EUROPEAN COMMISSION

Brussels, 6.2.2012
C(2012) 675 final

Subject: **State Aid SA.34148 (2011/N) – Greece**
Third prolongation of the Recapitalisation of credit institutions in Greece under the Financial Stability Fund (FSF)

Sir,

I. PROCEDURE

(1) On 3 September 2010, the Commission approved recapitalisation operations under the Financial Stability Fund (hereinafter 'FSF' or 'the Fund') until 31 December 2010[1] (hereinafter the "original decision").

(2) On 14 December 2010, the Commission approved the prolongation of recapitalisation operations under the FSF until 30 June 2011 (hereinafter 'the first prolongation decision').[2]

(3) On 27 June 2011, the Commission approved a second prolongation of recapitalisation operations under the FSF until 31 December 2011[3].

(4) On 21 December 2011, the Greek authorities notified an extension of the measure until 30 June 2012 and exceptionally accepted that the Commission decision be adopted in the English language.

II. DESCRIPTION

II.1 Legal basis and objective

[1] See Commission decision of 3 September 2010 in State Aid N 328/2010 "Recapitalisation of credit institutions in Greece under the Financial Stability Fund (FSF)", OJ C 316, 20.11.2010, p. 7.

[2] See Commission decision of 14 December 2010 in State Aid case SA.31999 (2010/N), "Prolongation of the Recapitalisation of credit institutions in Greece under the Financial Stability Fund (FSF)", OJ C 62, 26.02.2011, p. 16.

[3] See Commission decision of 27 June 2011 in State Aid case SA.33154 (2010/N), "Second prolongation of the Recapitalisation of credit institutions in Greece under the Financial Stability Fund (FSF)", OJ C 244, 23.08.2011, p. 2.

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(5) The Memorandum of Understanding on Specific Economic Policy Conditionality between the Greek Government, the European Union, the International Monetary Fund and the European Central Bank dated 3 May 2010 provided for the establishment of the FSF.

(6) On 13 July 2010, the Greek Parliament enacted the Law 3864/2010 on the establishment of the Fund. The Fund is a legal person governed by private law, with administrative and financial independence.

(7) The objective of the Fund is to safeguard the stability of the Greek banking system by providing equity capital to credit institutions[4]. The Fund provides a safety net for credit institutions that may not be able to continue to comply with their capital requirements.

II.2 The Beneficiaries

(8) According to the law establishing the FSF, the beneficiaries of the Fund are all credit institutions, including subsidiaries of credit institutions having their registered office abroad, legally operating in Greece following authorization by the Bank of Greece.

II.3 Description of the Fund

(9) The capital of the Fund amounts to EUR 10 billion stemming from the EU-IMF financial support mechanism to Greece. The Fund's capital is gradually paid up by the Greek State. The Fund is set up for a limited duration until 30 June 2017.

(10) The activation of the Fund can occur in a number of situations as indicated in paragraph 15 of the original decision.

(11) When activated, the Fund and the credit institution shall jointly draw up a detailed restructuring plan or amend any plan already submitted to the European Commission, in accordance with the applicable EU State aid legislation and the relevant guidelines provided by the European Commission. Within six months from the granting of the capital injection, Greece shall submit the restructuring plan to the European Commission.

(12) According to Law 3864/2010, capital injections shall be carried out by issuance of preference shares, except when the credit institution does not comply with the Pillar 1[5] capital requirements and no private solution has been found, in which case the capital increase shall be carried out by issuance of common shares. Such capital increases shall be covered entirely in cash. In principle, the remuneration of the preference shares is 10%. The Greek authorities shall notify individually cases where the remuneration is lower than 10%.

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[4] The Fund will operate in parallel with the Recapitalisation Scheme established under Law 3723/2008 "For the enhancement of liquidity of the economy in response to the impact of the international financial crisis" and approved by the Commission decision of 19 November 2008 in State aid case N560/2008 with the subsequent prolongations and amendments (hereinafter the "Recapitalisation Scheme"). See para. 40 of the original decision.

[5] See paragraph 15 of the original decision. The banks' consolidated core tier 1 minimum regulatory capital requirement has been set at 9 percent since the beginning of 2012.

Amendments introduced to the scheme since it was approved on 27 June 2011

(13) Law 3864/2010 has been amended in several regards.

(14) Law 3864/2010 as amended now provides that capital support shall be supplied through the participation of the FSF in a capital increase of the credit institution carried out by issuance of **common shares** and covered entirely in cash. The old shareholders shall not have a pre-emption right over the new shares.

(15) The issue price of shares shall reflect the fair value of the credit institution, disregarding any actual or potential support by the Greek government, the FSF or the Bank of Greece outside the Eurosystem operations.

(16) In any event, if the credit institution is unable to raise funds from the private sector, the Fund may decide to provide capital support at prices considerably lower than the average prices prevailing at the market after the announcement of the capital increase by the credit institution, subject to conditions that minimise the risks of negative developments and, therefore, of any burden to the Greek government. The FSF shall ensure that credit institutions receiving capital support from the FSF take steps to achieve restructuring, merger or acquisition, or transfer of their business to another financial institution within 24 months from recapitalisation.

(17) The common shares shall confer the **special rights**. Such shares shall not be transferrable by the FSF to any third parties or tradable on a regulated market until the end of the duration of the FSF (30 June 2017).

(18) Unless the FSF is represented with at least one member in the recapitalised credit institution’s Board of Directors, it shall participate in the Board of Directors with an additional member.

(19) In any event, the remuneration of the Chairman, Managing Director and the other members of the Board of Directors, as well as the general managers and their deputies may not exceed the total remuneration of the Governor of the Bank of Greece. Any additional remuneration (bonuses) granted to the same persons shall be abolished for the period during which the credit institution participates in the capital support programme under this law.

(20) The FSF representative shall have free access to the credit institution’s books and records for the purposes of Law 3864/2010.

(21) The capacity of representative of the FSF under Law 3864/2010 shall be incompatible with that of representative of the Greek government under Article 1(3)(b) of Law 3723/2008 (i.e. support measures for credit institutions in Greece).

(22) In the event of liquidation of the credit institution, the FSF, as a shareholder, shall be satisfied from the liquidation proceeds with priority over all other shareholders, jointly with the government in its capacity as beneficiary of the preference shares of Law 3723/2008.

(23) The role of the FSF has also been extended to the resolution of failed credit institutions. However, that aspect of the Fund's operation is outside the scope of the present decision and not approved by it.

III. Operation of the measure

(24) According to the information provided by the Greek authorities, no recapitalisation operations have been carried out under the Fund yet.

(25) In the context of the Greek resolution framework, the FSF provided capital of around EUR 250 million to the transitional credit institution "New Proton Bank S.A.". As indicated above, an intervention in the framework of resolution of failed banks is not covered by the present decision.

IV. Position of Greece

(26) The Greek authorities have notified the prolongation measure as compatible State aid pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union (TFEU).

(27) Greece intends to extend the measure until 30 June 2012. The Greek authorities notified amendments to the conditions and commitments taken in the context of the original decision in State aid case N 328/2010, in particular with regards to the limited scope of the capital interventions (through ordinary shares only), the enhanced rights attached to the common shares in favour of the FSF and pricing in line with the 2011 Prolongation Communication for recapitalisations issued after 1 January 2012[6]. The current provisions of the FSF law (Law 3864/2010 as amended by art 50, last paragraph of Law 4021/2011) ensure that "if banks are nevertheless not able to raise capital from the private sector, the FSF may decide to offer a capital injection at prices substantially below the average market price prevailing after the announcement of bank capital needs, subject to conditions to minimize downside risks and thus the burden on taxpayers". Those provisions comply with the new pricing requirements of the 2011 Prolongation Communication. The Greek authorities also commit that any changes in the FSF Law envisaged in the next Memorandum of Understanding on Specific Economic Policy Conditionality between the Greek Government, the European Union, the International Monetary Fund and the European Central Bank will be effective by the date provided in that Memorandum and the requested changes will be notified to the Commission for State aid approval.

(28) The Greek authorities submit that an extension of the scheme until 30 June 2012 would prove beneficial for the restoration of confidence and the normalization of the functioning of the markets. According to Greece, it should be noted that the Greek banking system still faces acute funding problems. They result from a) the continued outflow of deposits, b) the inability to access the wholesale markets and c) the impact of increased spreads on the value of eligible collateral, as well as the deterioration of the economic situation of both corporates and households and the impact of both the forthcoming PSI[7] programme and the diagnostic study of banks' loan portfolios on the capital position of all Greek banks.

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6 Communication from the Commission on the application, from January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, paragraph 2, OJ C 356, 6.12.2011, p. 7.

7 PSI (Private Sector Involvement): Negotiation between the Greek authorities and its private creditors with the aim to achieve a partial waiver of the Greek government debt by its private creditors on a voluntary basis.

V. ASSESSMENT

V.1 Existence of State aid

(29) As set out in Article 107(1) TFEU any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market, save as otherwise provided.

(30) For the reasons indicated in its original decision in State aid case N 328/2010 and the prolongation decisions of 14 December 2010 and 27 June 2011, the Commission considers that the measure constitutes State aid. The notified extension does not affect that finding. The measure remains State aid within the meaning of Article 107(1) TFEU.

V.2 Compatibility of the measure

(31) For the reasons indicated in the original decision and the prolongation decisions, the Commission found the measure to be compatible with the internal market under Article 107(3)(b) TFEU, as it met the relevant criteria of appropriateness, necessity and proportionality.

(32) The Commission shares the view of the Greek authorities that the continuation of the measure can be deemed necessary to ensure financial stability as confirmed by the Fund. The Commission notes that all Greek banks will need capital injections triggered by: (i) the losses on the Greek government bonds due to the PSI in the Greek debt restructuring; (ii) the loan book diagnosis; (iii) the deep recession of the Greek economy which is in its fourth year of deeply negative growth, leading to an accumulation of non-performing loans, forcing banks to take large impairments.

(33) That analysis is confirmed also by the Economic Adjustment Programme for Greece-Fifth review of October 2011[8]. According to that report, the financial sector's situation remains fragile. The liquidity of Greek banks has tightened further, as the level of deposits continues to contract. In part, it results from households' and businesses' liquidity constraints, with the former reducing their deposits to finance and smooth consumption, but also the uneasiness caused by the ongoing discussion on debt restructuring, as well as the overall market uncertainty. Concomitantly, the reliance of Greek banks on borrowing from the central bank has remained very high. Several banks posted losses due to the PSI-related impairments of Greek government bonds and the continuation in asset quality deterioration amid a weak economic environment. Those losses occurred in spite of relatively strong pre-provisioning income. The Bank of Greece will require additional capital buffers against potential further deterioration of the operational environment, based on each bank’s specific risk profile.

(34) The Commission therefore considers that the extension of the measure until 30 June 2012 is appropriate and necessary to remedy a serious disturbance of the Greek economy.

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[8] http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp87_en.pdf, pp.3, 144,145.

(35) The Commission notes that the extension of the measure would prove beneficial for the restoration of confidence and the normalization of the functioning of the markets, taking into account a number of factors such as the deterioration of the economic situation and fiscal difficulties of Greece, current market demand conditions etc.

(36) The extension notified by the Greek authorities on 21 December 2011 is a response to the difficulties that Greek banks have to deal with, in order to restore confidence. The Commission notes that the measure is, under current circumstances, vital for the credit supply to the economy and financial stability.

(37) The Commission notes that six months from the granting of any capital injection, the Greek authorities shall submit to the Commission a restructuring plan for the credit institution recapitalised under the Fund[9] in accordance with the Restructuring Communication[10]. That obligation, already established in the original decision, is in line with the requirements set out in the 2010 Prolongation Communication for recapitalisations issued before 31 December 2011[11], and with the 2011 Prolongation Communication for recapitalisations issued after 1 January 2012[12].

(38) As regards the combination of aid granted under the scheme with other aid measures, as indicated in the Annex to the Restructuring Communication, any restructuring plan should take account of all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). It means that the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To that end an individual *ex ante* notification is necessary.

(39) Furthermore, the Commission recalls that, based on paragraph 16 of the Restructuring Communication, should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, it cannot be granted under an approved scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission's final decision on that bank.

(40) The Commission notes that the Greek authorities have limited the scope of the capital interventions carried out by the FSF to those in the form of ordinary shares only. Those common shares give the FSF special rights, enhancing its power of intervention. Moreover, the pricing is in line with the 2011 Prolongation Communication for recapitalisations issued after 1 January 2012. All the other conditions and commitments taken in the context of the original decision in State aid case N 328/2010 will continue to apply.

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[9] See para. 64 of the original decision.

[10] Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009.

[11] Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

[12] Communication from the Commission on the application, from 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.

(41) In terms of pricing, the Commission notes that for common equity the objective of an adequate remuneration can only be fulfilled through an entry price of the new shares which correctly reflects the value of the company. According to the 2011 Prolongation Communication the market price is to be used as reference for quoted companies whereas for non-quoted companies the price should be based on a valuation. According to point 8 of the Prolongation Communication a "sufficient discount" should be applied to the market price. The current provisions of the FSF law (Law 3864/2010 as amended by art 50, last paragraph of Law 4021/2011) ensure that "if banks are nevertheless not able to raise capital from the private sector, the FSF may decide to offer a capital injection at prices substantially below the average market price prevailing after the announcement of bank capital needs, subject to conditions to minimize downside risks and thus the burden on taxpayers". On that basis, the Commission concludes that the FSF recapitalisation scheme ensures that the new shares will be subscribed by the FSF at a price significantly below the stock market price and thereby fulfil the requirements of point 8 of the 2011 Prolongation Communication.

(42) Moreover, the Greek authorities commit that any changes in the FSF Law envisaged in the next Memorandum of Understanding signed by Greece will be effective by the date provided in the said Memorandum and the requested changes will be notified to the Commission for State aid approval. That commitment ensures that the scheme will not continue to operate in its current form if the Memorandum considers that changes must be introduced.

(43) In addition the Greek authorities commit to notify individually any recapitalisation of a bank which has already received a recapitalisation from the State in the current crisis. The Commission notes that commitment will allow it to assess individually recapitalisation of banks which receive successive aid. It is important, as, in such cases, it has to be assessed more in detail whether an additional recapitalisation of the bank is the best option to preserve financial stability and limit distortions of competition. In such cases of successive aid, it has also to be verified whether the recapitalisation instrument and remuneration to be used by the FSF are still appropriate.

(44) On the basis of the above, the measure remains compatible with the internal market until 30 June 2012.

VI. Decision

The Commission has accordingly decided to consider the extension of the aid measure until 30 June 2012 compatible with the internal market.

The Commission recalls the commitment of the Greek authorities to notify individually the recapitalisation of banks which have already received recapitalisation aid during the current crisis. Such recapitalisations are therefore not approved by the current decision.

The Commission notes that Greece has exceptionally accepted that the decision be adopted in the English language.

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President