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**Subject: State aid SA.36087 (2013/N) – Hungary
Sixth Prolongation of the Liquidity scheme for banks**

Sir,

1. PROCEDURE

- (1) On 14 January 2010 the Commission approved the measure under Hungary Liquidity scheme for banks (hereinafter "the scheme") by its decision in State aid NN 68/2009 (hereinafter "the original decision")¹.
- (2) On the basis of subsequent notifications, the Commission approved the prolongation of the scheme in its decisions of 28 June 2010 in State aid case N 225/2010², on 7 December 2010 in State aid case N 535/2010³ on 23 June 2011 in State aid case SA.32994 (2011/N)⁴, on 7 March 2012 in State aid case SA.34078 (2011/N)⁵ and on 30 July 2012 in State aid case SA.35144 (2012/N)⁶.
- (3) On 16 January 2013 Hungary notified a sixth prolongation of the scheme until 30 June 2013.

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

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

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

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

⁵ Commission decision C (2012) 1510 final; OJ C 286, 22.09.2012, p.2.

⁶ Commission decision C (2012) 5450 final; OJ C 286, 22.09.2012, p. 2.

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- (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 March 2009, in response to the ongoing exceptional turbulence on the financial markets, Hungary enacted a law which provides for liquidity support in the form of loans to financial institutions. The initial scheme and its prolongations so far are based on that law, i.e. on Article 5 of Act IV of 2009 published in the Official Gazette ("Magyar Közlöny") No. 2009/28 on 10 March 2009.
- (6) As a result of a process of re-codification in Hungary, the numbering the provisions of the legislation on which the scheme is based has changed. The content of the law, however, remains unchanged. The notified prolongation is now based on Article 44 (Chapter VII) of Act CXCV of 2011 which is published in the Official Gazette No. 2011/64 of 30 December 2011.
- (7) The Hungarian authorities now request a further prolongation of the scheme until 30 June 2013.
- (8) In its letter of 23 November 2012, the Hungarian Central Bank (MNB) confirms the necessity of the continuation of the scheme for reasons of financial stability.
- (9) The eligible instruments⁷ under the scheme and the provided overall budget remain unchanged.
- (10) The scheme is open to all credit institutions established in Hungary, including subsidiaries of foreign banks, but excluding banks operating in the form of branch offices. The eligibility of the banks is established by the MNB and the Hungarian Financial Supervisory Authority (PSZÁF). The loans are ultimately awarded by the Hungarian Ministry for National Economy on the basis of the MNB's and PSZÁF's recommendation. They are granted ordinarily for a maximum of three years, while up to one-third of the total amount may be granted for a maximum of four years.
- (11) A detailed description of the scheme is provided in the original decision, in particular recitals 5 to 11 concerning the legal basis, recitals 12 to 19 concerning the objective and description of the scheme.

3. POSITION OF HUNGARY

- (12) Hungary requests a prolongation of the scheme from 21 March 2013 until 30 June 2013

⁷ The liquidity support takes the form of loans. The financial institutions in receipt of such loans are obliged to use the funds to lend to the real economy. The loans cannot take the form of subordinated loans or any other form of structured instrument. Borrowers under the scheme are prohibited from referring to their having received State loans in their advertising and they are not allowed to finance acquisitions with the proceeds of the loan.

- (13) Hungary submits that the scheme 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.
- (14) Hungary submitted a letter by the MZB 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.
- (15) In line with the requirements of the 2011 Prolongation Communication⁸, Hungary provided an indicative fee (estimation) for financial institutions eligible to benefit from those loans. The estimation was based on an application of the scheme's remuneration formula and recent market data. The indicative fee for financial institutions which do not have CDS data or an external credit rating was estimated by Hungary in line with the 2011 Prolongation Communication to be 400,24 basis points.
- (16) Hungary submitted following commitments relating to the scheme:
- i. to grant aid measures under the support scheme only to solvent financial institutions which meet capital requirements;
 - ii. to provide liquidity only for maturities from three month up to five years (or a maximum of seven years in the case of covered bonds) and to limit the instruments with maturity of more than three years to one-third of the scheme's overall budget;
 - iii. to impose a ban on advertising 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;
 - iv. to submit an individual notification if a restructuring plan has already been submitted that did not foresee the envisaged liquidity measure;
 - v. to submit individual restructuring or liquidation plans, within six months, for banks that default on State loans;
 - vi. to determine the minimum level of State remuneration in line with the formula set out in the 2011 Prolongation Communication;
 - vii. to communicate to the Commission, within three months following each liquidity provision, the actual fee charged;
 - viii. to report on the operation of the scheme and on the issuance by 15 April 2013 (for the period 1 January 2013 to 31 March 2013) and by 15 July 2013 (for the period 1 January 2013 to 30 June 2013) at the latest;

⁸ Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2010, p. 7.

- ix. to complement reports on the operation of the scheme with updated available data on the cost of comparable (nature, volume, rating, currency) market funding;
- x. to present a viability review for every financial institution that issued liquidity for which, at the time of the issuance, the total outstanding State loans exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication⁹ within three months of the granting of the loans.

4. ASSESSMENT

4.1. Existence of State Aid

- (17) 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.
- (18) 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 liquidity support 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 therefore threatens to distort competition. The measure therefore constitutes State aid within the meaning of Article 107(1) TFEU.

4.2. Compatibility

- (19) Under the scheme Hungary intends to provide aid in the form of liquidity support in favour of credit institutions.
- (20) 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.
- (21) 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

⁹ Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

assessment has been confirmed in the Recapitalisation Communication¹⁰ and the Restructuring Communication.¹¹ 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 Communication¹², 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.

- (22) The Commission does not dispute the position of the Hungarian authorities that the banks' access to long-term funding is still constrained, the reliance on external funds is still significant and the uncertainties in funding conditions in Europe can have an effect on Hungarian banking system. In addition, the risk of contagion between parent banks and their subsidiaries has also risen. Hence, the Commission finds that the scheme aims at remedying a serious disturbance in the Hungarian economy.
- (23) Therefore, the Commission continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

Appropriateness

- (24) The objective of the liquidity scheme is to temporarily offer appropriate measures to establish backstops for the financial system in a timely and efficient manner, where financial institutions face difficulties in obtaining sufficient funding. The Commission observes that the continuing crisis has eroded confidence in the creditworthiness of the banks, which results in difficulties in obtaining necessary funding on the financial markets. Hence, a backstop mechanism by the Member State, which in case of urgency ensures that the banks would have access to funding, is an appropriate means to strengthen financial institutions and thus to restore market confidence.

Necessity

- (25) With regard to the scope of the measure, the Commission notes positively that Hungary has limited the size of the liquidity scheme by determining its maximum budget at EUR 3.8 billion and that the scheme applies until 30 June 2013. Moreover, the granting of the loans is subject to specific uses as the receiving banks commit to use the proceeds from the loans to lend to the economy.
- (26) The pricing of the liquidity measures under the scheme also meets the more stringent requirements of the new formula introduced by the 2011 Prolongation

¹⁰ 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, OJ C 10, 15.1.2009, p. 2.

¹¹ Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

¹² Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of bank's in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

Communication. The fee applicable for the liquidity measures under the scheme¹³ remains as a minimum at the level resulting from that new formula plus a liquidity premium¹⁴. The liquidity measures are hence in line with the remuneration criteria set out in the 2011 Prolongation Communication. The fact that the fee might be set at a level higher than that acceptable under the 2011 Prolongation Communication is irrelevant, as that Communication sets minimum requirements. As liquidity measures are clearly more distortive than liquidity guarantees, the Commission takes a favourable view of a pricing formula that takes into account that increased distortive effect and makes those measures more expensive than liquidity guarantees.

- (27) The measure is also limited to the minimum necessary in scope and time. Loans under the liquidity measure may be granted for a maximum of three years ordinarily, while up to one-third of the total amount may be granted for a maximum of four years.
- (28) With regard to the size of the measure, the Commission notes that the budget is limited to a maximum amount of approximately EUR 3.8 billion (HUF 1100.8 billion)¹⁵.
- (29) Therefore, the Commission considers the measures as limited to the minimum necessary.

Proportionality

- (30) As regards proportionality, Hungary committed to present a viability review for any bank that requests new loans under a scheme which take or keep the total amount of the bank's outstanding liabilities above 5% of the bank's total liabilities and above the absolute amount of EUR 500 million. That commitment ensures that the use of liquidity scheme will not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments.
- (31) Second, the Commission notes that Hungary has committed to a number of behavioural safeguards such as a ban on advertisements referring to the State support and a ban on any aggressive commercial strategies which would not take place without the State support. Such safeguards help ensure that the participating institutions do not misuse the received State support to expand their activities.
- (32) Finally, the Commission welcomes that Hungary undertakes to submit individual restructuring or liquidation plans, within six months, for banks that default on their obligations.
- (33) As regards the combination of the scheme with other aid measures, the Commission recalls that, as indicated in the Annex to the Restructuring Communication, the

¹³ An indicative fee for financial institutions which do not have CDS data or an external credit rating was estimated by Hungary in line with the 2011 Prolongation Communication to be 400.24 basis points.

¹⁴ That formula was used to provide the indicative fee as defined in the scheme.

¹⁵ With exchange rates of 5.2.2013 (HUF/EUR 292.142).

restructuring plans to be submitted should contain all State aid received as individual aid or under a scheme during the restructuring period.

- (34) 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

- (35) The Commission welcomes that Hungary undertakes to present every three months a report on the operation of the scheme and to complement it with updated available data on the cost of comparable (nature, volume, rating, currency) debt issuances.

Conclusions on the compatibility of the aid measure

- (36) The liquidity scheme for banks 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 and the prolongation decisions. 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.
- (37) In line with the Commission's decisional practice the liquidity scheme for banks can therefore 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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Yours faithfully,
For the Commission

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Vice-President