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7-3-2012

State Aid SA.32994 (2011/N) Extension of the Hungarian bank support scheme

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Recommended Citation

Almunia, Joaquin, "State Aid SA.32994 (2011/N) Extension of the Hungarian bank support scheme" (2012). *YPFS Documents (Series 1)*. 12644.

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EUROPEAN COMMISSION

Brussels, 7.3.2012
C(2012) 1510 final

**Subject: State Aid SA.34078 (2011/N) – Hungary
Extension of the Hungarian liquidity scheme for banks**

Sir,

I. PROCEDURE

- (1) The Hungarian authorities notified a liquidity scheme (hereinafter "the scheme") on 9 November 2009.
- (2) On 14 January 2010 the Commission approved the scheme on the basis Article 107(3)(b) of the Treaty on the Functioning of the European Union (TFEU) in State aid case NN68/2009 until 30 June 2010¹.
- (3) Extensions of the scheme were approved on 28 June 2010 in State aid case N 225/2010², on 7 December 2010 in State aid case N 535/2010³ and on 23 June 2011 in State aid case SA.32994 (2011/N)⁴.
- (4) On 14 December 2011 Hungary notified a request to prolong the scheme by six months until 30 June 2012. The Notification was registered on 15 December 2011. Additional information regarding new pricing conditions for the scheme were sent by Hungary on 27 February 2012.
- (5) Hungary accepts that the decision exceptionally be adopted in the English language.

II. DESCRIPTION

- (6) In response to the ongoing exceptional turbulence on the financial markets, Hungary enacted a law which provides for liquidity support in the form of loans

¹ Commission decision C(2010) 91 final; OJ C 47, 25.02.2010, p. 16.

² Commission decision C(2010) 4399 final; OJ C 217, 11.08.2010, p. 2.

³ Commission decision C(2010) 8810 final; OJ C 32, 01.02.2011, p. 4.

⁴ Commission decision C(2011) 4511 final; OJ C 236, 12.08.2011, p. 3.

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to financial institutions. The scheme is based on Article 5 of Act IV of 2009 published in the Official Gazette ("Magyar Közlöny") No. 2009/28 on 10 March 2009.

- (7) Under the Act, the Minister responsible for public finances, acting through ÁKK Zrt. (Government Debt Management Centre), is empowered to conclude loan contracts with financial institutions.
- (8) The Hungarian Central Bank ("*Magyar Nemzeti Bank*" hereinafter: "MNB") in a letter of 8 November 2011 confirms the necessity of the continuation of the scheme for reasons of financial stability.
- (9) In line with point 18 of the Commission decision of 23 June 2011, Hungary has submitted information on the operation of the scheme to date.⁵
- (10) The Hungarian authorities now seek to prolong the scheme until 30 June 2012.
- (11) The extension does not include any substantial changes to the eligible instruments under the scheme.⁶ Hence, the extension of the scheme concerns only the expiry of the deadline of the liquidity scheme.
- (12) The loans are granted for a maximum of three years, while up to one-third of the total amount may be granted for a maximum of four years.
- (13) The scheme is open to all credit institutions established in Hungary, including subsidiaries of foreign banks, but excluding banks operating in the form of branch offices. The eligibility of the banks is established by the MNB and the Hungarian Financial Supervisory Authority ("*Pénzügyi Szervezetek Állami Felügyelete*", hereinafter: "PSZÁF") according to objective and well-defined criteria.⁷
- (14) The loans are ultimately awarded by the Hungarian Ministry of Finance on the basis of MNB's and PSZÁF's recommendation.

III. REMUNERATION

- (15) For loans issued until 30 June 2012, the fees and reporting obligations have been amended to align the scheme with the Commission Communication on the application, from January 2012, of State aid rules to support measures in favour

⁵ Three Hungarian banks concluded loan agreements under the scheme in the first half of 2009. However no banks have applied for liquidity support from the second half of 2009 onwards.

⁶ The liquidity support takes the form of loans. The financial institutions in receipt of such loans are obliged to use the funds to lend to the real economy. The loans cannot take the form of subordinated loans or any other form of structured instrument. Borrowers under the scheme are prohibited from referring to their having received State loans in their advertising and they are not allowed to finance acquisitions with the proceeds of the loan.

⁷ The MNB's evaluation shall consist of:

- an assessment of the importance of the credit institution for the stability of the financial intermediary system and the review of its impact on other regulated institutions, financial markets, infrastructure and on the real economy;
- an assessment of the short-term liquidity position of the credit institution;
- an analysis of the situation on major financial markets as well as of the availability of liquidity.

The PSZÁF's evaluation shall consist of:

- an assessment of the level of own funds of the credit institution;
- an assessment of the mid-term and long-term liquidity position of the credit institution;
- for a credit institution falling under consolidated supervision or supplementary supervision, an assessment of the group's mid-term and long-term liquidity and own funds positions.

of banks in the context of the financial crisis ⁸ (the "2011 Prolongation Communication").

- (16) The pricing of the loans under the scheme on 31 December 2011, when the scheme expired, was the higher of either
- i. the weekly rate called "SDR Interest Rate Calculation" published on the IMF website + 345 bps; or
 - ii. the 12 month-IBOR⁹ + 100bps + a credit risk margin of 123.5 bps, which had been adjusted upwards according to the rating of the bank during the first prolongation of the scheme¹⁰.
- (17) Hungary confirms that the scheme continues to have two options for the pricing of loans and that the pricing is to be the higher of those options.
- (18) As far as the IBOR-based pricing formula as described in recital 16 (ii) is concerned, Hungary confirms that the new fees, in line with the 2011 Prolongation Communication, are to be added to the IBOR-based reference rates. Accordingly, Hungary confirms that for the IBOR-based pricing-formula, the overall costs of the loans consist of the IBOR-based reference rates and the new fees.
- (19) In that regard, for loans covering maturities of one year or more, the fees to be added-up to the reference rates will as a minimum be the sum of:
- i. a basic fee of 40 basis points (bp); and
 - ii. a risk-based fee equal to the product of 40 basis points and a risk metric composed of (i) one-half of the ratio of the beneficiary's median five-year senior CDS spread over the three years ending one month before the date of issue of the loan to the median level of the iTraxx Europe Senior Financials five-year index over the same three-year period, plus (ii) one-half of the ratio of the median five-year senior CDS spread of all Member States to the median five-year senior CDS spread of the Member State granting the loan over the same three-year period¹¹.
- (20) For banks without CDS data, or without representative CDS data, but with a credit rating, an equivalent CDS spread will be derived from the median value of five-year CDS spreads during the same sample period for the rating category of the bank concerned, based on a representative sample of large banks in the Member States. The supervisory authority will assess whether the CDS data of a bank are representative.

⁸ OJ C 356, 6.12.2011, p. 7.

⁹ The actual benchmark depends on the currency in which the loan will be granted.

¹⁰ According to recital (15) of the Commission decision of 28.6.2010 on State aid case N225/2010, the IBOR-based pricing formula part was adjusted upwards by

- 20 basis points for banks with a rating of A+ or A
- 30 basis points for banks rated A-, and
- 40 basis points for banks rated below A-. Banks without rating will be considered to belong to the category of banks with a BBB rating.

¹¹ The formula for the loan fee can be written as:

$$\text{Fee} = 40\text{bp} \times (1 + (1/2 \times A/B) + (1/2 \times C/D)),$$

,where A is the beneficiary's median five-year senior CDS spread, B is the median iTraxx Europe Senior Financials five-year index, C is the median five-year senior CDS spread of all Member States and D is the median five-year senior CDS spread of the Member State granting the loan. The medians are calculated over the three years ending one month before the date of issue of the loan.

- (21) For banks without CDS data and without a credit rating, an equivalent CDS spread will be derived from the median value of five-year CDS spreads during the same sample period for the lowest rating category¹², based on a representative sample of large banks in the Member States. The calculated CDS spread, for that category of banks, may be adapted on the basis of a supervisory assessment.¹³
- (22) For loans with a maturity of less than one year, as CDS spreads may not provide an adequate measure of credit risk for debt with a maturity of less than one year, the loan fee for such debt will as a minimum be the sum of:
- i. a basic fee of 50 basis points; and
 - ii. a risk-based fee equal to 20 basis points for banks with a rating of A+ or A, 30 basis points for banks with a rating of A-, or 40 basis points for banks rated below A- or without a rating.
- (23) The remuneration above will be applied to loans issued until 30 June 2012.

IV. POSITION OF HUNGARY

- (24) The Hungarian authorities argue that the scheme is compatible with the internal market because it is still necessary to remedy a serious disturbance in the Hungarian economy pursuant to Article 107(3)(b) TFEU.
- (25) The Hungarian authorities are of the view that it is necessary to prolong the deadline for granting loans until 30 June 2012, since the original goals of the measure are still valid. The MNB in its letter of 8 November 2011 confirms the necessity of the continuation of the scheme for reasons of financial stability.
- (26) Hungary undertakes to maintain the conditions and commitments made since the introduction of the liquidity scheme and maintained in the context of its last extension, as reflected in the Commission decision of 23 June 2011.¹⁴

¹² The 2011 Prolongation Communication lays down that for banks without CDS data and without a credit rating, an equivalent CDS spread should be derived from the median value of five-year CDS spreads during the same sample period for the lowest rating category, based on a representative sample of large banks in the Member States. In footnote 12 of the Communication it is explained, that the lowest rating category to be considered is A, as there is insufficient data available for the rating category BBB. However, due to the recent downgrade of many banks in the framework of the sovereign crisis, there are now many banks with a rating below A with representative CDS. Therefore the Commission services have been able to ensure that the sample of European banks with a representative CDS includes banks in the "BBB or below" -rating bucket. Therefore, the lowest category to be considered for that purpose is the BBB-rating basket. (SA.34149 – Sixth prolongation of the Support Measures for Credit Institutions in Greece, point 16, not yet published; SA.34224 – Reintroduction of the Spanish Guarantee Scheme, point 18 (iv), not yet published; SA 34344 – Amendment of the Italian guarantee scheme for banks, point 12, not yet published.)

¹³ According to point 22 of the 2011 Prolongation Communication, Member States when notifying new or prolonged liquidity schemes, should indicate an indicative fee for each bank eligible to benefit from the measure, based on an application of the formula presented in the Annex of the Communication. An indicative fee for financial institutions which do not have CDS data or an external credit rating was estimated by Hungary in line with the 2011 Prolongation Communication to be 98.82 basis points.

¹⁴ In the context of the original decision on the scheme and the extension decisions thereafter, Hungary has given the following commitments:

- Hungary has committed to file individual restructuring and/or liquidation plans, within six months, for financial institutions that default on State loans.
- Hungary undertakes to present every six months reports on the operation of the scheme. The reports will also provide, for each beneficiary, detailed information on the liquidity support provided and its specific conditions as well on liquidity raised by the beneficiary during the existence of the present scheme from sources other than the State. That information shall include the nature and amount of the liquidity raised, its source, conditions and pricing, in order to allow for the assessment of the availability and conditions of liquidity on the markets.

- (27) In addition to the existing commitments concerning reporting obligations, Hungary commits to provide report on the operation of the scheme and on market funding of participating banks until 15 October 2012, if there are any participating banks in the scheme during the first half of 2012.

V. ASSESSMENT

- (28) In its decision of 14 January 2010, the Commission concluded that the scheme constitutes State aid within the meaning of Article 107(1) TFEU. No elements have been presented to the Commission which would alter that assessment. In its decision of 14 January 2010, the Commission also found that the measure was compatible with the internal market under Article 107(3)(b) TFEU, because it was apt to remedy a serious distortion of the Hungarian economy. To that end, the Commission had assessed the appropriateness, necessity and proportionality of the measure.
- (29) The Commission observes that the extension of the scheme is a response to the continuing financial difficulties that Hungary, as most Member States, continues to experience. Since the objective of the measure is to provide short- and medium-term financing to financial institutions which have difficulties to obtain funds on the financial markets, it is important to ensure the availability of the scheme as long as the global financial crisis continues.
- (30) Although access to funding for banks has gradually improved in most funding markets over the past year and is no longer a systematic and generalized problem, markets have not yet fully returned to normal functioning. Against that background and taking into account the residual fragility of recovery process and the possibility of setbacks in that process, the continuation of the subject scheme can be deemed necessary to ensure financial stability as confirmed by the MNB. The Commission therefore considers that the extension of the scheme until 30 June 2012 is appropriate and necessary to remedy a disturbance of the Hungarian economy.
- (31) The Commission notes the extension does not include any substantial changes to the eligible instruments under the scheme. The modifications on pricing have been introduced to align the scheme with the 2011 Prolongation Communication.
- (32) In particular, the new pricing formula to be applied from 1 January 2012 takes into account the greater differentiation by risk of banks' CDS spreads in recent times, by referring to median CDS spreads over a three-year period ending one month before the grant of loans. Since increases in CDS spreads in recent years are partially due to influences that are not specific to individual banks, in particular the growing tensions in sovereign debt markets and an overall increase in the perception of risk in the banking sector, that formula should isolate the intrinsic risk of individual banks from changes in CDS spreads of sovereigns and of the market as a whole.

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- Hungary commits to report to the Commission on the implementation of the scheme.
 - Hungary undertakes to present a viability review for any bank that is granted liquidity support on new or renewed liabilities for which at the time of the granting of the new liquidity support the total outstanding liabilities (including liquidity support accorded before before 1 July 2010) exceed 5% of total liabilities and EUR 500 million.
 - Finally, the Hungarian authorities acknowledge that the Commission will cumulate the amount of any aid granted under the scheme with that of any other State aid and that the impact of such aid will be taken into account in the Commission's assessment of any lending bank's viability/restructuring plan.

- (33) The prerequisites for the compatibility of guarantee schemes with Article 107(3)(b) TFEU that have been established by the Banking Communication¹⁵ and the Commission's subsequent decisional practice continue to apply.
- (34) As regards the specific features of the scheme, in assessing the request for the extension the Commission has to balance its positive effects for financial stability, the distortions of competition that the extension entails and the delay in the return to a normal functioning of the financial markets. Liquidity schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States. The Commission considers that the conditions of the scheme comply with those requirements.
- (35) As regards the combination of the scheme with other aid measures, as indicated in the Annex to the Restructuring Communication¹⁶, any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To that end an individual *ex ante* notification is necessary in such cases.
- (36) Furthermore, the Commission recalls that based on point 16 of the Restructuring Communication, if aid not initially foreseen in a notified restructuring plan is necessary for the restoration of viability, that additional aid cannot be granted under an approved scheme but needs to be subject to individual *ex ante* notification and any such further aid will be taken into account in the Commission's final decision on that bank.
- (37) In addition to the existing commitments, Hungary commits to provide reports on the operation of the scheme and on market funding of participating banks for the period until 15 October 2012, if any banks participate in the scheme during the first half of 2012.
- (38) On the basis of the above, the Commission concludes that the notified extension of the scheme does not alter its previous assessment in the decision of 23 June 2011 in State aid case SA.32994 (2011/N), and considers that the notified extension of the scheme is compatible with the internal market until 30 June 2012.

VI. DECISION

The Commission concludes that the notified extension of the scheme is compatible with the internal market. The Commission has accordingly decided not to raise objections.

¹⁵ Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8.

¹⁶ Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.08.2009, p. 9.

The Commission recalls that, according to the commitment of the Hungarian authorities, the measure is limited in duration until 30 June 2012.

The Commission notes that Hungary exceptionally accepts that the decision be adopted in the English language.

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Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President