2011

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by Yassine Boudghene, Matthaeus Buder, Zetta Dellidou, Cristophe Galand, Violeta Iftinchi, Max Lienemeyer, Christos Malamataris, Danila Malvolti ([1])

Snapshot

This article is written looking back from June 2011, newer developments are not reflected.

Introduction

The substantial support programme, designed by the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) to address the sovereign crisis in Greece, was not without impact for the normal safety measures that Greece had devised to react to the global financial crisis. In order to describe how these measures coincide, an explanation will be given of the general Greek State aid support measures, adopted before the sovereign crisis (section 2). After describing the support programme (section 3), the analysis will address the Commission's assessment of the general measures put forward under the programme. Emphasis is placed on measures dealing with problems of liquidity and solvency (section 4). Some general thoughts will then be presented about the impact of the programme on the assessment of the return to viability of the credit institutions concerned (section 5). Finally, there is a conclusion (section 6).

State aid support measures adopted before the sovereign crisis

During the last quarter of 2008, Greece, like other European Member States, put forward a comprehensive package of emergency measures designed to ensure the stability of its financial system in the wake of the global financial crisis. As the measures are funded from State resources, are selective and have the potential to distort competition and trade between Member States, they constitute State aid and had to be deemed compatible by the Commission under Article 107 (3) lit b TFEU ([2]).

In detail, the package of State aid measures included (i) a Recapitalisation Scheme, (ii) a Guarantee Scheme, and (iii) a Government Bond Loan Scheme:

- the *Recapitalisation Scheme*, with a total budget of EUR 5 billion, allows the State to inject Tier 1 capital into participating institutions in the form of preference shares that need to be remunerated at 10%. The aim is to enhance solvency;

- the *Guarantee Scheme*, with a total budget of EUR 15 billion, allows participating institutions to issue certain debt instruments with a maturity ranging from three months to three years, with a State guarantee. The objective is to enhance liquidity, by allowing credit institutions to have better access to funding;

- In the context of the *Bond Loan Scheme*, with a total budget amount of EUR 8 billion, Greece lends to participating institutions (against collateral and applying specific haircuts) specifically issued Greek government bonds, with a maturity of up to three years. The objective is also to enhance liquidity, as banks can use such bonds as collateral in the refinancing transactions or marginal lending facilities of the ECB or as collateral in interbank transactions.

In order to achieve compatibility with the internal market, Greece made various commitments. In particular, Greece agreed that the recapitalisation would need to be followed up by a restructuring plan after six months and it also agreed to go along with several behavioural restrictions, such as a government representative on the board of the bank, a dividend and a hybrid coupon ban.

The total package of support measures, initially amounting to EUR 28 billion, was of a relatively limited size in comparison with other countries. Moreover, as of end-December 2009, it was used for only 40% of the budget.

Most of the 19 commercial banks incorporated in Greece participated in the support measures. The Recapitalisation Scheme, in particular, was used by 10 banks, which were reported to have received capital injections totalling around Euro 3.7 billion: They were the National Bank of Greece (NBG), Eurobank EFG, Piraeus Bank, Alpha Bank, Agricultural Bank of Greece (ATE), Hellenic Postbank (TT), Attica Bank, Proton Bank, First Business Bank (FBB) and Panellinia Bank.

([1]) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

([2]) The measures were approved by the Commission Decision of 19 November 2008 in State Aid Case N 560/2008 "Support Measures for The Credit Institutions in Greece", OJ C 125, 05.06.2009, p. 6.

General measures in the context of the Greek sovereign crisis

As underlined by the limited support measures in the last chapter, the 2008 financial crisis had a relatively limited impact on the Greek banking sector. This is due, *inter alia*, to the lesser degree of openness of the economy (3) and to the fact that the main Greek banks were universal banks. They were less exposed to "toxic" structured credit assets and traditionally did not rely very heavily on wholesale funding.

Notwithstanding this, the Greek sovereign crisis did seriously affect the Greek banks. Starting from the last quarter of 2009, the uncertainties and fears around the budgetary situation of Greece gradually increased. They were further fuelled in October 2009 by the revision of the estimates of the 2009 deficit from 6.7% of gross domestic product (GDP) to 12.7% of GDP, which led to a sharp increase in the credit spreads of Greek government bonds. This gradually foreclosed access of the Greek sovereign to the international bond market and subsequently also the access of the Greek banks.

In order not to compromise the refinancing of the Greek sovereign, a quick response was vital. With the aim of supporting the Greek government, the Eurozone countries agreed on 2 May 2010 to provide EUR 80 billion in bilateral loans to Greece over a three-year programme, while the IMF agreed to provide EUR 30 billion under its Stand-By Arrangement for Greece, putting together a joint package totalling EUR 110 billion (4). These loans are conditional on the fulfilment of a Programme plan (5) including provisions for fiscal, structural and financial sector reforms (6). The application of this Programme plan in the Greek economy is being closely monitored by a joint mission of the EC, ECB and IMF (the so-called 'Troika'), with further disbursements being subject to approval by the Eurosystem.

The fiscal problem of Greece is impacting on banks in (mainly) two ways: (i) the government's foreclosure of access to international capital markets has been extended to the Greek banks and has been having a severe impact on their funding capacity (ii) the austerity measures are impacting on the asset quality of Greek banks, leading to an increase in non performing loans which is in turn weighing on the profitability and the solvency of the Greek bank. Special measures were designed to contain these effects and will be discussed in the following section.

In addition, the Greek State has considered its shareholding in public companies and intends in the medium term to sell most of its stakes. To this end, during the summer of 2010 the Greek authorities assessed their strategy with regard to their holdings in three banks: ATE Bank, Attica Bank and TT. The conclusions of the strategic review (7) were that, ATE should be restructured on a stand-alone basis, with reduced lending to public entities and more enhanced corporate governance. A recapitalisation of the bank will take place in the short term and is subject to the Commission's approval. As regards government stakes in TT and Attica Bank, the government will consider disposing of its direct holdings in TT and its indirect holdings in Attica Bank.

State aid measures in the context of the sovereign crisis

In order to address the above-mentioned issues, the support measures that existed before the sovereign

(3) OECD Document DAF/COMP(2010)9, Roundtable on Competition, Concentration and Stability in the Banking Sector, 18.10.2010, p. 123seq, 128seq, also available at http://www.oecd.org/officialdocuments/displaydocumentpdfv2/?cote=DAF/COMP%282010%299&docLanguage=En.

(4) Statement by President Van Rompuy following the Eurogroup agreement on Greece (02 May 2010), also available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114128.pdf. See also the European Commission Press Release of 3 May 2010, "Euro area and IMF agreement on financial support programme for Greece", also available at http://ec.europa.eu/economy_finance/articles/eu_economic_situation/2010-05-03-statement-commissioner-rehn-imf-on-greece_en.htm. For an analysis of the response to the Greek sovereign crisis at the EU level, see K. Featherstone, 'The Greek Sovereign Debt Crisis and EMU: A Failing State in a Skewed Regime' (2011) 49 *Journal of Common Market Studies* 193-217.

(5) In accordance with Article 1(3) of Law 3845/2010, Annex III (Memorandum on economic and financial policy) and Annex IV (Memorandum of Understanding on specific economic policy conditionality) are jointly referred to as the 'Programme plan'.

(6) The program includes inter alia a sustainability-enhancing fiscal consolidation through measures that generate savings in public sector expenditure and improve the government's revenue-raising capacity, financial sector policies aiming at stabilising the Greek financial system, medium-term structural reforms in order to improve the Greek economy's competitiveness through the modernization of the public sector, the increase in efficiency and flexibility of product and labour markets and the creation of a more open and accessible business environment for domestic and foreign investors, including a reduction of the State's direct participation in domestic industries. See for details DG Economic and Financial Affairs, "The Economic Adjustment Programme for Greece: Second Review - Autumn 2010", Occasional Paper No. 72, also available at http://ec.europa.eu/economy_finance/publications/occasional_paper/2010/pdf/ocp72_en.pdf

(7) See IMF, "Greece: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding", 8 December 2010, pg.12-14, available at http://www.imf.org/external/np/loi/2010/grc/120810.pdf.

crisis were reinforced. The Commission subsequently approved amendments to the measures and prolonged them several times [8], while, at the same time, other measures were put in place.

4.1. Liquidity: increased budget for the Guarantee Scheme

Greek banks have lost access to wholesale markets and have experienced some deposit outflows, resulting in an increased dependence on ECB refinancing operations. Moreover, the repeated downgrades of the Greek government rating have eroded the quality of collateral that Greek banks could use in such refinancing operations and required an increase in the eligible collateral.

The Programme plan did not provide for the allocation of any additional liquidity support to the Greek banks. Instead, it was decided to continue to rely on a combination of State-guaranteed bonds which could be used as collateral to obtain funding from the Eurosystem. To ease the liquidity strains, first the initial amount of EUR 15 billion was fully allocated. Subsequently, Greece needed to raise the ceiling of its Guarantee Scheme. To that end, on 12 May 2010 the ceiling for the Guarantee Scheme was raised to EUR 30 billion. On 30 June 2010 the ceiling was further raised to EUR 55 billion. Another increase of the ceiling by EUR 30 billion is planned for the first half of 2011.

As the issuance of State guarantees for bonds constitutes State aid, these instruments had to be approved by the Commission. The Commission found the guarantees compatible with the internal market under the standard rules incorporated in the Commission's banking communication. [9] Under these rules, the support has to be limited to six months and, if it has not been used during this period, will need to be extended [10]. This type of support measure has been the typical instrument to deal with the market failure stemming from the financial crisis and a priori requires no follow up as such, and in particular does not require the provision of a restructuring plan [11]. This liquidity support, albeit resulting in a significant exposure to the Eurosystem, did not bring anything new from the point of view of State aid control.

4.2. Solvency: The Financial Stability Fund

With the Financial Stability Fund (FSF), the Programme plan put forward a relatively novel instrument. Anticipating a further worsening in asset quality and increasing provisions, which might impact on the banks' solvency, a "safety net" for banks was established in order to maintain the stability of the Greek banking system. To this end, the FSF received EUR 10 billion under the Programme plan which is to be used for recapitalising the banks in Greece.

The FSF was established by Law 3864/2010 of 13 July 2010. The FSF is a legal person governed by private law, and is administratively and financially independent. It is funded by the government with resources from the programme. The FSF is managed by a Board of Directors, where representatives of the EC and the ECB also participate, without voting rights.

The activation of the FSF can occur when a credit institution does not comply with the first pillar [12] or second pillar [13] capital requirements or when there is a well-founded risk that such a credit institution may not, in the opinion of the Bank of Greece, be able to comply with Pillar 2 capital requirements. However, participation in the FSF comes only after the credit institution has failed to increase its own funds with the support of its current or new shareholders or to ease its capital strains in some other way. This has to be set out in a business plan "*specifying the amount of the required capital injection and detailing the measures which the credit institution intends to take in order to safeguard and strengthen its solvency the soonest possible, by increasing its capital and/*

(8) Commission Decision of 18 September 2009 in State Aid Case N 504/2009 "Prolongation and amendment of the Support Measures for the Credit Institutions in Greece", OJ C 264, 06.11.2009, p. 5, Commission Decision of 25 January 2010 in State Aid Case N 690/2009 "Prolongation of the Support Measures for the Credit Institutions in Greece", OJ C 57, 09.03.2010, p. 6, Commission Decision of 12 May 2010 in State Aid Case N 163/2010 "Amendment to the Support Measures for the Credit Institutions in Greece", OJ C 166, 25.06.2010, p. 2, Commission Decision of 30 June 2010 in State Aid Case N 260/2010 "Extension and amendment to the Support Measures for the Credit Institutions in Greece", OJ C 238, 03.09.2010, p. 3, Commission Decision of 21 December 2010 in State Aid Case SA.31998 (2010/N), "Fourth extension of the Support Measures for the Credit Institutions in Greece".

(9) Commission Communication of 13 October 2008, OJ 2008/C 270/08, as of second half 2010 also the phasing out re commendations are applied, cf; http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf

(10) This happened several times. See above footnote 8.

(11) However, since July 2010 a viability review needs to be provided in certain cases. Cf Commission Decision of 30 June 2010 in State Aid Case N 260/2010 "Extension and amendment to the Support Measures for the Credit Institutions in Greece", OJ C 238, 03.09.2010, p. 3. This is based on a general policy considerations, see http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf

(12) The level of Pillar 1 capital requirements is set up at present at 8% of Risk Weighted Assets.

(13) As established for each credit institution by the Bank of Greece (BoG), in its capacity of competent supervisory authority.

or restoring its profitability through cost-cutting, reducing risks or receiving support from other companies of its group, etc. The plan may also include any prospects of a merger or absorption, or a transfer of its activities or units to another credit institution or financial organisation."

On the basis of the business plan, the capital injections shall be carried out by the FSF through the issuance of preference shares with a remuneration of 10%. If the credit institution does not comply with the Pillar 1 capital requirements, the capital shall be increased by the issuance of common shares.

Thereafter the FSF and the credit institution shall jointly draw up a detailed restructuring plan or amend any plan already submitted to the Commission, in accordance with the applicable EU State aid legislation and the relevant guidelines provided by the Commission. Within six months from the granting of the capital injection, Greece shall submit the restructuring plan to the Commission. To this end, the FSF will be equipped with very far reaching powers to impose restructuring measures and to monitor the restructuring process.

On 3 September 2010, the Commission approved the FSF as a recapitalisation scheme ([14]) in line with the rules on support schemes for the financial sector during the crisis. Despite the existence of the FSF, which is established under Greek law until 2017, the FSF was approved, as is the case for all crisis-related State aid schemes, for a six-month period. This allows the Commission to reassess the necessity, appropriateness and proportionality of the measures every six months.

In its assessment of the FSF, the Commission concluded that the capital measures provided under the FSF do constitute State aid, given that it is financed through State resources and is selective, and therefore has the potential to distort competition and affect inter-State trade.

The Commission then concluded that the measure was compatible under Article 107(3)(b) TFEU to remedy a serious disturbance in the economy of a Member State. This was the case despite the existence of the original recapitalisation scheme, because the FSF is an additional instrument that is based on the Programme plan. The Commission found that the FSF scheme was appropriate, necessary and proportional to the objective of Article 107(3)(b). In this context, the Commission took note of the obligation of the credit institution to submit a restructuring plan, drafted in cooperation with the FSF and an undertaking by the beneficiaries to continue to provide the same behavioural commitments as under the 2008 support measures.

A novelty of the FSF is that it is no longer strictly speaking an emergency recapitalisation scheme. The national authorities have been forced to go a step further and also to intervene in the restructuring process under the emergency programme. It therefore comes very close to a scheme that allows restructuring measures to maintain the viability of a financial institution on the basis of the restructuring plan. However, given that any aid must be subject to a restructuring plan and to the final approval of the Commission, it is still in line with the Commission's regulatory framework.

Impact of the Programme on the assessment of the return to viability of the relevant banks

The Recapitalisation Communication requires that the rescue obligations befollowed up by a restructuring plan for distressed banks or a viability report for fundamentally sound banks. The demarcation is assessed on the basis of the risk profile of the bank. For this, four indicators have been identified in the Annex of the Recapitalisation Communication. The decisive factor in Greece should be the amount of aid in relation to the banks' risk weighted assets, since the other indicators, like CDS and rating, are strongly affected by the Greek sovereign problems.

In the summer of 2010, the Greek authorities submitted the first versions of the viability reviews and restructuring plans for the 10 banks ([15]). The assessment is still ongoing and aims to determine whether the measures provided for in the plans restore the viability of the banks, address possible distortions of competition and provide sufficient burden-sharing from both the bank itself and its stakeholders (shareholders, subordinated debt holders, etc).

This Commission's assessment will certainly not be unaffected by the Programme plan put in place in May 2010. A significant advantage for the assessment is, *first*, the information flow between the Commission and the Greek authorities, which is in particular enhanced through the regular missions

([14]) Commission Decision of 3 September 2010 on State aid Case N 328/2010, "Recapitalisation of Credit Institutions in Greece under the Financial Stability Fund (FSF)", OJ C 316, 20.11.2010, p.7. The FSF was prolonged until end-June 2011. See Commission Decision of 14 December 2010 under State aid case SA.31999 (2010/N), "Prolongation of the Recapitalisation of credit institutions in Greece under the Financial Stability Fund (FSF)", OJ C 62, 26.02.2011, p.16-17.

([15]) For a more precise distinction, see Commission Decision of 18 September 2009 in State Aid Case N 504/2009 "Prolongation and amendment of the Support Measures for the Credit Institutions in Greece", OJ C 264, 06.11.2009, p. 5

and information updates received from the Bank of Greece in the context of the programme.

At the same time, the programme poses a *second* challenge to the viability reviews in that it sets out a number of parameters which cannot be ignored. The Commission's evaluation has to take into consideration the provisions and the assumptions of the programme, in particular regarding overall GDP growth, unemployment, inflation and, where appropriate, its impact on credit provision and on savings ([16]). In terms of credit supply, this means that in principle the banks should not count on either on growth in deposits, or on a net increase in credits, at least for 2011 and 2012.

Third, the exit from State aid, which is a cornerstone of all viability reviews and restructuring plans, will also be challenging because the banks' funding is heavily reliant on State guarantees which are provided on instruments used as collateral for receiving ECB funding. As the viability reviews should explain how State support measures are redeemed, some assumptions have to be made as regards the reopening of financial markets. However, this will depend very much on confidence being restored in Greece, which the Programme plan assumes will happen in mid 2012. However, even though a viability assessment is based on prudent assumptions, the uncertainties around the reopening of wholesale markets for Greek financial institutions cannot be ignored. Consequently, several banks should consider a de-leveraging process aimed at relying on more stable sources of funding going forward.

Finally, more interference can be expected if a bank has to raise capital from the FSF. As indicated above, in such a case, the FSF should be driving the restructuring process. It remains to be seen whether the intention of the aid grantor and the Commission are closely enough aligned.

Conclusion

Although the financial crisis had initially not resulted in much State support for Greek banks, the Greek sovereign crisis underlined the need for enhanced State measures. The Programme plan had the same effect as State aid rescue packages had had in 2008-2009 in Europe: it stabilized the sector and contained any threats to financial stability. Therefore, as in other countries in Europe, the return to viability should now be on the agenda.

However, it needs to be emphasized that, so far, the crisis in Greece has mainly been a liquidity crisis, and not much State capital support has been required. Notwithstanding this, the redemption of liquidity support is no less of a challenge and will probably take longer than in other countries. This will depend on the implementation of the measures set out in the programme and how it is perceived by the market.

Moreover, until now, in-depth restructuring has not been on the agenda for the major financial institutions in Greece. However, while the obvious problems of the Greek banks were caused in the main by the sovereign crisis, the possibility that some banks in Greece were already facing structural problems cannot be ruled out. They now need to reconsider their individual business models and will need to undertake structural adaptations. Furthermore, if the banks are unable to reduce their dependence on State guarantees, they will also need to consider structural measures, in particular deleveraging.

From a State aid perspective, the priority remains to ensure that the State aid measures to support the Greek banking sector are compliant with EU rules. There is no reason for any deviation from the normal crisis management, including "*adherence to principles and flexibility on procedure*" ([17]), which should mainly be a timing issue.

([16]) The programme makes the following assumptions on growth: GDP is projected to decline by 3 percent in real terms in 2011 while the economy is projected to grow by 1 percent in 2012 and by slightly above 2 percent in 2013 and 2014. See http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp77_en.pdf

([17]) See the speech of the European Commissioner for Competition Policy, Neelie Kroes, "The Road to Recovery", address at 105th meeting of the OECD Competition Committee, Paris, 17th February 2009, available at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/63&format=HTML&aged=0&language=EN&guiLanguage=en.