EUROPEAN COMMISSION

Brussels, 22.2.2012
C(2012) 1021 final

In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].		PUBLIC VERSION This document is made available for information purposes only.

COMMISSION DECISION

of

ON THE STATE AID
No SA.29608 (C37/2010)

Implemented by Hungary

for the recapitalisation of FHB Jelzálogbank Nyrt

(Only the English version is authentic)

(Text with EEA relevance)

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above[1] and having regard to their comments,

Whereas:

I PROCEDURE

(1) On 25 March 2009, Hungary granted FHB Jelzálogbank Nyrt (hereinafter "FHB" or the "bank") a mid-term State loan of 120 billion Hungarian Forint (HUF) (approximately 410[2] million EUR) under the liquidity scheme for Hungarian banks which had been approved by the Commission on 14 January 2010[3]. On 31 March 2009 the Hungarian authorities recapitalised FHB in the sum of 30 billion HUF (approximately 100 million EUR) in the form of newly-issued Special Dividend Preference Shares plus one voting share, granted on 31 March 2009 under the guarantee and recapitalisation scheme approved by the Commission[4] .

(2) By letters dated 3 April, 13 May, 14 July and 11 September 2009, the Commission requested information from the Hungarian authorities regarding the terms of the recapitalisation. The Hungarian authorities replied by letters dated 24 April, 2 June, 12 August and 9 October 2009.

(3) Because of doubts as to the soundness of the bank at the time of the recapitalisation the Commission requested Hungary on 19 October 2009 to submit a restructuring plan for FHB in line with the Commission's Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under

1 OJ C 178, 8.6.2011, p. 7.
2 Based on the exchange rate of 15 February 2012 of EUR/HUF(289.63)
3 OJ C 47, 25.02.2010, p. 16.
4 OJ C 147, 27.06.2009, p. 2.

the State aid rules[5] (hereinafter the "Restructuring Communication"). Hungary provided further information on 12 and 19 November 2009 and a draft restructuring plan on 26 January 2010.

(4) On 19 February 2010, FHB repaid the full amount of the recapitalisation to the State.

(5) By letters dated 24 and 25 March 2010, Hungary submitted further information to the Commission. FHB held a general assembly of shareholders on 21 April 2010, in which FHB decided on the payment of remuneration to the State for the recapitalisation, following which the Commission requested information by letter dated 22 April 2010.

(6) The Commission requested further information by letters dated 2 June and 1 October 2010. The Hungarian authorities provided additional information by letter of 11 June 2010.

(7) On 15 June 2010, Hungary submitted an updated restructuring plan, which was supplemented by a further essential data submitted on 30 September 2010.

(8) The Hungarian authorities submitted further information by letters dated 18 June, 28 July and 5 October 2010 and informed the Commission by letter dated 29 October 2010 that FHB had paid remuneration for the recapitalisation.

(9) On 16 December 2010 the Commission decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union (hereinafter the "Treaty")in respect of the aid measures in favour of FHB. Subsequently, the Hungarian authorities requested the Commission to amend that decision as some parts of it were incorrect and not up to date. The decision was therefore replaced by a new decision of 24 January 2011[6] hereinafter the "opening Decision"). By letter dated the 24 January 2011 the Commission informed the Hungarian authorities that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty in respect of the aid measure. The Commission decision to initiate the procedure was published in the Official Journal of the European Union on 18 June 2011 . The Commission invited interested parties to submit their comments on the measure.

(10) By letter dated 2 March 2011, the Hungarian authorities submitted their comments on the Commission opening decision of 24 January 2011, opening a formal investigation procedure with regard to the measure granted to FHB.Those observations were supplemented by comments received from FHB by letter dated 11 July 2011.

(11) By letter dated 18 July 2011, a third party (the Magyar Jelzálogbank Egyesület – the Association of Hungarian mortgage banks) submitted its comments on the opening decision to the Commission.

(12) A further update of the restructuring plan and additional information on the repayment of the recapitalisation to the Hungarian State was submitted by the Hungarian authorities on by letter dated 3 October 2011.

(13) On 15 December 2011, a new agreement was signed between FHB and the Hungarian State, under which the bank committed to pay to the State the remuneration which had initially been agreed in the recapitalisation agreement.

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5 OJ C 195, 19.8.2009, p. 9.

6 OJ C 178, 8.6.2011, p. 7.

II. DESCRIPTION OF THE BENEFICIARY

1.1. The beneficiary

(14) FHB was set up by the State in 1997. The State gradually sold off its stake in FHB. In 2003 FHB was listed on the Budapest Stock Exchange and in August 2007 the State reduced its majority stake in the bank to just over 4%.

(15) FHB was originally set up as a mortgage bank in order to promote the use of mortgage bonds. It was subject to strict rules regarding limited activity, collateral and specific supervision in order to ensure the maximum safety of mortgage bonds. FHB was initially allowed only to provide long-term mortgage loans and guarantees in connection to mortgage loans and to conclude some types of derivative transactions to hedge its own position deriving from its mortgage lending activity. Mortgage bonds were the main funding source of its lending activity. The bank also refinanced mortgage loans extended by other banks.

(16) In 2006, FHB introduced the New Strategic Plan to expand its banking activity and branch network, aiming to widen its funding and operational base by entering the retail market through FHB Commercial Bank. Over time, FHB started selling various retail and corporate loan products, as well as offering account management, deposit-taking and card services, thereby expanding its product range on the liability side.

(17) FHB is a group consisting of a mother company, FHB Mortgage Bank Co. Plc, and wholly-owned subsidiaries: FHB Commercial Bank Ltd, FHB Service Ltd, FHB Real Estate Ltd and FHB Life Annuity Real Estate Investment Ltd. It is active mainly on the mortgage bond market. In that market, FHB has a market share of 23% (2009) and is the second-largest player on the Hungarian market (after OTP Bank with 74% market share). FHB has a market share of 4.6% in the retail mortgages market and 0.6% in retail deposits.

(18) When the bank was recapitalised in March 2009, its total balance sheet amounted to 746,2 billion HUF. At the same date, the bank's capital adequacy ratio (hereinafter "CAR") amounted to 10.5%. The capital injection by the State increased FHB's CAR to 16.1% at the end of 2009 (computed under Hungarian accounting rules).

1.2. The context

(19) Hungary is one of the Member States most severely affected by the financial crisis. Years of excess government spending and a credit-fuelled construction and consumption boom led to serious imbalances in the economy even before the crisis. The prevalence of Euro- and Swiss franc denominated household loans as well as the continued reliance on external financing made the country and its banking sector especially vulnerable to fluctuations in the value of the Hungarian forint, which weakened significantly during the crisis.

(20) The financial crisis affected Hungary to the point that the International Monetary Fund (hereinafter "IMF"), the European Union (hereinafter "EU") and the World Bank had to provide emergency loans to Hungary in November 2008 in order to calm tensions on the country's financial markets.

(21) As a response to the serious disturbance in the Hungarian economy caused by the crisis, the Hungarian government introduced several measures aimed at supporting the

financial sector and financed jointly from IMF/EU/World Bank package.The measures included a liquidity support scheme and a guarantee and recapitalisation scheme.

(22) The liquidity support scheme (hereinafter the "liquidity scheme"), established in the Hungarian Act on Public Finance provides for liquidity in the form of loans to financial institutions. It was approved by the Commission on 14 January 2009[7] and prolonged several times thereafter, most recently until 31 December 2011[8]

(23) By decision of 12 February 2009[9] the Commission approved the Hungarian guarantee and recapitalisation scheme. Under the scheme, the Hungarian State could subscribe preference shares, which are considered as Tier 1 capital in banks. The recapitalisation part of the scheme has been prolonged several times, most recently until 31 December 2011

(24) Under the guarantee and recapitalisation scheme if a recapitalisation exceeds 2% of a bank's risk weighted assets (hereinafter "RWA"), the Hungarian authorities must first inform the Commission and provide a detailed assessment on why they believe such a bank should still be regarded as a fundamentally sound institution. If the Commission does not accept the assessment of the bank as fundamentally sound, the recapitalisation may still take place, but the remuneration must be increased in order to reflect the higher risk and a restructuring plan must be submitted to the Commission within six months of the recapitalisation.

Reasons for FHB's difficulties

(25) Hungary was severely affected by the financial crisis, which, coupled with other internal problems in the banking sector, aggravated the situation for Hungarian banks.

(26) FHB required State support because, unlike many other Hungarian banks, it did not have a parent company in the Eurozone and thus could not obtain cheap funding provided by the European Central Bank (hereinafter "ECB"). The ECB facilities, including various repo facilities, were available in the Eurozone as from autumn 2008. The National Bank of Hungary created a facility in early 2010 but it only increased access to Hungarian forint funding and not to Euro funding, which, according to FHB, was crucial during the hardest time of crisis[10].

(27) According to the Hungarian authorities, the recapitalisation of FHB was required to ensure the solvency of the bank and to counteract the liquidity difficulties faced by the whole banking sector in Hungary.

III. DESCRIPTION OF THE AID MEASURES

(28) The aid measures granted by Hungary to FHB, described in the Commission opening decision of 24 January 2011, consist of:

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7 OJ C 47, 25.02.2010, p. 16.

8 OJ C 236 of 12.8.2011.

9 OJ C 147, 27.06.2009, p. 2.

10 For a more detailed explanation of FHB's difficulties, see Recital (39) seq.of the opening decision of 24 January 2011.

- A mid-term State loan under the liquidity scheme of 120 billion HUF (approximately 410 million EUR) granted on 25 March 2009, with a maturity date of 11 November 2012;

- A recapitalisation of 30 billion HUF (approximately 100 million EUR), in the form of newly-issued Special Dividend Preference Shares plus one voting share, granted on 31 March 2009 under the guarantee and recapitalisation scheme.

(29) A recapitalisation agreement between Hungary and FHB fixed the formula for the calculation of the State's remuneration rate for the shares at 10.49%, which is in line with the remuneration rate for fundamentally sound banks fixed in the guarantee and recapitalisation scheme, to be paid in the form of dividends. The recapitalisation amounted to 9% of the RWA of FHB, which is above the 2% threshold defined in the guarantee and recapitalisation scheme under which the beneficiary institutions can be considered as fundamentally sound. Since the measure was not notified to the Commission before implementation, the Commission had no opportunity to check whether the bank should have been considered as fundamentally sound under the guarantee and recapitalisation scheme. Where the beneficiary is deemed not sound under the guarantee and recapitalisation scheme, a restructuring plan is required and the remuneration rate must reflect the non-fundamentally sound character of the bank, and be higher than the remuneration rate for a fundamentally sound bank.

(30) In spite of its difficulties, the bank managed to cope well during that period: it had a strong capital position (CAR of 10.5% in March 2009) and it had a rating of Baa3 by Moody's Investors Service (hereinafter "Moody's") which is still in the investment grade category. In February 2010, less than nine months following the recapitalisation, the bank bought back the Special Dividend Preference Shares held by the State.

(31) The bank decided to repay the recapitalisation on the basis of a reviewed consolidated current and expected CAR, considering the macroeconomic forecast used in its 2010 planning and the expected volumes, balances and risk information from the bank's 2010 financial plan. The review concluded that despite the global financial crisis, the situation of the bank by the end of the year was remarkably better than expected at the time of the agreement with the Hungarian State on the recapitalisation of the bank in early 2009.

(32) FHB repaid the recapitalisation to the State and did not pay any remuneration to the State, resulting in a violation of the recapitalisation agreement[11]. However, the bank considered that the Special Dividend Preference Shares held by the State were not automatically entitled to the payment of dividends and their preference meant only that the bank had to pay the stated dividend to the State prior to paying dividends on common stock. Given that common shareholders did not receive any dividends in the period during which the State held the Special Dividend Preference Shares, according to the bank there was no obligation to pay preference dividends. Furthermore, FHB argued that in any event the State was not in possession of the Special Dividend Preference Shares when dividends were declared for the year 2009, given that the repurchase of shares took place beforehand.

(33) FHB informed the Commission that it had participated in the 2010 EU-wide stress test exercise coordinated by the Committee of European Bank Supervisors, in cooperation with the ECB and the Hungarian Financial Supervisory Authority. The stress test was focused on capital adequacy while liquidity risks were not directly stress-tested. The

[11] See above para. 29, second indent.

results of the test, based on the consolidated year-end 2009 figures, suggested a buffer of [above 50] million EUR of Tier 1 Capital against the threshold of 6% of Tier 1 adequacy ratio for FHB.

(34) By Act CX of 2010 on the Amendment of Certain Acts Pertaining to the Economy and Finance (hereinafter "Act CX of 2010"), which entered into force on 21 August 2010, Hungary amended Act CIV of 2008 on the stability of the financial intermediary system (hereinafter the "Stabilisation Act"). Act CX of 2010 retroactively created a legal title for the Hungarian State to claim remuneration from FHB concerning the recapitalisation even though the Hungarian State was no longer a shareholder at the time of the FHB shareholders' meeting deciding on the payment of dividends.

(35) On 28 October 2010, the Hungarian State and FHB signed an agreement according to which FHB was to pay remuneration of 890 million HUF to the Hungarian State for the recapitalisation plus late payment interest of 11.726.786 HUF.

(36) The level of remuneration was allegedly determined on the basis of the terms of the liquidity scheme. The Hungarian authorities argued that the recapitalisation had been provided from the same funding source as the liquidity support in the form of the loan and for those reasons the remuneration for the recapitalisation and for the liquidity support should be the same. The capital was made available to FHB on 6 May 2009 and it was reimbursed on 19 February 2010. The interest rate ultimately applied was the same as the interest rate paid for the loan of approximately 400 million EUR. According to the information provided by Hungary, the monthly average interest rate which resulted amounted to between 3.79% and 4.08%; the actual amount was calculated on a weekly basis. According to information provided by Hungarian authorities the total remuneration amount of 890 million HUF was paid at the end of 2010.

(37) Late payment interests were charged in line with the Hungarian reference rate of 5.97% as published by the Commission,[12] increased by 100 basis points. The late payment interest was calculated for the period from 21 August 2010, when the amended Stabilisation Act entered into force, until 28 October 2010, when the agreement was signed.

(38) On 15 December 2011, the Hungarian State and FHB entered into a new agreement by which the bank agreed to pay to the State an aggregate amount of 10.49% of the total recapitalisation amount (i.e. total payment amount of 2.491.742.552 HUF). Under that new agreement, FHB thus committed to pay to the State by 31 December 2011 an additional amount of 1.601.742.552 HUF, calculated as the difference between the total remuneration amount of 890 million HUF mentioned above in Recital (36) and the remuneration that had already been paid on 28 October 2010.

IV. THE RESTRUCTURING PLAN

(39) On 30 September 2010 Hungary submitted an updated restructuring plan for FHB to the Commission. Additional information on the restructuring plan was submitted to the Commission by letter dated on 3 October 2011. The main aspects of the restructuring

[12] OJ C 14, 19.1.2008, p. 6 and "Base rates (since 1.7.2008, EUR27) calculated in accordance with the Commission Communication of 19.1.2008" available at http://ec.europa.eu/competition/state_aid/legislation/reference_rates.html

plan have been already described in the Commission opening decision. Additional elements were submitted on 3 October 2011 and are described in sections 4.1 to 4.3.

4.1 Viability

(40) In 2010 the international and domestic economic environment was rather difficult, though there were signs of improvement. In 2010, profitability of the Hungarian banking sector lagged far behind that of the previous year. By virtue of Act XC of 2010 that entered into effect on 13 August 2010, the Hungarian government introduced a special tax payable by financial organisations amounting to a cumulative 187 billion HUF and mainly paid by credit institutions.

(41) Retail customers' demand for loans was severely reduced throughout 2010; at the same time, the supply side was weakened by unfavourable changes in the regulatory environment and in the market conditions. Corporate lending also suffered overall in the sector, though some banks – including FHB – expanded their corporate activities.

(42) The most important event concerning both operations and financial results of FHB was its acquisition of Allianz Commercial Bank Ltd (hereinafter "Allianz Bank") and the long-term strategic cooperation agreement between Allianz Hungaria Insurance Co. Ltd. (hereinafter "Allianz Hungaria Insurance") and FHB. The acquisition was closed by 30 September 2010. At the same time an integration project was launched in FHB in order to merge Allianz Bank and FHB Commercial Bank and to rationalize and optimize the operations of the entire group (branch network, distribution channels, product portfolio, IT operations, organization structure and HR, etc.).

(43) The acquisition positively affected FHB Group's net profit for 2010; one-off items related to the acquisition counterbalanced the negative impact of the special banking tax, losses on the loan portfolio and the increasing cost of funding. The total profit of FHB in year 2010 amounted to 11.2 billion HUF, representing an increase of 58.9% compared to 2009.

(44) As a result of the acquisition of Allianz Bank the number of retail and corporate bank accounts in FHB significantly increased, from […] in December 2009 to […] in December 2010 (+[…] %). However, due to the large number of dormant accounts, the amount of deposits did not increase proportionately, but increased from […] billion HUF in December 2009 to […] billion HUF in December 2010 (+[…]%). The market share of FHB on the retail and corporate deposit markets, increased respectively from […] % to […]%, and from […] % to […] %. The acquisition of Allianz Bank thus increases the share of deposits in FHB's funding mix and reduces the amount of mortgage bonds from […] billion HUF in 2010 to […] billion HUF in 2011.

(45) FHB forecast that, based on the estimated consolidated balance sheet and income statement for 2011, its CAR should be around […] % in December 2011. That forecast takes into account the additional payment to be made to the Hungarian State with regard to the recapitalisation carried out in March 2009, which additional payment was made on 15 December 2011 in agreement with the Hungarian State.

4.2 Burden-sharing

(46) For the recapitalisation of 30 billion HUF, FHB has paid remuneration of 890 million HUF in October 2010. The interest rate originally applied was the same interest rate which was paid for the loan of 120 billion HUF or a monthly average of between 3.79% and 4.08%.

(47) Under the new agreement signed on 15 December 2011 between FHB and the Hungarian State, the bank committed to pay to the State a total remuneration of 2.491.742.552 HUF, representing 10.49% of the recapitalisation amount, as initially agreed between the bank and the State in the recapitalisation agreement.

4.3 Measures to limit distortions of competition

(48) The additional information provided in October 2011 did not specifically address distortions of competition, aside from underlining the fact that, despite the purchase of Allianz Bank, the market share of FHB regarding retail and commercial deposits remains limited (at [0.7%-1.3 %] and [0.4.%-0.95%], respectively, on 31 December 2010 and [0.65.%- 1.3.%] and [1%-1.35 %], respectively, on 30 June 2011).

V. REASONS FOR THE OPENING OF THE FORMAL PROCEDURE

(49) The Commission opened a formal investigation procedure because it considered that the main assumptions underlying the restructuring plan and business forecast of FHB were not sufficiently justified and did not take into account the recent purchase by FHB of Allianz Bank. Furthermore, the Commission also expressed doubts as to the long-term viability of FHB given its strong exposure to wholesale funding and the real estate market in Hungary.

(50) In addition, given the low level of remuneration to the State paid in October 2010 on the recapitalisation amount (corresponding to the average interest rate of 3,79% to 4,08% as set out in the liquidity scheme), the Commission also expressed doubts whether the bank's own contribution to its restructuring effort was sufficient. FHB's purchase of Allianz Bank and agreement with Allianz Hungaria Insurance also raised doubts on whether the aid was limited to the minimum amount necessary.

(51) Finally, the Commission also considered that the Hungarian authorities had not demonstrated that sufficient measures were undertaken in order to limit the distortions of competition caused to the market by the aid received by FHB, in particular in view of its expansion strategy, its recent acquisition of Allianz Bank, and the insufficient remuneration paid for the recapitalisation by the State.

VI. *COMMENTS FROM* INTERESTED PARTIES

(52) The Commission received comments from the Association of Hungarian mortgage banks (hereinafter The "Association")on 18 July 2011. In its comments, the Association recalled the scale of the crisis that hit the Hungarian economy and banking sector in 2008-2009. and pointed out that the recapitalisation of FHB took place as a result of the difficult macro-economic environment deriving from the crisis. The State intervention in favour of FHB was aimed at addressing serious risks to the Hungarian mortgage credit sector and the mortgage bond market. Indeed, as a result of vulnerability to currency fluctuation, the strengthening of the Swiss franc against the Hungarian forint decreasing consumer income and the rise in unemployment, there was a rapid and severe degradation of the quality of the mortgage credit stock and an increase in the number of "bad credits" and dwindling funding possibilities for banks. It was especially true in the case of FHB, which is financed from the capital market.

VII. COMMENTS FROM THE MEMBER STATE

(53) The Commission received observations from the Hungarian authorities on 2 March 2011, supplemented by comments from FHB by letter dated 11 July 2011.

7.1 Viability

(54) In response to the Commission's doubts on the accuracy of assumptions underlying the bank's restructuring plan, the Hungarian authorities state that financial forecasts are based on external experts' assumptions and are consistent with the information that is available at the time when they were made. In terms of soundness, they are no different from any other financial plans or forecasts made by FHB.

(55) According to Hungarian authorities, the long-term viability of FHB is ensured as evidenced by the success of FHB in raising funds in both the money and capital markets: in 2009, FHB issued mortgage notes and bonds for over 60 billion HUF and private investors also lent the bank a total of […].

(56) Furthermore, the Hungarian authorities state that, regarding retail deposit accounts, data reveals that FHB’s share in the retail deposit segment rose from […] % to […] % in 2009; the projection for the end of 2010 is for […] %. Further, the number of retail accounts as well as the size of the portfolio of such accounts has been rising consistently and dynamically despite a market projection for a decline in the portfolio. Therefore, the bank and the Hungarian authorities do not consider the projections on retail deposits and retail accounts as over-optimistic.

(57) As regards FHB’s liquidity position, it can be regarded as consistently stable, which is due, inter alia, to the fact that it has to comply with the liquidity requirements prescribed by rating agencies. The bank’s liquidity situation was stable even in the most difficult periods of the crisis, which is confirmed by the letter of 19 March 2009 of the Governor of the Hungarian Central Bank to the Minister of Finance.

(58) Finally, the weakening of the bank's asset quality during the crisis was mainly due to Hungary’s macro-economic situation, dwindling household income, declining employment rates and rising unemployment rate rather than the upward trend of the Swiss franc against the Hungarian forint. Although FHB has launched several schemes aimed at addressing the problems of distressed debtors, the quality of the loan portfolio will be permanently improved primarily by an economic upturn and improved economic indicators. The economic projections of the Hungarian Central Bank and the Hungarian government for 2011 are for growth in Gross Domestic Product (hereinafter "GDP"), gradual improvement in employment and a lower rate of unemployment, which is also likely to have a significant impact on FHB’s loan portfolio.

7.2 Burden-sharing

(59) The Hungarian authorities remark that FHB concluded the agreements with Allianz Bank and Allianz Hungaria Insurance after FHB had repaid the State in full on 19 February 2010 for the entire issued value of the shares and redeemed the shares issued during the recapitalisation. The agreements of FHB with Allianz were entered into in June and July 2010 and the acquisition took place in September 2010. At that time, no State funds were held by FHB. Therefore, FHB cannot have financed the acquisition from the recapitalisation repaid in February 2010. The preparatory analyses and discussions between FHB and Allianz started only after the State loan had been repaid.

Further, the purchase price that FHB paid for Allianz Bank (with the value of the treasury shares taken into consideration) amounted to approximately 3.3 billion HUF, while Allianz Bank's equity capital was close to 14 billion HUF as at 30 September 2010. Thus, in order to be able to acquire Allianz Bank, FHB did not need any capital, and the transaction did not reduce FHB's equity.

(60) Furthermore, the fact that the aid was limited to the minimum necessary is reflected in the fact that FHB's CAR, which stood at 11.3% in 2008, reached the 12% CAR target, approved by the Commission within the guarantee and capital scheme, only after the recapitalisation.

(61) The Hungarian authorities also note that FHB has not paid dividends for several years in succession, and it has only purchased back a minor portion of its shares relative to the total value of the shareholder's equity. Accordingly, as the amount of funds returned to owners and shareholders has been low over the past years, an appropriate burden-sharing has been ensured.

7.3 Measures to limit distortions of competition

(62) In addition to the measures to limit distortions of competition mentioned by the Commission in its decision, the Hungarian authorities point to additional measures linked with the guarantee and recapitalisation scheme and the recapitalisation agreement between FHB and the Hungarian State:

- The State is entitled to a special veto right over dividend payments and acquisitions[13]; and

- Some restrictions must be implemented by the bank in respect of the salary, remuneration and benefits of its senior officers until the cessation of the interest of the Hungarian State[14].

(63) The Hungarian authorities note that, according to their interpretation of State aid rules, those behavioural measures and other measures limiting the distortion of competition are or were binding on FHB for as long as the State was a shareholder of the bank.

(64) In addition to the measures mentioned above, FHB made further commitments in point 3.8 of the recapitalisation agreement, which sets out that the recapitalisation should be used to reach the following objectives:

- That FHB performs a capital increase in FHB Commercial Bank;

- That the recapitalisation contributes to the stabilisation of the Hungarian mortgage note and mortgage loan markets and finances the development of retail lending and lending to SMEs;

- That the recapitalisation improves the stability of FHB and strengthens its active presence in the capital market, thereby contributing to the restoration of investor confidence;

- That FHB participates in the consolidation of the above market segments;

[13] See Article 13 of the Stabilisation Act, points 25 and 26 of Commission Decision 664/2008 and point 5 of the Recapitalisation Agreement.

[14] See Article 8, Section (3), Sub-section e) of the Stabilisation Act, point 27(b) of Commission Decision 664/2008 2008 and point 9 of the Recapitalisation Agreement

- That FHB optimises its financing structure (liability structure);
- That FHB expands its toolkit needed to fend off the extreme impacts of macro (exchange rate) risks on the capital side.

(65) Contrary to the doubts expressed by the Commission, the recapitalisation of FHB was not aimed at distorting competition by expanding the activities of FHB Commercial Bank. The capital increase in the latter was a commitment undertaken in the recapitalisation agreement. The core activity of FHB Commercial Bank, also supported by the 25 billion HUF capital increase financed from the State's recapitalisation, has remained. The corporate loan portfolio has been expanding consistently but not in excess of its earlier trend growth.

(66) In their view, the foregoing reveals that there is no foundation to the Commission's summary judgement on the measures aimed at limiting the distortion of competition and its claim that "these measures are very limited". Therefore, the Hungarian authorities insist that the recapitalisation agreement met the criteria laid down in both the Stabilisation Act and the relevant Commission Communications.

VIII. ASSESSMENT OF THE AID

8.1 Existence of aid

(67) The Commission has already found in its opening decision of 24 January 2011 that both the recapitalisation and the liquidity support in the form of the loan provided to FHB constitute State aid within the meaning of Article 107(1) of the Treaty[15]. Neither the Hungarian State nor FHB have put forward any argument to cast doubt on that finding.

8.2 Legality of aid

(68) The Commission has already stated in its opening decision of 24 January 2011 that the recapitalisation in favour of FHB did not comply with the conditions of the guarantee and recapitalisation scheme. In particular it did not respect the requirements to be applied when the capital increase exceeds 2% of the beneficiary RWA. The measure should thus have been notified to the Commission separately in accordance with the conditions of the guarantee and recapitalisation scheme and with Article 108(3) of the Treaty.

(69) As a consequence, Hungary unlawfully implemented aid in the form of a recapitalisation in favour of FHB, in breach of Article 108(3) of the Treaty.

8.3 Quantification of aid

(70) In the context of the restructuring of FHB, all measures granted to it need to be taken into account. Therefore, both the recapitalisation of 30 billion HUF and the liquidity loan of 120 billion HUF need to be taken into account in the compatibility assessment.

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15 See Recitals (89) and following of the opening decision of 24 January 2011.

8.4 Compatibility of the aid

8.4.1 Legal basis

(71) As already stated in the Commission's decision of 24 January 2011, given the specific circumstances on the financial markets, the Commission considers that the measures can be examined under Article 107(3)(b) of the Treaty , which states that '*The following may be considered to be compatible with the internal market:* […] *aid* […] *to remedy a serious disturbance in the economy of a Member State*'. As the present decision aims at assessing the aid received by FHB and its restructuring plan, the Commission finds it appropriate to base its assessment on communications on the application of State aid rules to the financial sector during the crisis.[16] In particular, as regards the assessment of the bank's restructuring plan, it will be based on the Restructuring Communication[17]

8.4.2 Compatibility of the restructuring plan

8.4.2.1 Restoration of the long-term viability of the institution

(72) In the opening decision[18], the Commission expressed doubts as to the reliability of the assumptions adopted by FHB in its financial projections. The Commission noted that the restructuring plan submitted by FHB in September 2010 did not explain why those assumptions were correct. Furthermore, since the financial projections did not seem to take into account the consequences of the purchase of Allianz Bank and of the agreement with Allianz Hungaria Insurance, the Commission could not consider that the presented projections remain valid. The Commission has also expressed doubts about the assumptions of the bank relying upon a strong growth in deposits.

(73) Furthermore, the Commission was also concerned about the long-term viability of the bank in view of the business model of FHB, which was deemed vulnerable to liquidity crises due to its strong reliance on wholesale funding and small share of deposits. The Commission considered that the bank's restructuring plan of September 2010, whilst it focused on the capital perspective, did not provide sufficient details on the long-term sustainable funding of the bank.

(74) On the basis of additional information provided on the bank's restructuring plan in October 2011, the Commission notes that the financial forecasts in the restructuring plan of September 2010 are based on sound and reliable assumptions. The updated information including the purchase of Allianz Bank shows an increase in the bank's retail and commercial deposits stemming from the accounts acquired from Allianz Bank. That acquisition supports the assumptions made on the growth of deposits.

(75) The Commission also notes favourably the fact that the growth in deposits contributes to diversifying the funding sources of the bank, to reducing the relative weight of mortgage bonds in the funding mix and reducing the bank's dependence on wholesale funding. Based on information provided, the share of wholesale funding (i.e. the sum of bonds issued, deposits from banks and the part of mortgage bonds that is not used to refinance loans) has decreased as a percentage of the total liabilities of the bank from [35%-30%] in 31 December 2009 to [30%-25%] in 31 December 2010. As a result of

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

[17] Commission comunication 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 of 19.8.2009, p.9.

[18] See recital 108.

that rebalancing of the bank's funding mix towards deposits, its average funding cost (calculated as interest expenses on total liabilities) has improved from [7-6.5] basis points on 31 December 2009 to [6-5.5] basis points on 31 December 2010. The return on assets also improved from [0.90% -1%] in 2009 to [1,05%-1,10%] in 2010. That positive trend is confirmed in the bank's forecast with return on assets forecast to stabilise in 2014 at [1.05% -1.2 %] in a base case scenario, and [0.9%-1.05%] in a stressed scenario. In 2014, return on equity would amount to [11%-13%] in a base case scenario and [10%-12%] in a stressed scenario.

(76) In the opening decision, the Commission also expressed its concerns on the sufficiency of the measures provided by the Hungarian authorities at that time to address the exposure of FHB to the Hungarian real estate market and the adverse currency movements. On the basis of the information submitted by Hungary on 9 December 2011, however, the Commission notes positively that FHB has taken the necessary steps to significantly reduce its involvement in the mortgage bond market[19]. The bank has also considerably increased its share of retail loans from [3%-5%] in 2009 to [9%-11%] in 2011. The Comission further notes that the 'Allianz deal' [20] contributed significantly to those positive trends. As for the bank's exposure to adverse currency movements, the commitment of FHB to expand its toolkit needed to fend off the extreme impact of foreign exchange risks on the capital side can be accepted as adequate to dispell the Commission's doubts[21] because it provides the possibility for the bank to eliminate or hedge its foreign exchange risk resulting from transactions in foreign currencies.

(77) The Commission therefore considers that the updated restructuring plan,taking into account the Allianz Bank deal, provides justification for concrete target levels for FHB's financial projections and contributes to restoring the bank's long-term viability.

8.4.2.2 Own contribution by the bank (burden-sharing)

(78) The Commission notes positively that the amount of the recapitalisation has already been fully paid back to the State on 19 February 2010, i.e within a period of less than a year and that the bank repaid the aid amount by using its own resources. FHB also used its own funds to repay four instalments of the mid-term State loan that were due on 11 February 2011, 11 May 2011, 11 August 2011 and 11 November 2011

8.4.2.3. Limitation of restructuring costs, remuneration

(79) The Commission considers favourably the early repayment of the amount of the recapitalisation to the State. Further, the acquisition of Allianz Bank by FHB improves the liquidity profile of the bank increasing the amount of retail and commercial deposits. That acquisition is thus an important aspect of the bank's business plan and contributes to its long-term profitability. Thus, it cannot be considered that the aid granted to FHB was used to develop its activities in new business areas, as Allianz Bank and FHB both operate in the same retail and commercial markets. As a result, the

[19] As of 30 June 2011, the bank's liabilities from mortgage bonds decreased to [365 billion HUF-350 billion HUF] (from [435 billion HUF – 445 billion HUF]at the end of 2009) for a total balance sheet of [835 billion HUF- 845 billion HUF] as of June 2011 (compared to [800 billion HUF -810 billion HUF] at the end of 2009), while at the same period the amount of deposits increased (from [60 billion HUF-65 billion HUF] in 2009 to [124 billion HUF-130 billion HUF] in 2011).

[20] The "Allianz deal" refers to the acquisition of Allianz Bank and the merger between Allianz Bank and FHB, also to the agreement for a strategic co-operation with Allianz Hungary Insurance Co. Ltd.

[21] See above recital (64), sixth indent

Commission considers that the acquisition of Allianz Bank Ltd by FHB an appropriate measure to maintain the bank's long-term viability.

(80) The Commission further notes that the information provided by the Hungarian authorities dispels the doubts expressed by the Commission in the opening decision of 24 January 2011 as to whether the acquisition of Allianz Bank had been carried to a large extent at the cost of the State. The acquisition of Allianz bank was completed on 30 September 2010, after the repayment of the recapitalisation to the State on 19 February 2010. As regards the outstanding amounts of the loan, the Commission notes positively that the bank has already repaid four instalments of the loan since February 2011[22]. The evaluation of the Commission is not altered by taking into consideration the "missing" remuneration of the recapitalisation, i.e., the amount that was originally not paid by FHB, since that payment amounted to around 1.6 billion HUF (Recital (40)) and the price paid for Allianz Bank was 3.3 billion HUF (Recital (60)).

(81) As regards remuneration of the aid measures, the Commission notes favourably that FHB and the Hungarian Government entered into an agreement on 15 December 2011 by which FHB agreed to pay to the State an additional remuneration of 1.6 billion HUF. In addition to the payment of 890 million HUF made in October 2010, the total payment on the recapitalisation by the Hungarian State of FHB corresponds to the remuneration rate of 10.49%, in line with the conditions set out in the guarantee and recapitalisation scheme.

(82) The Commission notes positively that the bank repaid the recapitalisation granted by the State within a period of less than a year (i.e the bank was recapitalised on 23 March 2009 and the State was repaidon 19 February 2010).

(83) The mid-term loan received by the bank under the liquidity scheme bears a remuneration of the higher of (i) IMF Special Drawing Right (hereinafter "SDR") + 345 bps and (ii) 12 month Interbank offered Rate (hereinafter "IBOR") + 100 bps + 123.5 bps (corresponding to a monthly average of between 3.79% and 4.08%), in line with the conditions set out in the liquidity scheme.

(84) The loan agreement for the mid-term State loan provides for its repayment […] starting from 11 February 2011. According to the information submitted by the Hungarian authorities, FHB has paid four installments of the loan that were due on 11 February 2011, 11 May 2011, 11 August 2011 and 11 November 2011. The Commission positively notes that FHB has been prompt in meeting, so far, its payment obligations regarding the mid-term loan. The Commission has no reason to doubt that there will be full and timely repayment of the loan by its maturity.

(85) That assessment is confirmed by the good performance of FHB despite difficulties in the Hungarian banking sector and the bank's relatively high core tier 1 ratio (12% at the end of 2008, which increased to 16.9% after the recapitalisation in 2009 and remained high at 10.5% after the repayment of the State capital). The capital requirement for Hungarian banks was 8% at that time. In contrast to some of its peers, the bank was able to maintain its strong capital position (CAR of 10.5% in March 2009, after the repayment to the State of the recapitalisation). In addition, it kept a rating of Baa3 by Moody's, which is still in the investment grade category.

(86) In the light of those facts, the Commission believes that FHB encountered difficulties only temporarily and not in a fundamental fashion. It therefore considers that the

[22] In line with the liquidity scheme , the bank has to pay back the amount of the loan in eight equal instalments.

remuneration paid by the bank is adequate, as corresponding to the remuneration required from a fundamentally sound bank.

(87) Given that the bank's viability was not endangered by Hungary's ongoing difficulties, the Commission will not ask for further remuneration to be paid to the State.

(88) Furthermore, the remuneration of the State by FHB for the mid-term loan (see Recital (84)) was in line with the conditions set out in the liquidity scheme. Therefore, the Commission considers that the remuneration of both aid measures is appropriate.

(89) The Commission also notes favourably that the bank paid no dividend on its ordinary shares for the years 2009 and 2010. Some restrictions were also implemented by FHB in respect of the salary, remuneration and benefits of its senior officers until the cessation of the interest of the Hungarian State.

(90) The Commission therefore considers that the restructuring plan ensures an appropriate own contribution of the bank, its shareholders and management to the restructuring costs.

8.4.2.3 Measures to correct the distortions of competition

(91) The Commission notes that measures contained in the bank's restructuring plan to limit distortions of competition are limited. First, no structural measures are undertaken. Second, the behavioural measures in the restructuring plan apply only as long as the bank benefits from the capital injected by the State. Third, the Commission positively notes that FHB has been prompt in meeting, so far, its payment obligations arising from the mid-term loan. The Commission has no reason to doubt the bank's ability to make full and timely repayment of the loan by its maturity. Fourth, the market position of FHB has not significantly changed since the acquisition of Allianz Bank (with market shares of [3%-3.3%] and [3.4%-3.6%] before and after the acquisition respectively) which reassures the Commisson that the effect of that acquisition on distortions of competition remains limited.

(92) The behavourial measures are limited to the following:

- The bank shall not follow any aggressive business strategy;

- The bank should not invest in new business areas, unless those investments were approved before the signing of the recapitalisation agreement

- The bank should avoid marketing the existence of the State aid.

(93) The Commission does not consider that other behavioural measures associated with the recapitalisation, mentioned by Hungarian authorities in their response to the opening decision of 27 January 2011, can be considered as measures to limit the distortions of competition caused by the aid.

(94) However, considering the limited size of FHB on the retail and commercial markets in Hungary ([0.9% - 1.08%] and [0.5 %-0.9%] market share respectively in the retail and corporate deposit markets) and considering the fact that the bank repaid the capital injected by the State less than one year after it has been issued, the Commission is of the opinion that the distortions of competition remain limited. Additionally, given that FHB has already paid back four instalments of the mid-term State loan under the

liquidity scheme, the Commission has no reason to doubt the bank will reply the loan in full and in a timely manner.

(95) Further, the remuneration paid to the State is in line with the recapitalisation and guarantee scheme and is therefore appropriate as is required by point 34 of the Restructuring Communication.

CONCLUSION

(96) The Commission finds that on the basis of the information communicated by the Hungarian authorities and the updated restructuring plan of FHB set out in section IV of this Decision, the implemented support measures in form of a liquidity support loan and a recapitalisation are compatible with the internal market pursuant to Article 107(3)(b) of the Treaty and fulfil the requirements of the Restructuring Communication in terms of viability, burden-sharing and measures to mitigate the distortions of competition.

(97) Hungary has exceptionally agreed that this Decision be adopted in English as its only authentic language,

HAS ADOPTED THIS DECISION:

Article 1

The measures consisting of a mid-term State loan of 120 billion HUF (approximately 410 million EUR*)* granted on 25 March 2009 with a maturity date of 11 November 2012 and a recapitalisation of 30 billion HUF (approximately 100 million EUR), in the form of Special Dividend Preference Shares plus one voting share granted on 31 March 2009 which Hungary implemented for FHB Jelzálogbank Nyrt are compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union.

Article 2

This Decision is addressed to Hungary.

Done at Brussels,

For the Commission

Joaquín ALMUNIA
Vice-President

If the decision contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of the decision. Your request specifying the relevant information should be sent by registered letter or fax to:

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