Subject: SA.45940 (2016/N) – Austria – Repurchase offer for guaranteed liabilities of Heta Asset Resolution AG

Sir,

1. **PROCEDURE**

   (1) On 18 May 2016, Austria signed a Memorandum of Understanding with creditors of Heta Asset Resolution AG (“Heta”) for the settlement of guaranteed liabilities (the "settlement agreement").

   (2) On 29 June 2016, Austria notified to the Commission for reasons of legal certainty the Haftungsgesetz Kärnten (liability law Carinthia, the "implementing law") which implements that settlement agreement.

   (3) On 6 and 14 July 2016, respectively, the two chambers of the Austrian parliament, Nationalrat and Bundesrat, adopted the implementing law which specifies that Commission approval of the measure is required for it to come into force.

   (4) Between 19 July and 24 August 2016, Austria replied to questions from the side of the European Commission and provided additional information.
2. DESCRIPTION

2.1. State guarantees on the liabilities of Austrian public banks

(5) According to the notification by the Austrian authorities, the senior and junior bonds affected by the settlement agreement are guaranteed within the limits of existing aid as identified in Commission decision E8/2002 of 2003\(^1\) (the "2003 decision").

(6) In that decision, the Commission came to the conclusion that the State guarantees on the liabilities of Austrian public banks (the "Ausfallhaftung") – which also covered all liabilities of Hypo Alpe Adria – was incompatible albeit existing aid. Correspondingly and in line with the Commission's prerogatives under Article 108 TFEU, the Commission proposed to the Republic of Austria to abolish the Ausfallhaftung. Austria committed to abolish the Ausfallhaftung as of 2 April 2003, with a transitional period until 1 April 2007 during which new liabilities could be guaranteed by the State if they came to maturity no later than 30 September 2017.

2.2. Hypo Alpe Adria/Heta

(7) Hypo Alpe Adria ("HAA") was a large Austrian banking group with world-wide operations which got into difficulties during the financial crisis from 2008 onwards. In September 2013, the European Commission approved a plan for the orderly liquidation of HAA\(^2\) (the "2013 decision"). In that decision, Austria committed to ensure that HAA would implement a wind-down plan, which foresaw the divestment of HAA's marketable entities and a wind-down of the remaining assets. The wind-down segment comprised all assets which were not part of marketable entities.

(8) On 31 July 2014, Austria adopted the Gesetz zur Schaffung einer Abbaueinheit (GSA), according to which all banking businesses requiring a license would be separated from HAA and the remaining assets be held in a wind-down company without a banking license. To implement that law, HAA's banking network in South Eastern Europe was split off from HAA to be sold, Hypo Bank Italien was split off in order to be wound down (deposits until 2018) as committed by Austria and approved in the 2013 decision. The remaining HAA was renamed Heta Asset Resolution AG and the banking license was withdrawn in October 2014.

(9) After Heta management notified to the Austrian Financial Markets Authority ("FMA") potential further losses of between EUR 4 billion and EUR 7.6 billion, the FMA as the Austrian resolution authority under the Austrian Banken Sanierungs- und Abwicklungsgesetz ("BaSAG") took a decision on 1 March 2015, imposing a temporary debt moratorium on all outstanding Heta debt until 31 May 2016. FMA decreed that (i) Heta would stop all debt services until 31 May 2016. FMA decreed that (i) Heta would stop all debt services until 31

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May 2016 (including interest payments and repayments of principal) and (ii) FMA would devise a resolution plan for Heta.

(10) On 10 April 2016, FMA issued the final decision. Measures include a full loss participation of all capital instruments including a 100% haircut on all junior liabilities, a haircut of 53.98% on senior unsecured liabilities, a reset of the maturities of all senior unsecured liabilities to 31 December 2023 when Heta’s wind-down is planned to be completed and the cancellation of interest payments on liabilities as of March 2015.

2.3. The measure

(11) Heta still has about EUR 11 billion of outstanding senior and junior debt which has been guaranteed by the Land of Carinthia. On 18 May 2016 the Republic of Austria and a number of Heta creditors representing 48.7% of senior and 12.3% of junior debt concluded a Memorandum of Understanding on the settlement of the creditors' claims against the Austrian Land of Carinthia by virtue of the guarantee.

(12) That settlement is intended to end legal disputes between Austria and the creditors of Heta following the measures by the FMA. In order for that settlement to be finally accepted, creditors representing 66.6% of the total nominal value of the bonds covered by the settlement need to agree to it as well as 25% each of senior and junior debt. In the absence of such an agreement, the creditors would retain the full benefit of the original guarantee. Austria is confident that these quorums will be met following the planned publication of the offer in September 2016.

(13) Under the settlement agreement, senior creditors will have the following choices:

(a) Receive 75% of the face value of their bonds in cash; or

(b) Swap their bonds one-for-one for zero-coupon bonds ("ZCB") issued by the Kärntner Ausgleichszahlungsfonds ("K-AF", the Carinthian settlement payment fund) with a federal Austrian guarantee to be issued no later than 31 October 2016.

(14) Following a hold period of maximally 60 calendar days, the holders of the ZCB have the option to sell back the ZCB to Austria during a period of 180 calendar days following the hold period (the so-called "stabilisation period"). During the stabilisation period, Austria has agreed to set daily buy-prices for the ZCB based on the spread and maturity as determined below and the swap rate corresponding to the maturity at the daily market rate (the “repurchase price”).

(15) The terms of the ZCB will be determined according to the following procedure:

(a) On the reference date of 18 April 2016, the maturity of the ZCB was set to 13.5 years to be discounted with a rate of Euro par swap of 13.5 years (the

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3 Heta outstanding guaranteed bonds’ face value is ca. EUR 10.8 billion. There are 233 different types of bonds, most of which come to maturity in the period between 2015 and September 2017. The maturity of the remainder, with a combined face value of EUR 300 million, is up to 2043.
“swap rate”, interpolated between 10 years and 15 years) and a spread of 0.7 basis points (“bps”)\(^4\) to yield a repurchase price of 90.0%.

(b) A week before the transaction offer to be made by Austria according to the settlement agreement (i.e. on 29 August 2016 at the latest), the spread is going to be fixed jointly by the K-AF and Austria. The spread can be fixed within a range of plus minus 20 bps.

(c) Two days before the issue date, the actual maturity of the ZCB (“maturity”) is determined on the basis of the prevailing swap rate plus the fixed spread to yield a repurchase price of close to 90.0%.

(16) Under the settlement agreement, junior creditors have the following choices:

(a) Receive 30% of the face value of their bonds in cash; or

(b) Swap their bonds two-for-one for the ZCB available to senior creditors (including the stabilisation period); or

(c) Swap their bonds one-for-one for a different zero-coupon assignable loan ("Schuldscheindarlehen") issued by the Austrian government with a maturity of no less than 54 years according to current market conditions of Republic of Austria government bonds. There will be no stabilisation period for this bond.

(17) The notified implementing law contains a legal provision making it subject to the European Commission accepting it as not containing new aid or approving any new aid as compatible or as already subject to an existing aid decision.

3. POSITION OF AUSTRIA

(18) Austria has included Commission approval in the legal text in order to create legal certainty and avoid further litigation. Austria also believes that the settlement law will contribute significantly to securing macroeconomic equilibrium and sustainable orderly public finances.

(19) Austria considers that the implementing law does not contain any new State aid and notified the measure for reasons of legal certainty.

(20) First, Austria argues that the implementing law does not involve any new State aid to Heta as it is not affected by the repurchase offer.

(21) Second, Austria also considers that the repurchase offer does not involve any new State aid to the owners of debt guaranteed by the Land Carinthia because under the terms of the implementing law they would receive a lower net present value even in the most advantageous scenario so that economically they are not better off than under the original guarantee by Carinthia.

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\(^4\) 1 basis point = 0.01%
4. **ASSESSMENT OF THE MEASURE**

(22) Heta’s predecessor HAA has benefitted from State guarantees which the Commission has found to be existing aid in the 2003 decision. Furthermore, HAA has received substantial amounts of State aid since the onset of the financial crisis. That aid was found compatible with the internal market in the 2013 decision.

(23) The measures Austria commits to undertake under the settlement agreement as specified in the implementing law need to be assessed from a State aid perspective in two regards, namely in relation to Heta and in relation to the creditors.

(24) In the 2003 decision, the Commission found that State guarantees on liabilities such as HAA’s constituted existing aid to public banks which benefitted from the guarantees. The Commission considered the aid incompatible with the internal market.

(25) Austria agreed with the Commission’s proposal to abolish the guarantees on new liabilities subject to a transitional period which ended on 1 April 2007. Under the terms of the 2003 decision, guarantees granted on all liabilities issued before 2 April 2003 and on liabilities issued until 1 April 2007 with a maturity of no later than 30 September 2017 were considered existing aid.

(26) The 2013 decision on HAA did not further consider the aid assessed in the 2003 decision. The Commission merely notes that it has no indications that Austria was in violation of the commitments it undertook for that decision.

4.1. **Austria’s assumption of Carinthian liabilities**

(27) The Treaty regards the Member State as the grantor of State aid. Therefore, the Commission addresses State aid decisions to the Member State. It is of no importance which entity within one Member State grants the aid.

(28) Therefore whether the Federal State of Austria itself or another entity whose actions are those of the Member State, the Republic of Austria, decides to honour obligations by the Austrian Land of Carinthia does not affect the assessment to be carried out in the present decision.

(29) That rationale is also reflected in the 2003 decision where the Commission did not raise objections against a guarantee provided by Austria as existing aid, provided that the guaranteed instruments predated the date of the 2003 decision or their issuance was covered under the exceptions defined under the transitory regime in that decision.

4.2. **Possible aid to Heta**

(30) The implementation law is proposed by the Republic of Austria and affects only existing creditors of Heta. It concerns only bonds issued before 2 April 2007 and covered by those guarantees that were qualified as existing aid in the 2003 decision.

(31) State aid in guarantees of that nature may arise from an advantage accruing to the entity which originally emitted those bonds with a State guarantee. The presence
of such a guarantee significantly reduced the funding costs paid by that entity, i.e. HAA, at the time. Those guarantees have already been qualified as existing aid in the 2003 decision.

(32) The Commission considers that the payout of those guarantees as proposed in the notified settlement agreement does not constitute a new advantage to HAA and its legal successor Heta and merely constitutes the materialisation of the risk inherent in the granting of such guarantees. Consequently, no new State aid is granted to Heta under the terms of the settlement agreement.

4.3. Possible aid to creditors

(33) The creditors of Heta are not beneficiaries of the State aid contained in the guarantees that were considered existing aid in the 2003 decision, since those creditors acquired those bonds under market conditions prevailing at the time when the bonds were issued with an Austrian State guarantee. The beneficiary was HAA because its funding costs were reduced thanks to those guarantees. Moreover, the potential payment of guarantees to the creditors is a risk inherent in the execution of those guarantees that were qualified as existing aid in the 2003 decision. The settlement agreement concerns only payments on the guaranteed bonds that were considered existing aid in 2003.

(34) Therefore, new aid to the existing creditors of Heta would be excluded provided that they are not economically better off under the terms of the settlement agreement than they would have been under the original guarantee on their liabilities from which they would benefit in the absence of the notified settlement agreement.

4.3.1. Terms of the existing guarantee

(35) Regarding the date when a payment would be made by the guarantor under the terms of the original guarantee, the Commission has not been provided with a single date.

(36) In particular, Austria states in the notification that the guarantees could have been at least partially due as early as 10 April 2016 when the FMA issued its decree comprising a haircut on Heta debt, namely on the amount subjected to the haircut. This is also reflected in the wording of the implementation law.

(37) At the same time, according to the initial report of the Heta parliamentary inquiry as a general legal principle a guarantor would step in only if, when and to the extent that the assets of the bank are insufficient to repay the guaranteed bonds in full unless orderly insolvent procedures had been triggered in which case claims against the guarantor become due in full immediately.

(38) Finally, the FMA in its 2016 resolution decision considers that the wind-down of Heta including all legal proceedings surrounding the wind-down will be resolved by the end of 2023 which coincides with the maturity of all bonds which were reset by the FMA to end of 2023.

(39) While the Commission is not in a position to make any assessment as to when, under Austrian law, the guarantees are actually due, the Commission considers that according to the provided information, repayment in full of the original guaranteed bonds would have occurred at some point in the period between today
and the date considered by the FMA as highly likely to be the legal endpoint of the wind-down of Heta at the end of 2023. At the date of that payout, creditors would have received in full the outstanding amount of liabilities held (through a sum of cash flows from the Heta wind-down and a payout under the guarantee).

4.3.2. Options to senior creditors

(40) According to the settlement agreement, senior creditors have two choices: (a) a settlement at 75% of face value in October 2016 or (b) a one-for-one swap of the original bond into the ZCB. If senior creditors opt for (b), they have the option to sell the ZCB back to Austria at the repurchase price during the stabilisation period, sell it in the market or simply hold it to maturity.

(41) Economically, the different options have the following effects:

(a) Under the first choice, senior creditors will receive 75% of face value in cash at a settlement date in October.

(b) Under the second choice, senior creditors will receive the ZCB which they will have to hold for the holding period. Then, they could:

(i) Continue to hold the ZCB to maturity which economically corresponds to receiving in full the payout from the original guaranteed bond but only at the maturity of the ZCB;

(ii) Sell the ZCB in the market which is economically equivalent to choice (i) as the market price in the absence of a stabilisation offer would be equivalent to the hold-to-maturity value discounted with the appropriate market rate; or

(iii) Sell the ZCB to Austria for the repurchase price during the stabilisation period.

(42) Based on current market conditions and a limited spread range of plus minus 20 bps, the Commission considers that the maturity of the ZCB is likely to be fixed between 14-18 years. Therefore, on the basis of the information at hand the Commission considers that full payment under the proposed settlement agreement would always be received significantly later as compared to a full payout of the original guaranteed bonds either immediately or in seven years by the end of 2023 pursuant to the 2016 FMA resolution decision. Therefore, options (b)(i) and (b)(ii) do not lead to an economic advantage.

(43) Comparing option (a) and (b)(iii), the Commission notes that since short-term interest rates are currently close to zero and likely to remain so for the immediate future, the fact that senior creditors would have to hold the ZCB during the holding period of up to 60 days before the start of the stabilisation period is unlikely to have any discernible effect on the value of the payout. The same holds true for the settlement period of the cash payout of 75% which will be physically paid before the end of October 2016.

5 See recital (13)
Moreover, the Commission notes that spread and maturity are fixed so that the value of the repurchase price at the issue date will be close to 90% (not exactly 90% because of the two-day difference between the date when the maturity will be fixed and the issue date).

Finally the Commission considers that the difference between the values of options (a) and (b)(iii) at the issue date – roughly 75% and 90% – is such that the repurchase price would not fall below 75% before the beginning of the stabilisation period – i.e. in a period of less than 60 days.

In view of the preceding points the Commission considers that the economically most beneficial option for the senior creditors under the settlement agreement appears to be option (b)(iii), i.e. receiving the ZCB and selling it to Austria at the repurchase price during the stabilisation period.

4.3.3. Possible aid to senior creditors

In order to exclude new State aid to senior creditors, the Commission needs to assess that selling back the ZCB to Austria during the stabilisation period according to the settlement agreement could not make Heta creditors economically better off than a full repayment of the original guaranteed bond according to the guarantee by Austria qualified by the Commission as existing aid in the 2003 decision.

Regarding the economic value from selling back the ZCB to Austria, the Commission first considers a repurchase price of 90% as determined at the issue date. Any repurchase price of up to 90% paid during the stabilisation period will be economically less advantageous. In a second step, the Commission will consider the case of repurchase prices above 90% paid during the stabilisation period.

Regarding the economic value of the full repayment of the original guaranteed bond, the Commission points out that if the payout of 100% of face value of the bond under the original guarantee was made immediately, the economic value of selling the ZCB back to Austria at a price of around 90% would clearly not yield any new advantage.

If the full repayment of the original guaranteed bond occurred no earlier than at the end of 2023, the value of the payout, i.e. 100% of face value, would have to be discounted back to today. To discount that payout, the Commission takes the Austrian government funding rate as the discount rate because Austria was addressed as the provider of existing aid in the 2003 decision on the original guarantee.

While the discounted payout could in theory be worth less than 90% today, Figure 1 shows the development of the Austrian seven-year government bond yield. Under currently prevailing market conditions, that yield is negative. Therefore, the 100% payout at the end of 2023 would in fact be worth more than 100% today or – assuming that negative rates would not be passed on to customers – be worth 100%.
In fact, in order for the 100% payout at the end of 2023 to be worth 90% or less at the end of October 2016, the applicable discount rate would have to be 1.52% or greater. Comparing this figure to the seven-year Austrian bond rate in Figure 1, the Commission notes that since the European sovereign debt crisis at the beginning of 2012, that rate has only been greater than 1.52% during a couple of months in 2013, and certainly not since the European Central Bank (ECB) started quantitative easing in January 2015. The Commission considers it to be extremely unlikely that the Austrian seven-year rate would go from currently -35 bps back to above 1.52% during the stabilisation period.

The Commission therefore concludes that senior creditors do not receive an additional benefit from selling at a repurchase price of 90% under the settlement agreement that could amount to new aid.

It is possible under the terms of the settlement agreement that the repurchase price would be greater than 90% if the swap rate corresponding to the maturity of the ZCB would fall further during the stabilisation period. However, in that case, the Commission considers it likely that the value of the Austrian seven-year government bond yield would have fallen further as well, leading to a corresponding rise in the value of the 100% payout at the end of 2023.

Even if one considers all payouts to be capped at 100%, the swap rate for a maturity of between 14-18 years would have to come down to below 15 bps (plus a spread of between -10 and -15 bps summing up to a discount rate of 0). Currently, the 15 year swap rate is already at an all-time low of 58 bps and based on current market expectations, it seems highly unlikely that a further significant reduction would occur within the next months.

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6 As the discount rate and the price of the bond have an inverse relationship, any increase in the discount rate which is linked to the swap rate would lead to a fall in the repurchase price and vice versa.

7 There is a very high correlation between the swap rate used to calculate the ZCB repurchase price and the Austrian government rate. Over the last twelve years, only during the height of the European sovereign crisis in early 2012 has the seven-year Austrian government bond rate been higher than the 15-year swap rate.
Overall, the Commission considers that a sale of the ZCB to Austria at the repurchase price during the stabilisation period is extremely unlikely to result in an economic improvement of the current position of the senior creditors holding the guaranteed bonds.

In this regard, the Commission points out that the above considerations remain valid even where under the settlement agreement Austria is pre-funding the full amount paid to creditors whereas under the original guarantee agreement it would only have been liable for the difference between payout from the Heta wind-down and the guaranteed amount. The reason is that under the settlement agreement, the State receives the rights to all cash flows that those creditors would have received from the Heta wind-down. Therefore, Austria is simply pre-funding that part of the return to creditors which they would otherwise have received from the Heta wind-down. It does so, however, without assuming any additional risks.  

Therefore, discounting at the Austrian sovereign borrowing rate would fully compensate Austria for the pre-funding of that commitment while, as demonstrated above, the actual discount rate implied in the repurchase price is very likely to be much higher.

Therefore, the Commission considers that the settlement agreement does not result in any new State aid being provided to senior creditors.

### 4.3.4. Possible aid to junior creditors

Under the terms of the original guarantees the junior creditors would be entitled to the same payout by the guarantor as the senior creditors. However, under the terms of the settlement agreement the present value of the payout for the junior creditors is materially lower than the present value of the payout for the senior creditors.

Specifically, the junior bond holders can swap into the ZCB benefitting from the stabilisation period only at a rate of two-to-one which puts them economically in a clearly inferior position to senior creditors. Alternatively, they can invest in another zero-coupon bond. However, in the absence of a stabilisation period, that alternative zero-coupon bond can simply be held to maturity or sold in the market. In either case, it results economically in a much reduced payout compared to the original guarantee agreement.

Consequently, since the senior creditors do not receive an additional benefit from the settlement, the Commission therefore concludes that the junior creditors do not receive an additional benefit from the settlement that could amount to new aid either.

### 4.4. Conclusion on the existence of aid

The Commission concludes that the measure intended by Austria to settle between Austria and senior and junior creditors of Heta, as laid out in the notified

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8 If the Heta wind-down would have led to lower results than the project roughly 46% of return of face value, Austria would in any case have been responsible for those additional losses under the original guarantee agreement.
implementation law and the settlement agreement, remains covered by the existing aid identified in the Commission decision of 2003 regarding Heta and it does not constitute new aid within the meaning of Article 107(1) TFEU regarding Heta's creditors.

5. CONCLUSION

The Commission has accordingly decided that the measure does not constitute new aid.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen 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 the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
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Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

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