases for distressed banks a market-oriented pricing is not required in the short-term. In that respect, the Commission notes that the beneficiary, i.e. the commercial segment of MLB, is apparently not able to pay such a level of remuneration.

(185) On the basis of the objective of the Latvian government to phase out the commercial activities of the bank by selling them by 31 March 2012 and, in any case, by 31 July 2012, and, in particular, in view of the base case scenario as set out in the sales strategy (entailing a sale of the commercial activities in bundles), the Commission considers that in the short-term the appropriate remuneration for the recapitalisation measures may be foregone. However, in line with point 15 of the Recapitalisation Communication, the lower than otherwise required remuneration should be reflected in the final assessment of the restructuring in the form of the phasing-out of the commercial activities of MLB and in particular when assessing the competitive effects thereof. Moreover, the Commission notes that, at least in the short-term, keeping MLB afloat is necessary for financial stability.

(186) Further, the Commission notes that all the capital of MLB (as well as subordinated loans) is held by the Latvian State. In this case, the timely sale of the commercial activities of the bank, as set out in the sales strategy, is considered to entail appropriate incentives for the bank to exit from the State support as soon as possible.

(187) In the light of the foregoing, the Commission can at this stage temporarily accept remuneration below the above-mentioned benchmarks. A final conclusion in that respect will be left for the assessment in the final decision.

(188) As regards the remuneration of the guarantees and the liquidity measures in the form of loans or deposits to be granted after 1 January 2012, the Commission notes that it is in line with the 2011 Prolongation Communication. In particular, the remuneration for loans and deposits will include an appropriate fee element for the credit risk premium (so-called add-on fee in Table 4), which is in line with the required remuneration for guarantees, and a funding cost element for the liquidity provided. The funding cost element of the remuneration will always be above the State's funding costs and the interbank borrowing cost for the respective maturity. That remuneration structure is necessary to ensure that the bank does not receive cheaper funding than other fundamentally sound banks in Latvia or other Member States.

(189) On the basis of the above, the Commission finds that the interest rates charged by Latvia will remain above or will equal the floor pricing accepted in other cases for fundamentally sound banks. Taking into account the commitment of the Latvian authorities to sell the commercial activities of the bank in bundles by mid-2012, such remuneration can be considered appropriate for this distressed bank.

(190) The Commission further notes that, contrary to the aim set out in point 15 of the 2011 Prolongation Communication, the State will guarantee existing liabilities of the bank. That broader scope of the guarantee is however acceptable for the Commission, given the State's commitment to sell the commercial activities of the bank in bundles by mid-2012.

(191) In sum, the Commission concludes that the State aid is appropriate to rescue MLB in the short-term and will for the time being not entail an undue distortion of competition. The Commission however reiterates that the approval is temporary and limited in time until the final decision is taken on the restructuring aid to MLB.

Compatibility of the aid measure under the Restructuring Communication

(192) The Commission notes that the notified recapitalisation measure, which immediately followed the two recapitalisations approved by the November 2009 decision, in principle, triggered the requirement to submit an in-depth restructuring or a liquidation plan.

(193) The Restructuring Communication sets out the State aid rules applicable to the restructuring of financial institutions in the current crisis. According to the Restructuring Communication, in order to be compatible with Article 107(3)(b) TFEU, the restructuring of a financial institution in the context of the current financial crisis has to:

— lead to a restoration of the viability of the bank or demonstrate how it can be wound-up in an orderly fashion;

— include sufficient own contribution by the beneficiary (burden-sharing);

— contain sufficient measures limiting the distortion of competition.

(194) The Commission will conduct the compatibility assessment in this opening decision on the basis of the sales strategy submitted on 2 November 2011 and on the information subsequently submitted by the Latvian authorities. However, any final decision will have to be based on the situation of MLB at the time of adoption of that final decision.

(195) The Commission notes positively the further elaboration of the plan in the form of the sales strategy. In particular, the assumptions of the valuation of the bundles are based on the tested market interest.

(196) However, presently, the Commission does not possess sufficient information to conclude on the compatibility of the aid for the discontinuation of the commercial activities of MLB. In particular, the Commission needs more certainty regarding the milestones envisaged for the sale of the activities as well as further information regarding the liquidation of the activities that cannot be sold in the short-term (so-called alternative scenario in the sales strategy). Latvia is invited to provide additional information and commitments in that respect.

(197) The Commission was also made aware that the due diligence of the bank's operations is being performed by an external consultant. To validate the projections contained in the sale strategy, the Commission asks Latvia to submit the finalised due diligence analysis. Further, it asks to complement the financial projections with the actual data over the past three years, where relevant.

(198) According to the sales strategy, the economic activities of the commercial segment of MLB are discontinued and sold in bundles and only limited part of the activities are sold as legal entities and thus entail continuation of an economic activity. Notably, the activities of Hipolizings and Hipo Fondi continue to be carried out by those same entities also after the sale.

(199) The Restructuring Communication provides in points 9 and 10 that the Member State should provide a comprehensive and detailed restructuring plan which should include a comparison with alternative options. In that respect, the Commission notes that with the help of an external consultant the Latvian authorities assessed a wide range of alternative scenarios for the transformation of MLB and the phasing-out of its commercial activities.

(i) *Restoration of long-term viability of economic activities of MLB group continued after the sale*

(200) As to the viability of economic activities to be sold, the Restructuring Communication in point 17 confirms that a sale of (part of) the financial institution to a third party can help to restore its long-term viability.

(201) In that respect, the Commission notes positively the track record of profitability of Hipolizings and Hipo Fondi.

(202) However, the information provided in the sales strategy does not allow the conclusion that the subsidiaries to be sold as legal entities (Hipolizings, Hipo Fondi) would be viable on a standalone basis. In particular, it is not clear who will provide the necessary infrastructure and/or funding instead of MLB upon the sale. Also, the Commission does not yet possess information regarding the perspective buyer(s).

(203) Therefore, at this stage, the Commission cannot conclude that the economic activities to be continued after the sale will be viable and invites Latvia to provide evidence thereof.

(ii) *Orderly wind-down of unsold commercial activities*

(204) Although the sales strategy provides more clarity, the Commission needs to further investigate if the conditions for an orderly winding-down will be met.

(205) At present, the Commission doubts that sufficient safeguards were put in place against undue distortions of competition. Latvia is therefore invited to provide additional measures to mitigate the effects of additional aid granted to the commercial activities of the bank. In particular, in line with the case practice [36], Latvia is invited to terminate the sale in a timely manner, and to propose additional measures to ensure non attractive pricing of the commercial products of the bank, where the bank has the margin to adjust them, to cap the advances on the existing loans.

(206) In line with point 46 of the Restructuring Communication, to verify that the restructuring plan is being implemented properly, the Commission requests regular detailed reports. The first report has normally to be submitted to the Commission not later than six months after approval of the restructuring plan. The Commission has not yet received an undertaking of Latvia to submit regular detailed reports so as to verify that the restructuring plan is being implemented properly. Latvia is, therefore, invited to undertake to monitor the liquidation process to the relevant level of detail and to submit monitoring reports to the Commission. Further, the Commission asks Latvia to submit to the Commission a final monitoring report containing the ex-post valuation of the liquidation at the end of the process.

(iii) *Aid limited to the minimum necessary/own contribution*

(207) The Restructuring Communication indicates that an appropriate contribution by the beneficiary is necessary in order to limit the aid to minimum and to address distortions of competition and moral hazard.

[36] See, inter alia, Commission decision of 25 October 2010 in case N 560/2009, Denmark, *Aid for the liquidation of Fionia Bank* (OJ C 76, 10.3.2011, p. 3).

(208) The bank makes contribution to the restructuring via a sale of commercial assets. Moreover, the Commission considers a timely manner of the sale of those assets positively.

(209) As regards the limitation of the aid to the minimum, the Restructuring Communication indicates in point 23 that the restructuring aid should be limited to cover the costs which are necessary for the restoration of viability (or *mutatis mutandis* for a solvent wind-down).

(210) In line with the external consultant's opinion presented in the transformation plan of April 2011 and in the sales strategy, the Commission considers the base case scenario as set out in this decision above to ensure the limitation of the aid - needed for the phasing-out of the commercial activities of MLB - to the minimum.

(211) The bank and its capital holders should contribute to the restructuring as much as possible with their own resources. That requirement ensures that rescued banks bear adequate responsibility for the consequences of their past behaviour and creates appropriate incentives for their future behaviour.

(212) In the present case the Commission notes that all the capital of the bank was held by the State. By means of a sale, the State discontinues the commercial activities of MLB. Further, the Commission notes positively that a senior expert with international experience has been selected and appointed as a Head of Transformation for MLB.

(iv) *Avoidance of undue distortions of competition*

(213) As regards the measures limiting the distortion of competition, the Restructuring Communication indicates that the following elements should be taken into account when determining appropriate measures: the amount of aid, the degree of burden-sharing and the effects on the position that the financial institution will have on the market after the restructuring. On the basis of that analysis, suitable measures to limit distortions of competition need to be put into place.

(214) The Commission has doubts whether, at this stage, the measures to limit distortions of competition should be sufficient. Therefore, further investigations would be carried out.

(215) As regards the total amount of aid, based on its preliminary analysis, the Commission considers it to be substantial.

(216) As of 30 June 2011, MLB was the eighth-largest bank in Latvia by its volume of assets (market share – 3,6 %, total assets LVL 660 6 million, EUR 936,4 million). With LVL 566 million of loans, it is the seventh-largest bank by the volume of loan portfolio (4,2 % market share). With LVL 368 million of deposits, it is the tenth-largest bank by the volume of deposits (4,2 % market share).

(217) The timely divestitures of MLB's subsidiaries separately from the bank as well as the split of the bank in several bundles prior to the sale are considered as relevant for the mitigation of undue distortions of competition caused by the aid. Therefore, they are viewed positively. In that context, the Commission invites the Latvian authorities to respect the timing as indicated for the key processes by the sales strategy and to inform the Commission immediately of any delays in the sales process.

(218) Notably, as a result of the envisaged sale, MLB is likely to exit from the commercial retail banking, lending and deposit taking markets in a timely manner. However, the Commission will further examine the situation as the sale advances.

(219) The activities remaining within HipoNIA also appear to be limited, thus limiting potential distortions of competition. Nonetheless, the Commission invites Latvia to propose additional measures to limit potential distortions of competition and notably to cap the advances on the existing loans.

(220) As regards the legal entities to be sold, the Commission notes that according to Latvia Hipolizings has a market share of 5 % in leasing market and Hipo Fondi has a market share of around 4 % in the second level pension management market. However, it also notes the potentially limited character of the aid transferred to those entities, if any.

(221) In the light of the limited market presence, limited aid granted to those subsidiaries, and their timely sale by the bank, the Commission preliminary concludes that the measures to limit distortions of competition caused by the aid granted to Hipolizings and Hipo Fondi are adequate.

(222) In conclusion, the Commission will further examine the sale as well as the wind-down of the unsold commercial activities, whilst preliminarily concluding that the compensatory measures provided in respect of Hipolizings and Hipo Fondi appear to be adequate.

(223) The Commission invites Latvia and third parties to comment on the above issues.

Conclusion

(224) In the light of the foregoing, the Commission concludes that the State aid in favour of MLB, consisting of a recapitalisation of LVL 70,2 million granted on 23 March 2010, a recapitalisation measure of LVL [30-75] million granted at the end of 2011 (granted as liquidity measure to be converted into capital), a standby liquidity facility of up to LVL 250 million, guarantees […] of the commercial segment of MLB of up to LVL 32 million and liquidity support of up to LVL 60 million for the solvent liquidation of the bad assets within HipoNIA, is temporarily approved until the final decision is taken and all those measures are considered temporarily compatible with the internal market pursuant to Article 107 (3)(b) TFEU.

(225) In the light of the information yet outstanding, as set out above, the Commission needs to further examine the conditions of the transformation plan and of the sale process so as to ascertain their compatibility with the internal market.

(226) At this stage, the Commission doubts that the transformation plan would fulfil all the conditions laid down in the Restructuring Communication.

5. DECISION

The Commission concludes that the measures in favour of MLB, consisting of a recapitalisation of LVL 70,2 million granted on 23 March 2010, a recapitalisation measure of LVL [30-75] million granted at the end of 2011 (granted as liquidity measure to be converted into capital), a standby liquidity facility of up to LVL 250 million, guarantees […] of the commercial segment of MLB up to LVL 32 million and liquidity support of up to LVL 60 million for the solvent liquidation of the bad assets within HipoNIA, constitute State aid pursuant to Article 107(1) TFEU.

The Commission observes that the recapitalisation measures of LVL 70,2 million and of LVL [30-75] million (the latter granted as liquidity measure yet to be converted into capital) have been put into effect in breach of Article 108(3) TFEU.

In the light of the foregoing considerations, the Commission finds that the above-mentioned measures fulfil the requirements of Article 107(3)(b) TFEU and are temporarily compatible with the internal market as rescue aid for reasons of financial stability, until the Commission has adopted a final decision on the measures as restructuring aid to MLB in the light of the transformation plan.

It has also decided to initiate the procedure laid down in Article 108(2) TFEU with regard to the measures identified as restructuring aid in favour of MLB and to its transformation plan to verify whether the conditions of the Restructuring Communication regarding viability, solvent liquidation, burden-sharing and measures limiting the distortion of competition are met.

Latvia accepts exceptionally that the adoption of the decision will be in the English language.

The Commission 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.

The Latvian authorities are requested to forward a copy of this letter to the recipient of the aid immediately.

The Commission wishes to remind Latvia that Article 108(3) TFEU 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*. All such interested parties will be invited to submit their comments within one month of the date of such publication.”