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Support Measures for the Credit Institutions in Greece

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EUROPEAN COMMISSION

Brussels, 19.11.2008
C(2008) 7382

**Subject: State Aid N 560 /2008 – GREECE
Support Measures for the Credit Institutions in Greece**

Madame,

I. PROCEDURE

1. Following two meetings between the Commission services and the Greek authorities, Greece notified to the Commission on 14 November 2008 a package of measures designed to ensure the stability of the Greek financial system (this includes a letter of the Bank of Greece confirming the necessity of the measures). On 17 November 2008 Greece transmitted additional information regarding the scope of the implementation of these measures.

II. DESCRIPTION OF THE SCHEME

1. Legal basis and objective of the measures

2. The proposed measures concern the Greek law "For the enhancement of liquidity of the economy in response to the impact of the international financial crisis" and its implementing laws.
3. In response to the ongoing exceptional turbulence in world financial markets, Greece intends to bring forward a comprehensive package of measures (hereinafter referred to as "the scheme" or "financial support measures") designed to ensure the stability of the Greek financial system.
4. These measures can be subdivided into the following categories:
 - A. Bank Recapitalisation Scheme (hereinafter "the Recapitalisation Scheme"): The Greek Government will make available Tier 1 capital by acquiring preference shares in order to build and maintain an adequate buffer of capital for each credit institution.

Mrs Dora BAKOYIANNIS
Minister for Foreign Affairs
Vasilissis Sofias 5
Greece-10671 Athens

- B. A Wholesale Funding Guarantee Scheme (hereinafter 'the Guarantee Scheme'): The Greek Government will provide, in return for an appropriate remuneration, a State guarantee for debt instruments with a maturity of between three months and three years designed to reopen the market for short and medium term wholesale funding.
 - C. Support through the issuance of Greek State special purpose securities to credit institutions (hereinafter "the Bond Loan Scheme"): The Greek Government will, in return for remuneration and appropriate collateral, issue and lend Greek State securities in order to enable the institutions to obtain immediate liquidity from the ECB and interbank markets.
5. The law came into effect on 24 October 2008. However, the Greek authorities commit that the law will not be applied before its approval under state aid rules by the Commission.
 6. The Greek authorities commit to notify to the Commission any prolongation of the scheme, in due time, before the end of a period of six months from the day of the approval of the scheme, i.e. on 19 November 2008, for which the scheme is authorised.

3. The Beneficiaries

7. Beneficiaries of the scheme are credit institutions authorised to operate in Greece by license from the Bank of Greece. According to the Greek authorities, subsidiaries of foreign institutions may participate in the scheme without having to fulfil any additional conditions.
8. The Greek authorities have clarified that the law is only applicable to credit institutions and will not benefit directly or indirectly any other undertakings not considered as financial institutions. In particular, the Greek authorities commit that Article 5 of the law, which provides that "*...the guarantee allocated according to Article 2 could relate to grants to businesses of vital importance for the country's growth*" refers to guarantees granted to credit institutions only, and will not be used, directly or indirectly, in order to favour the granting of loans or other financial instruments to particular undertakings or sectors of the Greek economy.
9. The credit institutions will obtain, with the help of the recapitalisation scheme, a tier 1 capital ratio of above 8 %, which should be maintained for the duration of the scheme. Moreover for the other measures the institutions will also, according to the law, need to fulfil the capital adequacy ratios set by the Bank of Greece which also corresponds with aforementioned 8 % of tier 1 capital.

4. Description of the measures

A. The Recapitalisation Scheme

10. Under Article 1 of the law Greece is establishing a Recapitalisation Scheme. It aims at facilitating the increases of tier 1 capital in participating banks in order to strengthen the credit institutions' capital base. Banks authorised to operate in Greece by license from the Bank of Greece (including subsidiaries of foreign banks) may increase their capital by issuing preference shares irrespective of whether or not their transferable securities are listed in organized markets/on the stock exchange. Preference shares are the only instrument used for recapitalisation under the law and the Commission understands that this is considered as tier 1 capital by the Bank of Greece.

11. To facilitate the capital increases, the Greek Government is prepared to acquire preference shares up to an overall maximum of EUR 5 billion in the credit institutions that choose to enter the recapitalisation scheme. Those institutions wishing to participate in the recapitalisation scheme must express their interest by 1 February 2009 at the latest. They then must issue the preference shares by 19 May 2009, i.e. 6 months after the approval of this scheme. The window to issue the preference shares can be extended up to 31 December 2009, upon the Commission's approval.
12. The amount of preference shares purchased by the Greek State will be based upon a Decision of the Minister of Economy and Finance (hereinafter 'the Minister'). The Minister's decision will be informed by a recommendation from the Governor of the Bank of Greece (hereinafter 'the Governor') as to the amount to be allocated per bank for acquiring these shares.
13. This recommendation shall be based on the following supervisory criteria:
 - the capital required to reach the capital adequacy level of the credit institution as defined by the Bank of Greece. More specifically, the target Tier 1 ratio after recapitalisation will be between 8% and 10%. The weighting of this criterion is set at 0,5 of the total evaluation;
 - the size of the credit institution relating to its market share in the general financing of the economy and to its importance in maintaining financial stability. The weighting of this criterion is set at 0,4 of the total evaluation;
 - the contribution of the credit institution in financing small and medium sized enterprises and residential loans. The weighting of this criterion is set at 0,1 of the total evaluation.
14. In the case where the recapitalisation measure is not redeemed by the beneficiaries after 6 months from the granting of the measure, the Greek authorities shall notify to the Commission a restructuring plan.
15. These preference shares will contain an annual fixed rate of return of 10% on the injected capital. The preference shares are non-cumulative and are considered as non-core tier 1 capital. The preference shares have, in the case of the bank's liquidation, priority over ordinary shares.
16. These preference shares entitle the Greek State to be represented in the Board of Directors by a representative who is appointed as member to the Board of Directors. The State representative is present at the General Assembly of ordinary shareholders and has the power to veto any decision related to dividends distribution and to the policy regarding benefits accorded to the President, the Managing Director and other members of the Board of Directors, General Directors and Deputy General Directors, if he considers that such a decision may jeopardise the interests of depositors or substantially affect the solvency and the good functioning of the bank.
17. The law ensures that the preferred shares are repurchased by the bank for an amount that is equivalent to the amount originally invested in the financial institution. The preference shares shall be repurchased by the bank at the latest after five years, upon approval by the Bank of Greece. The bank can repurchase the preference shares before this date at its own initiative subject to the approval by the Bank of Greece but, in any case, not before 1 July 2009. The Bank of Greece will prevent the financial institution from repurchasing the preference shares in the case the capital adequacy ratio is not fulfilled. If at the end of the five year period the bank cannot repurchase the preference shares because the capital

adequacy requirements are not fulfilled, the preference shares shall be converted into ordinary shares or other similar instruments. The fact that the preferred shares are not redeemed but instead converted into ordinary shares shall also be considered within the above mentioned restructuring plan.

18. In the case conversion of the preference shares takes place, the conversion value will be equal to the issuance value. For the determination of the conversion rate of the preference shares into ordinary shares or shares of another category existing at the time of the conversion, the average of the value of these securities in the latest trading year will be taken into consideration. In case these securities are not listed in an organised market, the internal book value of the latest fiscal year will be taken into consideration for the determination of the conversion rate.
19. Greece will impose the following behavioural conditions to participating institutions in the Recapitalisation Scheme:
 - a) The salary and benefits accorded to the President, the Managing Director and other members of the Board of Directors, General Directors and Deputy General Directors of the participating banks cannot exceed the total amount of salary and benefits received by the Governor of the Bank of Greece.
 - b) All additional bonuses of the abovementioned persons are abolished for the period of the existence of the recapitalisation measures.
 - c) No dividends will in principle be paid out during the time that the State participates in the institution. To this end, the Greek authorities commit in the context of Article 1(3) of the Law that, upon decision of the Minister for Economy and Finance, the representative of the State will ensure through his/her veto rights that no dividends are distributed until the State participation has been redeemed (it is understood that the veto right is real and cannot be overruled). In case dividends are distributed, the Greek authorities will notify this to the Commission individually and seek its approval.
 - d) Participating credit institutions will inform the Bank of Greece every three months of the precise use of the amounts of the funds received. The Governor informs the Supervisory Council for the Implementation of the Scheme.¹ The Greek State has the right to cancel or reform the conditions of the above measures following a proposal by the Bank of Greece for the proper use of the amounts of funds received by the credit institutions. The credit institutions must submit quarterly reports based on which the Bank of Greece prepares a semi-annual report on the use of the funds received. These reports will outline the implementation of the business plans of each credit institution as well as any restructuring plans and will be submitted to the European Commission. In case of serious violation of the terms and conditions under which the credit institutions are included in the scheme there may be sanctions as well as full or partial cancellation of the above measures by decision of the Minister following the proposal of the Governor.
 - e) Moreover, each participating credit institution is obliged not to undertake aggressive market strategies including advertising with the guaranteed status of the

¹ This Supervisory Council is set up by Article 7 of the Law. It is chaired by the Minister with the participation of the Governor, the Deputy Minister of Economy and Finance competent for the General Accounting Office and the State's Representatives at the Board of Directors of the banks participating in the scheme. The Council will convene once a month in order to coordinate the correct and effective implementation of the law and secure that the liquidity created is used to the benefit of depositors, the borrowers and the Greek economy in general.

beneficiary bank, especially against those competitors not receiving the same coverage/ not participating in the scheme.

- f) Participating credit institutions are also obliged to abstain from expanding their activities or pursuing other purposes in a way that unduly distorts competition. For this purpose, the participating credit institutions are obliged to ensure that during the implementation period the average increase of the total assets does not exceed the highest amount among:
- the annual growth rate of the Greek nominal GDP on the previous year or
 - the average rate of increase of the Greek banking sector's total assets for the period 1987-2007 or
 - the average rate of increase of the EU banking sector's total assets for the previous six months.

The compliance with the above obligations is controlled by the Supervisory Council and is based on the reports mentioned under d).

B. The Guarantee Scheme

20. Under Article 2 of the law Greece is making available a State guarantee to the credit institutions covering new debt issued after 19 November 2008. The guarantees cover all debt, except for subordinated debt and interbank deposits, issued in the following six months. This may be prolonged after approval of the Commission until 31 December 2009. The debt is further limited in so far as only debt with duration from three (3) months up to three (3) years is eligible.
21. The overall limit allocated to the scheme is set at EUR 15 billion.²
22. This amount will be distributed per financial institution based on the following criteria:
- the liquidity and capital adequacy position of the financial institution and the likelihood its capital adequacy to be affected. The weighting of this criterion is set at 0,5 of the total evaluation;
 - the size of the credit institution as derived by its market share in the general financing of the economy, as well as its importance in maintaining financial stability. The weighting of this criterion is set at 0,3 of the total evaluation;
 - the size of the residual maturity of the financial institution's liabilities until 31/12/2009. The weighting of this criterion is set at 0,1 of the total evaluation; and
 - the contribution of the credit institution in financing small and medium sized enterprises and residential loans. The weighting of this criterion is set at 0,1 of the total evaluation.
23. The guarantee will be provided for an appropriate fee. Collateral can also be provided although this is not compulsory.
24. The fee is calculated based on the procedure decided by the European Central Bank ("ECB", see in particular points 3 to 8). There will be a measure of institution-specific risk coupled with an additional per annum mark-up to cover the Greek State's credit risk.

² This limit is, however, being kept under review and can be amended but cannot exceed the amount of EUR 23 billion. Any amendment will have to be approved by the Commission.

25. This means for guarantees with duration of 3-12 months there will be only a fee of 50 basis points, or 25 basis points when collateral is provided. Guarantees with duration of more than 1 year will in principle be priced based on the median of five year CDS spreads of the credit institution concerned for the period 1/1/2007-31/8/2008 with an additional mark-up of 50 basis points when there is no collateral or 25 basis points when collateral is provided (the details correspond to points 6 to 8 of the ECB recommendations).³
26. The type of eligible collateral is listed in the implementing legislation (Article 4). In order to protect the State against a fall in the value of the collateral provided, a coefficient of adjustment (haircut) is applied according to the quality of the collateral. For example, for corporate loans with variable interest rates, with credit rating AAA, AA, A, a haircut of 10-15% (for the residual maturity below and above 5 years respectively) will be applied, for loans with credit rating BBB a haircut of 15-20% (for residual maturity below and above 5 years respectively) will be applied, for loans with credit rating BB a haircut of 20-25% and for loans with 1% < probability of default < 2,5% a haircut of 40% will be applied. For residential loans a haircut of 20% is applied irrespective of the residual maturity or the way that the interest rate is determined. For loans to shipping companies, a haircut of 50% will be applied. For loans in foreign currency, except loans to shipping companies, an additional haircut of 15% will be applied.
27. The implementing law reserves the right to adjust the fee rate by a decision of the Minister of Economy and Finance according to market conditions but only upon approval of the European Commission.
28. The representative of the Greek State will participate in the Board of Directors of the credit institutions under the same terms and with the same legal consequences as under the recapitalisation scheme until the expiry of the guarantee provided.
29. Greece will impose the behavioural conditions referred to under point 19 d) to f) on the institutions benefiting from a state guarantee as those referred to under the recapitalisation scheme aimed at eliminating or minimising any distortive spillover effects. These will include a prohibition on the institution explicitly promoting itself on the basis of the state guarantee.
30. Finally, the Greek authorities commit in the case where the guarantee is drawn upon, to notify to the Commission within 6 months the restructuring or liquidation aid accompanied by a respective business plan.

C. The bond loan scheme

³ More specifically, credit institutions for which there are CDS data will pay a fee which is defined as the aggregate of: i) the minimum between the median of the current spreads of five year contracts of CDS type for the credit institution and the median of five year CDS spreads of a representative sample of Euro-zone banks, having equal credit rating with the credit institution concerned, for the period 1/1/2007-31/8/2008 and ii) 50 or 25 basis points. The median of five year CDS spreads of the banks' sample may also be used in case the spread of a particular institution is not considered appropriate to its credit quality. Credit institutions for which there are no CDS data, and for which there is a credit risk rating, will pay a fee, which is defined as the aggregate of: i) the median of five year CDS spreads for the same period of a representative sample of Euro-zone banks as defined by Eurosystem, having the same credit rating with the credit institution concerned and ii) 50 or 25 basis points. For credit institutions for which a credit risk rating is not available, the fee is defined as the aggregate of: i) the median of five year CDS spreads for the same period of a representative sample of Euro-zone banks as defined by the Eurosystem, having the worst credit rating for which data are available, adapted to the supervisory evaluation of each credit institution and ii) 50 or 25 basis points.

31. Under Article 3 of the law the Greek State authorises the Public Debt Management Office (PDMO or O.D.DH.C) to issue Greek Government special purpose securities, i.e. bonds. These special purpose securities, with a maturity of up to three years, will be lent to eligible credit institutions for enhancing their liquidity. According to the Greek implementing laws, credit institutions that borrow these titles under the provisions of this scheme are obliged to use them as collateral in the refinancing transactions or marginal lending facilities of the European Central Bank and/or as collateral in interbank transactions for liquidity purposes.
32. The securities have zero coupons. They are listed in the Athens Stock Exchange, have an ISIN code and are monitored in the Secondary Market platform run by the Bank of Greece (H.D.A.T). Their lending to the credit institutions is materialised in tranches of 1.000.000 Euros. The securities are lent in their nominal value directly and exclusively to the credit institutions, transmitting to them the legal ownership of titles for the whole period of lending.
33. The overall limit allocated is EUR 8 billion. The initial window for credit institutions to borrow the bonds lasts for a period of six months and can only be extended upon the approval of the Commission. This amount will essentially be distributed per financial institution based on same criteria as the guarantee scheme (cf. point 22). The only difference is the second criterion i.e. it is the activity of the credit institution in the money market and its ability to redistribute liquidity that will be taken into account in the order of 0,3 of the total evaluation.⁴
34. The credit institutions in possession of these special purpose securities are obliged to use the product of their liquidation for granting residential loans and loans to small and medium-sized enterprises under competitive terms.⁵ The use of securities for enhanced liquidity as well as the use of the proceeds of liquidation will be supervised by the Bank of Greece. Also the behavioural conditions referred to under point 19 d) to f) apply.
35. These securities will be provided against a fee and collateral. The fee and collateral are equal to what the credit institution would pay for receiving a State guarantee (see point 25 and 26). The fee is payable at the beginning of the six months period or at the beginning of the remaining period up to the expiry of the securities if the remaining period is less than six months.
36. Except from the above granted fee, no other financial transaction is taking place for these securities. Consequently, the credit institutions do not transfer to the Greek State the amount received from using these securities for financing purposes, neither does the Greek State transfer to the credit institutions the nominal amount of securities at expiration. The coupon on the collateral provided remains with the credit institutions for the duration of the measure.
37. Finally, the Greek authorities commit in the case where a bank is unable to return the bonds and the collateral provided is not sufficient, to notify to the Commission within 6 months the restructuring or liquidation aid accompanied by a respective business plan.

⁴ The provision of these securities to the credit institutions will be based on bilateral agreements concluded between the PDMO and the credit institution. The securities are returned to the PDMO and cancelled at the expiry of these agreements.

⁵ See Article 5 of the Greek Law.

III. POSITION OF GREECE

38. The Greek authorities accept that the scheme contains state aid elements. They have stressed, however, that in creating these measures they have incorporated the recommendations of the Eurosystem, formulated to ensure a coordinated approach.
39. The Greek authorities seek urgent authorisation for the financial support scheme. [...]*
40. The various elements contained in the scheme: increased capital, a temporary guarantee to stimulate wholesale funding markets and the provision of necessary liquidity, represent in the view of the Greek authorities a comprehensive, necessary and proportionate package [...].
41. The Greek authorities claim that the scheme is compatible with the common market because it is necessary to remedy a serious disturbance in the Greek economy pursuant to Article 87(3)(b) of the EC Treaty.
42. A letter sent by the Bank of Greece dated 14 November 2008 [...].
43. The Greek authorities consider that the notified scheme does not involve any unduly adverse spill-over effects on other Member States or undue distortions of competition. The measures are open to any bank authorised to operate in Greece (whether Greek or foreign-owned) which requires it, and therefore are open and non-discriminatory and do not threaten to distort competition.
44. The Greek authorities submit that all possible measures have been taken in order to ensure the Commission that the scheme will not allow the credit institutions to expand their business in a disproportionate manner. To this end, they have undertaken to impose a number of behavioural conditions as set out under point 19 of this decision.
45. The Greek authorities commit to seek the Commission's approval, should it be necessary for the measures to continue beyond six months. They will also seek approval if the funds dispensed under the different categories are modified or exceed the thresholds in this notification.

IV. ASSESSMENT

1. State aid character of the scheme

46. As set out in Article 87(1) EC, 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 common market.
47. First, the Commission agrees with the position of Greece that the scheme constitutes aid to the credit institutions concerned, pursuant to Article 87 (1) EC.
48. The recapitalisation, the guarantee and the bond loan to the credit institutions allow the beneficiaries to secure the required capital as well as liquidity on more advantageous conditions than would otherwise be possible in the light of the prevailing conditions in the financial markets. This gives an economic advantage to the beneficiaries and

* Confidential information, also indicated below by [...].

strengthens their position compared to that of their competitors in Greece and other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. The advantage is selective since it only benefits the beneficiaries of the scheme and is provided through State resources.

49. In particular, it should be noted that no market economy investor would have undertaken the recapitalisation, provided the guarantee or the bond loan. Regarding the capitalisation, the Commission recalls that a market economy investor expects a reasonable return on his investment⁶ which is not the case here. For the current scheme this is confirmed by the fact that the State is investing because no market economy operator would have been willing to invest on similar terms. Regarding the guarantee, the Commission is convinced that in the current circumstances of financial crisis no market economy investor would have granted such a guarantee on securities or loans to be provided by the participating banks.⁷ The same applies to the risk assumed through the bond loan.

2. Compatibility of the Financial Support Measures

a) Application of Article 87(3)(b) EC

50. Greece intends to provide capital injections and operating aid under a scheme which is granted to assist credit institutions. Given the present circumstances in the financial market, the Commission considers that it is appropriate to examine this measure directly under the Treaty rules and in particular under Article 87(3)(b) EC.
51. Article 87 (3) (b) EC enables the Commission to declare aid compatible with the Common Market if it is "to remedy a serious disturbance in the economy of a Member State. The Commission recalls that the Court of First Instance has stressed that Article 87 (3) (b) EC needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State."⁸
52. The Commission considers that the present scheme concerns the entire Greek banking industry. The Commission does not dispute the analysis of the Greek authorities that the current global financial crisis has made access to liquidity more difficult for credit institutions across the board and has also eroded confidence in the creditworthiness of counterparties. In these circumstances, even fundamentally sound credit institutions are under severe pressure. The Commission also considers that if the issues of lack of liquidity and lack of confidence are not addressed, it will result not only in difficulties for the banking sector but, due to that sector's pivotal role in providing financing to the rest of the economy, will also have a systemic effect on the Greek economy as a whole. The Commission does not dispute that the present scheme is designed to address the problems of the lack of liquidity and lack of confidence that are currently striking Greek banks.

⁶ Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale* [2003] ECR II-435, para. 314.

⁷ Cf Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 32.

⁸ Cf. in principle case Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Confirmed in Commission Decision in case C 47/1996, *Crédit Lyonnais*, OJ 1998 L 221/28, point 10.1, Commission Decision in Case C28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, page 1, points 153 *et seq* and Commission Decision in Case C50/2006 *BAWAG*, not yet published, points 166. See Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, OJ C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, *Rescue aid to WestLB*, OJ C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

Therefore it finds that the scheme aims at remedying a serious disturbance in the Greek economy.

b) Conditions for compatibility under Article 87 (3) (b)

53. In line with the Commission Communication on 'The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis',⁹ in order for an aid scheme to be compatible, any aid or aid scheme must comply with general criteria for compatibility under Article 87 (3) EC, viewed in the light of the general objectives of the Treaty and in particular Articles 3 (1) (g) and 4 (2) EC, which imply compliance with the following conditions:¹⁰

- a. *Appropriateness*: The aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the measure is not appropriate to remedy the disturbance.
- b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g. a temporary and limited guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.¹¹
- c. *Proportionality*: The positive effects of the measures must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measures' objectives. This follows from Article 3 (1) g EC and Article 4 (1) and (2) EC, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87 (1) EC prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87 (3) b) EC which authorises State aid must ensure that such aid is limited to that necessary to achieve its stated objective.

c) Assessment of the Recapitalisation Scheme

54. The objective of the Recapitalisation Scheme is to strengthen the economic capital of the banking system and to ensure that banks are sufficiently strongly capitalised so as to better withstand potential stress. The Commission has already observed in several cases

⁹ OJ C 270 of 25.10.2008, p. 8.

¹⁰ Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 41. As well as all following schemes such as N 512/2008 (UK), N 48/2008 (Ireland), N 512/2008 (Germany), N 533 /2008 (Sweden), N 548/08 (France), NN 54/A/2008 (Spain) etc.

¹¹ Cf. Case 730/79, *Philip Morris* [1980] ECR 2671. This line of authority has recently been reaffirmed by the Court of Justice in. Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive* of 15 April 2008, where the Court held that, "As is clear from Case 730/79 [...], aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market [...]."

that a recapitalisation scheme is in principle an appropriate means to strengthen the banks and thus to restore market confidence.¹²

55. In addition, the Commission notes that the scheme is in principle not aimed at enterprises in difficulty but applies to enterprises whose capital base is only to be strengthened against possible losses. The provision of capital can be seen as a confidence building measure aimed at restoring the trust of third parties in Greek credit institutions and is thus intended to prevent enterprises which are fundamentally sound from falling into difficulties as a result of the existing ongoing crisis. The scope of the recapitalisation scheme therefore seems appropriate to strengthening the Greek banking sector and to contributing to the revival of interbank lending in Greece.¹³
56. In addition, the allocation of capital is based on objective criteria, with particular importance on ensuring a sufficient level of capitalisation with respect to the solvency requirements.¹⁴
57. The Recapitalisation Scheme is also limited to the minimum necessary in scope and time. With regard to its temporal scope, the Commission notes positively that Greece has limited the window to enter the scheme initially to 6 months only. With regard to the size of the measure, the Commission notes positively that the recapitalisation scheme is limited to a maximum amount of EUR 5 billion.
58. Moreover, capital interventions in credit institutions must be done at terms that minimise the amount of aid. A key element in this respect is an appropriate, market oriented remuneration on the capital invested.¹⁵ The Commission observes that Greece is requesting a remuneration of 10 % for the preference shares on a non cumulative basis and that it expects redemption after 5 years, if the banking authorities approve such a redemption. However, in the event that the bank is unable to repay the State after five years or if the banking supervisor does not approve such redemption, the latter will be entitled to take an equity stake with a similar value to its original investment.
59. Regarding market orientated terms that minimise the amount of aid, recent data show that, reflecting current distressed market conditions, the current yield for hybrid Tier 1 capital, such as preference shares, is in the vicinity of 15% or more.¹⁶ However, the Commission acknowledges that setting the remuneration as high as the current clearing level would restrain the credit institutions from using such measures. Moreover, it is the Commission's intention to adjust to long term market conditions and not to impose the current unfavourable conditions on the credit institutions today. In addition, in recent decisions on the recapitalisation schemes in the UK and Germany, the Commission accepted, in the context of strict behavioural conditions, remuneration levels of 12% and

¹² Commission Decision of 13 October 2008 in Case N507/2008 Guarantee Scheme for banks in the United Kingdom, not yet published, point 46 et seq. and Commission decision of 27.10.2008 in case N512/2008 *Support measures for financial institutions in Germany*, not yet published, point 41 et seq.

¹³ Commission Decision of 13 October 2008 in Case N507/2008 Guarantee Scheme for banks in the United Kingdom, not yet published, par. 49

¹⁴ This is emphasised in the Commission communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, OJ C 270 of 25.10.2008, p. 8, point 37.

¹⁵ See in particular the Commission communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, OJ C 270 of 25.10.2008, p. 8, point 39.

¹⁶ For example JP Morgan, Europe Credit Research, 27.10.2008; Merrill Lynch data on euro denominated tier 1 debt from at least investment grade rated financial institutions, publicly issued in the Eurobond market or in the domestic market of Member States' having adopted the euro. Data are provided by ECOWIN (ml: et10yld).

10% respectively.¹⁷ Therefore, the Commission considers that an expected overall return of 10% would be also acceptable in the present case, if equivalent behavioural conditions are met.¹⁸

60. The irreversible nature of capital injections also entails the need that the scheme must establish some clear ex ante behavioural safeguards which the Member State must monitor and enforce in order to ensure their observance and to take steps avoiding undue distortions of competition.¹⁹
61. One crucial behavioural constraint is the ban on dividends, which provides a clear incentive for a bank's shareholders to support redemption of the State's participation at the earliest opportunity. The non-distribution of dividends also ensures that the capital base of the bank is built up through the accumulation of reserves, which is in line with the overall purpose of the measure.
62. Furthermore, the Commission observes a number of other significant behavioural commitments, as indicated above in point 20. In particular the obligation that the beneficiary needs to maintain a certain solvency ratio (see above point 9) and that the credit institutions are not allowed to grow their balance sheets faster than at agreed indicative rates, should ensure that the institutions do not engage in aggressive commercial strategies or expansion of their activities that would imply undue distortions of competition.²⁰ In that context, the fact that the law requires the credit institutions to review their operations on a regular basis and limits the remuneration of the credit institutions' executives for the period of application of the relevant scheme is also viewed positively by the Commission.
63. Finally, the Commission notes positively that the Greek authorities committed that the beneficiaries will within six months of implementation of the measure present a restructuring plan.²¹ Such plans are the cornerstone of the Community Guidelines on State aid for Rescuing and Restructuring Firms in Difficulty²² (hereinafter "R&R guidelines") which articulate the Commission's understanding of Article 87 (3) (c) EC for this type of aid. For any aid to a firm in difficulty, it is in the common interest that the company returns to long term viability and that this is sufficiently scrutinized, by means of the restructuring plan. However, and also in line with the R&R guidelines, the Commission will not require such a plan where the beneficiary has redeemed the State's stake within 6 months.
64. On the basis of the above, the Greek Recapitalisation Scheme can be considered compatible with the common market.

¹⁷ See Commission decision of 13.10.2008 in case N507/2008 *Financial Support Measures to the banking Industry in the UK*, not yet published, point 52 and Commission decision of 27.10.2008 in case N512/2008 *Support measures for financial institutions in Germany*, not yet published, point 55. Remuneration was even higher in Commission decision of 12.11.2008 in case N 528/08 *ING*, not yet published.

¹⁸ Commission decision of 27.10.2008 in case N512/2008 *Support measures for financial institutions in Germany*, not yet published point 55 fn. 19.

¹⁹ See in particular the Commission communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, OJ C 270 of 25.10.2008, p. 8, point 27.

²⁰ Commission Decision of 13 October 2008 in Case N507/2008 *Guarantee Scheme for banks in the United Kingdom*, not yet published, par. 53.

²¹ In order to facilitate the work of the Member States and the Commission, the Commission will be prepared to examine grouped notifications of similar restructuring cases. The Commission may also consider that there is no need to submit a plan relating to a pure liquidation of the institution, or where the size of the residual economic activity is negligible.

²² OJ C 244, 1.10.2004, p. 2.

d) Assessment of the Guarantee Scheme

65. The objective of the present guarantee scheme is to provide a safety net to investors that purchase the newly issued debt of, or lend to, the participating credit institutions, so that these institutions can have sufficient access to liquidity. This is a reaction to the international market failure where even healthy banks are facing difficulties in fulfilling their central role in financial intermediation. The Commission considers that such guarantee schemes should help to overcome this market failure, by establishing the conditions for the revival of the interbank lending market. It therefore regards the scheme as an appropriate means to meet the objective.²³
66. In addition, the scheme is targeted at the appropriate beneficiaries which are all Greek banks, including the subsidiaries of foreign banks. The scheme is limited in principle to solvent companies that fulfil a certain capital adequacy ratio set by the Bank of Greece i.e. above 8%. Moreover, the maintenance of an appropriate ratio is one of the main eligibility criterion for the allocation of the guarantee.
67. Furthermore, only the borrowing of credit institutions can benefit from the guarantee scheme; therefore there will be no guarantees granted for lending in favour of particular undertakings or sectors of the Greek economy. Although Article 5 of the law states that "...and the guarantee allocated according to Article 2 could relate to grants to businesses of vital importance for the country's growth" the Greek authorities will ensure that this refers to guarantees granted to credit institutions only and will not be used directly or indirectly in order to favour the granting of loans or other financial instruments to particular undertakings or sectors of the Greek economy. That means that, apart from the general motivation of the State guarantee scheme to support the Greek economy, there should be no condition or any other link that the guarantee has to be related to specific Greek businesses.
68. As regards necessity, the guarantee scheme is limited to the minimum necessary in material scope and time. As regards material scope, the Commission notes positively that Greece is in principle limiting the guarantee to the forms of financing that are considered a specific source of difficulties, i.e. short to medium term interbank lending.²⁴ On the other hand it excludes from its scope subordinated debt as well as existing debt.
69. As regards temporal scope, the guarantee applies to the newly issued debt for up to three years. In general, the Commission is of the view that the duration of a guarantee should be as short as possible. In this regard, the Commission notes positively an additional safeguard in the present scheme in so far as it has a limited issuance period of initially six months. The temporal scope is thus in principle justified.
70. As regards proportionality, the distortion of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market orientated premium. It can be estimated that in this way the credit institutions pay on average an adequate premium. The banks will pay a premium of 50 bps plus the median of the 5-year CDS spread over the 20 months period ending on 31 August 2008. This can be considered

²³ See Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 42, Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, not yet published, at point 56, and Commission decision of 13 October 2008 in case NN 48/2008 *Guarantee scheme for banks in Ireland*, not yet published, at point 59.

²⁴ This is emphasised in the Commission communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, OJ C 270 of 25.10.2008, p. 8, point 21.

proportionate and consistent with the recent practice of the Commission.²⁵ In addition, the Commission notes that this is also in line with the recommendations of the ECB, which also aim at the establishment of an appropriate framework for premiums on guarantees issued in the Euro zone.

71. Also the fact that, for guarantees where collateral is provided, the add-on is lowered, is in line with the ECB as it allows for a lower add on in cases where the guaranteed debt is collateralised. Indeed the participating institutions must provide collateral to the Bank of Greece that will be subject to significant haircuts, of up to 60% in some cases, and will be monitored throughout the duration of the scheme. Therefore a reduction of 50 % in the add-on fee seems on this basis reasonable.²⁶
72. Given that these ECB recommendations are themselves building upon the Commission's decision in the case of the UK (N 507/2008), the ECB criteria should be applied in parallel with the behavioural constraints that were established in this decision. In this regard, the behavioural constraints outlined in point 19 and 29 fulfil this requirement.
73. Indeed, the scheme includes several strong behavioural constraints which help to ensure that the participating credit institutions do not expand their activities under the scheme and thus do not receive more support than necessary for re-establishing their long term viability.²⁷ This concerns a limitation of the expansion of activities on an individual and an aggregate level of all participating credit institutions against clear benchmarks.
74. Furthermore, the Commission acknowledges that Greece has committed to provide a restructuring or liquidation plan, within six months, for any institution that causes the guarantee to be drawn.
75. On the basis of the above, the Greek Guarantee scheme can be considered compatible with the Common market.

e) Assessment of the bond loan scheme

76. As in the case of the guarantee scheme, the objective of the bond loan scheme is to ensure that credit institutions have sufficient access to liquidity. The temporary acquisition of government bonds to be used as collateral should enable illiquid assets to be released and used for other purposes. In the current financial situation, other banks may not be willing to accept these types of assets as collateral for loans. This measure therefore allows the credit institutions to fund their business more easily. Therefore, measures such as a bond loan mechanism can also be considered as an effective means of overcoming the current difficulties and is thus appropriate.
77. The measures are limited in principle to solvent companies that fulfil a certain capital adequacy ratio set by the Bank of Greece i.e. above 8%. Moreover, the maintenance of an appropriate ratio is one of the main eligibility criterion for the allocation of the bonds.

²⁵ A similar approach is taken in Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, not yet published, point 66 and the following schemes such as N 533/2008 (Sweden), N 548/08 (France), NN 54/A/2008 (Spain), N524/2008 (The Netherlands), N 567/08 (Finland).

²⁶ See for the case of covered bonds Commission Decision of 29 October 2008 in case NN 533/2008 *Support measures for the banking industry in Sweden*, not yet published, at point 46.

²⁷ A similar principle is contained in point 44 of the Rescue and Restructuring guidelines.

78. The Commission therefore considers the approach taken by the bond loan mechanism as appropriate to resolving the liquidity problem currently facing Greek credit institutions.
79. As far as necessity is concerned, the mechanism consisting in the temporary loan of Greek Government bonds to eligible credit institutions is limited to the minimum necessary in scope and time.
80. As regards temporal scope, the window to enter into the bond loan scheme will be initially only six months. The duration of the bond loan will not exceed three years, after which the securities must be returned to the Greek State.
81. As regards scope, the economic effect of the bond loan is comparable to a guarantee against collateral. The state is providing a bond for a defined period, against collateral that has been subjected to a significant haircut, which will allow the banks to access liquidity from interbank markets or the ECB. No financial transaction, other than the fee paid by the borrowing banks, takes place on the transfer of the bonds. Only in the event that the bank is both unable to repay the institutions that provided it with liquidity and that the collateral provided by the credit institutions is insufficient to cover the creditors' claims, will the state be called upon to repay the bonds that it originally issued. It must therefore be ensured that the State is properly remunerated for the guarantee.²⁸
82. In this regard, the aid amount is minimised through the provision of collateral and a market orientated premium. As in the case of the guarantee the participating institutions must provide eligible collateral, to the Bank of Greece, which will be subject to significant haircuts, of up to 60% in some cases, and be monitored throughout the duration of the scheme. In the event of a bank defaulting on its obligations to its creditors, who would then approach the state to redeem the Greek bonds that they had accepted as security, this collateral would protect the state from losses.
83. Furthermore, the credit institutions will pay an adequate premium of 25 bps plus the median of the 5-year CDS spread over the 20 months period ending on 31 August 2008. This is in line with the Commission's practice on guarantees and the ECB's recommendations on the fee guarantees where collateral is provided, as outlined above. Moreover, given that the State only provides bonds with a zero coupon and not liquidity, the State has, contrary to other systems where the state accepted assets directly for liquidity, no direct financing costs.²⁹ As a result, the Commission considers that the bond loan scheme can be considered proportional.
84. Finally, the scheme is aimed at supporting the granting of residential loans and loans to small and medium-sized enterprises at competitive terms and includes the same safeguards as the guarantee scheme (see point 34 above), which help to ensure that participating credit institutions do not expand their activities under the scheme and thus do not receive more support than is necessary for re-establishing their long-term viability.

²⁸ Commission Communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, point 40.

²⁹ Cf. Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, not yet published, point 74 and in the Commission Decision of 2 November 2008 in case N 548/2008 *Financial Support Measures to the Banking Industry in the France*, not yet published.

85. Furthermore, the Commission acknowledges that Greece has committed to provide a restructuring or liquidation plan, within six months, for any institution that is unable to properly repay the bond loan.

86. On the basis of the above, the Greek bond loan scheme can be considered compatible with the Common market.

V. DECISION

The Commission concludes that the notified measures are compatible with the Common market and has accordingly decided not to raise objections against the notified package, since it fulfils the conditions to be considered compatible with the EC Treaty.

If this letter contains confidential information which should not be published, please inform the Commission within five 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 publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
Rue de la Loi/Wetstraat, 200
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission