Brussels, 29.10.2019
C(2019) 7731 final

In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, 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.

Subject: State Aid SA.53869 – Romania
Market-conform recapitalisation of CEC Bank

Excellency,

The Commission wishes to inform the Romanian authorities that it has decided not to raise objections to the measure for the reasons set out below.

1. PROCEDURE

(1) On 20 February 2019, Romania approached the Commission in the context of the planned recapitalisation of state-owned CEC Bank ("CEC" or the "Bank" hereafter), pre-notifying the measure. The pre-notification was registered on 27 March 2019 under the case number SA.53869.

(2) On 24 April 2019, Romania submitted a first draft business plan for the 2019-2023 period, together with an independent expert opinion. Further details were provided on 9 May 2019.

(3) Additional information and supporting documentation were submitted via electronic mail by Romania between mid-May and mid-September 2019: on 20 May, 20 June, 16 July, 13 August, 2 September and 20 September 2019.

(4) Meetings, conference calls as well as other electronic email exchanges also took place throughout this period, as follows: a conference call took place on 14 May

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2019 followed by a meeting on 21 May 2019, another conference call on 4 July 2019, a meeting and a conference call on 23 July 2019 and 19 September 2019 respectively.

(5) On 10 October 2019, Romania submitted an updated business plan.

(6) By letter dated 11 October 2019, Romania formally notified for legal certainty the recapitalisation of CEC planned for the last quarter of 2019.

(7) By letter dated 11 October 2019, Romania agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/1958[1] and to have the present decision adopted and notified in English.

2. DESCRIPTION

2.1. The Bank

(8) CEC is a state-owned bank with total assets of RON 29 billion (ca. EUR 6.2 billion) at the end of 2018. It used to be a national savings bank before its transition to commercial banking. The Bank runs a business model mostly relying on its retail deposit base and underwriting loans on the Romanian market.

(9) The Bank is supervised by the National Bank of Romania ("NBR"), as are other commercial banks operating in the country. It belongs to the group of "other systemically important institutions" (also known as "O-SII") in Romania.

(10) CEC has a significant territorial network and rural presence. Its lending business primarily focuses on small and medium enterprises ("SMEs"), retail products, agriculture, public entities and projects that, by their nature, "contribute to economic development and support employment". The Bank has the largest branch network in Romania, with 1,024 branches as of end 2018, including 480 in rural areas (more than 85% of all commercial banks' rural branches).

(11) The Bank's financial performance was stable at a low level between 2014 and 2016 before moving onto an ascending trend in 2017. In 2018, the Bank was profitable and adequately capitalised. It had:

- Total assets market share of about 6.5% (7^{th} biggest bank in Romania);
- Total assets of RON 29,320 million (~EUR 6.2 billion or ca. 3% of GDP of Romania in 2018);
- Net profit of RON 355 million (~ EUR 90 million);
- NPL ratio of 6.0% (vs 5.0% in the Romanian banking system)
- Total Common Equity Tier 1 ("CET1") and total capital ratio of 17.3% (vs 20.7% in the entire banking sector);
- Return on Equity ("RoE") of 14.7% (vs 14.6% for the aggregate sector); and
- Cost-to-income ratio of 53% (vs 53% in aggregate).

(12) The 2018 results, albeit representing a major improvement compared to previous years, are mainly due to: (i) the significant increase of the Romanian benchmark

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1 Council Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.

interest rate (ROBOR) in 2018 (from 1.3% to 3.0%) which boosted net interest income by 35%; (ii) a reversal of loan loss provisions; and (iii) the reduction of exposure to interest rate risk by adopting a more cautious approach when acquiring government bonds (less held-to-maturity instruments) and by maintaining the level of all non-financial customers deposits although ROBOR was increasing.

(13) Its market share in terms of assets and deposits has decreased since 2015, with CEC dropping one place in the 2017 bank ranking, from sixth to seventh. The decrease in total assets and deposit market shares came as a result of the Bank's decision to attract less deposits from individual customers. This decision was partly triggered by the fact that the Bank had to restrain the lending business, given that its total capital ratio has been close to its minimum required level.

(14) The Bank operates in a competitive market dominated by foreign-owned banks and with a low financial intermediation level. While economic growth accelerated in the last two years, the depth of the Romanian banking sector has been, both in terms of deposit and loan penetration, lower compared to other EU Member States. As of December 2018, the deposit base as a share of GDP stood at 42% vs. 146% average in the Eurozone. Total assets as a share of GDP reached 47% as of March 2019, which is the lowest level across all EU Member States.[2]

2.2. The measure

(15) According to the proposal presented by the Romanian authorities, the recapitalisation will be carried out through a direct capital injection in the amount of RON 940 million (ca. EUR 200 million) corresponding to 6.2% of RWA, with the Romanian Government purchasing 9.4 million shares to be issued by the Bank, thereby increasing the share capital (initially composed of 13,5 million registered shares). Romania will remain the sole shareholder of the Bank.

2.3. The Business Plan

(16) The Business Plan (or the "Plan") submitted by the Romanian authorities covers the period 2019-2023 and takes as starting point the last audited figures of 2018. The Bank does not foresee changes in its business model but its assets are expected to grow in line with expected developments in the Romanian banking sector. The Business Plan is based on the following main pillars:

(a) Maintain focus on individual clients and SMEs;

(b) Improve efficiency, decrease operational risk and grasp the opportunities offered on the domestic market.

(17) The Business Plan presented by the Romanian authorities contains financial projections incorporating the planned capital increase. The Romanian authorities also presented financial projections for the counterfactual scenario without the capital increase.

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2 See ESRB Risk Dashboard, September 2019 (Issue 29) (https://www.esrb.europa.eu/pub/pdf/dashboard/esrb.risk_dashboard191002~dceca88a9d.en.pdf)

(18) The Business Plan explains that the capital increase will allow (i) enhancing the lending potential of CEC to allow the Bank to maintain its position in the Romanian banking sector and (ii) modernising CEC's outdated IT system and implementing a centralised core-banking solution.

(19) The Business Plan provides an estimation of the Cost of Equity (hereafter "CoE") of CEC. The CoE of the Bank is estimated at [10-12]%. The formula is based on the Capital Asset Pricing Model ("CAPM") that considers a risk-free rate, a country-risk premium, a beta coefficient estimate for the Bank and an equity market risk premium.

(20) Projections used for determining the profitability of the Bank and the return generated by the investment take into account standard forecasts on macroeconomic developments, but are complemented with considerations for more adverse developments to reflect the Plan's execution risks.

(21) For the purposes of the Commission's assessment of the planned measure, the Romanian authorities submitted a number of scenarios described hereafter.

2.3.1. *Base-case* scenario with capital increase ("Scenario 0 WITH")

(22) The base-case scenario is based on macroeconomic assumptions that foresee a continuous robust growth in the Romanian real GDP combined with a moderate increase of benchmark interest rates. The key macroeconomic assumptions underlying the base-case are presented in Table 1 below.

(23) The Business Plan puts forward that the degree of financial intermediation in Romania, as reflected by the total bank assets as a percentage of GDP, will slightly decrease in 2019 and 2020 (50% and 48% respectively) before gradually increasing to reach 52% in 2023. The different categories of the banking sector assets (credit granted to non-financial corporations, credit to households etc.) are projected to growth in line with the total assets growth and assuming that their respective weight is maintained at the 2018 level.

(24) The total balance of non-governmental deposits for the whole banking sector is projected to remain at ca. 35% of GDP. The non-governmental loan-to deposit ratio is expected to decrease from 76% in 2018 to 74% in 2019 and to 71% in 2020. After 2020, the trend would reverse with the ratio increasing and reaching 78% in 2023. On aggregate, deposits held by individuals and legal entities customers are projected to keep their 2018 weight (60% and 40% respectively).

Table 1 - Base-case macroeconomic assumptions.

	2019	2020	2021	2022	2023
Real GDP growth (annual change)	3.4%	3.3%	3.2%	3.2%	3.1%
Inflation rate (annual average)	2.7%	2.8%	2.6%	2.5%	2.5%
3-month ROBOR (annual average)	2.6%	2.8%	3.0%	3.1%	3.5%
5-year Romanian government bond yield	4.3%	4.5%	4.6%	4.8%	5.2%

Source: CEC's Business Plan based on the International Monetary Fund ("IMF") projections

(25) In the Business Plan, the Bank assumes that the applicable minimum capital requirement set by the NBR would be set for the next 5 years at the current requirement 15.1% of Risk-Weighted Assets ("RWA").

(26) Since the amendment of the Banking Recovery and Resolution Directive ("BRRD")[3] entered into force in June 2019, the Bank is expected to comply with a target Minimum Requirement for own funds and Eligible Liabilities ("MREL") by the deadline envisaged by the National Resolution Authority ("NRA"),[4] i.e. either 2024 as prescribed by default in the BRRD or another date determined by the NRA within the margins of appreciation provided by the BRRD. The MREL requirement implies building up a layer of financial instruments that could absorb losses in resolution.

(27) The Romanian authorities submitted to the Commission a letter in which the NRA informs the Bank about its target MREL requirement. The latter is preliminarily estimated at […]% RWA in 2024, tentatively with […] its composition. In the submitted projections, the Bank assumed instead a slightly higher requirement ([…]% RWA) to be met in 2024 and an interim target for 2023 of […]%. Based on this latter figure, the Business Plan assumes that the MREL funds will be built-up linearly between 2019 and 2023 ([…]% of RWA in 2019, […]% in 2020, […]% in 2021, […]% in 2022 and […]% in 2023). To comply with the MREL requirement, the Bank […], subject to future approval by the NRA. The Business Plan foresees the issuance of a […] (RON […] million in […]). Based on recent benchmarks observed in the Romanian banking system, the Bank expects to pay an interest rate of […]% on this […].

(28) The Bank is targeting a total balance sheet of around RON [40-50] billion at the end of the plan in 2023 as compared to around RON 29 billion in 2018. The increase is expected to be mostly driven by the growth of the loan portfolio ([…]%), notably loans granted to legal entities and individuals ([…]% and […]% respectively between 2018 and 2023). In parallel, deposits held by customers are expected to increase from RON 25,300 million to RON [35,000-40,000] million with a significant contribution from individuals ([…]% between 2018 and 2023).

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3 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, OJ L 173, 12.6.2014, p. 190-348 (available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014L0059-20190627).

4 The NBR in the case of Romania.

(29) With the additional capital, the Bank expects notably to be able to increase its market share in the loan market from 7.2% in 2018 to a peak of […]% in 2020/2021 before falling to […]%. In the deposit market, the Bank expects to increase its market share and stabilise it around […]% in 2023, therefore reversing the downward trend of the past few years mentioned in recital (13).

(30) On the basis of the macroeconomic assumptions and the business outlook, the Bank's total net profit is planned to increase from RON 355 million in 2018 to RON [350-400] million in 2023 (see Table 2), i.e. by RON [10-20] million over the five years, corresponding to a compound annual growth rate ("CAGR") of […]%, based on:

- A RON [200-250] million increase ([…]% CAGR) in net interest income, mostly stemming from the […] clientele (+RON [450-500] million or […]% CAGR) while the net interest income stemming from […] clients would contract due to the increase in the deposit base with higher interest rates (RON -[250-300] million or […]% CAGR);

- Net fee income (+RON [100-150] million or […]% CAGR) grows as the loan and deposit portfolios are expected to expand. In addition, the net fee income generated per unit of loan and deposits is expected to increase by about […]bps between 2019 & 2023 to reflect the sustained promotion of banking products such as Internet Banking, Mobile Banking and Cards.

(31) Consequently, at the end of the plan, […]% of the operating income will be generated by net interest income (vs. 80% in 2018) and […]% by non-interest income ([…]% from trading and […]% from net fee income). The main assumptions in estimating net interest income are as follows:

- Placing the interest rates of individuals' loans […] close to the expected interest rates set by the Romanian banking sector, in order to reach the target lending volumes and in agreement with the positioning strategy used in past years;

- Progressively aligning the deposit interest rates for individuals with the expected interest rates set by the Romanian banking sector (from -60bps in 2018 to […] in 2023), in order to attract increasing volumes from this main customer segment;

- […] the interest rates applied on loans and deposits to […] with expected market rates in the sector, given the higher market awareness of these customers.

(32) Operating expenses are expected to increase from RON 714 million in 2018 to RON [900-950] million in 2023. This will mainly stem from the investment in a new IT infrastructure that will allow for streamlined reporting, optimisation of product offer and increased user/consumer satisfaction. Over the next 5 years, the total IT-related expenditures are broken down in the following way: (i) RON […] million will be dedicated to the investment needed for the introduction of the new core-banking system (RON […] million for software licences, RON […] million for hardware equipment, RON […] million for first-year maintenance and RON […] million for implementation costs), (ii) RON […] million for the existing system and (iii) RON […] million for logistics and security. The Business Plan

puts forward that the implementation costs of comparable IT projects in three other banks in Romania amounted to about RON […] million without VAT, including software licence, required equipment (hardware), first year maintenance and implementation costs.

(33) The Bank is planning a slight decrease in administrative expenses between 2019 and 2023 based on further optimisations. It will maintain its geographical footprint across Romania with the same number of branches (1,024) over the 5 years of the Plan, especially in rural areas. In terms of staff expenses, the Bank's number of full-time equivalents ("FTEs") employees is set to decrease organically, from 6,060 in 2018 to […] in 2023. CEC's employees are paid on average around […]% less than an average Romanian banking sector employee. The plan puts forward that this situation is due to the large proportion of CEC's branches in rural areas, where the cost of living is lower, compared with other banks which have fewer rural branches.

(34) In terms of cost efficiency, the Bank expects its cost-to-income ratio to remain more or less constant and reach 52% in 2023 (vs. 53% in 2018), which is in line with the market average at the end of 2018. The base-case scenario also foresees that assets generated per FTE will substantially increase (+72% between 2018 and 2023).

(35) In terms of asset quality, the Bank foresees the continuation of its approach to loan loss provisioning. The cost of risk is expected to remain at a high level and fluctuate between 120-130bps, while the NPL ratio will continue to fall (from 6.0% in 2018 to 4.6% in 2023).

(36) As a result of the implementation of the Business Plan, in 2023 the Bank plans to achieve a net profit of RON [350-400] million. The after-tax RoE is expected to reach 9% in 2023 while the CET1 and total capital ratio (which is […]) are expected to be [10-20]% and [20-30]% respectively. In parallel, the Bank assumes a payout ratio of […]% for the distribution of dividends between 2020 and 2023. This would translate into a dividend per share of RON […]in 2023.

Table 2 - Financial projections for the base-case scenario ("Scenario 0 WITH").

Key financial indicators RON million	**2018 Actual**	**2019 Plan**	**2020 Plan**	**2021 Plan**	**2022 Plan**	**2023 Plan**
Net interest income	1,088	[…]	[…]	[…]	[…]	[…]
Net fee and commission income	217	[…]	[…]	[…]	[…]	[…]
Operating income	1,352	[…]	[…]	[…]	[…]	[…]
Operating expenses	(714)	[…]	[…]	[…]	[…]	[…]
of which staff expenses	(430)	[…]	[…]	[…]	[…]	[…]
Loan provisioning and impairments	(205)	[…]	[…]	[…]	[…]	[…]
Tax	(78)	[…]	[…]	[…]	[…]	
Net profit	355	[…]	[…]	[…]	[…]	[300-400]
Total assets	29,320	[30-35]	[35-39]	[39-42]	[43-45]	[45-47]
Total own funds	2,635	[…]	[…]	[…]	[…]	[…]

RWA	15,238	[…]	[…]	[…]	[…]	[…]
After-tax RoE (%)	14.7%	[…]	[…]	[…]	[…]	9.0%
Cost-to-income ratio (%)	53%	57%	53%	54%	50%	52%
CET1 ratio (%)	17.3%	[…]	[…]	[…]	[…]	[15-17]
Total capital ratio/MREL (%)	17.3%	[…]	[…]	[…]	[…]	[…]
MREL requirement*	[…]	[…]	[…]	[…]	[…]	[…]

** Based on the NRA's preliminary estimation and the Bank's assumptions.*

Source: CEC's Business Plan

2.3.2. *Base-case scenario* without capital increase ("Scenario 0 WITHOUT")

(37) In the counterfactual Business Plan without the capital increase, the macroeconomic & sectoral assumptions are identical but the Bank's profile over the next 5 years is expected to significantly differ from the base-case scenario. CEC will be constrained in its growth by its prudential requirements. In particular, meeting the MREL requirement would entail the issuance of […] sooner than in Scenario 0 WITH (RON […] million in […]) with an interest rate of […]%.

(38) Total assets would only reach RON [35,000-40,000] million in 2023, meaning the Bank would be 25% smaller without the capital injection. Lending would slightly increase over the next five years but the Bank would see its loan market share in 2023 falling below the 2018 level ([…]% vs 7.2%). Mirroring this trend, the Bank is expected not to attract as many deposits as under the base-case scenario 0 WITH (RON [30,000-35,000] million in 2023, i.e. ca. 25% less).

(39) While the level of net interest income would be lower, the Bank assumes the same projections for interest rates (both loans and deposits). With the smaller balance sheet, the net interest margin would be quite close to Scenario 0 WITH. Given the smaller book of loans and deposits, net fee and commission income would be mechanically lower as well. On the cost side, staff and administrative expenses would remain unchanged with the number of FTEs and branches identical. Thus, compared with Scenario 0 WITH, efficiency gains would be more limited as assets generated per FTE would only increase by […]% (vs. […]% in Scenario 0 WITH) and would be 20% lower in 2023 than in Scenario 0 WITH.

(40) At the end, the Bank is expected to end up with a net profit of RON [100-200] million in 2023 and an after-tax RoE of […]%. To ensure that it always complies with capital and MREL requirements, the Bank foresees a lower payout ratio between 2020 and 2023 ([…]% in 2023) to build up capital through retained earnings compared with Scenario 0 WITH. This has an impact on the dividend per share which is expected to reach RON […] in 2023, i.e. […] times smaller than in Scenario 0 WITH.

2.3.3. *Adjusted* scenarios

(41) To evaluate the potential impact of downside risks and check the robustness of the Business Plan, Romania has also submitted two adjusted scenarios based on

the following assumptions (macroeconomic & sectoral assumptions remain the same):

(a) Scenario 1 with capital increase *("Scenario 1 WITH")*

- -10bps to the interest rates on corporate loans every year;
- +30bps to the interest rates of deposits to individual clients every year;
- Fee income per unit of gross loans and deposits to customers to increase by 1bp per year starting from 2019;
- Annual growth of staff costs/FTE higher by 1.5 percentage points;
- MREL at […]% RWA in 2023 with the interest rate on the […] to be set at […]% and final target to be achieved with the issuance of […] (RON […] million);

(b) Scenario 2 with capital increase *("Scenario 2 WITH")*

- +30bps to the interest rates of deposits to individual clients every year;
- Annual growth of staff costs/FTE higher by 1.5 percentage points;
- MREL at […]% RWA in 2023 with the interest rate on the […] to be set at […]% and final target achieved with the issuance of […] (RON […] million);

(c) Scenario 1 without capital increase *("Scenario 1 WITHOUT")*

- MREL at […]% RWA in 2023 with the interest rate on the […] to be set at […]% with the issuance of […] (RON […] million).

As a result of these adjustments, the Bank would in 2023 achieve

(a) In Scenario 1 WITH: a net profit of RON [150-200] million, an ROE after tax of […]%, a CET 1 ratio of [10-20]% and a MREL of […]%;

(b) In Scenario 2 WITH: a net profit of RON [200-250] million, an ROE after tax of […]%, a CET 1 ratio of [14-16] % and a MREL of […]%;

(c) In Scenario 1 WITHOUT: a net profit of RON [150-200] million, an ROE after tax of […]%, a CET 1 ratio of [14-16]% and a MREL of %.

3. POSITION OF ROMANIA

(42) The Romanian authorities notified the recapitalisation measure accompanied by the Business Plan to the Commission for legal certainty.

(43) Romania considers that the recapitalisation is market-conform and therefore does not constitute State aid.

(44) Romania puts forward two objectives behind the planned recapitalisation: (i) growth in line with the general growth of the Romanian banking market; (ii) financing the upgrade of the IT system. Romania stresses that, over the past five years, the Bank has been deliberately reducing deposits market share in order to avoid underwriting additional loans, due to regulatory capital constraints and liquidity requirements. In light with expected banking sector developments in the country, Romania argues that the proposed capital injection would allow the Bank to participate in the expected growth of the local banking sector. The Romanian authorities stress that, without the capital increase, the Bank would be strongly restrained in its growth. Finally, they highlight that the necessary upgrade of the outdated IT infrastructure would be facilitated with the capital increase.

(45) Regarding the IT infrastructure upgrade which drives part of the recapitalisation amount, the Romanian authorities argue that, based on their research on the Romanian market, a comparable IT core-banking implementation costs around RON […] million (without VAT), including software licence, required equipment (hardware), first year maintenance and implementation costs.

(46) Romania also argues that CEC's strategic objectives supported by the capital injection would not generate structural changes in the banking sector in Romania (as the Bank expects to stay among the top 7 banks in the country) and, instead, would only facilitate its development and modernisation.

(47) To support their claim that the capital injection is market-conform, the Romanian authorities argue that the return on the equity investment (the Internal Rate of Return or "IRR") is above the CoE of the Bank. The investment will take place in end-2019 and the terminal value of the Bank is computed at end-2023. The IRR calculation takes into account the prior exposure of the Romanian State and focus on the marginal return obtained from the capital injection compared with a counterfactual without it (i.e. Scenario 0 WITHOUT). Romania puts forward IRR estimated through both a standard Dividend Discount Model ("DDM") and *ad-hoc* estimates for the Bank's price-to-book ("P/B") ratios which stem from a benchmarking with a sample of 41 listed European banks. The perpetual growth rate in the DDM is set at 2.5% and the CoE of CEC at [10-12]%.

(48) The Romanian authorities consider that the IRR of the operation for a market economy investor that is already the sole existing shareholder is within the range [10.5-46.8%], with the DDM yielding [20.2-46.8%] and the P/B methodology [10.5-28.2%] across all scenarios considered.

(49) For Scenario 0 WITH & WITHOUT, the Romanian authorities used the following assumptions:

- The dividend in 2023 is assumed to be RON […] million in Scenario 0 WITH and RON […] million in the counterfactual Scenario 0 WITHOUT. Based on these figures, the terminal value of the Bank at end-2023 was estimated at RON [3,500-4,000] million and RON [750-800] million respectively;

- In the "P/B" methodology, the terminal value of the Bank at end-2023 was estimated to be equivalent to a P/B ratio of 0.80 in Scenario 0 WITH and 0.58 in Scenario 0 WITHOUT.

(50) For Scenario 1 WITH & WITHOUT, the Romanian authorities used the following assumptions:

- The dividend in 2023 is assumed to be RON […] million in Scenario 1 WITH and RON […] million in the counterfactual Scenario 1 WITHOUT. Based on these figures, the terminal value of the Bank at end-2023 was estimated at RON [1,500-2,000] million and [400-450] million respectively;

- In the P/B methodology, the terminal value of the Bank at end-2023 was estimated to be equivalent to a P/B ratio of 0.69 in Scenario 1 WITH and 0.58 in Scenario 1 WITHOUT.

(51) For Scenario 2 WITH & Scenario 1 WITHOUT, the Romanian authorities used the following assumptions:

- The dividend in 2023 is assumed to be RON […] million in Scenario 2 WITH and RON […] million in the counterfactual Scenario 1 WITHOUT. Based on these figures, the terminal value of the Bank at end-2023 was estimated at RON [2,000-2,500] million and [400-450] million respectively;

- In the P/B methodology, the final value of the Bank at end-2023 was estimated to be equivalent to a P/B ratio of 0.69 in Scenario 2 WITH and 0.58 in Scenario 1 WITHOUT.

(52) The IRR ranges include the alternative versions of the Plan with downside adjustments (Scenario 1 WITH, Scenario 2 WITH & Scenario 1 WITHOUT). In Romania's view, the alternative scenarios do not change the conclusion of market conformity. In that setting, the IRR would remain very close or above the CoE.

4. ASSESSMENT

4.1. Existence of aid – Application of Article 107(1) TFEU

(53) Article 107(1) TFEU provides that 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, insofar as it affects trade between Member States, be incompatible with the internal market.

(54) According to the established case law, the qualification as State aid in the sense of Article 107(1) TFEU requires that all conditions mentioned in that article are met.[5] Thus, for a state measure to be qualified as State aid in the sense of Article 107(1) TFEU, the latter would need to (i) be a state intervention or deployed

[5] Ruling of the European Court of Justice (ECJ), 2 September 2010, Commission/Deutsche Post, C-399/08 P, ECLI:EU:C:2010:481, point 38 and quoted case law, ECJ's ruling of 21 December 2016, Commission/Hansestadt Lübeck, C-524/14 P, ECLI:EU:C:2016:971, point 40, ECJ's ruling of 21 December 2016, Commission/World Duty Free Group SA e.a., C-20/15 P et C-21/15 P ECLI:EU:C:2016:981, point 53, and ECJ's ruling of 20 September 2017, Commission/Frucona Kosice, C-300/16 P, ECLI:EU:C:2017:706, point 19.

through state resources; (ii) be liable to affect trade between Member States; (iii) grant a selective advantage to its beneficiary and (iv) distort competition.[6]

(55) Moreover, according to the established case law, the intervention of public authorities in the capital of an undertaking, whatever form it may take, could constitute State aid in the sense of Article 107(1) TFEU when the conditions of this article are met.[7]

(56) Regarding the condition under which the concerned measure must be assessed as the provision of an advantage to its beneficiary in the sense of Article 107(1) TFEU, interventions through State resources in whatever form that are liable to favour directly or indirectly undertakings, or that grant the beneficiary undertaking an economic advantage that it would not have obtained under normal market conditions,[8] are considered State aid.

(57) It seems appropriate to question first the presence of an advantage in favour of CEC that is financed through State resources. If the Commission could not conclude that such an advantage is present or that it was not financed through State resources, the Commission will have to conclude that the measure being assessed does not constitute State aid, given that the conditions for the existence of State aid are cumulative.

(58) The recapitalisation is an investment made by Romania as provided for in the 2019 budget law.[9] Therefore, the measure involves State resources within the meaning of Article 107(1) TFEU.

(59) The EU legal order is neutral with regard to the system of property ownership, that is, it does not prejudice the right of Member States to act as economic operators.[10] However, under EU State aid rules, it is necessary to assess whether economic transactions carried out by public bodies (including public undertakings) are in line with market conditions, so as not to confer an advantage on its counterpart.[11] This principle has been developed with regard to different economic transactions. When public authorities make injections in the capital of a given undertaking, the Commission examines whether the State's behaviour in making the investments under consideration was in line with the Market Economy Investor Principle ("MEIP").

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6 ECJ's ruling of 2 September 2010, Commission/Deutsche Post, C-399/08 P, ECLI:EU:C:2010:481, point 39 and quoted case law, ECJ's ruling of 21 December 2016, Commission/Hansestadt Lübeck, C-524/14 P, ECLI:EU:C:2016:971, point 40, ECJ's ruling of 21 December 2016 Commission/World Duty Free Group SA e.a., C-20/15 P and C-21/15 P, ECLI:EU:C:2016:981, point 53, and ECJ's ruling of 20 September 2017, Commission/Frucona Kosice, C-300/16 P, ECLI:EU:C:2017:706, point 19.

7 ECJ's ruling of 14 September 1994, Spain/Commission, C-278/92 to C-280/92, ECLI:EU:C:1994:325, point 20 and quoted case law, and ECJ's ruling of 8 May 2003, Italy and SIM 2 Multimedia/Commission, C-399/00 and C-328/99, ECLI:EU:C:2003:252, point 36 and quoted case law.

8 ECJ's ruling of 2 September 2010, Commission/Deutsche Post, C-399/08 P, ECLI:EU:C:2010:481, point 40 and quoted case law.

9 See Art 30 Law 50/2019 March 15, 2019 - https://static.anaf.ro/static/10/Anaf/legislatie/L_50_2019.pdf

10 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Function of the European Union ("Notice on the notion of aid"). OJ C 262, 19.7.2016, p. 17, paragraph 73.

11 Notice on the notion of aid, paragraph 74.

(60) The Commission will assess whether a market economy investor would have injected capital in the Bank under the same conditions as the State intends to do. For that purpose, the Notice on the notion of aid lists possible avenues. It notably highlights for a transaction such as the present one, that the compliance with the MEIP can be established on "the basis of a generally-accepted, standard assessment methodology".[12]

(61) In the present case, the Commission has used a methodology that primarily relies on a set of relevant quantitative indicators to assess the profitability of the Bank and the return on investment made by a potential market economy investor through the capital injection.

(62) To assess its profitability, the Commission would generally consider the RoE that the Bank can generate over the Business Plan period. As the RoE reflects the maximum cash that an average investor holding the Bank's shares would obtain, a bank is generally considered profitable if it can generate enough profits to adequately remunerate its shareholders by the end of the Business Plan. Concretely, this means that the Bank's RoE needs to be higher than its specific CoE by the end of the Business Plan, i.e. in 2023. However, that approach alone does not take into account the specificities of the investment and does not provide the return which is specific to the Romanian State as the sole and existing shareholder of the Bank.

(63) Regarding the return on investment to be made by Romania, as mentioned in the Notice on the notion of aid,[13] the Commission has assessed the recapitalisation on the basis of common financial metrics such as the IRR. As the Romanian State is already the sole shareholder of CEC and will remain so after the capital injection, the IRR calculation needs to take into account this prior exposure of the Romanian State and consider the counterfactual without the capital increase.[14] To assess whether the equity investment is made on market terms, the marginal IRR, stemming from the difference between the capital increase scenario and its counterfactual without the injection, must be higher than the normal expected market return, i.e. the Bank's CoE.

(64) On top of quantitative considerations, the MEIP assessment by the Commission also takes into account all relevant circumstances of the case at hand.[15] This notably means that qualitative aspects can underpin the conclusion stemming from the quantitative indicators.

4.2. Assessment of the equity investment in the MEIP framework

4.2.1. Assessment of the CoE

(65) The Commission considers the [10-12]% CoE to be in line with CEC's risk profile. The figure reflects (i) the current level of interest rates in Romania; (ii) the country-specific risks of investing in Romania's equity market as well as the low risk-profile of the Bank (simple business model and adequate capitalisation).

[12] See paragraph 101 of the Notice on the Notion of Aid.
[13] See paragraph 102 of the Notice on the Notion of Aid.
[14] See paragraph 106 and 107 of the Notice on the Notion of Aid.
[15] See paragraph 82 of the Notice on the Notion of Aid.

In particular, the Commission views that the country-risk premium added in the CAPM appropriately reflects i.a. the judicial, legislative, fiscal and regulatory risks which a market economy investor would be exposed to in Romania. The Commission also positively notes that the specific risks rely on parameters empirically determined by an independent expert contracted by the Bank.

(66) The Commission acknowledges that the [10-12]% CoE is an appropriate benchmark that reflects the opportunity cost of investing in the Bank's equity. In general, the Bank would be considered profitable enough if the RoE is above the CoE by the end of the Plan. However, to better take into account the specificities of the present equity investment (notably the fact that Romania has been the sole shareholder), the Commission would consider instead that the MEO test would be met if the IRR is above this bank-specific benchmark.

4.2.2. Assessment of the business measures considered in the Business Plan

(67) The starting point of the Business Plan is the previous 2017-2020 Development Strategy of the Bank that already set out the strategic objectives of the company. The new Plan maintains the previous goals which include, among others, the following :

- Keeping the Bank's prudential metrics at the levels recommended under European and national regulations;
- Maintaining a position in the top 7 banks in Romania;
- Improving the Bank's profitability and its efficiency;
- Digitalising the technological platforms to become a modern bank.

(68) The capital increase envisaged by the Romanian authorities aims at fulfilling several of these objectives. Given the projections made in the Business Plan, the Commission considers that the equity investment by the State is consistent with that multi-pronged rationale. The equity investment will notably allow the Bank to better exploit its potential and grow further in tune with the increased intermediation of the Romanian economy. At the same time, the injected capital will allow the Bank to stay profitable while maintaining its capital ratio above its prudential requirements.

(69) The Commission notes that the Business Plan is based on prudent macroeconomic assumptions which stem from the October 2018 forecasts made by the IMF for Romania. For instance, real GDP is expected to grow at 3.4% in 2019 and 3.3% in 2020. These forecasts are in line with the Commission's latest edition of its own Spring forecasts. One other critical assumption is the benchmark short-term interest rate (3-month ROBOR) which is forecast to moderately increase until 2023 in the Business Plan. The pathway is consistent with the GDP growth foreseen for the next 5 years and the December 2018 shape of the Romanian government bond yield curve. The latter foresees a progressive increase of the 5-year government bond yield between 2019 and 2023.

(70) The Commission notes that the underlying sectoral projections for the Romanian banking sector correspond to a moderate deepening of financial intermediation over the next five years (i.e. total banking assets would grow slightly faster than

GDP). Deposits would grow to the same extent as GDP, which mechanically results in a slight increase of the aggregate loan-to-deposit ratio.

(71) While the Bank's market share is expected to only slightly increase in 2018-2023 period ([…]p. in the loan and deposit market), the Commission notes that the expansion of the loan book is likely to be significant as gross loans to clients are projected to increase by […]% between 2018 and 2023 (CAGR of 10.3%), under Scenario 0 WITH. The Commission considers that such evolution is possible considering the fact that while CEC is planning to […] on the market of loans granted to individuals (mortgages + consumer loans) by around […]bps, it will […] other banks on the segment of loans granted to legal entities (SME/corporates).

(72) The expansion is to be funded with deposits attracted from […]. In order to sustain the lending business, bearing in mind the prudential liquidity requirements, the Bank is projecting a […]% increase of such deposits from the 2018 starting point. While in fact CEC plans to […] interest rates on […] deposits, it will […] deposits by around […]bps. The Commission considers this assumption plausible as the difference between CEC's and competitors' interest rates on retail deposits will be more or less […] as compared to 2018.

(73) The MREL requirement is expected to be met through the issuance of […]. Thus, the Business Plan assumes a […] the MREL buffer. The Commission considers this assumption as conservative, corresponding to what a market economy investor can be expected to assume.

(74) The Commission notes positively that the final MREL requirement considered in the business plan base case scenario is […]%, higher than the current estimate provided by the NRA set at […].

(75) Regarding the price of the […] the MREL buffer, the Business Plan assumes under Scenario 0 WITH an interest rate of […]%. The Commission notes that the interest rate has been derived by the Bank from benchmarks on […].

(76) The Commission notes that, under Scenario 0 WITH, the net fee income generated by one unit of loan and deposit is expected to increase by […]bps between 2019 and 2023 ([…]bps). This rise takes place in parallel with the expansion of the loan and deposit book.

(77) Regarding staff expenses, while the number of FTEs is expected to decrease, staff expenses will continue to grow. In particular, the Commission notes that the annual growth rate of the average staff costs per FTE will barely compensate for future inflation in Scenario 0 WITH. The Commission also notes that the average wage in the Bank is currently 35% lower than for its competitors. The Commission acknowledges that the assumption is plausible considering the share of staff located in rural branches

(78) Expenses for deprecation and asset impairment is expected to be significantly impacted by the commissioning of the new IT system. Though each of these projects are tailor-made to clients and thus difficult to compare, based on the submission by Romania, the Commission considers that the total cost for the IT upgrade of the Bank is within the range of similar projects implemented by other financial institutions.

(79) Loan loss provisions are projected to grow from RON 205 million in 2018 to RON [350-400] million in 2023. In parallel, the NPL ratio is set to slightly decrease. The Commission notes that the Business Plan is based on a provisioning policy assuming a constant cost of risk over the 5 years of the Plan at a high level (ca. […]bps). The Commission notes that such an approach to loan loss provisioning to be in line with what a market economy investor would consider in its assessment, considering the planned economic and credit cycle developments.

(80) Overall, the Commission considers that the base-case scenario (Scenario 0 WITH) is realistic. The assumptions are in line with projected developments concerning the Romanian market and do not foresee a significant growth of CEC's market share (in terms of total assets in the domestic banking sector). The Commission considers that, with its simple business model, CEC will be able to leverage its extensive regional territorial footprint while keeping in check credit risks as reflected in the base-case scenario. The RoE in Scenario 0 WITH is projected to be 9% in 2023. However, given the relatively low level of financial intermediation, the Romanian banking market offers growth opportunities. In addition, a market economy investor would take note of the relative low riskiness of the Bank given its simple business model (taking in retail deposits and underwriting loans to Romanian households and companies) and its high capitalisation.

(81) The Commission positively notes that the further adjustments made to the Business Plan as embodied by "Scenario 1 WITH" reflect additional execution risks that a prudent market economy investor could expect:

a) A downward adjustment to the interest rates of corporate loan. Given the expected contribution of this segment in the expansion of the loan book, the Commission considers that it is a prudent assumption reflecting execution risk.

b) A further increase of deposit rates for individuals to stick to the average rate of CEC's peers. Given the high price demand elasticity of Romanian individual depositors, the Commission considers that it is a prudent assumption reflecting execution risk.

c) The issuance of […] to fulfil the final MREL requirement of RWA already in 2023, the final year of the Business Plan. Given the horizon of the plan, the Commission considers that it is a prudent assumption reflecting execution risk to comply with a regulatory requirement.

d) A higher interest rate for […] envisaged for building up the MREL buffer. Given that the level of interest rates will rise by the time the […], the Commission considers that it is a prudent assumption reflecting execution risk.

e) A lower fee income generated by unit of loan and deposit. As the brand-new IT infrastructure will not be operational before 2024 at the earliest, the Commission considers that it is a prudent assumption reflecting execution risk.

f) A higher annual growth rate of the average staff costs per FTE. Given that the Bank intends to develop a more elaborate talent policy in view of the further digitalization of the Bank, the Commission considers that it is a prudent assumption reflecting execution risk related to its human-resource policy.

(82) The Commission notes that "Scenario 1 WITH" provides a situation where all execution risks would be materialising simultaneously in all years of the execution of the Business Plan. The Commission considers this scenario to be very conservative. Under this scenario, the Bank would expect a net profit of RON [150-200] million and a RoE of 4.9% in 2023.

(83) The Commission also notes that "Scenario 2 WITH" takes into account a fewer number of execution risks (namely those flagged in recital (81)(b)(c)(d)(f)). The Commission considers that "Scenario 2 WITH" reflects a minimum reasonable adjustment and therefore provides an additional comfort for a typical market economy investor as compared to Scenario 0 WITH. Under this scenario, the Bank would expect a net profit of RON [200-250] million and the 2023 RoE would still be 6.1%.

(84) While the RoE in Scenarios 0, 1 & 2 WITH is below the CoE, that approach based on RoE does not sufficiently take into account the specificities of the investment and does not provide the return which is specific to the Romanian State as the sole and existing shareholder of the Bank. A market economy investor that already has prior exposure to a company will consider the incremental return that it will obtain from its investment and not merely look at the RoE of the bank.

4.2.3. *Assessment of the return on investment*

(85) The Commission considers that assessing the investment made by the Romanian State based on a marginal IRR is appropriate considering the nature of the transaction.

(86) The Commission has analysed the assumptions and calculations used and made by Romania.

(87) The Commission is of the view that a market economy investor would mainly consider the base-case Business Plan (Scenarios 0 WITH & WITHOUT) while also looking at Scenarios 1 & 2 WITH and Scenario 1 WITHOUT, which better incorporate the execution risk. This would result in a more conservative assessment. The Commission considers that the adjustments made by Romania to the Plan are consistent with the various execution risks flagged in recital (81). As stated in recitals (82) and (83), the Commission also considers that Scenario 1 WITH would represent the most conservative perspective for a market economy investor while Scenario 2 WITH would reflect its minimum level of adjustments. Both scenarios are conservative versions of Scenario 0 WITH that a market economy investor could use as a robustness check.

(88) For the DDM methodology, the Commission considers that the assumptions on growth rate and CoE are appropriate. The 2.5% perpetual growth rate is below the potential GDP growth of Romania (currently estimated to be above 4%).[16] This is

[16] See for example: https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-romania_en.pdf.

a reasonable assumption to make given that the Bank is operating a mature business that will deliver dividends growing at a slower pace than the economy as a whole.

(89) In such a context, the IRRs stemming from Scenarios 1 & 2 WITH and Scenario 1 WITHOUT with the Romanian assumptions on growth rate and CoE constitute a prudent estimate of the return a market economy investor could obtain. As the Commission is of the view that a market economy investor would also consider in its assessment a more conservative scenario (as reflected in both Scenarios 1 & 2 WITH and Scenario 1 WITHOUT), applying the DDM methodology would yield an IRR in the range [20.2% - 30.7%], i.e. well above the Bank's CoE of [10-12]%.

(90) A P/B-based methodology can complement the results of the DDM calculations. In the same vein, a market economy investor would make sure that the IRR is above the CoE when considering Scenarios 1 & 2 WITH and Scenario 1 WITHOUT. The Commission takes note that the Business Plan puts forward market multiples benchmarked on a sample of listed European peers that has been assessed by an independent expert.

(91) From a forward-looking perspective, as the Bank is expected by 2023 (i) to be closer to its lending potential; (ii) have increased its market share; (iii) have improved its efficiency (e.g. in terms of assets generated per FTE); (iv) have an average RoE of 5.8% over the 5 years of the Plan, the Commission considers that 0.69 is an appropriate P/B ratio for the terminal value in 2023 in Scenario 1 WITH. By extension, the Commission views 0.69 as a lower bound for the P/B in Scenario 2 WITH. On the contrary, the Commission considers the final P/B of 0.58 in Scenario 0 WITHOUT estimated by Romania to be rather high. Given the lower P&L projections for Scenario 1 WITHOUT, the latter's 2023 P/B should be in principle even lower than in Scenario 0 WITHOUT. In the absence of capital increase, the constraints hampering the expansion of the loan book will have already led by 2023 to a loss of market share, lower efficiency gains and lower distributed dividends than in Scenario 1 WITH (so as to comply with prudential requirements). In particular, the 2023 dividend per share would be 2.4 times smaller in Scenario 1 WITHOUT than in Scenario 1 WITH (RON 2.7 vs RON 6.4) while efficiency gains would be 25% lower (in terms of assets generated per FTE). On a forward-looking basis, the prospects of extracting value after 2023 from the Bank as a shareholder in Scenario 1 WITHOUT would be rather bleak. Thus, given these elements above and the average RoE of 5.5% between 2019-2023, the Commission considers that the P/B ratio for Scenario 1 WITHOUT should be significantly lower than 0.58. Mechanically, this would increase the IRR of the equity investment to a level above [10-12]% using Scenario 1 WITH (by extension, the resulting IRR for Scenario 2 WITH would be higher than the initial 13.5% estimated by Romania).

(92) Overall, the Commission notes that the IRR is above the CoE of the Bank in all scenarios of the Business Plan, even in the most conservative scenarios that a market economy investor could consider in its due diligence. In addition, the Commission also positively notes that the IRR remains above CoE in all standard methodologies used to compute it.

4.2.4. Conclusion on the MEIP assessment

(93) The Commission concludes, based on the notified Business Plan, that CEC could obtain the same capital injection from the market and therefore, the recapitalization by the Romanian Government is in line with the MEIP. As a consequence, the capital injection does not grant an advantage to the Bank.

(94) In the absence of an advantage in favour of the Bank through State resources in the sense of Article 107(1) TFEU, it is not necessary to analyse whether the other conditions required to establish the presence of State aid are met.

5. CONCLUSION

The Commission has accordingly decided that the recapitalisation of CEC Bank does not constitute aid in the light of the submitted Business Plan.

For reasons of urgency, Romania exceptionally accepts that the present decision be adopted and notified in the English language.

If this letter contains confidential information which should not be disclosed to third parties, 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 the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm.

Your request should be sent electronically to the following address:

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Yours faithfully,

For the Commission

Margrethe VESTAGER
Member of the Commission

CERTIFIED COPY
For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION