COMMISSION

COMMISSION DECISION
of 10 November 1999
conditionally approving the aid granted by Italy to the public banks Banco di Sicilia and Sicilcassa

(notified under document number C(1999) 3865)

(Only the Italian text is authentic)

(Text with EEA relevance)

(2000/600/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Articles 87 and 88 thereof;

Having regard to the Agreement on the European Economic Area, and in particular Articles 61 and 62 thereof,

Having given interested parties notice to submit their comments in accordance with the abovementioned Articles [1],

Whereas:

1. PROCEDURE

(1) By letter of 24 July 1997 the Commission asked the Italian authorities for information concerning the proposal to remedy the crisis affecting Sicilian public-sector banks and to set up a regional banking unit under the aegis of the public-sector bank Banco di Sicilia (BS), suitably reinforced, and Mediocredito Centrale (MC), a specialised bank controlled by the Treasury. The Italian authorities replied by letters dated 1 and 11 September 1997, which contained both the documents requested by the Commission and a general explanation of the plan to rescue public-sector banking in Sicily.

(2) The measures involved the liquidation of the savings bank Sicilcassa (SC), placed under compulsory administration, and the transfer of its assets and liabilities to BS with support from Banca d'Italia, and Fondo Interbancario di Tutela dei Depositi (FITD). In order to determine whether the recovery plan contained State Aid, the Commission asked for further details by letter dated 8 October 1997, to which the Italian authorities replied by letter of 3 December 1997.

(3) The package of measures in support of the transfer included a contribution from FITD to absorb up to ITL 1 000 billion of the losses incurred by SC and assistance from Banca d'Italia in accordance with the Treasury Decree of 27 September 1974. The latter measure was not quantifiable at that stage as there was no precise figure for the deficit resulting from the liquidation of SC. It was also planned that MC would become the majority shareholder of BS through a subscription to its capital

[1] OJ C 297, 25.9.1998, p. 3.

of ITL 1 000 billion. Furthermore, although no specific provision was made for this in the plan, it is also necessary to consider, as part of the efforts to strengthen BS, the Treasury's decision to transfer to BS its own holding in Irfis-Mediocredito della Sicilia, a small public-sector financial institution specialising in the management of regional funds for Sicilian firms. The value of Irfis was not known at the time of its transfer. The transaction was to have taken place when SC was wound up, i.e. in September 1997.

(4) Taking the view that the proposed measures could contain elements of State Aid in respect of SC or BS within the meaning of Article 87(1) of the Treaty, on 7 May 1998, the Commission initiated proceedings under Article 88(2). At the same time, it asked the Italian authorities to clarify the aid measures envisaged.

(5) Under the management of MC, BS, after integrating the remaining parts of SC, undertook a radical restructuring based on a plan providing for stringent cuts in staff costs, by then well above the average for the sector, a management programme for poor quality assets and a plan to develop service activities so as to provide the bank with diversified sources of income, in line with other more viable credit institutions. Rigorous application of the restructuring plan allowed the bank to attain profitability a year earlier than anticipated by the plan. The efforts made by BS were acknowledged by the market when, in June 1999, the insurance company Cardiff, a member of the Paribas group, decided to take a minority holding (about 6 %) in the bank's capital.

(6) At meetings on 11 December 1998, 19 March 1999 and 5 July 1999 the Italian authorities provided the Commission with the documents it had requested, including a report on the value of Irfis, the BS restructuring plan drawn up by MC and a report which estimates the debit balance from the liquidation of SC at ITL 4 445 billion and the total provisions required by Banca d'Italia to cover the debit at ITL 3 400 billion.

(7) Lastly, by fax of 18 October 1999, the Italian Government informed the Commission of its commitment to privatise MC through an open, transparent and non-discriminatory sales procedure by 30 June 2000. The sale will take place under the general privatisation of the Italian banking system, at the same time as the privatisation of BS.

2. **DESCRIPTION**

2.1. **Sicilian public-sector banks**

(8) BS is a former public-sector financial institution transformed into a joint stock company pursuant to Law No 218 of 30 July 1990 (the 'Amato' Law) and its implementing decrees. The Law required the banking activities to be entrusted to a private joint stock company separated from the former public body, whilst the social security activities were entrusted to a banking foundation pursuing objectives of public interest and social value previously entrusted to the public-sector banks. The banking foundation holds the capital of the banking company. Before the aid in question, Fondazione Banco di Sicilia held 31,11 % of the equity of BS, the rest being held by the Treasury (36,52 %) and the Sicilian Region (32,37 %).

(9) The BS group is engaged in several banking and financial intermediation sectors and is composed of BS at the head, two banks controlled by BS (Banco di Sicilia International SA in Luxembourg and Irfis-Mediocredito della Sicilia SpA, a small public-sector financial institution specialising in the

management of regional funding for Sicilian firms) and two financial companies. BS is a domestic bank: most of its branches are in Sicily, although it has two abroad, in London and New York respectively.

(10) When the Italian authorities presented the proposal in question, the BS group was just emerging from a period of crisis. Not only had it been affected by the difficulties of the Sicilian economy and the resulting deterioration in its assets, it was hampered by long-standing operational and resource allocation inefficiencies, as well as an inadequate commercial policy which prevented it from diversifying its sources of income sufficiently. In particular, the group had high operating costs, especially wage costs, which significantly reduced profits. In the financial years 1993, 1994 and 1995, BS incurred total losses of ITL 1 781,5 billion. In 1993, in order to make up the shortfall in own funds, the six largest Italian banks subscribed a subordinated debenture loan of ITL 700 billion. At the end of 1995, the bank's own funds comprised ITL 1 000 billion of subordinated debt against a total of ITL 1 806 billion. BS started to record a slight improvement only at the end of 1996, due to the satisfactory performance of portfolio holdings and the reduction in value readjustments in respect of loans. Profits reached some ITL 12 billion, but the return on equity was still inadequate at 0,84 %.

(11) The bank's restructuring was also assisted by the capital injected by the Treasury (ITL 200,2 billion already paid and ITL 115,5 billion outstanding) under the Amato Law and by the Sicilian Region (ITL 600 billion) under Regional Law No 39/91 on the recapitalisation of Sicilian banks [2]. The capital injected by the shareholders improved the solvency ratio from 7,1 % to 8,2 %, in accordance with the prudential ratios laid down by European banking rules.

(12) The Treasury also contributed to the strengthening of BS when, in 1995, it transferred its controlling interest (68 %) in Irfis, a small public-sector financial institution specialising in the management of regional aid for Sicilian firms, to BS. The acquisition of Irfis by the BS group has not significantly altered the group's balance, as in 1995 its assets accounted for only 4 % of the group's consolidated assets and its effect on the consolidated result is limited.

(13) In September 1997, BS decided to acquire the assets and liabilities of SC [3], a small regional bank in serious difficulty which had been wound up by the Treasury on 5 September 1997 after two years under extraordinary administration. That decision had been necessitated by the serious losses incurred by SC as a result of management on the part of its administrators that was incompatible with the principles of healthy and prudent management and sometimes ambiguous as regards relations with some of the bank's customers. The bank's position, revised by the administrators, and despite a value adjustment in respect of claims of ITL 2 197 billion, showed a loss of ITL 1 138 billion which included a deficit of ITL 227 billion. Despite an injection in 1996 of ITL 300 billion by the Sicilian Region which supplemented the contributions provided for in Regional Law No 39 of 19 June 1991 on the recapitalisation of Sicilian banks, net assets totalled only ITL 73 billion. In August 1997, the administrators estimated that a minimum of ITL 1 800 billion was required to recapitalise and restructure SC.

(14) As the bank's accounting situation precluded a return to viability, pursuant to Article 90 of the Italian banking law and with the approval of Banca d'Italia, the administrators transferred to BS the entire banking business of SC for the symbolic sum of ITL 1. The assets and liabilities of SC to BS were not sold following an invitation to tender but by private negotiation.

[2] The Comission had not objected to those financial contributions in 1996 (OJ C 160, 26.6.1992, p.8).
[3] Formerly a public-sector bank converted into a public limited liability company under Law No 218/90 (Amato Law), its capital of ITL 400 billion was held by the Sicilian Region (23,1 %) and Fondazione Sicilcassa (76,9 %)

(15) The contract of sale provides that the administrators will continue to manage 50 % of the loan defaults (ITL 1 600 billion), as well as the legal actions in respect of non-transferred or settled debts and legal actions for civil liability and damages in respect of the former administrators of SC. The 'due diligence' process concerning the assets and liabilities transferred, which had been entrusted to an international audit firm and was to have been completed in September 1998, was eventually concluded at the beginning of 1999, calculating the liquidation deficit at ITL 4 445 billion.

(16) The effort by BS to integrate SC into its own organisational structure and to set up a Sicilian banking unit was assisted by MC, a wholly-owned Treasury subsidiary which specialises in open-market and subsidised medium- and long-term loans for small and medium-sized firms. In the last quarter of 1997, MC underwrote an increase in BS's reserved capital by injecting ITL 1 000 billion, thus becoming its principal shareholder (40,88 %), the Treasury having a direct holding of 21,59 %, the Sicilian Region 19,14 % and Fondazione Banco di Sicilia 18,39 %. To ensure that MC had a place on the board of BS, its members were increased from seven to 11 and a second vice-chairman was appointed. The interest acquired by MC in BS not only allows the former to benefit from a network of branches and the latter to improve its loan offer to firms owing to the Treasury bank's experience in the 'project financing' sector, but also produces significant synergies. Following the acquisition by MC of a stake in BS, the rating agencies Standard and Poor and Moody lowered their assessment by one point, to A and A1 respectively. ([4])

(17) On completion of the transaction, SC became a division of BS, although its branches are continuing under the same name. BS proceeded to integrate the two organisations and the data-processing systems. Under an agreement with the trade unions (confirmed by Decree-Law No 292 of 9 September 1997, converted into Law No 388 of 8 November 1997 laying down urgent measures to resolve the Sicilcassa SpA crisis and to restructure Banco di Sicilia SpA), SC staff continued to benefit from the pre-existing wage and social security arrangements pending a new trade union agreement which should regulate the consequences for employees of Banco di Sicilia's industrial plan. Law No 388/1997 stipulates that an agreement may derogate from the provisions in force or the collective agreements in the banking sector.

(18) Following the integration of SC's economic activity in 1997, BS had a total balance sheet of ITL 57 billion (Table 1), giving it 10th place among Italian banks in terms of assets. It almost doubled the number of its branches to 641, of which 85 % in Sicily, and employed 10 240 persons. Through the shares brought by SC, its controlling interest in Irfis rose from 68 % to 76,26 %.

(19) BS is essentially active in Italy: most of its assets are there (87,5 %). Following the sale of the Frankfurt subsidiary, its direct holdings abroad are now limited to the London and New York subsidiaries, its representatives in Paris and its Luxembourg subsidiary. BS holds significant stakes in the Italian Banca Italo-Romena SpA (30 %), which specialises in financing trade between Italy and Romania, and in the Austrian bank Centro Internationale Handelsbank Ag Centrobank (27,23 %), BS has a 14,5 % holding in Bank of Valletta Ltd, Malta.

(20) With regard to capital, the ITL 1 000 billion injection by MC, the ITL 33,3 billion recapitalisation by the Treasury under the Amato Laws ([5]) and some ITL 150 billion from its new partner Cardiff gave BS own funds of some ITL 2 440 billion, in line with the minimum solvency ratio imposed by the banking supervisory authority. Furthermore, its good financial results enabled it to repay part of the subordinated loans in advance, reducing them by almost half as against 1996.

([4]) Standard and Poor's rating agency uses the following scale: AAA: the issuer's capacity to reimburse is extremely strong; AA: capacity is very strong; A: capacity is still strong but the issuer is susceptible to changes in economic conditions; BBB: capacity is adequate but with great sensitivity to changes in economic conditions; BB and B: speculative characteristics and uncertainty of payment; CCC, CC and C: doubtful claim; D: already in payment default. Moody's scale for investment grade risks is as follows: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2. The two scales are not comparable on a one-to-one basis.

([5]) See footnote 2.

Table 1

Balance sheet of Banco di Sicilia

(billion ITL)

	31.12.1998	31.12.1997	31.12.1996
Assets			
Cash, securities issued by public entities	7 954	4 844	3 218
Loans	33 576	40 587	34 017
(a) to banks	6 441	10 163	9 243
(b) to customers	27 135	30 424	24 774
Securities	3 658	2 868	2 467
Fixed assets	1 873	1 499	1 207
Shares	890	1 142	1 076
Other deferred income	7 414	6 230	3 284
Total assets	55 365	57 170	45 269
Liabilities			
Loans	22 680	23 190	16 765
(a) from financial institutions	5 636	6 247	6 053
(b) from customers	17 044	16 943	10 712
Debts represented by securities	22 971	24 427	21 213
Other liabilities	6 966	6 744	5 385
Subordinated debts	259	377	537
Capital and reserves	2 441	2 401	1 357
Profit/loss	48	31	12
Total liabilities	55 365	57 170	45 269

Source: Banco di Sicilia, reports for 1997 and 1998.

(21) The SC transaction led to a deterioration in the position of BS, in particular as regards loan defaults and doubtful loans which rose overall by 36 % and 30,3 % respectively. Of that increase, 86 % is due to SC. The high level of loan defaults is still one of the principal reasons for the bank's results.

(22) Income from services as a proportion of the brokerage margin is still limited (18,6 % at the end of 1998) and is to a large extent dependent on traditional banking activity (69 %) (Table 2). As the operating result was subjected to considerable value readjustments in respect of loans relating to former SC assets, the profit of some ITL 48 billion is due to extraordinary income. In 1998 BS sold its banking subsidiary Banca del Sud to Banca Credem as well as a branch in Ravenna (for a total of ITL 114 billion). However, according to BS forecasts, 1998 is the last year in which value readjustments in respect of loan defaults will reach an extraordinary level. BS considers that, as it has provided very adequately for losses on loans over the last three years, it will produce positive results next year through ordinary management.

Table 2

Profit and loss account of Banco di Sicilia

(billion ITL)

	31.12.1998	31.12.1997	31.12.1996
Interest on assets and similar income	3 590	3 539	3 735
Interest on liabilities and similar charges	(2 204)	(2 458)	(2 777)
Income from securities	7	9	12
Interest margin	1 393	1 090	970
Commissions received	373	282	233
Commissions paid	(41)	(28)	(17)
Net profit on financial operations	160	170	188
Other operating income	123	98	45
Brokerage income	615	522	449
Brockerage margin	2 008	1 612	1 419
General management costs	(1 355)	(1 167)	(1 089)
(a) staff costs	(959)	(863)	(855)
(b) other administrative expenditure	(396)	(304)	(234)
Value adjustments in respect of fixed and movable assets	(174)	(65)	(58)
Gross operating result	479	380	272
Value readjustments	136	197	129
Provisions	(79)	(74)	(77)
Value adjustments	(555)	(553)	(314)
Profit/loss on ordinary activities	(19)	(50)	10
Extraordinary income	207	194	61
Extraordinary charges	(80)	(110)	(59)
Extraordinary profit or loss	127	84	2
Taxes	(60)	(3)	(1)
losses	48	31	11

Source: Banco di Sicilia, reports for 1997 and 1998.

2.2. **Measures taken by the State**

(23) The measures described above by which the Italian authorities plan to deal with the serious crisis affecting Sicilian credit institutions and which the Commission has examined as part of these proceedings in order to determine whether they contain state aid under Article 87(1) of the EC Treaty are the following:

(a) the decision of FITD to contribute ITL 1 000 billion to the liquidation of SC in order to cover part of the deficit resulting from the transfer of SC's assets and liabilities to BS;

(b) the possibility for Banca d'Italia of granting BS, as part of the transfer of SC's assets and liabilities to Banca d'Italia, advances in accordance with the Treasury Decree of 27 September 1974 in order to offset losses resulting from the compulsory winding-up. The deficit was established at ITL 4 445 billion on 18 December 1998, plus ITL 417 billion to be paid by SC to BS as interest on that amount. Banca d'Italia contributed ITL 3 400 billion towards covering the deficit [6].

The Italian authorities stated that the residual charges would be covered by the liquidation of SC, through the sale of the assets not sold to BS;

(c) the capital increase of ITL 1 000 billion in BS reserved for MC;

(d) the transfer to BS of the Treasury's shares in Irfis (52 %).

(24) In the course of these proceedings, the Commission established that, at the time, the contribution by FITD of ITL 1 000 billion to the liquidation of SC, aimed at covering the deficit resulting from the sale to BS of the SC assets and liabilities, did not appear to constitute State Aid under Article 87 of the Treaty, according to the information available.

3. **COMMENTS FROM OTHER INTERESTED PARTIES**

(25) No comments from third parties were received by the Commission within the specified period.

4. **COMMENTS FROM ITALY**

(26) In the course of the procedure, the Italian authorities put forward several arguments intended to demonstrate that the measures do not constitute state aid or that, even if they could be regarded as such, they are compatible with the EC Treaty. The comments from the Italian authorities were submitted in several documents and memoranda on 18 August 1999.

(27) As regards the action taken by Banca d'Italia under the Treasury Decree of 27 September 1974, the Italian authorities emphasised that the measure benefited SC depositors and not the purchaser of its assets and liabilities (i.e. BS). They considered that SC cannot benefit from the measure because it is in liquidation and has ceased trading. They denied that the bank's economic activity could be separated from its legal personality and regarded as the recipient of the aid. As regards BS, the authorities regarded the BI contribution as compensation for the disadvantages encountered by BS in its acquisition of SC, in particular the difficulties of integrating the two bodies and managing the inherited debts.

(28) In addition, the Italian authorities stated that the sale of all the assets and liabilities of SC in a block was the best way of minimising the costs borne by depositors and the community and stressed that, despite the efforts made to find a buyer for SC's economic activity, only BS had been prepared to acquire them, as it was the credit institution in the best position to exploit the potential of the transaction owing to its knowledge of the Sicilian territory and environment.

(29) If Banca d'Italia had not acted, the FITD would have had to contribute a far larger amount (about ITL 6 500 billion), with negative consequences for several participants in the Fund.

[6] The remaining liabilities of ITL 462 billion not yet covered continue to be borne by the firm in liquidation.

(30) The Italian authorities stressed that:

(a) the contribution had been made only as a last resort, when all endeavours to restructure and revive the credit institution had failed. As a result, public resources had been kept to a minimum;

(b) the machinery provided for in the Treasury Decree of 27 September 1974 had been activated in order to calculate the public resources exactly. As a result of the 'due diligence' procedure between the liquidation administrators of SC and BS, the sale deficit was determined definitively, so that any liabilities attached to the assets transferred to SC will be borne by BS.

(31) Lastly, the Italian authorities stated that, should the Commission consider that the contribution constitutes aid, it would be aid to FITD, as it would benefit the entire Italian banking system in view of the fact that all Italian banks and the subsidiaries of foreign banks in Italy participate in the Fund.

(32) As regards the capital injected by MC into BS, the Italian authorities state that the investment by MC was carried out in accordance with the principles of a private investor operating in a market economy. In two letters dated 15 March and 7 July 1999 to the Commission, MC described how its institutional bodies operated in order to demonstrate their independence from the Treasury and the economic, financial and strategic reasons for the investment.

(33) With regard to the independence of the bank, MC stated that the bank's administrative board included members not appointed by the Treasury, which had no power to influence the board's management policy apart from decisions within the remit of the shareholders meeting.

(34) As regards the profitability of the investment, MC stated that a return on capital of 11 % after tax from the third year was a good investment prospect for the bank, given the downward trend in long-term rates. MC also had very strong strategic reasons for carrying out the transaction. As a specialised bank, following the abolition of the distinction between short-term banks and medium- and long-term banks, it required a network of distributors for its products, especially in the *Mezzogiorno*. It had in fact already attempted to acquire the other public-sector bank in the south, Banco di Napoli, at the time of its recent privatisation.

(35) In order to assess the value of the Treasury holding in Irfis, the Italian authorities communicated a report drawn up by the financial company Giubergia Warburg (GW). In their opinion, the report indicates that the value of the BS shares acquired by the Treasury in exchange for its stake in Irfis was their nominal value. In addition, the authorities claimed that, in contributing its interest in Irfis, the Treasury was not attempting to help BS but rather to rationalise the structure of its holdings in public-sector financial institutions (Irfis, BS, SC, MC). Lastly, they stated that they regarded the transfer of Irfis to BS as compensating the latter for the delay in the payment of resources granted under the Amato Law and already approved by the Commission.

5. **ASSESSMENT OF THE AID**

(36) The Commission notes that it was unable to determine whether the aid to BS prior to the recapitalisation by MC and the contribution from Banca d'Italia was compatible owing to the failure of the Italian authorities to notify the proposed measures and their decision to grant the aid. As the information in its possession was incomplete, the Commission has been unable, prior to this Decision, to assess the data.

(37) Whilst it understands the reasons why the Italian authorities carried out the transactions as quickly as possible, the Commission regrets that they were not notified in advance. In view of the delay in the presentation by the Italian authorities of the restructuring plan and the other information requested by the Commission, the aid is unlawful as it was granted before the Commission determined its compatibility within the meaning of Article 88(3) of the EC Treaty.

5.1. **Advantage to the recipient**

(38) When it assesses the financial transactions of Member States, the Commission applies the principle of the 'private investor operating in a market economy'. As the aid in question was granted in September 1997, the Commission applied that principle as set out in its communication on public undertakings ([7]), according to which a transaction involves aid if a private investor, operating under normal market economy conditions, would not have undertaken the transaction in question owing to the poor return in relation to the risk involved.

5.1.1. *The contribution by Fondo Interbancario di Tutela dei Depositi*

(39) On the basis of information submitted by the Italian authorities in the course of these proceedings, the Commission took the view that the FITD decision to contribute ITL 1 000 billion to the liquidation of SC to cover the deficit resulting from the transfer of its assets and liabilities to BS might not, on the basis of the infonnation available at the time, constitute State aid within the meaning of Article 87(1) of the Treaty. The Commission has since concluded, from documents communicated by the Italian authorities, notably the articles of association of FITD and the minutes of the FITD Board meeting, that the measures in question do not constitute State aid. It verified the significant contribution of non-public-sector banks to the adoption of the decision of 13 August 1997 in accordance with Commission Directive 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings ([8]), as last amended by Directive 93/84/EEC ([9]), and found that the decision had been taken in accordance with the articles of association and unanimously. It was noted that private-sector banks accounted for a majority of the votes of the FITD board on the date of the decision in question.

5.1.2. *Advances granted by Banca d'Italia in accordance with the Decree of 27 September 1974*

(40) The transfer of the assets and liabilities of Sicilcassa to Banco di Sicilia was made possible by the support given by Banca d'Italia under the Treasury Decree of 27 September 1974. The Decree provides that Banca d'Italia may grant 24-month advances on government securities at an interest rate of 1 % to banks which take the place of depositors of banks in compulsory liquidation and must cover the losses associated with the impossibility of recovering their claims from such institutions. Banca d'Italia fixes the amount of the advances according to the extent of the losses and to the redemption plans.

(41) In the present case, the intervention by the central bank is intended to reimburse BS for the losses which it will incur in respect of SC's business activities it has taken over and which are not covered by the contribution from FITD. In other words, the liquidators calculated that the total losses incurred by SC resulted in a deficit of ITL 4 445 billion, which determined the contribution of ITL 3 400 billion from Banca d'Italia.

(42) In the course of the procedure, the Commission assessed the information provided by the Italian authorities, in particular the comments concerning the conditions in which public resources are granted under the Decree of 27 September 1974 and the position of the Italian authorities, namely, that the aid was intended solely for SC.

(43) Although the contribution from Banca d'Italia was intended to reimburse BS only for the losses on the assets transferred from SC, it must also be regarded as aid to BS since BS acquired all the assets of SC, including the loan defaults, and was then reimbursed by Banca d'Italia for the losses on SC defaults.

([7]) Commission communication to the Member States on the application of Articles 92 and 93 of the EC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, 13.11.1993, p. 3).
([8]) OJ L 195, 29.7.1980, p. 35.
([9]) OJ L 254, 12.10.1993, p. 16.

(44) Although the intervention of Banca d'Italia was only theoretical at the time of the decision, it was fundamental to the decisions of BS and MC. As confirmed by the Italian authorities, without that measure there would not have been a purchaser for SC. It therefore constituted a sort of guarantee which, whilst intended for BS, also covered the operating losses of SC and allowed it to survive.

(45) The public contribution creates distortion both because it leads to the survival of an economic activity with no apparent prospect of viability (SC) and which should normally have disappeared, and because it allows that economic activity to be included in the restructuring of BS and form an integral part of it. The fact that SC is in liquidation does not alter the Commission's assessment of the distortion of competition, since the productive structure of the bank, especially its network of branches, will continue to exist and operate on the market. Despite the liquidation of the legal entity, the 'going concern' stays in business.

(46) The distortion caused by a public contribution which allowed an economic activity without any apparent prospect of economic or financial viability to survive can also be assumed from the fact that there was no official and transparent invitation to tender. The Italian authorities stated that, apart from BS supported by MC, no Italian bank had expressed an interest in acquiring the package of assets and liabilities of SC. They pointed out that, when Banco di Napoli had been put up for sale, no foreign banks had been interested in investing in southern Italy. However, it cannot be concluded from the information provided by the Italian authorities that there was any actual competitive tendering, with deadlines, for SC between domestic and foreign candidates. On the other hand, the report of the liquidators contains references to expressions of interest from other banks in the purchase of part of the banks, after removal of their liabilities. There are economic reasons for believing that the SC network was worth more to potential buyers abroad than to BS. As BS already has a large network in Sicily, the marginal value and hence the price it is prepared to pay for a new branch is less than that of a potential foreign buyer.

(47) Lastly, as both banks are in the same area and may thus have the same customers, the Commission does not have sufficient information to rule out the possibility that BS benefited directly from the advances granted by Banca d'Italia in order to limit its own exposure risk.

(48) The Commission has also considered the statement by the Italian authorities that the public resources were essential in order to prevent greater damage to the banking market which could result from a much larger contribution from FITD. When a State directly or indirectly provides the principal portion of financial assistance to a bank in difficulty, the Commission must decide whether any State aid is invoked. The fact that state support may be necessary does not alter the Commission's assessment of such support under Article 87 of the Treaty.

(49) In short, the Commission concludes on the basis of the foregoing that the contribution granted to BS by Banca d'Italia under the Decree of 27 September 1974 in order to allow SC to remain in business does not satisfy the criterion of a private investor in a market economy. The decision to use the advances from Banca d'Italia in connection with the transfer of SC's assets should therefore have been notified in advance to the Commission.

5.1.3. *Capital injection in Banco di Sicilia*

(50) When the Italian authorities announced the plan to aid Sicilian banks, they included provision for direct aid for BS in the form of a capital increase reserved for MC. There were two aims:

— to rationalise the structure of Treasury holdings by placing all banking activities in Sicily under government control through Mediocredito,

— to inject fresh capital into BS.

(51) Although BS was not in urgent need of capital as its solvency ratio complied with the prudential regulations, its profitability was poor and could be improved only by rationalising costs, especially structural costs, and through investment aimed at renewing its productive activity which, however, BS was unable to fund.

(52) The Commission first examined the public or private nature of BS and MC in order to decide whether their contributions could be regarded as complying with the principle of a private investor in a market economy. Article 2 of Directive 80/723/EEC ([10]) allows the public nature of the two banks, as it provides that public undertakings are undertakings over which the public authorities may exercise directly or indirectly a dominant influence ([11]) because they hold the major part of the firm's subscribed capital or exercise de facto control through its social bodies.

(53) In the present case, the private (limited company) status of the two banks does not prevent them from being regarded as public undertakings, as the shareholders are the public authorities. The two banks were created through the transformation into limited liability companies of former public credit institutions under Law 218/90 although, compared with other public-sector banks, in the present case the Treasury retained a much larger holding.

(54) The financial difficulties of BS led to a reduction in the share of Fondazione Banco di Sicilia and of the Sicilian Region, to the benefit of the Treasury, as they did not have the necessary financial resources to continue to capitalise the bank in the recent crisis years. The Commission therefore notes that, even before its capital injections, BS was in any event controlled by public-sector bodies.

(55) As regards MC, it was clearly a public-sector bank at the time of the transaction. Converted into a limited company under Law No 489 of 26 November 1993 on the conversion into limited companies of all banks in which the State had a majority holding, MC continued to be wholly-owned by the Treasury.

(56) According to the Italian authorities, although MC is wholly owned by the Treasury, it operates completely independently of the public authorities, which have only normal shareholders' rights at meetings. However, on the basis of information provided by the authorities, the Commission has established that there are no special rules applicable to MC to strengthen the independence of its administrators in relation to the majority shareholder (in this case the Treasury). On the contrary, the powers to appoint and dismiss administrators and establish the bank's general commercial policy are the same powers enjoyed by all firms under commercial law. The management of MC is thus defined by its majority shareholder, i.e. the Treasury, which wholly-owns MC.

(57) The decision taken by MC to acquire an interest in BS through a reserved capital increase is a public measure. In order to assess public measures in the form of capital contributions, the Commission applies the principle of the private investor in a market economy: there is no State aid if the public measure is carried out in conditions which would be acceptable to a private investor.

(58) According to the communication on public authorities' holdings in 1984 ([12]), there is a presumption that there is State aid where a public undertaking contributes capital in circumstances that would not be acceptable to a private investor operating under normal market economy conditions. This is the case in particular:

— where the financial position of the company, and particularly the structure and volume of its debt, is such that a normal return cannot be expected within a reasonable time from the capital invested,

— where, because of its inadequate cash flow if for no other reason, the company would be unable to raise the funds needed for an investment on the capital market.

([10]) See footnote 8.
([11]) A dominant influence is presumed when the public authorities, directly or indirectly, hold the major part of the undertaking's subscribed capital or control the majority of the votes attaching to shares issued by the undertakings or can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body.
([12]) See Bulletin EC 9-1984.

(59) The principle is also applicable to the banking sector: in particular, in the case of public holdings in the capital of a firm, there is likely to be State aid where the financial position of the firm is such that a normal return (in dividends or capital gains) cannot be expected within a reasonable time from the capital invested or where the risks involved in such a transaction are too high or extend over too long a period.

(60) To enable the Commission to establish whether the private investor test is satisfied, it must be shown that the State in its capacity as shareholder is indeed acting as a private shareholder would. To that end, the Commission requires a coherent and detailed restructuring plan which shows that it can reasonably be supposed that there will be a normal return on the State's investment in the whole operation which would be acceptable to a private investor in a market economy. Otherwise, there is a State aid component.

(61) The Italian authorities provided the Commission with the industrial plan for MC that had been drawn up at the time of the investment in BS. Under the plan, BS would be restructured over three years by integrating SC, rationalising management costs, especially staff costs, and rigorously managing non-performing loans, thus creating a diversified banking unit in southern Italy.

(62) The Italian authorities pointed out that the MC transaction should be examined from the standpoint of its policy in recent years aimed at diversifying its sources of revenue. According to MC, access to a network like that of BS, although chiefly concentrated in one region, should enable it to integrate its activities as a bank specialising in soft loans, merchant banking and project financing with those of corporate and retail banking.

(63) The Commission acknowledges that the decision of MC to become a majority shareholder in BS is similar to other measures taken recently by several specialised financial institutions to diversify their business and sources of income. However, the Commission notes that such strategic diversification measures are taken by credit establishments provided that their overall effect is positive in terms of profitability, owing to the consequent reduction in overall risk and the acquisition of more stable sources of profit. The plans accompanying such industrial projects forecast the expected returns which discount the positive effects of the diversification.

(64) In the case of the plan drawn up by BS, the Commission notes that, although profitability is improving, it remains below the average for the European banking sector and will reach only 11 % by the third year.

(65) Despite the extensive restructuring, the plan shows that BS will not attain a sufficient level of profitability before three years. The positive effects of cooperation between a commercial bank and an investment bank are not satisfactorily reflected in the industrial plan. No private investor would wait for three years before obtaining a satisfactory return on an investment involving a similar risk. It would seem on the contrary that MC based its choice more on public objectives than on that of obtaining adequate profitability.

(66) It should also be noted that MC has produced only relatively modest profits in recent years. The Commission considers that a private investor would have invested in such projects only if the investment helped to restore the financial equilibrium of the firm, by obtaining a return on the capital invested capable of offsetting or improving the poor return on assets.

(67) In the opinion of the Commission, the capital increase in BS reserved for MC does not satisfy the criterion of a private investor in a market economy, as defined in the Commission communication of 13 November 1993 to the Member States ([13]), and must therefore be regarded as State aid.

([13]) See footnote 7.

(68) As already noted in other Commission decisions concerning the banking sector, recapitalisation transactions constitute aid if they are not carried out by the shareholding State under normal market conditions, even if the amount is less than the possible costs of winding up the assisted firm.

(69) The minimum solvency ratio is one of the criteria of a bank's viability and at the same time it guarantees equal competition given that, in theory, banks can always reduce their commitments in order to comply with the solvency criterion rather than increase their net worth.

(70) Although the viability of BS was poor, it had never threatened its solvency ratio. However, the Commission considers that, although the contribution from MC was not determined by the need to guarantee BS's solvency ratio, it was necessary to assess it in terms of the private investor principle.

5.1.4. *Transfer to Banco di Sicilia of the Treasury holding in Irfis*

(71) Until July 1995 and following the capital increase in 1994, Irfis equity was principally divided between the Sicilian Region (21 %), the Treasury (52 %) and SC (8,26 %). The problem of the insufficient capitalisation of BS in relation to that of its competitors had prompted its main shareholders to propose capital operations with regard to Irfis in order to bring new holdings to BS.

(72) In July 1995 the Treasury contributed its controlling interest (52 %) in Irfis to BS, which already held a minority interest. The Treasury's share was estimated at ITL 218 841 million. Since 1995 Irfis has thus formed part of the composition of consolidation of BS, increasing the value of the group's holdings.

(73) By letter of 16 October 1995 the Sicilian Region informed the Commission of a proposal for a draft regional law on repurchasing the Treasury's former holding from BS, using part of the regional support funds. The region's holding in Irfis would subsequently be sold on the market to the regional cooperative banks. The proposed plan was not implemented because the draft regional law was not discussed by the Regional Assembly, which had ended work in June 1996.

(74) With regard to the contribution from the Treasury the operation was never regularised: in 1995 the Treasury apparently transferred its holding in Irfis without defining the value of the latter's shares in the absence of an evaluation of its assets. The Treasury provided assistance to the Sicilian bank but wished to wait until BS recovered in 1996 before establishing the value of the exchange between the Irfis shares and those of BS in order to benefit from the reduction in the bank's net position.

(75) It should be noted that, when the Article 88(2) procedure was initiated, it was impossible to quantify the State assistance owing to insufficient information on the BS shares received in exchange by the Treasury.

(76) At the meeting held in Brussels on 11 December 1998, the Italian authorities presented the Commission with a report from the independent consultancy firm Giubergia Warburg (GW) which assesses the value of the shareholding which the Treasury received in exchange for its stake in Irfis.

(77) The consultants, pointing out that the considerable degree of uncertainty had made it very difficult to value BS exactly, produced an estimate within a very wide range, from ITL 417 billion to ITL 1 437 billion. On the basis of that estimate, one BS share was valued at a level fluctuating from a negative minimum to a maximum of ITL 104 000, i.e. ITL 4 000 above its nominal value.

(78) The Commission considers that such a broad-ranging value is of no use in determining the amount of the Treasury contribution. However, it notes that the maximum value is slightly above that used by the Italian authorities (ITL 100 000, or the nominal value), who thus opted for a value at the higher end of the range.

(79) It should be noted that the Italian authorities could not consider a lower figure as the law in force prohibits the issue of shares with a value below the nominal value [14].

(80) The Commission also notes that a private investor would not have acted as the Treasury did, since the contribution was granted without an industrial plan showing that BS would return to a level of profitability at least in line with the market average. According to the GW report, the bank's rate of return in 1997 was 2,7 %.

(81) The transaction nevertheless strengthened the competitive position of BS as well as its net worth and financial status.

(82) With winding-up still being an option, a recapitalisation constitutes aid if it does not take place under conditions providing a return that would be acceptable to a private investor. In comparing the State measure with that of a private investor in a market economy, an assessment of the amount of aid must be based on a comparison between the cost of the transaction and its value once it has been appropriately discounted.

(83) The Commission concludes, on the basis of the information in its possession, that the capital increase constitutes aid whose compatibility should be assessed in the light of the BS restructuring measures.

(84) In conclusion, the total aid granted to the Sicilian banks amounts to ITL 4 618 billion, as set out in the table below.

Table 3

Summary of aid measures

(billion ITL)

Measures concerned	Amount of aid
Banca d'Italia contribution (Decree of 27 September 1974)	3 400
Reserved capital contribution by MC	1 000
Transfer of Irfis	218
Total	4 618

5.2. **Effect on trade between Member States**

(85) The liberalisation of financial services and the integration of financial markets are malcing intra-Community trade increasingly sensitive to distortions of competition. This is a trend that is set to continue with economic and monetary union.

5.2.1. *Distortion of trade*

(86) When aid is granted to a banking group such as BS, which provides businesses with loans and other financial services and collects resources from a wide range of customers, it is liable to distort competition between other credit institutions. Aid to the weakest institutions has a harmful effect and contributes to downward pressures on banking margins. Aid encourages inefficiency and defeats market discipline. Protection by a government which is ready to intervene, should credit institutions run into difficulties, removes the incentive for creditors to monitor the behaviour of their debtors. Institutions are no longer subject to the supervision and verdict of the markets. Not only is

[14] Article 2346 of the Civil Code.

protection of this nature unjustified and excessive, it also acts as an incentive to poor management on the part of credit institutions. BS supplies loans and other financial resources to firms competing on international markets and offering financial services in competition with other European credit institutions. Although BS has only a limited presence abroad, the aid granted to it and to the SC assets in question may distort trade between Member States.

(87) In terms of the collection of resources, an area where the degree of competition is also high, the distortion of competition caused by the aid was considerable since BS has the largest network of branches in southern Italy. The addition of the SC network significantly improved the size and scope of BS, giving it a considerable competitive advantage in that area compared with potential new operators, especially foreign firms.

5.2.2. *Effect on trade between Member States*

(88) Although banks can in principle offer their services freely and without restriction across frontiers, principally by taking deposits and granting loans, they encounter obstacles to their expansion abroad.

(89) These obstacles are frequently linked to the firm local rooting of domestic banks, which makes market entry more expensive for foreign competitors. Since completion of the single market has given banks the opportunity to offer their services in other Member States, any aid granted to a bank, whether it operates nationally or internationally, is liable to restrict these opportunities.

(90) Aid that is designed to secure the survival of banks, even operating only at local level, which would otherwise have been forced out of the market as a result of their lower profitability and their lack of competitiveness, may therefore distort competition at Community level since it makes it more difficult for foreign banks to enter the Italian market.

(91) Without the aid in question, SC would probably have had to be wound up without any transfer of assets and liabilities to BS. In that event, its assets could have been acquired by one or more foreign competitors wishing to acquire a significant commercial presence in Sicily. SC's customers would have had to turn to another bank, possibly from another Member State. BS would not have been able to acquire the SC liabilities and assets without the asset restoration guaranteed by the advances from Banca d'Italia. SC customers would have had to transfer to another bank, possibly one from another Member State.

(92) Furthermore, the expansion of BS's network through its acquisition of SC, could not have been achieved without the capital contributed by MC. It must therefore be concluded that the aid to SC and BS for the acquisition of the assets and liabilities of SC is caught by Article 87(1) of the Treaty since it distorts competition to an extent liable to affect intra-Community trade.

5.3. **Assessment of the compatibility with the Treaty of the aid to the Sicilian public-sector banks**

(93) Having established that the financial support granted to BS and SC involves State aid, the Commission must consider whether such aid can be declared compatible with the general interest in accordance with Article 87(2) and (3) of the Treaty.

(94) In the present case, it should first be noted that the aid is not aid of a social character granted to individual consumers, or aid to promote the development of certain areas of Italy. Neither is it aid designed to remedy a serious economic disturbance, since it is intended to remedy the difficulties of specific recipients, BS and SC, and not those of all operators in the sector.

(95) The Commission considers that the problems of the Sicilian banks do not stem from a systemic banking crisis in Italy. BS and SC are not the only Italian credit institutions in difficulty, and a number of other banks, particularly State-owned ones, are also encountering difficulties. However, the causes of SC's losses are specific to itself and seem to be linked largely to a poorly managed commercial lending policy in Sicily, and insufficiently strict monitoring of the risks involved, especially as regards SC. Furthermore, as SC is a medium-sized bank and as there is a deposit guarantee fund, the possible negative consequences for the financial markets of the possible collapse of the bank would have been marginal. Even if the bank had failed, the Italian authorities had the means to organise its controlled liquidation and avoid a crisis. Consequently, the aid cannot be justified in the Community interest on the ground of a generalised banking crisis.

(96) Only the derogation in the second part of Article 87(3)(c) can be taken into consideration. The compatibility of the aid in question must be assessed on the basis of the specific rules governing rescue and restructuring aid ([15]). The general principle is that State aid to firms in difficulty is compatible if a number of conditions are met, and in particular in the case of restructuring aid:

1. full implementation of a restructuring plan based on realistic assumptions and making it possible to restore within a reasonable timescale the required minimum return on capital invested and thus to secure the firm's long-term viability;

2. the taking of sufficient measures to offset the distortion of competition, allowing the conclusion to be drawn that the aid is not contrary to the common interest;

3. proportionality of the aid to the aims pursued and limitation of the amount of the aid to the minimum necessary for restructuring, so as to ensure that the recovery effort receives maximum support from the firm itself;

4. full implementation of the restructuring plan and compliance with any other obligation laid down by the Commission in its final decision;

5. establishment of arrangements for monitoring fulfilment of the latter condition.

In accordance with the guidelines on restructuring aid, the Commission considers that such aid should normally be necessary once only.

(97) In its assessment, the Commission took the view that in such situations it is necessary to take special measures to prevent the bankruptcy of a bank from having negative consequences for financial markets, especially if the difficulties are of a general nature and not specific to the bank in question. This, however, is not true of the case under examination in view of the local nature of the assisted bank.

5.3.1.1. Viability of the firm

(98) At a meeting held in Palermo on 17 September 1998, the director-general of BS provided the Commission with the restructuring and strategic redeployment plan for the new banking entity resulting from the integration of SC with BS which was drawn up by the credit establishment in agreement with MC and with the assistance of the auditors KPMG. The plan provided for the recovery of the bank within three years and its return to a level of profitability appropriate for the sector. On the basis of the plan, MC informed the Commission of its reasons for contributing to the Sicilian banking unit.

(99) The hypotheses of the plan appear to be sufficiently realistic. They concern all the weaker aspects of BS and are aimed at renewing its operating profile and restoring financial and economic equilibrium to its own funds. The plan also takes account of the regional external context.

([15]) OJ C 368, 23.12.1994, p. 12.

(100) The plan correctly identifies the most important problems that BS will have to deal with, including the effects of old structural, financial and management weaknesses which, whilst not all equally serious, were common to BS and SC, as well as the integration of the branches of the two banks which had in the past conducted competing territorial expansion projects.

(101) In particular, from the management standpoint, there was a complex organisational structure, an inappropriate staff policy, incompatible computer systems, undeveloped commercial activities and risky financial management. From the standpoint of strategic development, the analysis shows non-homogenous territorial expansion, uncontrolled credit policy, non-integrated presence abroad, investment in high-risk transactions and a lack of innovative products. These inadequacies caused losses in the claims portfolio, inadequate capitalisation, a fall in profitability and a liquidity crisis. The losses on claims increased the operating imbalance (reduction in the interest margin and annual losses) and the asset imbalance (increase in unproductive assets and reduction in liabilities without charges) together with excessive recourse to the interbank market. The network of branches was characterised by uncontrolled expansion: branches opened in northern Italy, where banking is very competitive, proved less profitable owing to inadequate margins, excessive risks and high structural costs. Staff costs were out of proportion to other credit establishments in the area, and to market trends, both individually and overall.

Table 4

Banco di Sicilia business plan

(billion ITL)

	1997	1998	1999	2000	1997-2000 (%)
Interest margin	1 094	1 247	1 148	1 124	2,74
Services margin	484	565	579	604	24,79
Brokerage margin total	1 578	1 811	1 727	1 728	9,51
Staff costs	922	983	863	742	– 19,52
Administrative costs	318	384	377	377	18,55
Total general costs	1 240	1 368	1 240	1 193	– 3,79
Gross operating profit	337	444	487	609	80,71
Losses on loans and provisions	375	300	300	323	– 13,87
Net extraordinary profits	54	15	15	15	– 72,22
Result before tax	16	159	202	301	1 781,25
Tax	1	12	14	125	12 400,00
Result after tax	15	147	188	176	1 073,33

(102) The plan also correctly takes account of all the significant variables in the recent development of the banking system, notably the reduction in margins and the incomplete substitution of the various constituent parts. The reduction in the brokerage margin due to the reduction in managed funds and competition from other financial intermediaries can only be partly offset by the increase in revenue from service activities. The number of banking services should increase not only in savings management but also payment services. The latter, for the most part not used by BS customers, are the sources of revenue with the highest added value, of which part may be retained by the bank. By restoring the profitability needed to cover general expenditure and costs and to finance the necessary investments in the process of conversion, reorganisation and growth, BS may be able to offset the competitive pressure it has faced with the arrival on the Sicilian market of banks from northern Italy. On the basis of an analysis of the characteristics of customers and the reference market contained in the business plan, segmenting customers by income bracket will contribute to a return to profitability.

(103) In the course of the two meetings with the Italian authorities and the management of BS and MC on 17 September 1998 and 26 July 1999, the Commission was able to take stock of progress made with the plan. In spite of difficulties due to the international financial crises in Asia and Russia, the plan is proceeding as expected.

(a) The internal restructuring rationalised the group's staff structure by regrouping subsidiaries more efficiently and cutting the workforce by some 19 %.

(b) Commercial action was one of the priorities of the BS management and it produced significant results as regards the production of income from less traditional banking services. The efforts of the commercial network enabled BS to contain its loss of market share in retail banking, replacing it with alternative forms of fund collection.

(c) The sale of assets as part of a recentering on basic banking helped to improve the bank's liquidity. In 1998, it sold assets and non-strategic shareholdings worth about ITL 200 billion.

(d) As regards loan defaults and liabilities, the situation is still serious. However, total defaults have been reduced in parallel with the fall in total loans, the bank taking the view that it made sufficient provision in the first two years of the business plan to cover future risk. This will have a positive effect on profits before the end of the business plan.

(e) Considerable efforts have been made to improve monitoring of risks and commitments entered into by subsidiaries.

(f) The greatest efforts concerned structural costs with a view to integrating the operations of the two banks and reducing operating costs. However, results in this area have not been as good as expected.

(104) The restructuring plan forms part of a privatisation of MC which was carried out over a very short period of time, well before any confirmation of the recovery of its subsidiary BS. The Commission notes that such measures in principle provide a definitive solution to the recovery of a bank and help to reform the overall management system known as corporate governance which lay at the root of the liquidation of SC and the lack of profitability of BS. The Commission considers that this solution is appropriate because it allows a more effective control system to be set up without distorting markets. Thus the Commission regarded the decision of Cardiff-Paribas to acquire a stake in BS with a view to stable cooperation on the Sicilian market as confirmation of the viability of the plan.

5.3.1.2. Offsetting measures

(105) It should first be pointed out that, without State resources, it would have been necessary to wind up all the SC activities. In accordance with the Commission guidelines on rescue and restructuring aid ([16]), it is necessary to check whether a solution causing the least distortion of competition has been sought. If significant distortion is inevitable, extensive measures are needed to offset the negative effects of the aid on other operators in the sector.

(106) Such offsetting measures must involve an additional effort on the part of the assisted firm in relation to the restructuring measures needed for its recovery. In particular, the measures must not be financed directly or indirectly from State aid. In cases where there is no capacity closure, offsetting measures may take the form of cessation of activities, provided they are profitable, or a reduction in the firm's commercial presence.

(107) In banking, the statutory solvency requirement (basic own funds and total capital must constitute 4 % and 8 % respectively of the assets weighted by risk) introduces an obligation which limits the growth capacity of credit institutions. In practice, all firms are subject to a similar medium and long-term capitalisation requirement in absolute terms, but in banking it is constant and immediate. It can be quantified conventionally and cannot be temporarily relaxed for any growth strategy which a credit institution might adopt. An institution which only strictly satisfies the solvency constraint does not have a growth margin as it is not able to attract new capital or to grow its own capital by increasing its profitability. Thus an inefficient institution has a limited growth capacity, whilst a highly profitable bank has a growth margin that is commensurate with its profitability. This 'limiting' of growth in less efficient bodies that is due to the solvency constraint provides a good illustration of the complementary nature of preventive prudential policies and competition policy.

(108) The existence of the solvency constraint makes it possible to estimate the distortion of competition caused by aid to credit institutions ([17]). If the aid is regarded as capital injections, the distortion of competition can be measured in terms of assets weighted by degree of risk. For example, a capital injection of 1 million or any measure having a similar effect enables a bank to increase the level of weighted assets in its balance sheet (taking account of the compulsory solvency constraint of 8 %) and hence its level of activity. This transaction results in a potential distortion of competition, in terms of assets, of some EUR 12,5 million (without the aid the bank would not have been able to increase by EUR 12,5 million the amount of its assets weighted by degree of risk). This correlation also means that, if the aid to a credit institution exceeds its own funds, the distortion of competition is greater than its total assets weighted by risk. The role of compensation, in a similar context, is to limit the distortion of competition, assessed here purely for guidance purposes.

(109) In the present case, it must be pointed out that, as regards the information requested by the Commission when it initiated the Article 88(2) procedure in respect of the offsetting measures offered by BS to competitors, the Commission does not consider that the reduction in income deriving from traditional banking as provided for in the business plan is an offsetting measure, since it is more a result of the reduction in the repositioning of BS activities aimed at diversifying sources of income.

(110) The Italian authorities did nevertheless present adequate offsetting measures to accompany the restructuring of BS following the integration of SC. In this respect the Commission regards BS's decision to sell or close 55 branches in Sicily (i.e. 8,6 % of total branches and 10 % of those in Sicily) and to refrain from opening any new ones in the region in the next three years as significant measures capable of offsetting the distorting effect of the aid on competition.

([16]) See footnote 15.
([17]) See Commission Decision 98/490/EC, Credit Lyonnais (OJ L 221, 8.8.1998, p. 28).

(111) These measures represent a major contribution towards offsetting the distortion created, to the extent that it can be conventionally estimated in the present instance, and will reduce the bank's market share in southern Italy.

5.3.1.3. Proportionality of the aid and contribution of the firm to the restructuring

(112) It is noted that the Italian authorities began the process of restructuring the Sicilian public-sector banks well before the State aid in question, which only became necessary after the failure of other efforts to restructure the banks. The decision of the Italian authorities to wind up SC meant that it was removing the less efficient intermediary from the market.

(113) As regards the contribution made by BS to its recovery and that of SC, the Commission took a favourable view of the decision of the Italian authorities not to create a 'bad bank' and to decide on the specific amount of State aid only when the debit balance of the liquidation is assessed. Accordingly, BS inherited responsibility for the financial administration of loans transferred to SC and relieved the State of the need for further action.

(114) Although the restructuring of BS, which became even more pressing following the integration of SC, has already been completed for the most part, the Commission considers that remaining doubts concerning its definitive viability should be removed as a result of the bank's transfer to MC and the subsequent privatisation of its parent.

(115) The return on own funds obtained by the bank in 1998, based on the ratio of consolidated profits to consolidated own funds, amounted to some 4,5 % and should reach 10 % to 11 % at the end of the current year. That percentage, which is still not in line with the average for the sector or with the expectations of a private investor, justifies its transfer to a solid partner under the forthcoming privatisation of the bank so as to strengthen its viability.

(116) The fact that the rebuilding of own funds and the definitive recovery of the bank are entrusted to a major partner, which should allow the business plan to be carried out, presents problems as regards its sale.

(117) In its assessment of the compatibility of aid, the Commission must examine the conditions of the bank's privatisation, as announced by the Italian authorities by Decree of 19 February 1999. By fax of 18 October 1999 the Italian Minister for the Treasury informed the Commission of the Italian Government's commitment to privatise MC on the basis of an open, transparent and non-discriminatory sale procedure. The authorities also stated that they would not retain any legal or de facto control over the firm in the form of special rights or privileges on its management board (golden share). The privatisation will take place as soon as possible, depending on market conditions, and in any case before 30 June 2000. The Commission takes note of the undertaking and recalls the general principles it applies in cases of privatisation in order to determine whether there is any element of State aid, principles it set out in its 1993 Competition Report ([18]).

(118) At this stage and on the basis of the information available on the privatisation of BS, to be achieved through the sale of the MC group, since the choice of the buyer is to be determined by reference to market criteria as far as the price and the buyer's business plan are concerned, the Commission takes the view that the privatisation procedure does not give rise to any presumption of further State aid. As part of the process of monitoring this Decision, the Commission will verify compliance with the principles set out in the 1993 Competition Report.

([18]) Twenty-third Report on Competition Policy, p. 276, point 403. The principles to which the Commission refers in order to determine whether a privatisation involves State aid had earlier been indicated to the French authorities in a letter from the Commission's Director-General for Competition dated 14 July 1993.

(119) The Commission considers that the privatisation should provide a definitive solution to the above-mentioned problems encountered by BS and will ensure that in future the bank turns to its private shareholders or to the market if it requires financing.

(120) In assessing the aid the Commission has not taken account of how much privatisation of the bank could bring in for the Government: at this stage, a selling price has not yet been determined for MC, the contribution of BS to that value is not known and it does not have a valuation.

(121) In view of the foregoing and having regard to the amount of aid in relation to the offsetting measures taken, the Commission considers that BS has contributed significantly to the restructuring costs from its own resources, in particular through its commitment with regard to the management of SC's loan defaults and participation in liability for compensation in respect of loans inherited from SC and not covered by provisions under the Decree of 27 September 1974.

6. **CONCLUSIONS**

(122) On the basis of the information available, the Commission concludes that the recovery plan for the Sicilian banks involves substantial State aid, in particular in the form of:

— advances granted by Banca d'Italia to BS under the Decree of 27 September 1974 for losses resulting from the compulsory winding-up of SC,

— the capital increase of ITL 1 000 billion in BS reserved for MC,

— the transfer to BS of the Treasury's shares in Irfis (52 %).

(123) These measures have been examined under Article 87(3)(c) of the EC Treaty to determine whether they can be regarded as compatible with the common market. For the reasons set out above, the Commission takes the view that the aid granted to the Sicilian public-sector banks BS and SC complies with the conditions laid down in the guidelines on State aid for rescuing and restructuring firms in difficulty, provided that the conditions specified in the latest plan notified are fulfilled.

(124) It is also necessary, in view of the large amount of aid involved, for the proper implementation of the plan to be monitored, with special reference to the restructuring and privatisation efforts, to ensure that the recovery plan submitted to the Commission is carried out effectively and in full. The Italian authorities should therefore inform the Commission, every six months following the date of approval of this Decision and until the objectives of the restructuring plan have been achieved, of progress in implementing the plan and any deviation of actual results from the forecasts. No change that could result in an increase in State aid to BS may be made to the plan without the Commission's prior approval.

(125) The Italian authorities have stated that the charges remaining from the liquidation of SC will be covered by the proceeds from the sale of the assets not transferred to BS. If the sums in question prove insufficient, the Italian State would probably have to allocate further resources to the liquidation. If so, the Commission could consider that such an operation constituted additional aid and reconsider this Decision. Accordingly, any such operation should be notified in advance.

(126) Under these conditions, the aid in question qualifies for exemption from the ban laid down in Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement since it can be regarded as compatible with the common market pursuant to Article 87(3)(c) of the EC Treaty and Article 61 (3)(c) of the EEA Agreement,

HAS ADOPTED THIS DECISION:

Article 1

1. The aid measures, totalling an estimated ITL 4 618 billion, intended for the recovery and restructuring of Banco di Sicilia and Sicilcassa, in particular:

— use of the advances granted by Banca d'Italia, pursuant to the Treasury Decree of 27 September 1974, to absorb losses resulting from the liquidation of Sicilcassa,

— the capital increase of ITL 1 000 billion injected into Banco di Sicilia by Mediocredito Centrale, and

— the transfer to Banco di Sicilia of the Treasury's shares in Irfis

are compatible with the common market and the EEA Agreement pursuant to Article 87(3)(c) of the Treaty and Article 61(3)(c) of the EEA Agreement, subject to compliance with the conditions set out in Article 2.

2. The contribution of ITL 1 000 billion by Fondo Interbancario di Tutela dei Depositi towards the liquidation of Sicilcassa to cover part of the losses resulting from the transfer to Banco di Sicilia of the assets and liabilities of Sicilcassa does not constitute State aid within the meaning of Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

Article 2

Italy shall comply with the following conditions:

(a) it must ensure that all the recovery measures and all aspects of the restructuring plan submitted to the Commission are implemented;

(b) it must not amend the conditions laid down in the restructuring plan, after taking into account the conditions imposed by this Decision, without the Commission's prior consent;

(c) it must prevent Banco di Sicilia from benefiting from a carryover of tax losses in respect of the losses covered by the capital injected by Mediocredito Centrale;

(d) it must ensure that Banco di Sicilia does not repurchase assets from the winding-up of Sicilcassa, unless it proves impossible to sell them to other parties or acquire them on more advantageous terms for the winding-up;

(e) it must ensure that Banco di Sicilia sells or closes 55 branches in Sicily by no later than the end of December 2000;

(f) it must guarantee that Banco di Sicilia does not open or acquire branches, agencies, subsidiaries or other commercial structures to distribute its products in Sicily before 31 December 2002.

Article 3

1. The Italian authorities shall cooperate fully in monitoring compliance with this Decision and shall submit to the Commission a detailed report on the application and implementation of the restructuring plan and on the privatisation of the firm.

In particular, the report must:

— examine the viability of any entities of the group remaining under State control by presenting detailed results compared with the estimates contained in the plan,

— describe the extent to which the undertaking and conditions set out in Article 2 have been complied with,

— report on progress in the repayment by Sicilcassa in liquidation of the debit balance of ITL 462 billion not yet covered and taken over by the firm in liquidation,

— provide a detailed analysis of the privatisation of BS, to be achieved through the sale of the Mediocredito Centrale group and in particular the financial restructuring of the State holdings in that bank and in Banco di Sicilia.

2. The report referred to in paragraph 1 shall be sent to the Commission immediately after approval by the management boards of the firms and thereafter every six months until the date of fulfilment of the undertaking and conditions referred to in Article 2.

The following documents shall be attached to the report: balance sheets, accounts and reports (both annual and half yearly) drawn up by the administrators of Banco di Sicilia and Sicilcassa until the winding-up is completed.

3. The Commission may ask for such documents and the implementation of the plan to be assessed by means of special audits. The Italian authorities shall if necessary cooperate in the performance of such audits.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 10 November 1999.

For the Commission

Mario MONTI

Member of the Commission