State aid SA.36088 (2013/N) – Hungary Prolongation of Hungarian Bank Support Scheme

European Commission
Subject: State aid SA.36088 (2013/N) – Hungary

Prolongation of Hungarian Bank Support Scheme

Sir,

1. PROCEDURE

(1) On 12 February 2009 the Commission approved the measures under the Hungarian Bank Support Scheme (hereinafter "the scheme") by its decision in State aid case N 664/2008 (hereinafter "the original decision")¹. That scheme comprised a recapitalisation measure and a guarantee measure.

(2) On the basis of subsequent notifications, the Commission approved an amendment and a prolongation of the scheme in its decision of 3 September 2009 in State aid case

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(3) On 31 January 2013 Hungary notified an eighth prolongation of the scheme until 30 June 2013.

(4) For reasons of urgency, Hungary accepts that exceptionally the present decision is adopted in the English language.

2. **DESCRIPTION OF THE SCHEME**

(5) In response to the on-going exceptional turbulence in world financial markets, the scheme brought forward by the Hungarian authorities was designed to ensure the stability of the Hungarian financial system. It consists of a recapitalisation measure with the objective of building and maintaining an adequate buffer of capital for the credit institutions concerned, and thus enhancing their solvency and their ability to lend to the real economy\(^9\).

(6) Beneficiaries of the scheme are credit institutions of systemic importance established in Hungary\(^10\).

(7) Under the recapitalisation measure, the Hungarian State is empowered to undertake the recapitalisation of certain credit institutions with an overall budget of HUF 300 billion (EUR 1027 million\(^11\)). The measure aims at increasing the capital adequacy ratio of the participating banks in order to strengthen the credit institutions’ capital base and thereby boost the confidence of other market players. The recapitalisation can take the form of preference shares, designed to be classified as Tier 1 capital. The aim of such recapitalisations is to keep the participating banks’ Capital Adequacy Ratio on a level of up to […]*.

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\(^{6}\) Commission decision C (2011) 4510 final; OJ C 237, 13.08.2011, p. 2.

\(^{7}\) Confidential information.


\(^{10}\) The original scheme consisted of two measures: a recapitalisation measure and a guarantee measure. The guarantee measure expired on 31 December 2009. The recapitalisation measure expired on 31 December 2012.

\(^{11}\) Including subsidiaries of foreign banks, but excluding banks operating in the form of branch offices.

\(^{12}\) With exchange rates of 5.2.2013 (HUF/EUR 292.142).
The overall objective of the recapitalisation scheme is to restore market confidence in banks through improved capital buffers and to avoid ultimately any negative spill-over to the Hungarian economy.

A detailed description of the scheme is provided in the original decision, in particular recitals 2 to 7 concerning the legal basis and the objective of the scheme and recitals 8 to 18 on the general description of the scheme.

3. **Position of Hungary**

Hungary requests a prolongation of the scheme from 1 March 2013 until 30 June 2013.

Hungary submits that the recapitalisation measure constitutes State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"), but is of the view that the proposed prolongation is compatible with the internal market on the basis of Article 107(3)(b) TFEU as it is necessary in order to remedy a serious disturbance in the economy of Hungary.

Hungary submitted a letter by the Magyar Nemzeti Bank (the Hungarian Central Bank) further supporting the need for the proposed prolongation to safeguard the stability of the financial system in Hungary, because prevailing market conditions do not allow for a termination of the scheme.

During the entry window of the scheme - from 12 February 2009 to October 2012 - the Hungarian State concluded only one agreement under the scheme in the first half of 2009. According to the agreement, the capital provided to FHB Jelzálogbank Nvrt. was HUF 30 billion. The bank has already paid back the whole amount of the support.

Hungary submitted following commitments relating to the scheme:

- to impose a ban on advertisement referring to the State support on the beneficiaries of the scheme and to prevent them from employing any aggressive commercial strategies, which would not take place without the State support;
- to impose a dividend ban on the beneficiaries of the scheme for the rescue period, i.e. until the Commission adopts a restructuring decision;
- to ensure that the scheme entails fixed limitations in the remuneration policy for the members of the bodies and management of the beneficiary financial institution;
- to ensure that financial institutions will not pay coupon on hybrid capital during the rescue period, i.e. until the Commission adopts a restructuring decision, where they have no legal obligation to proceed with such payment. Coupon on hybrid capital held by the State will be paid, unless such payments would trigger coupon payments to other investors which would otherwise not be obligatory;
- to submit a restructuring plan for any financial institution which benefits from a recapitalisation after 31 December 2012 within six months from the date of granting
the aid (unless the European Commission requests the plan sooner in line with point 14 of the 2011 Prolongation Communication\textsuperscript{12}), irrespective of whether pursuant to the rules set out in the Recapitalisation Communication\textsuperscript{13} it is considered to be fundamentally sound or distressed. Hungary undertakes that the restructuring plan to be submitted shall comply with the principles set out in the Restructuring Communication\textsuperscript{14} in order to re-establish the individual financial institution's long-term viability without continued reliance on State support, while containing adequate burden-sharing measures and measures to limit distortions of competition;

- to notify individually any aid to a beneficiary which has already received aid in the past and needs to approach the scheme for further support;

- to present every six months a report on the implementation of the scheme, including the list of all beneficiaries and all the relevant information;

- to ensure an appropriate remuneration of the State recapitalisation by complying with the following requirements:

  i. The subscription price of the State shares will be based on the market (or market-based) value of the outstanding company shares to which a dilution-adjusted discount will be applied, in line with points 8 and 9 of the 2011 Prolongation Communication.

  ii. For listed financial institutions, the benchmark share price will be the quoted market price of liquid shares observed on the market in the five trading days preceding the announcement of the issue under the scheme or the opening of the subscription, whichever is first. For non-listed financial institutions, the benchmark share price will be an appropriate market-based value (determined by means of generally accepted valuation methodologies).

  iii. The dilution-adjusted discount to the share price will be achieved by applying a discount to the theoretical ex-rights price (TERP). The discount to the TERP will be in line with the discounts observed for rights issues (they are currently around 30% to the TERP) in the market.

- to impose a ban on the beneficiaries of the scheme from acquiring any stake in any undertaking. That ban covers acquisitions of both undertakings which have the legal form of a company and of packages of assets which form a business. That ban will apply for the rescue period, i.e. until the Commission adopts a restructuring decision.


\textsuperscript{13} Commission Communication - Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, C 10, 15.1.2009, p. 2.

Despite the ban, beneficiaries may acquire stakes in undertakings provided that the purchase price paid for any acquisition is less than 0.01% of the balance sheet size of the beneficiary at the date of the recapitalisation and that the cumulative purchase prices paid for all such acquisitions over the whole restructuring period is less than 0.025% of its balance sheet size at the date of the recapitalisation. The ban does not cover acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms.

4. **Assessment**

4.1. **Existence of State Aid**

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

(16) For the reasons indicated in the original decision, the Commission considers that the scheme constitutes State aid within the meaning of Article 107(1) TFEU, because it concerns the provision of State resources to a certain sector, i.e. financial sector, which is open to intense international competition. Under the scheme, participating financial institutions obtain capital under conditions which would not be available to them under market conditions, and so receive an advantage. Given the characteristics of the financial sector, any advantage from State resources to a financial institution affects intra-Union trade and threatens to distort competition. The measure therefore constitutes State aid within the meaning of Article 107(1) TFEU.

4.2. **Compatibility**

(17) Under the scheme Hungary intends to provide aid in the form of recapitalisations in favour of credit institutions.

(18) Given the exacerbation of tensions in sovereign debt markets that has taken place since 2011, the Commission considers it appropriate to examine the measure under Article 107(3)(b) TFEU.

(19) Article 107(3)(b) TFEU empowers the Commission to find that aid is compatible with the internal market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance. That assessment has been confirmed in the Recapitalisation Communication and the Restructuring Communication. The Commission still considers that requirements for State aid to be approved pursuant to Article 107(3)(b) TFEU are fulfilled in view of the reappearance of stress in financial
markets. The Commission confirmed that view by adopting the 2010 Prolongation Communication, which prolonged until 31 December 2011 the application of State aid rules to support measures in favour of banks in the context of the financial crisis. The Commission has since extended the application of those rules beyond 31 December 2011 under the 2011 Prolongation Communication.

(20) The Commission does not dispute the position of the Hungarian authorities that the global macroeconomic and financial environment continues to be dominated by tensions from the euro area sovereign debt crisis. Furthermore, risk remains elevated, as European peripheral countries encounter overwhelming challenges in achieving economic growth. There is a restrained credit supply, still weak banking sector and sustainable debt levels. Hence, the Commission finds that the scheme aims at remedying a serious disturbance in the Hungarian economy.

(21) Therefore, the Commission continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

Appropriateness

(22) The objective of the scheme is to temporarily offer appropriate measures to establish backstops for the financial system in a timely and efficient manner, where private solutions for strengthening the capital base fail. The Commission observes that applicable prudential requirements have recently been significantly increased by the European regulators. That development has given rise to concerns about the creditworthiness of certain financial institutions. Hence, a backstop mechanism by the Member State is an appropriate means to strengthen financial institutions and thus to restore market confidence.

(23) Moreover, the exceptional circumstances at the origin of the notified measure persist. Therefore, the Commission recognizes the need for the prolongation of the scheme. The letter from the Central Bank endorses that necessity (see recital 12). In particular, taking into account the persistent risks of the euro area sovereign debt crisis and high asymmetries in the domestic banking sector, the Central Bank supports the initiative of setting aside sufficient funds to cover capital needs for a stress scenario. In addition, the prolongation of the scheme is justified in view of the existing funding challenges. Therefore the availability of the Hungarian capital support programme is a necessary and proportionate measure to ensure financial stability in Hungary even under adverse conditions.

(24) Therefore the Commission considers that the prolongation of the measure is appropriate to remedy a potential serious disturbance of the Hungarian economy.

Necessity

(25) With regard to the scope of the measure, the Commission notes positively that Hungary has limited the size of the scheme by determining its maximum budget at EUR 1043 million and that the scheme applies until 30 June 2013.

(26) The Commission regards an appropriate remuneration for the capital provided by the State, which is based as far as possible on the market price, to be the best safeguard for the necessity of a capital injection measure. In addition, remuneration and terms of recapitalisation should, where possible, be structured so that it is attractive for banks to repay the capital injections as soon as the market conditions allow16.

(27) The Commission notes that Hungary has committed to follow the pricing and other conditions for State recapitalisations laid down in the 2011 Prolongation Communication which requires, in particular, that new pricing conditions based on market data are applied. Further, the Commission confirms the need for a presentation of a restructuring plan whenever recapitalisation measures are granted as laid down in 2010 Prolongation Communication.

(28) Also, the Commission notes positively that the scheme entails terms and conditions, which incentivise banks to repay the capital injections as soon as the market conditions allow. In particular, in order to provide an incentive to the banks to redeem the State capital as soon as circumstances make it possible, the amount that has to be repaid to the State increases by a step-up of one percentage point each year.

Proportionality

(29) The Commission observes that a rescue phase, i.e. the period from the recapitalisation until the Commission adopts a restructuring decision, can last in some cases for as much as several years. Therefore, it is important to introduce as early as possible safeguards which aim at limiting the aid to the minimum.

(30) In that context, the Commission welcomes that Hungary has committed to introduce a number of behavioural safeguards already for the rescue phase. In particular, Hungary submitted the following behavioural commitments: an acquisition ban, a dividend ban, a hybrid coupon ban and a remuneration cap. Those commitments ensure adequate burden-sharing and prevent the beneficiary from using the aid to finance anti-competitive behaviour or activities, which are not necessary for restoration of its viability.

(31) The Commission welcomes that Hungary undertakes to submit a restructuring plan for any bank which benefits from a recapitalisation, in line with the rules set out in the 2010 Prolongation Communication. The Commission also welcomes the fact that Hungary undertakes that any restructuring plan to be submitted will comply with the principles set out in the Restructuring Communication in order to re-establish the individual bank's

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long-term viability without reliance on State support, while containing adequate burden-sharing measures and measures to limit distortions of competition.

(32) As regards the combination of the scheme with other aid measures, the Commission recalls that, as indicated in the Annex to the Restructuring Communication, any restructuring plans to be submitted should contain all State aid received as individual aid or under a scheme during the restructuring period.

(33) Furthermore, based on point 16 of the Restructuring Communication, the Commission recalls that, should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, such additional aid cannot be granted under an approved scheme but needs to be subject to individual ex ante notification. All State aid measures received by a bank as individual aid or under the scheme during the restructuring period will be taken into account in the Commission's final decision on that bank.

Monitoring

(34) The Commission welcomes that Hungary undertakes to present every six months a report on the implementation of the scheme, including the list of all beneficiaries and all the relevant information.

Conclusions on the compatibility of the aid measure

(35) The Hungarian bank support scheme remains an appropriate, necessary and proportionate measure to remedy a serious distortion of the Hungarian economy and does not alter the Commission’s previous assessment in the original decision of 12 February 2009 and the prolongation decisions of 3 September 2009, 17 December 2009, 23 June 2010, 7 December 2010, 23 June 2011, 8 March 2012 and 30 September 2012. The notified prolongation therefore complies with the requirements set out above and is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

(36) In line with the Commission’s decisional practice the Hungarian bank support scheme can therefore, as of the date of the Commission's approval of the aid measure, be prolonged until 30 June 2013. Any further prolongation will require the Commission’s approval and will have to be based on a review of the developments in financial markets and the scheme’s effectiveness.

5. CONCLUSION

The Commission has accordingly decided:

- to consider the aid to be compatible with the internal market.

Hungary exceptionally accepts that the present decision be adopted in the English language, for reasons of urgency.
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Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
J70 03/225
B - 1049 Brussels
Fax No: +32 2 296 12 42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President