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Subject: State Aid SA.53519 – Greece – Hellenic Asset Protection Scheme ("Hercules")

Excellency,

1. PROCEDURE

(1) In February 2019, the Greek authorities initiated an informal discussion on a proposed Hellenic Asset Protection Scheme ("the Scheme", also named "Hercules"), based on the Italian securitisation scheme "GACS", which the Commission had assessed as a no-aid measure[1].

(2) From February to August 2019, during a number of pre-notification contacts, the Greek authorities provided additional information to the Commission services.

(3) On 13 September 2019, the Greek authorities notified the measure for reasons of legal certainty.

(4) By letter dated 13 September 2019, Greece exceptionally agreed to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958[2] and to have the present decision adopted and notified in English.

[1] OJ C 161, 4.5.2016, p. 5.
[2] OJ 17, 6.10.1958, p. 385.

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2. BACKGROUND

(5) The economic recession in Greece in the past decade has severely affected the capacity of Greek households and firms to service their debt. It has led to a sharp increase of non-performing loans (“NPLs”), up from EUR 15 billion in 2008 to a peak of EUR 106 billion[3] in September 2016, which decreased since then to below EUR 80 billion in March 2019. The NPL ratio[4] of the Greek banking sector as a whole has increased by more than eight times since 2008 and stood at 45.1%[5] at the end of March 2019.

(6) The European Central Bank (ECB) in its capacity as banking supervisor has set binding targets for Greek banks to significantly reduce the amount of their NPLs to strengthen the stability of the Greek banking system. Achieving these targets requires a further decrease of NPLs by approximately EUR 50 billion by the end of 2021.

(7) There has been already a number of other reforms and measures aiming at improving the banks' ability to deal with NPLs (*inter alia* including the establishment of a comprehensive legislative and regulatory framework for the licensing and supervision of servicing companies for NPLs and new legislation on primary residence protection[6]) and actions from the banks themselves. To contribute to reducing the overhang of NPLs and increase financial stability, the Greek authorities intend to introduce the Scheme.

3. DESCRIPTION OF THE NOTIFIED SCHEME

(8) Greece has notified a guarantee scheme under which a State guarantee covers the senior tranches of securitisation structures containing NPLs from banks' balance sheets. Greece notified the Scheme for legal certainty and submits that the State guarantees granted under the Scheme do not constitute State aid as they are priced on market terms.

3.1. Securitisation structure

(9) The Scheme is voluntary and open to all banks. It concerns a State guarantee on the senior tranche of individual banks' securitisation structures (the "originator"), as per the conditions described in recitals (10) to (21).

(10) The necessary financing is raised through issuing senior and junior notes (with an option to issue mezzanine notes). The senior notes rank above the mezzanine and the junior notes in the waterfall structure and benefit from a State guarantee. The mezzanine notes rank between the senior and the junior notes. Neither the

[3] Data of the Bank of Greece, presented on a solo basis and referring to on-balance sheet gross loans and advances of Greek commercial and cooperative banks as available under: https://www.bankofgreece.gr/Pages/en/Statistics/loans.aspx.

[4] The NPL ratio is the ratio of the stock of gross non-performing loans over gross loans and advances.

[5] Only three Member States within the EU have NPL ratios above 10%, with Greek Banks’ NPL ratio being about twice as high compared as Cyprus and four times as high as Portugal: see the Commission’s Fourth Progress Report on the reduction of non-performing loans and further risk reduction in the Banking Union, as available on: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019DC0278&from=EN

[6] The Commission adopted a no-objection decision on the Primary Residence Protection Scheme on 19 September 2019 (SA. 52520).

mezzanine nor the junior notes will benefit from a State guarantee. The junior notes, which are initially underwritten by the issuer, rank the lowest and are fully participating in gains and losses. They do not give any right to cash flows until the notional of the senior and the mezzanine tranches have been repaid in full.

(11) Both the senior and the mezzanine notes have a floating coupon and a flexible redemption structure to pass on cash flows from the securitised NPL portfolio. Coupons are paid quarterly, semi-annually or annually and are based on the remaining outstanding notional of the notes.

(12) The senior notes have a target rating of BB-, Ba3, BB-, BBL or higher, taking into account the cost of the guarantee but not the protection of the State guarantee. The setup of the securitisation structure will be calibrated such that the target rating on the senior notes is achieved. The rating and the calibration is performed by an External Credit Assessment Institution ("ECAI") approved by the ECB (the "rating agency")[7]. When two ratings are assigned to the senior notes, the second rating can be performed by a rating agency registered pursuant to Regulation 1060/2009[8]. A guarantee under the Scheme can be provided only if both ratings are not lower than a BB- (or equivalent) rating. For the purpose of the remuneration of the guarantee as outlined in section 3.2, only the lower of the two ratings is considered.

(13) The State guarantee on the senior tranche will become effective only after the originating bank has sold to private investors at least 50% plus one share of the junior tranche at a positive value and has sold at a positive price a part of the junior and mezzanine tranches which is sufficiently large to achieve accounting de-recognition of the sold NPLs. The junior and the mezzanine notes cannot be bought by the State or by State-related bodies or companies.

(14) NPLs on the originator's balance sheet are securitised at no higher than the current Net Book Value (NBV, gross book value minus current provisioning level).

(15) Upon securitisation, the originator will appoint an independent servicer[9] to work-out the underlying NPLs of the securitisation structure. This will allow the rating agency, which will perform the calibration and assign a rating to the senior tranche of the securitisation structure, to take into account the benefits that the work-out capabilities of the chosen servicer may bring. If the junior notes are sold after the originator has appointed a servicer of the NPLs, the new owner of the junior notes has the right to appoint a different servicer, subject to confirmation of a non-negative rating action by the rating agency.

(16) To manage potential liquidity mismatches between cash flows from the underlying NPL portfolio and contractually obligatory coupon payments on the senior and the mezzanine notes, the securitisation structure will seek a liquidity

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[7] DBRS, FitchRatings, Moody's and Standard & Poor's.

[8] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ L 302, 17.11.2009, p. 1–31.

[9] Alternatively, a captive recovery unit of the originating bank can work-out the NPLs, upon the disposal of such unit to private investors. The disposal of the captive recovery unit will be considered as fulfilled when the relevant transaction is closed (payment of price and transfer of shares). The private investor should have control to this unit according to International Financial Reporting Standards (IFRS 10).

line (from either the originator or any other commercial bank) or create a liquidity buffer in an amount sufficient to achieve the minimum required rating. That liquidity line will rank senior to all notes in the waterfall structure.

(17) In accordance with the rating agency's criteria, possible interest rate mismatches between assets and liabilities of the securitisation structure will be covered with appropriate hedging arrangements to be negotiated between the issuer and suitable market counterparties.

(18) Cash flows from the underlying NPL portfolio and the swap counterparties will be used for payments in the following waterfall order:

(a) Obligatory regular payments

(i.) Fees to the servicer;

(ii.) Interest on the liquidity line;

(iii.) Guarantee fees on the senior notes;

(iv.) Payments to the swap counterparties;

(v.) Interest on the senior notes;

(vi.) Replenishment of the liquidity line (if previously utilized);

(b) Regular payments to mezzanine noteholders which may be subject to performance triggers and deferral provisions

(i.) Interest on the mezzanine notes (if mezzanine notes present);

(c) Repayment starting at the highest seniority still outstanding

(i.) Repayment in full of senior notes;

(ii.) Repayment in full of mezzanine notes (if mezzanine notes present);

(iii.) Pay-out on junior notes.

(19) Performance triggers for the NPL servicer in charge of working out the NPLs, at the moment that mezzanine tranche interest payments are due, can provide that the payment of mezzanine tranche interest is postponed. The latter payment will be resumed only at the next moment at which mezzanine tranche interest is due, and actual recoveries have caught up with projected recoveries, or when the senior tranche has been fully repaid. A part of the fees to be paid to the NPL servicer can also be conditional upon performance targets. The payment of the deferred fees will be resumed only when actual recoveries have caught up with projected recoveries, or when the senior tranche has been fully repaid.

(20) The initial appointed NPL servicer can be replaced by another NPL servicer in case the State guarantee is called upon and if, at two consecutive interest payment dates, the NPL servicer has cumulatively recovered less than the cumulative NPL recoveries projected in his business plan as assessed by the credit rating agency. In case of such a replacement, no penalty or compensation is due to the replaced

NPL servicer. The new NPL servicer cannot be linked to the replaced servicer. Furthermore, the replaced servicer is obliged to cooperate in good faith to ensure a swift handover. In addition, the originating bank needs to demonstrate that it made the necessary preparations to enable a rapid and effective replacement.

(21) The performance of the NPL servicer will be monitored also by the Bank of Greece and shall be reported to the General Accounting Office and the Public Debt Management Office, against its projected cash flows, in order to alert against eventual delays in payments or a potential State guarantee call.

3.2. Pricing of the State guarantee

(22) The Greek authorities submit that the pricing of the State guarantee on senior notes will be on market terms in order to ensure the aid-free nature of the Scheme. The remuneration (the "Guarantee Fee") reflects the risks taken by the State and depends on the maturity of the notes. The Guarantee Fee is calculated with the following formula:

$$Guarantee\ Fee = Pre - Adjustment\ Fee * Adjusted\ Spread\ Ratio\ Factor$$

Where:

$$Pre - Adjustment\ Fee = base\ rate + penalty$$

$$Adjusted\ Spread\ Ratio\ Factor = 1 - Spread\ Ratio\ Factor * Overall\ Average\ Scoring$$

(23) The Pre-Adjustment Fee is determined as follows:

(a) The starting point is given by the Hellenic Republic Credit Default Swap ("CDS") ("Benchmark"). For the Benchmark price, the average over the last two months of mid-prices at the time of the transaction is taken from Bloomberg.

(b) A basic step up fee is charged on the guarantee in the following way:

(i.) in years 1, 2 and 3, the price of the 3-years Benchmark CDS;

(ii.) in years 4 and 5, the price of the 5-years Benchmark CDS;

(iii.) in years 6 and 7, the price of the 7-years Benchmark CDS;

(iv.) thereafter, the price of the 10-years Benchmark CDS.

(c) An additional penalty (the "penalty") is applied in the following way:

(i.) in years 4 and 5, if the senior tranche has not been repaid in full by the end of year 3, a penalty charge is added to the basic fee corresponding to making up the difference in payments from a 5-years Benchmark CDS held over the full period of years 1 to 5 compared to the actual payments made in years 1 to 3;

(ii.) in years 6 and 7, if the senior tranche has not been repaid in full by the end of year 5, a penalty charge is added to the basic fee

corresponding to making up the difference in payments from a 7-years Benchmark CDS held over the full period of years 1 to 7 compared to the actual payments made in years 1 to 5;

(iii.) in years 8, 9 and 10, if the senior tranche has not been repaid in full by the end of year 7, a penalty charge is added to the basic fee corresponding to making up the difference in payments from a 10-years Benchmark CDS held over the full period of years 1 to 10 compared to the actual payments made in years 1 to 7.

(d) The calculations in (c) are made on the basis of the following assumptions:

(i.) a discount rate of 4%;

(ii.) a linear repayment schedule of the senior tranche to be fully paid off after year 10[10].

(24) This Pre-Adjustment Fee, which includes the penalties, is further adjusted by an "Adjusted Spread Ratio Factor". This factor takes into account the difference in the rating class of the senior tranche and of the average rating of the Benchmark[11]. This Adjusted Spread Ratio Factor is given by the following:

(a) For the initial Spread Ratio Factor, the average of the ratio of the yield-to-worst ("YTW") of two representative Bloomberg indexes[12], one including companies with a rating in the BB range and the other one with companies in the B range, minus the 5-years Euro swap rate respectively, has been calculated:

$$Spread\ Ratio\ Factor_t = \frac{YTW\ (BB\ index)_t - swap\ rate_t}{YTW\ (B\ index)_t - swap\ rate_t}$$

(b) due to the limited volatility of this ratio and to provide an adequate degree of stability and comparability for the originators, the Spread Ratio factor is fixed at 50%[13] for the duration of this scheme;

(c) at the time of each individual transaction this Spread Ratio Factor is then adjusted for the effective Benchmark average rating ("Overall Average Scoring"), given by the two-months average of the ratings assigned by the ECAI as defined in recital (12). Each rating notch is assigned a numeric score, depending on the rating of the senior notes in the respective transaction, as per the following scoring table:

Table 1: Numeric scores per notch

Rating of the	*Rating of senior note*		
	BB+	*BB*	*BB-*

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[10] That assumption implies a yearly repayment rate of 1/10.

[11] The Greek CDS refers to a Sovereign credit rating for Greece that in September 2019 is B1, BB-, B+, BB(low).

[12] The ticker symbols are LP07TREU and LHYBTREU for the BB and B index, respectively.

[13] The calculation provided by the Greek authorities show that the Spread ratio is 0.487, 0.507 and 0.508 when calculated respectively with a 1 year, 6 months and 3 months time horizon.

Benchmark			
BB+	*0*	*0*	*0*
BB	*0.33*	*0*	*0*
BB-	*0.67*	*0.33*	*0*
B+	*1.00*	*0.67*	*0.33*
B	*1.33*	*1.00*	*0.67*
B-	*1.67*	*1.33*	*1.00*

(d) the average score for each ECAI is calculated by weighting the rating for the relevant number of days over the reference period. A simple average of the weighted average scores of the ECAI results in the Overall Average Scoring;

(e) the Adjusted Spread Factor is then calculated as follows, where the 50% is the Spread Ratio Factor:

$$Adjusted\ Spread\ Ratio\ Factor = 1 - 50\% * Overall\ Average\ Scoring$$

(25) Multiplying the Pre-Adjustment Fee with the Adjusted Spread Ratio Factor results in the Guarantee Fee that has to be paid to the State by the securitisation structure.

3.3. Implementation

(26) Greece seeks legal certainty about the aid-free character of the Scheme, which will have a duration of 18 months as of the date of the present decision, implying an 18-month period during which the guarantees can be granted. Greece may decide to notify a prolongation of the Scheme. In such a case, all parameters are set to be reviewed after that period in order to ensure the continued aid-free character of the Scheme.

3.4. Commitments

(27) As part of the notification, the Greek authorities also provided commitments (the "Commitments"), which are outlined in this section.

(28) Greece commits that the rating and the calibration of the notes structure, i.e. the thickness of the different tranches of the securitisation notes, will take into account at least the following factors:

(a) The expected cash flows and their timings coming from the NPL servicing such as recovery payments, sales proceeds, etc.;

(b) Any cashflows received or paid under the hedging agreements;

(c) Fees for the servicing of NPLs;

(d) Contractual payment obligations on the issued notes;

(e) Guarantee fee on the guaranteed notes;

(f) Any other costs incurred by the securitisation structure in its normal business operations;

(g) The thickness of the junior tranche (and if present the mezzanine tranche).

(29) Greece commits to provide to the rating agency full access to at least the following information:

(a) Qualitative and quantitative information about the selected NPL servicer including:

(i.) Track record as successful NPL servicer in Greece (aspects considered: successful, present in Greece, unproven/without track record, no specialist);

(ii.) Management team present on the specific deal;

(iii.) Fee structure.

(b) Loan-by-loan information on the underlying NPL portfolio including the full loan documentation and contractual documents, including the vintage of the NPL cohorts and related work-out times under judicial procedures;

(c) The operational setup of the securitisation vehicle including all costs;

(d) The guarantee pricing formula to include related fee payments in the cash flow model.

(30) Where information is not available, assumptions will be made on a prudent basis.

(31) Greece commits that all information reflecting specificities of the NPL categories will be made available to the rating agency.

(32) Greece commits to ensure that the Scheme, its implementation and the various specificities in its setup, in particular the rating requirements and its application, will be subject to regular monitoring by a monitoring trustee, to be appointed by the Commission upon proposal by Greece.

(33) Greece will make available to the monitoring trustee a report setting out how the different criteria and conditions set out in sections 3.1 and 3.2 and recitals (28) and (29) have been taken into account and contributed to the final rating result.

(34) Greece will ensure that both the originating banks and the rating agency will provide the necessary access to information for the monitoring trustee to enable it to discharge its monitoring duties.

(35) Greece commits that for each individual guarantee application under the Scheme, the pricing of the Guarantee Fee will be calculated based on the formula provided in-here applied at the time of the granting of the guarantee.

(36) Greece commits to limit the window for granting guarantees under the Scheme for a period of 18 months following the Commission approval of the Guarantee Scheme as a no-aid guarantee scheme with an overall notional amount of guarantees estimated at up to EUR 9 billion.

(37) If a renewal of the scheme is notified, Greece commits to provide a report on the usage of the scheme together with the notification for renewal.

4. POSITION OF GREECE

(38) Greece has notified the Scheme for reasons of legal certainty and submits that any guarantee provided under the Scheme will be provided at market terms and therefore does not contain State aid within the meaning of Article 107(1) TFEU.

5. ASSESSMENT OF THE MEASURE

(39) By virtue of 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."*

(40) To constitute State aid within the meaning of Article 107(1) TFEU, a measure has to fulfil four conditions. First, the aid is granted by a Member State or through State resources. Second, the measure confers a selective advantage to certain undertakings or the production of certain goods. Third, the measure must be liable to affect trade between Member States. Fourth, the measure must distort or threaten to distort competition in the internal market.

(41) The criteria laid down in Article 107(1) TFEU are cumulative. If any of those criteria are not fulfilled, there is, thus, no need to examine the other criteria and the presence of State aid can be excluded.

(42) The Scheme will be implemented by a law and individual guarantees will be granted under the Scheme by the Greek Minister of Finance. The provision of a guarantee results in a concrete possible risk of imposing an additional burden on the State in the future. The Commission therefore concludes that the Scheme is imputable to the State and that it is financed through State resources.

(43) Given that the Scheme is designed to address banks with portfolios of NPLs, it is by its nature selective. In light of the characteristics of the financial services markets in the Union which feature high level of exchanges and trade, the Scheme is capable of affecting trade between Member States. If it were to provide an advantage to participating banks that they could not obtain on the market, the Scheme would be capable of distorting competition.

(44) In the following, the Commission will therefore assess whether Greece provides an advantage through the Scheme.

5.1. Guarantee Notice

(45) In the Guarantee Notice[14], the Commission has laid out conditions under which guarantee schemes can be considered not to include State aid.

(46) According to point 3.4 of the Guarantee Notice, guarantee schemes can be considered free of State aid under the following conditions:

(a) The scheme is closed to borrowers in financial difficulties;

(b) The guarantee amount can be measured when it is granted;

(c) The guarantee cannot cover more than 80% of the outstanding financial obligation;

(d) The remuneration is based on a realistic assessment of the risk and the premiums paid so that the scheme can be considered self-financing;

(e) The level of premiums has to be reviewed at least every 12 months in view of the self-financing nature of the scheme;

(f) The premiums charged have to cover the normal risks associated with granting the guarantee, the administrative costs and a yearly remuneration on the necessary capital.

(47) According to the notification, certain of the above conditions are clearly fulfilled, such as (b) and (e). However, as there are no commitments to the contrary, the Commission cannot exclude that the Scheme is open to borrowers in financial difficulty or might be used in specific circumstances to provide guarantees covering more than 80% of the outstanding financial obligation. The Commission therefore considers it likely that these conditions will not be fulfilled in all instances of the Scheme's usage. Therefore, the Commission cannot exclude the presence of aid in the Scheme on the basis of the conditions under point 3.4 of the Guarantee Notice.

(48) Notwithstanding the above, according to point 3.1 of the Guarantee Notice, the assessment of the Commission regarding the existence of aid should in general be based "*on the principle of an investor operating in a market economy (the 'market economy investor principle', or 'MEIP'). [...] State aid is not involved where a new funding source is made available on conditions which would be acceptable for a private operator under the normal conditions of a market economy*."

(49) The Commission will therefore assess whether under the Scheme Greece is acting in a way comparable to how a private economic operator would act under normal market conditions, bearing in mind that a guarantee provided under the Scheme can be free of State aid only if the State is remunerated at market terms for the risk it takes. Therefore, the Commission first assesses the risk taken by the State when providing such a guarantee and then whether that risk is remunerated under the proposed remuneration structure in a manner that would be acceptable for a private operator under normal market conditions.

5.2. Risk taken by the State

(50) In the Impaired Asset Communication[15], the Commission has outlined the conditions for how a transfer of risks on impaired assets from a bank concerned to the State can be structured either (a) at market value without State aid or (b) at the real economic value with compatible State aid.

[15] Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C 72, 26.03.2009, p. 1.

(51) Under the notified Scheme, the Commission will not be in a position to perform a case-by-case assessment of the value of the underlying assets. However, given the specific construction of the Scheme, the risk to which the State will be exposed can be assessed independently of the assessment of the value of the underlying assets. This risk is limited to a senior tranche in all cases where a guarantee is granted as per the construction of the Scheme as assessed in recitals (52) to (56). Consequently, the remuneration that a private operator would ask for insuring such risk can also be assessed.

(52) First, the Commission notes that the NPLs' management is transferred to an independent servicer[16], a company specialised in NPL management. Engaging such an independent servicer will increase the likely recovery and reduce the risk of the work-out not being performed in the most efficient way available. The option to make part of the fees to be paid to the NPL servicer conditional upon performance targets[17] can improve the alignment between the interests of the NPL servicer and the owners of the senior tranche, and thereby also those of the guarantor. Also the optional replacement[18] of the NPL servicer by another one in case of repeated underperformance and if the State guarantee is called upon can contribute further to this alignment of interests. In addition, the Commission notes positively the monitoring of the NPL servicers' performance by the Greek authorities against the projected cash flows[19] as such monitoring allows to detect early warning signs and offers the opportunity to take actions against potential delays in payments or a potential State guarantee call.

(53) Second, the Commission notes that the senior tranche has a fully preferred status. Cash flows cannot be paid to the junior and the notional cannot be repaid to mezzanine tranches before the senior tranche has been repaid in full. Furthermore, the Commission notes that the option to defer part of the interest payments on the mezzanine tranche when actual NPL recoveries fall behind projected recoveries[20] can contribute to reducing the risk of the State. When included in the structure, such deferral makes the timely repayment of a senior tranche's interest and principal more likely because it limits the pay-out of mezzanine tranche interest payments which would otherwise be senior to the reimbursement of the senior tranche.

(54) Third, the Commission notes that the exposure of the State is confined to the senior tranche of the securitisation vehicle. The proportion of non-guaranteed and loss-absorbing junior and mezzanine tranches (the latter being optional) in comparison with the overall financing of the special purpose vehicles ("SPVs") will be such that the senior tranche receives a rating of BB-, or higher, before taking into account the State guarantee[21].

[16] Alternatively, a captive recovery unit of the originating bank can work-out the NPLs, upon the disposal of such unit to private investors. Therefore, also in this case the servicer will be independent within a short time-frame.
[17] See recital (19) of this Decision.
[18] See recital (20) of this Decision.
[19] See recital (21) of this Decision.
[20] See recital (19) of this Decision.
[21] The Commission observes that in the case of Greece in particular, certain factors can put downward pressure or a cap on the rating, such as the country ceiling for Greece set by the rating agencies. The

(55) Fourth, the pre-guarantee rating of the senior tranche and the size of the loss-absorbing tranches will be established taking into account the points set out in recitals (52) to (53) by an ECAI approved by the ECB, ensuring that the necessary expertise for providing such a rating is available.

(56) Finally, the Commission takes account of the fact that the guarantee will only be effective once the originating bank has sold 50% plus one share of the junior tranches to a private market participant at a positive price. Therefore, any State guarantee on the senior tranche provided under the Scheme will in effect guarantee less than the transfer value of the underlying assets.

(57) The Commission considers that the elements in recitals (52) to (56) clearly define the exposure of the State and provide an adequate amount of confidence that the State guarantee is not provided at a level where losses are likely. That confidence is increased further by Greece's commitments to:

(a) Provide the rating agency with all the necessary information[22] to do a prudent assessment, in particular the information about the historical state and current development of the work-out speed in the Greek NPL market;

(b) Ensure that the data provided is taken into account in the process of providing the rating for the senior tranche[23];

(c) Submit the Scheme and the actions of the rating agencies involved to independent monitoring by a monitoring trustee.

(58) The Commission therefore concludes that the exposure of the State through the State guarantee on the senior tranche in the Scheme as notified will be limited to that of a BB- (or higher) instrument, based on expert determination and verified by market-based elements. Using only an ECAI for the expert determination, taken together with Greece's commitments to provide the necessary information and ensure that it is used, in conjunction with the submission to the Commission of a periodical monitoring report of the Scheme, provides the Commission with additional comfort that consistency across individual applications for guarantees under the Scheme is preserved.

5.3. Remuneration

(59) Given the limits on the exposure taken by the State, the Commission takes the view that a remuneration for the guarantee at market terms would ensure that the State is acting in accordance with the behaviour of a private economic operator under normal market conditions. In that case, the State guarantee would not give rise to any selective advantage for the participating banks and SPVs.

(60) With respect to the proposed pricing methodology, the Commission observes that the type of instrument envisaged by Greece is not currently traded in the Greek market. Therefore, no direct comparison with observable market transactions for

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sovereign risk in Greece makes it difficult to achieve an investment-grade rating on those senior tranches.

[22] See recital (29) of this Decision.

[23] And where information is not available, assumptions will be made on a prudent basis: see recital (30) of this Decision.

the same financial instrument can be made. However, the Commission considers that it is possible to find market benchmarks, which would indicate the adequate level of remuneration for equivalent levels of risk incurred as reflected by the rating of the senior tranche, and the duration of the exposure of the State.

(61) The pricing formula proposed by Greece for the Guarantee Fee consists of three separate elements:

(a) The choice of an appropriate benchmark for market prices (the "base rate");

(b) The choice of an appropriate penalty premium to be applied where required[24];

(c) The derivation of the Adjusted Spread Ratio Factor[25].

The Commission will consider these three elements in turn.

5.3.1. *The base rate derived from the Benchmark*

(62) The Commission observes the lack of a liquid CDS market in Greece for both corporate and financial institutions[26]. Therefore, a basket of corporate CDS cannot be used as benchmark to determine the pricing of the Scheme that a private economic operator would require.

(63) The main exposure of the guarantor of the senior tranche of a securitised NPL portfolio is linked also to Greek real estate risks, macroeconomic risks and the sovereign risk[27]. The cash flows from the underlying portfolios in Greece also rely on the sale of real estate assets securing the credit or the re-performance of the creditor. Therefore, the Commission considers that the Hellenic Republic CDS reflects also those underlying risks. Therefore, the Commission considers that for Greece, also considering the absence of a liquid CDS market in Greece for corporate bonds[28] and because of the relative high sovereign risk that will be reflected in the rating, the Hellenic Republic CDS with different tenors can be used as most appropriate benchmark and can serve as a base rate.

(64) Furthermore, the Commission takes positive note of the fact that for the Benchmark, instead of the current spot mid-price, the average over the previous two months of mid-prices at the time of the transaction is used for the purpose of calculating the value of the Benchmark. That feature will reduce volatility in the Scheme over time while also allowing for a timely incorporation of changes in the price of the Benchmark.

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24 See recital (23)(c) of this Decision.

25 See recital (24) of this Decision.

26 There are currently not a lot of liquid bonds outstanding as Greek companies have only issued a very limited number of benchmark bonds since the start of the crisis (among which there a number of 'covered bonds' by financial institutions). The lack of a liquid bond market also results in a lack of a (liquid) market for CDS on Greek bonds.

27 The sovereign risk will be an important risk factor in the specific case of Greece, since the current ratings identify the sovereign risk as 'below investment grade'/'speculative' risk

28 The Commission will reassess, upon a possible prolongation of the Scheme, whether the Greek sovereign CDS remains the most appropriate benchmark and there is still no (liquid) CDS market in Greece for corporate bonds.

5.3.2. *The base rate and penalty*

(65) The choice of the base rate and penalty in the Scheme is driven by the fact that the actual market price of such a guarantee will depend not only on the level of risk implied by the rating and priced based on the Benchmark, but also on how long the State will retain its exposure to the risk that it guarantees. That last element, in turn, depends on how long it will take to repay the senior tranche in full and thereby terminate the guarantee.

(66) In the Scheme, the step-up takes the form of the base rate:

(a) in years 1 to 3 being linked to the *ex-ante* three-year tenor of the Benchmark;

(b) in years 4 and 5 being linked to the *ex-ante* five-year tenor of the Benchmark;

(c) in years 6 and 7 being linked to the *ex-ante* seven-year tenor of the Benchmark;

(d) and from year 8 onwards being linked to the *ex-ante* ten-year tenor of the Benchmark.

(67) To that base rate, a penalty is added in years 4 to 10. Based on the work-out counterfactual and a discount rate of 4%, the penalty in years 4 and 5 is calibrated such that the discounted cash value paid by year 5 under the Scheme corresponds to the hypothetical value if the five-year tenor of the benchmark had been paid over all years 1 to 5. Equally, the penalty in years 6 and 7 is calibrated such that the discounted cash value paid by year 7 under the Scheme corresponds to the hypothetical value if the seven-year tenor of the benchmark had been paid over all years 1 to 7. Equally, the penalty in years 8 to 10 is calibrated such that the discounted cash value paid by year 10 under the Scheme corresponds to the hypothetical value if the ten-year tenor of the benchmark had been paid over all years 1 to 10. Figure 1 shows an example of the step-up compensation mechanism. The resulting rate (base rate + penalty) is then adjusted taking into account the Adjusted Spread Ratio Factor.

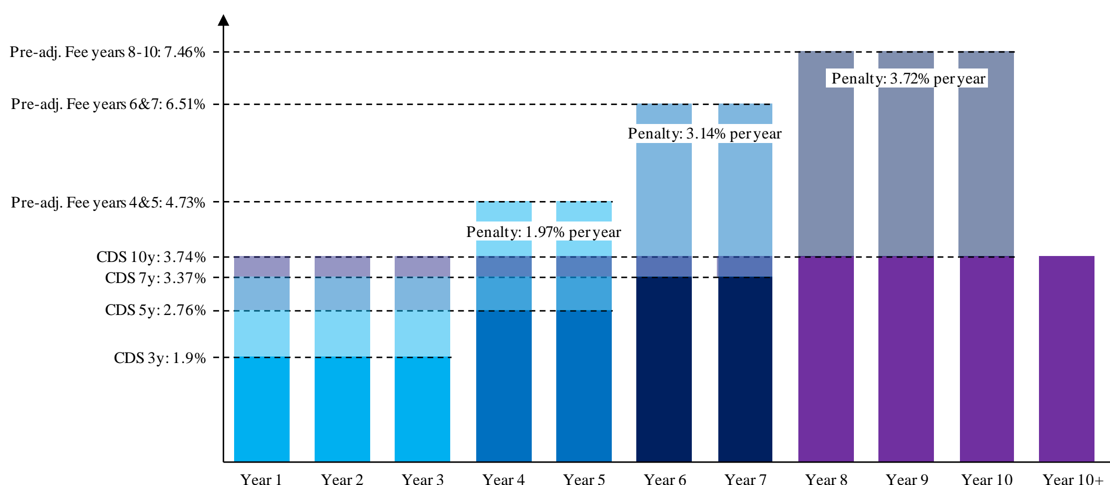

Figure 1: Example of the step-up compensation structure

(68) Assuming both a representative work-out time of 10 years and a discount rate of 4%, it is possible to calculate the penalty rates for years 4 to 10 as a function of the appropriate base rates. In years 4 and 5, the penalty will be 2.29 times the difference between the five-year and the three-year tenor of the Benchmark. In years 6 and 7, the penalty will be 5.14 times the difference between the seven-year and the five-year tenor of the Benchmark. In years 8 to 10, the penalty will be 10.05 times the difference between the ten-year and seven-year tenor of the Benchmark.

(69) The Commission notes at this point that according to its own analysis the sensitivity of the penalty to the discount rate is small. However, a discount rate of 4% is significantly greater than the current ten-year yield on Greek government bonds[29] and therefore conservative.

(70) Based on the available data, the Commission considers that it is unlikely that substantial proportions of a senior tranche benefitting from a guarantee under the Scheme will remain outstanding beyond the ten-year point. The Commission also recalls that the combination of the following three elements further decreases such a likelihood:

(a) By construction of the Scheme, cash flows on the junior tranche can be paid only after the full repayment of the senior tranche.

(b) A guarantee under the Scheme will only be provided if the majority of the junior tranche can be successfully sold to a private market investor.

(c) Investors present in the market as potential buyers for the junior (and, if present, the mezzanine) tranche will have return expectations as well as a strong preference for cash flows in the short to medium term.

(71) The Commission recalls that the NPL ratio in Greece is significantly higher when compared with the ratios of other countries[30]. This means that the work-out the NPLs might require more time in order to avoid fire sales and ensure a balance between timely repayment of the senior tranche without creating undue pressure on the overall market. Therefore, the Commission considers that the ten-year tenor corresponds to a time when a significant reduction in risk taken by the State will have been achieved even if the senior tranche has not yet been repaid in full.

(72) The Commission notes that the construction of the step-up mechanism puts significant emphasis on achieving the work-out targets implicit in the counterfactual work-out profile for years 4 and 5 and even more so for years 6 to 10. If those targets cannot be achieved, remuneration to the State will significantly increase compared to the counterfactual work-out through the high penalty rates applicable in years 4 to 10. The Commission also notes positively that the incentive structure created by the step-up fully aligns the interests of the servicer – who is usually remunerated depending on the success of its operations – with those of the economic owners, the holders of the junior tranche. That feature will again favour the fastest possible work-out while operating in the fashion which best preserves value.

[29] The yield of Greek ten-year government bonds as of 15 September 2019 is around 1.6%.

[30] See footnote (5) of this Decision.

(73) Based on the preceding considerations, the Commission concludes that in the context of the proposed structure of the Scheme, the step-up mechanism ensures that the remuneration of the guarantee to the State corresponds to the level and duration of the risk the State takes. If actual work-out times are shorter than in the work-out counterfactual, the step-up mechanism will result in lower compensation paid for the guarantee, commensurate with the shorter duration of the exposure of the State. If the work-out times are long, the State gets paid more, in line with what a market economy operator would require.

5.3.3. The derivation of the Adjusted Spread Ratio Factor

(74) The Commission notes that a further step follows the calculation of the Pre-Adjustment Fee: the application of the Adjusted Spread Ratio Factor as described in recitals (24) and (25), which accounts for the difference in the rating of the senior tranche and of the average rating of the Benchmark.

(75) The Commission notes that the two indexes used for the BB range and the B range, respectively, are comprised of a representative sample of issuers covering the two different rating classes. Further, each index represents one of the two rating classes. Therefore, the approach selected to represent the difference of the two rating classes is robust and objective.

(76) A comparison of the values for the Spread Ratio Factor, obtained by using different reference periods for the calculation has led the Commission to observe a low volatility of this value. In addition, a fixed value provides stability to the originators during the duration of the Scheme and allows a better comparability of the different transactions. Therefore, the Commission concludes it is appropriate that the Spread Ratio Factor is fixed for the duration of the Scheme.

(77) The Commission further notes that the Spread Ratio Factor is adjusted by taking into account the Overall Average Scoring to fine-tune the adjustment to the actual rating of the senior notes in each transactions[31]. Using the average of the ratings of the four rating agencies weighted is an objective method to set an adequate value for the rating. Incorporating this Overall Average Scoring in the calculation of the Guarantee Fee ensures that the remuneration is aligned to the specific circumstances of each transaction. Further, the Commission notes that applying a reference period of two months for the calculation of the Overall Average Scoring is in line with the time period used for the Benchmark.

(78) The Commission considers therefore that this adjustment, leading to the Adjusted Spread Ratio Factor, is adequate and ensures a rule-based timely incorporation of the Benchmark's rating changes.

5.4. Conclusion on market conformity of State guarantee

(79) Taking risk and remuneration together, the Commission concludes that the pricing structure provided is in line with market conditions. The risk taken by the State is remunerated at a level that a market operator would require, including a

[31] As described in recital (24)(c)-(e) of this Decision, noting the numeric scores are appropriate for circumstances where the rating of the senior note (minimum BB-) is above the rating of the Benchmark.

strong link between the risk taken and the derivation of the Guarantee Fee as well as between the time during which that risk is retained and the remuneration paid.

(80) The Commission concludes that the State guarantee provided to the securitisation structure as described in the present decision and remunerated in line with the remuneration structure as described in section 3.2, is provided at market terms and therefore does not confer an advantage to the participating banks and SPVs.

6. CONCLUSION

The Commission has accordingly decided that the measure notified by Greece, including the commitments made by that Member State, does not constitute aid within the meaning of Article 107 (1) TFEU.

The Commission notes that Greece exceptionally accepts the notified decision to be adopted and notified in the English language.

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Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully,

For the Commission

Margrethe VESTAGER
Member of the Commission

CERTIFIED COPY
For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
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