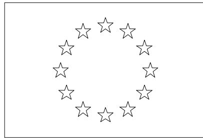

EUROPEAN COMMISSION

Brussels, 14.1.2010
C(2010)91 final

Subject: **State aid NN 68/2009 – Hungary**
Liquidity scheme for banks

Sir,

I. PROCEDURE

(1) In March 2009 the Commission became aware from press reports of State loans granted to several Hungarian financial institutions under a liquidity scheme. On 27 March 2009 a letter was sent to the Hungarian authorities to request information on the measures. The Hungarian authorities replied on 24 April 2009 and on 14 May 2009. On 25 May 2009 a further request for information was sent to Hungary.

(2) The Hungarian authorities pre-notified the measure on 3 June 2009. A request for information was sent on 9 July 2009 to which the Hungarian authorities replied on 20 July 2009, followed up by letters dated 7 and 28 August 2009.

(3) Finally, after a letter to the Hungarian authorities dated 23 September 2009 reiterating the Commission's preliminary assessment, the Hungarian authorities formally notified the liquidity scheme on 9 November 2009 under Article 107(3)(b) TFEU[1]. Since the measures had been implemented before the notification, the Commission registered the case as "non notified aid".

II. DESCRIPTION OF THE SCHEME

Legal basis

(4) In response to the ongoing exceptional turbulence on the financial markets, Hungary enacted a law which provides for liquidity in the form of loans to financial institutions.

[1] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the Treaty on the Functioning of the European Union (TFEU). The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

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(5) The notified scheme is based on Article 5 of Act IV of 2009[2] (hereinafter: "the Act") published in the Official Gazette ("*Magyar Közlöny*") No. 2009/28 on 10 March 2009.

(6) Under the Act, the Minister responsible for public finances (hereinafter: "the Finance Minister"), acting through *ÁKK Zrt.* (Government Debt Management Centre) is empowered to conclude loan contracts with the financial institutions.

The beneficiaries

(7) 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.

(8) The loans are granted on the request of the beneficiary. The applications are assessed by the Hungarian Central Bank ("*Magyar Nemzeti Bank*" hereinafter: "MNB") on the one hand, and by the Hungarian Financial Supervisory Authority ("*Pénzügyi Szervezetek Állami Felügyelete*", hereinafter: "PSZÁF") on the other.

(9) MNB's evaluation shall consist of:

- a) an assessment of the importance of the credit institution for the stability of the financial intermediary system and the review of its impact on other regulated institutions, financial markets, infrastructure and on the real economy;
- b) an assessment of the short-term liquidity position of the credit institution;
- c) an analysis of the situation on major financial markets as well as of the availability of liquidity.

(10) PSZÁF's evaluation shall consist of:

- a) an assessment of the level of own funds of the credit institution;
- b) an assessment of the mid-term and long-term liquidity position of the credit institution;
- c) for a credit institution falling under consolidated supervision or supplementary supervision, an assessment of the group’s mid-term and long-term liquidity and own funds positions.

(11) The loans are ultimately awarded by the Finance Minister on the basis of MNB's and PSZÁF's recommendation.

Objective and description of the measure

(12) The ultimate goal of the measure is to improve the overall liquidity position of the Hungarian banking system so as to maintain lending to the real economy. Hungary has been particularly affected by the financial crisis, to the extent that the IMF and the EU had to grant emergency loans in November 2008 in order to calm tensions on the country's financial markets. Although macro economic indicators and the level of stress of the Hungarian financial sector have since somewhat improved[3], additional measures

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[2] 2009. évi IV. törvény

[3] For example yields on Government bonds have fallen.

are still needed to promote the return of the Hungarian financial system to a normal functioning.

(13) The liquidity support takes the form of loans. The loans are granted on the basis of the Act, which empowers the Finance Minister to conclude the loan agreements and set out the conditions in the agreement. The loans granted under the scheme should be issued within a period of six months following the entry into force of the relevant provision of the Act. However, having in mind the fact that the decision of the Commission will be adopted after the expiry of the 6-month entry window originally planned, the Hungarian authorities also ask for an extension of the entry window of the scheme until 30 June 2010.

(14) According to the Act, the financial institutions in receipt of such loans are obliged to use the funds to lend to the real economy.

(15) Although there is no further implementing legislation to the Act, the Hungarian authorities commit that any measure will be granted in accordance with the principles of the present decision.

(16) The loans cannot take the form of subordinated loans or any other form of structured instrument. As for the maturity, the loans are granted for a maximum of three years, while up to one-third of the total amount may be granted for a maximum of four years.

(17) The pricing of the loans is the same for all participating financial institutions. Loans are priced as the higher of either:

- the weekly rate called "SDR Interest Rate Calculation" published on the IMF website + 345 bps; or
- the 12 month-IBOR[4] + 100bps + a credit risk margin of 123.5 bps.

(18) The overall budget of the measure is limited to EUR 4 billion (HUF 1,100.8 billion). However there is no limitation on the maximum amount that any individual applicant may receive under the scheme.

(19) 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.

The Scheme's application to date

(20) To date, three banks concluded loan agreements under the scheme: OTP Bank Nyrt. (hereinafter: "OTP"), FHB Jelzálogbank Nyrt. (hereinafter: "FHB") and MFB Zrt./Eximbank Zrt.[5] (hereinafter: "the MFB group").

(21) The loan agreement with OTP was concluded on 25 March 2009 for a total of approximately HUF 400 billion (EUR 1.45 billion[6]), with a maturity date of 11 November 2012. The loan amount is broken down as follows:

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[4] The actual benchmark depends on the currency in which the loan will be granted.

[5] Eximbank Zrt. is 74.95% owned by MFB Zrt.

[6] Exchange rate of 1 EUR = 275.2 HUF as of 21 December 2010

- 1st Tranche (disbursement 1 April 2009): EUR 357.7 million, GBP 97.1 million, JPY 14.361 million, USD 584.4 million.
- 2nd Tranche (disbursement 30 June 2009): EUR 143.1 million, GBP 38.8 million, JPY 5.745 million, USD 233.8 million.

(22) On 28 October 2009, OTP informed ÁKK Zrt. of its intention to repay the following amounts effective of 4 November: EUR 250.4 million, GBP 67.95 million, JPY 10.053 million, USD 409.1 million. This early repayment represents 50% of the outstanding loans of OTP.

(23) The loan agreement with FHB was concluded on 25 March 2009 for a total of approximately HUF 120 billion (EUR 436.05 million), with a maturity date of 11 November 2012. The loan amount is broken down as follows:

- 1st Tranche (disbursement 1 April 2009): EUR 200 million.
- 2nd Tranche (disbursement 30 April 2009): EUR 200 million.

(24) The loan agreement with MFB Group was concluded on 14 April 2009 for a total of approximately HUF 170 billion (EUR 617.7 million), with a maturity date of 11 November 2012. The loan amount is broken down as follows:

- 1st Tranche (disbursement 19 June 2009): EUR 93.8 million, GBP 25.4 million, JPY 3.765 million, USD 153.2 million.
- 2nd Tranche (disbursement for 10 December 2009) EUR 110 million, GBP 29.9 million, JPY 4.416 million, USD 179.7 million.

III. POSITION OF HUNGARY

(25) The Hungarian authorities accept that the scheme contains State aid elements. Hungary also acknowledges that it implemented the measure without prior notification to the Commission in breach of Article 108(3) TFEU.

(26) However, in the view of the Hungarian authorities, the scheme is compatible with Article 107(3)(b) TFEU as an aid measure intended to "*to remedy a serious disturbance in the economy of a Member State*".

(27) The global financial crisis has made access to liquidity more difficult for financial institutions and has also undermined the general confidence in the creditworthiness of counterparties. In these circumstances, even fundamentally sound financial institutions are running the risk of severe liquidity shortages which in turn could result in bankruptcy. The Hungarian authorities consider that the failure to address the issues of lack of liquidity and confidence in the banking sector could also have, due to its vital role for the real economy, a systemic effect on the Hungarian economy as a whole. Therefore, the scheme aims at remedying a serious disturbance in the Hungarian economy. Furthermore, a letter from the MNB dated 3 November 2009 confirms that the aid scheme is still required to prevent the recession from becoming deeper and more prolonged and investor sentiment to worsen again toward Hungary.

(28) In the view of the Hungarian authorities, the liquidity scheme represents a comprehensive, necessary and proportionate action to maintain the financial stability of

and confidence in the Hungarian economy. Given the severe stress in global financial markets and its impact on the Hungarian financial system, it is in their view imperative that the measures continue to be implemented.

(29) The State intervention of a temporary nature is necessary to achieve the predefined goals. Therefore, the Hungarian authorities consider that the notified scheme does not involve any unduly adverse spill-over effects on other Member States or undue distortions of competition.

(30) In addition, in their notification of the measures the Hungarian authorities make the following commitments:

a. The Hungarian authorities commit to file individual restructuring and/or liquidation plans, within 6 months, for financial institutions that default on State loans.

b. Should Hungary seek a prolongation of this scheme beyond 30 June 2010, it should be notified at least one month prior to the expiration of the scheme.

c. The Hungarian authorities undertake to present every six months reports on the operation of the liquidity scheme. The reports will also provide, for each beneficiary, detailed information on the liquidity support provided and its specific conditions as well on liquidity raised by the beneficiary during the existence of the present scheme from sources other than the State. This information shall include the nature and amount of the liquidity raised, its source, conditions and pricing, in order to allow for the assessment of the availability and conditions of liquidity on the markets. For loans provided more than six months before the adoption of this decision the report will be submitted as soon as possible.

d. Hungary confirms that any further aid under the scheme will be granted in accordance with the provisions of the present decision.

e. The Hungarian authorities commit to report to the Commission on the implementation of the scheme.

f. Finally, the Hungarian authorities acknowledge that the Commission will cumulate the amount of any aid granted under the liquidity scheme with that of any other State aid and that the impact of such aid will be taken into account in the Commission's assessment of any lending bank's viability/restructuring plan.

IV. ASSESSMENT

Existence of aid

(31) By virtue of Article 107(1) TFEU "any aid granted by a Member State of through 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 good shall, in so far as it affects trade between Member States, be incompatible with the internal market".

(32) The loans are granted by public authorities, i.e. from State resources, give an economic advantage to the banks and strengthen the position of these beneficiaries compared to that of competitors in other Member States. The scheme must therefore be regarded as distorting competition and affecting trade between Member States.

(33) In particular, the Commission is of the opinion that under the circumstances of the financial crisis no private investor would have granted loans of such amounts and on such terms to the participating financial institutions[7], in particular at the time they were granted.

(34) On the basis of the above, as the measure involves public financing, is directed at certain beneficiaries engaged in an economic activity affecting trade between Member States and distorts or threatens to distort competition inside the internal market it is to be considered State aid within the meaning of Article 107(1) TFEU.

(35) The Commission notes that Hungary put the aid scheme into effect, in breach of Article 108(3) TFEU, without prior notification to and approval by the Commission. Any liquidity already provided must therefore be considered as unlawful aid.

Compatibility of the aid

(36) It is therefore necessary to examine the scheme's compatibility in the light of Article 107 TFEU.

a) Application of Article 107(3)(b) TFEU

(37) Hungary intends to provide (and has already provided) loans to credit institutions in order to enhance their lending activity to the real economy. Given the present circumstances in the financial markets and the real economy as a whole, Hungary invokes Article 107(3)(b) TFEU as a basis for compatibility.

(38) Article 107(3)(b) TFEU enables the Commission to declare aid compatible with the internal market if it is necessary "*to remedy a serious disturbance in the economy of a Member State*".

(39) The Commission recalls that the General Court has stressed that Article 107(3)(b) TFEU needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State.[8] The Commission has issued a Communication setting out its application of State aid rules to financial institutions in the current crisis, "The application of State aid rules to measures taken in relation to financial institutions in the

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[7] See Commission decision of 9 December 2008 in Case N 557/2008 Measures under the law on the stability of the financial markets and on strengthening the interbank market for credit institutions and insurance companies in Austria, OJ C3, 08.01.2009, p.2(; Commission decision of 30 October 2008 in Case N 548/2008 Mesures de refinancement en faveur des institutions financières,OJ C 123, 03.06.2009, p.1.

[8] Cf. in principle Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Applied 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*, OJ L83, 26.03.2008, p.7 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*, OJ L104, 24.04.2009, p.34.

context of the current global financial crisis"[9] (hereinafter: "the Banking Communication).

(40) The Commission considers that the present scheme concerns the entire Hungarian banking industry. The Commission does not dispute the analysis of the Hungarian authorities that the financial crisis has made access to liquidity more difficult for credit institutions. Under these circumstances, even fundamentally sound credit institutions came under severe pressure. The Commission also agrees that if the issues of lack of liquidity and lack of confidence are not properly dealt with, it can result not only in difficulties for the banking sector but could also have a serious effect on the Hungarian economy as a whole.

(41) The Commission does not dispute that the present scheme is designed to address the problems that Hungarian banks have been and are still facing in raising liquidity on the markets. Therefore, it finds that the scheme aims at remedying a serious disturbance in the Hungarian economy.

b) Conditions for compatibility under Article 107(3)(b) TFEU

(42) In line with the Banking Communication, in order to be compatible, any aid or aid scheme must comply with general criteria for compatibility under Article 107(3) TFEU, viewed in the light of the general objectives of the Treaty and in particular Article 3 of the Treaty on European Union, which imply compliance with the following conditions:

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.[10]

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. Therefore, Article 107(1) TFEU prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 107(3)(b) TFEU which authorises State aid must ensure that such aid is limited to that necessary to achieve its stated objective.

c) Assessment of the Liquidity Measure

(43) The objective of the present scheme is to provide liquidity to financial institutions.

[9] OJ C 270, 25.10.2008, p. 8.

[10] 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* [2008] ECR I-2577, 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 […]."

(44) As a result of the financial crisis, even healthy Hungarian banks have been and are still facing difficulties in raising funds. The Commission considers that such a liquidity scheme can help to overcome this market situation. Paragraphs 51 and 52 of the Banking Communication acknowledges indeed that in dealing with acute liquidity problems of some financial institutions, Member States may wish to accompany guarantees and recapitalisation schemes with complementary forms of liquidity support and that the Commission considers that in the current exceptional circumstances a scheme of liquidity support form public sources can be found compatible. The Commission therefore regards the scheme as an appropriate means to meet the objective.[11]

(45) In addition, the scheme is targeted at the appropriate beneficiaries which are all Hungarian banks, including the subsidiaries of foreign banks. Their eligibility is established by the two main regulatory bodies for financial markets in Hungary according to objective and well defined criteria.

(46) 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, while up to one-third of the total amount may be granted for a maximum of four years. In that context, the Commission accepts Hungary's request to extend the entry window of the scheme until 30 June 2010.

(47) With regard to the size of the measure, the Commission notes that the budget is limited to a maximum amount of EUR 4 billion (HUF 1,100.8 billion).

(48) Moreover, the granting of the loans is subject to specific uses as the receiving banks commit to the use the proceeds from the loans to lend to the economy. The Commission recalls here as well that the participating entities are expressively prohibited from using the loan for acquisition purposes.

(49) As regards the pricing of the loans, the Commission notes that the pricing will be the higher of (i) IMF SDR + 345 bps and (ii) 12 month IBOR + 100 bps + 123.5 bps[12]. In this remuneration, the 12 month IBOR + 100 bps element is addressing the State's cost of funds while the 123.5 bps margin addresses the credit risk of the participating financial institutions.

(50) Firstly, the Commission notes that the credit risk premium is in line with the credit risk margin recommended by the ECB as stated in the "Recommendations on government guarantees on bank debt" of the European Central Bank of 20 October 2008. According to these recommendations, in the absence of CDS data, the CDS spread for the lowest rating category, which is A, is used namely 73.50 bps with an additional per annum mark-up of 50 basis points (hence a total risk premium of 123.5 bps). The Commission notes positively that this credit risk margin of 123.5 bps is equal to the guarantee fee to

[11] See Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, OJ C273, 28.10.2008, p.2 at point 42, Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, OJ, C290, 13.11.2008, p.4 at point 56, and Commission decision of 13 October 2008 in case NN 48/2008 *Guarantee scheme for banks in Ireland*, OJ C312, 06.12.2008,p.2, at point 59.

[12] As an example, for the euro denominated loan granted on 25 March 2009, the interest rate payable would be 4.088% as the sum of 12 month Euribor of 1.853% plus 1.00% plus 1.235%.

be paid under the Hungarian guarantee scheme which ensures the consistency of the State remuneration across both schemes[13].

(51) Secondly, as for the 12 month IBOR plus 100 bps element of the remuneration, the Commission considers that this remuneration is adequate in light of the exceptional situation of the Hungarian financial sector and in the context of the IMF financing package received by the Hungarian State. As a matter of fact, the monies used to fund the liquidity scheme come from the IMF-sponsored financing package granted in November 2008[14] which wasrendered necessary by the impact of dislocation of financial markets on the Hungarian financial market and economy[15]. The Commission draws comfort from the fact that at the time of granting the liquidity loans, the Euribor based pricing of the loans was higher than the SDR based pricing[16] and notes further that the terms of the loans are within the terms of the IMF-sponsored financing package as far as maturity and total budget are concerned.

(52) The Commission concludes that the overall remuneration of the measure is adequate to ensure that the aid meets the stated objectives while being limited to the minimum necessary.

(53) As regards proportionality, the distortion of competition is minimised by various safeguards. In particular, the Commission notes that the measure is open to all Hungarian banks and Hungarian subsidiaries of foreign institutions and that the total amount of funds available through the scheme is limited. Further, the Commission recalls that institutions must refrain from marketing which invokes the measure.

(54) Finally, the Commission notes that as indicated in the Annex to the Restructuring Communication[17], any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). This means that, as soon as a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To this end an individual ex ante notification is necessary.

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13 Commission decision C(2009) 993 final, OJ C 147, 27.6.2009, p.2.

14 The external financing package amounts to a total of USD 25 billion (Eur 20 billion), in which the IMF, the European Union and the World Bank participated. The IMF contribution is the largest in the form of a USD 17.3 billion Stand-By Arrangement. The European Union contributed Eur 6.5 Billion and the World Bank USD 1.3 billion. The financing package is drawable in instalments (last draw down scheduled for March 2010) and has a maturity of approximately 4 years. The interest rate is based on a margin above of SDR, an IMF specific floating rate. Usually IMF loans are priced at 100 bps in excess of SDR and may include additional margins depending on the amounts drawn down.

15 The financial crisis did indeed lead to the drying out of the market for Hungarian government bonds, leaving the Hungarian State with extremely limited financing options. In response, the CDS spread for Hungarian debt rose to 600 bps by the end of March 2009.

16 As a matter of fact the pricing of the loans is the higher of a Ibor and an SDR based pricing (which is the basis for the remuneration of the IMF financing). As of the end of March 2009, the Euribor based pricing was higher by approx. 15 bps compared to the SDR pricing. In March 2009, Euro was the largest currency in which the liquidity loans had been extended.

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

(55) Furthermore, the Commission recalls that, based on paragraph 16 of the Restructuring Communication, should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, this cannot be granted under an approved scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission's final decision on that bank.

(56) On the basis of the above, the Hungarian Liquidity Scheme can be considered compatible with the internal market.

V. CONCLUSION

(57) The European Commission regrets that Hungary put the aid scheme into effect, in breach of Article 108(3) TFEU. However, it has decided, on the basis of the foregoing assessment, to consider the aid scheme compatible with the internal market on the basis of Article 107(3)(b) TFEU.

(58) The Commission notes that Hungary exceptionally accepts the decision to be adopted in the English language.

(59) If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of receipt. If the Commission does not receive a reasoned request within 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/community_law/state_aids/state_aids_texts_hu.htm

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Yours faithfully,
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