EUROPEAN COMMISSION

Brussels, 6.3.2012
C(2012) 1472 final

Subject: State aid SA.34288 (2012/N) - Lithuania
Extension of the Lithuanian bank support scheme until 30 June 2012

Sir,

1. PROCEDURE

(1) On 27 January 2012, Lithuania notified a request to extend the bank support scheme by six months until 30 June 2012. On 7 and 22 February 2012, the Commission requested additional information, which the Lithuanian authorities provided on 10, 21 and 22 February 2012.

(2) The original scheme, which consisted of three measures - State guarantees for bank stability enhancement (hereafter "guarantee"), redemption of bank assets (hereinafter "asset relief") and subordinated loans to banks (hereinafter "recapitalisation") – was approved by the Commission on 5 August 2010 until 31 December 2010 (hereinafter "the original decision")[1]. The prolongation of the scheme until 30 June 2011 was approved by the Commission on 21 January 2011 (hereinafter "the first prolongation decision").[2] A second prolongation of the scheme until 31 December 2011 was approved by the Commission on 27 June 2011 (hereinafter "the second prolongation decision").[3]

(3) By letter dated 16 February 2012 Lithuania exceptionally accepted that the decision be adopted in the English language.

2. DESCRIPTION OF THE NOTIFIED MEASURE

(4) In response to the ongoing exceptional turbulence in world financial markets, Lithuania initially brought forward the original scheme consisting of three measures

[1] Commission decision in cases N 47/2010 and N200/2010, OJ C 283, 20.10.2010, p. 1.
[2] Commission decision in case SA.32188 (2011/N) OJ C 53, 19.2.2011, p. 4.
[3] Commission decision in case SA.33135 (2011/N) OJ C 274, 17.9.2011, p. 5.

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designed to ensure the stability of the Lithuanian financial system and to remedy a serious disturbance in the economy of Lithuania. The guarantee measure aims at enhancing the liquidity of a bank or otherwise strengthening its stability and credibility. The asset relief measure aims at cleaning up balance sheets and restoring bank's solvency. The recapitalisation measure aims at increasing the stability and credibility of a bank's activities by increasing its regulatory capital base.

(5) Beneficiaries of the scheme are banks whose financial situation poses a threat to the stability and credibility of the banking system, including foreign subsidiaries and branches of foreign banks established in the Republic of Lithuania.

(6) The Lithuanian authorities seek to prolong the entry window of the original scheme until 30 June 2012.

2.1. The guarantee measure

(7) For the guarantee measure approved by the original decision, the total budget was set at LTL 3 billion (EUR 869 million). The scheme was prolonged on 21 January 2011 until 30 June 2011 and on 27 June 2011 until 31 December 2011, respectively, with a reduced budget of LTL 1 billion (EUR 290 million). Under the present extension decision, the budget for the guarantee measure is maintained at LTL 1 billion (EUR 290 million). The measure covers newly issued senior loans and other senior financial liabilities, excluding interbank deposits.

(8) Lithuania has not modified the terms of the measure as approved by the previous Commission decisions, other than as regards calculation of guarantee fees.

(9) The remuneration for the guarantees remains the same as approved in the original decision[4]. In particular, the Lithuanian government Resolution No. 1673 of 24 November 2010 provides that the annual State guarantee fee cannot be lower than the weighted average of the preceding 12 months of the annual rates of five-year CDS of the Republic of Lithuania announced at least in one publicly acknowledged and used information system[5]. However, the Lithuanian authorities may, considering the riskiness of the bank, the situation in the financial market and other circumstances, require a higher remuneration.

(10) The Lithuanian authorities have stated that they may amend the method of calculating the guarantee fees as set out in the Lithuanian government Resolution No. 1673 of 24 November 2010. At the time, the Lithuanian authorities have also committed that, in any event, the guarantee fee will not be lower than that calculated based on the European Central Bank Recommendations on Government Guarantees on Bank Debt, taking into consideration the new conditions set by the Commission[6].

(11) Under the present extension decision, Lithuania undertook that the guarantee fees will be set so as not to be lower than the fee resulting from the application of Communication from the Commission on the application, from 1 January 2012, of

4 See recitals 42, 43 and 117 thereof.

5 As a result of the above methodology, the indicative annual fee in April 2010 would have been approximately 3.52% (see recital 42 of the original decision), which is significantly higher than the fee resulting from the application of the 2011 Prolongation Communication.

6 See DG Competition staff working document on the application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2010, dated 30 April 2010, available at: http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf.

State aid rules to support measures in favour of banks in the context of the financial crisis ("the 2011 Prolongation Communication")[7].

(12) The 2011 Prolongation Communication envisages two different basis rates, depending on whether the maturity of the guaranteed debt is above or below one year. The latter was not changed and the methodology set out in the Commission staff working document[8] was reconfirmed.

(13) For guarantees covering debt with a maturity of one year or more, in determining the minimum fee, the formula set in the 2011 Prolongation Communication will apply and the guarantee fee will be the sum of:

- a basic fee of 40 basis points; and
- a risk-based fee equal to the product of 40 basis points and a risk metric composed of (i) one-half of the ratio of the median five-year senior CDS spread over the three years ending one month before the date of issue of the guaranteed debt of the banks having a comparable rating as the beneficiary[9] to the median level of the iTraxx Europe Senior Financials five-year index over the same three-year period, plus (ii) one-half of the ratio of the median five-year senior CDS spread of all Member States to the median five-year senior CDS spread of the Member State granting the guarantee over the same three-year period.

(14) For banks that have no CDS and no rating or a lower rating than A-, the bucket of banks used to estimate the minimum guarantee fee will be "BBB-rating or below" bucket. In footnote 12 of the 2011 Prolongation Communication it is explained, that the lowest rating category to be considered is A, as there is insufficient data available for the rating category BBB. However, due to the recent downgrade of many banks in the framework of the sovereign crisis, there are now many banks with a rating below A with representative CDS. Therefore the Commission services have been able to ensure that the sample of European banks with a representative CDS includes banks in the "BBB or below" rating bucket. Following this, the lowest category to be considered for this purpose is the BBB-rating basket.[10]

(15) To enable the Commission to assess the application in practice of the revised minimum pricing for the guarantees, Lithuania provided an indicative fee (estimate) for banks belonging to "A-rating" bucket, on the one hand, and having a lower rating than A- or no credit rating, on the other hand, based on an application of the above formula using recent market data (respectively, 1% and 1.4%). Further, Lithuania undertook to consult with the Commission on the CDS data before approving the individual State guarantees.

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[7] OJ C 356, 6.12.2011, p. 7.

[8] Available at: http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf.

[9] The banks operating in Lithuania have no CDS. Hence, CDS will be determined on the basis of the best rating out of the external ratings that the beneficiary bank may have. Based on that rating, the beneficiary will be classified as belonging to "AA-rating", "A-rating" or "BBB rating or below" bucket of reference ratings. Then, the five-year senior CDS spread of the sample of large European banks having the same reference rating as the beneficiary bank will be considered for the calculation of the guarantee fee.

[10] See Commission decisions of 6 February 2012 in case SA.34149 – Sixth prolongation of the Support Measures for Credit Institutions in Greece, point 16, *not yet published,* of 9 February 2012 in case SA.34224 – Reintroduction of the Spanish Guarantee Scheme, point 18(iv), *not yet published*, and of 22 February 2012 in case SA.34344 – Amendment of the Italian guarantee scheme for banks, point 12, *not yet published*.

(16) The conditions for guarantees approved in the original decision will continue to apply after 31 December 2011. Notably, Lithuania will present a viability review for every bank that receives State guarantees on new or renewed liabilities and for which at the time of the granting of new guarantees the total outstanding guaranteed liabilities (including the new ones) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. Lithuania will communicate to the Commission a viability review within three months of the granting of guarantees and the review will comply with the principles set out in the Restructuring Communication[11]. In particular, it will cover the solidity of the funding capacity of the bank concerned; where necessary and in any event where requested by the Commission in case of doubt, a liquidity stress test will be carried out. No separate viability review has to be presented for banks that are subject to a pending viability review at the time new guarantees are granted.

(17) Further, for the banks in respect of which the State guarantee is called, Lithuania will notify a restructuring plan to the Commission within six months from that event.

2.2. The recapitalisation measure

(18) Initially, the total budget for both asset relief and recapitalisation measures was limited to LTL 3 billion (EUR 869 million). It was reduced when the scheme was prolonged until 30 June 2011 to LTL 2 billion (EUR 579 million) and again when the scheme was prolonged until 31 December 2011 to LTL 1 billion (EUR 290 million). Under the present extension decision, the budget for both asset relief and recapitalisation measures is maintained at LTL 1 billion (EUR 290 million).

(19) Under the scheme, the recapitalisation measure can be granted in the form of subordinated loans with a two- to five-year term, designed to be qualified as Basel II Tier 2 or Tier 3 capital, depending on their maturity.

(20) Lithuania furthermore provided an updated indicative fee based on February 2012 data for the remuneration of subordinated loans amounting to 10.3% where loans are provided in litas and amounting to 9.8% where loans are provided in euros.

2.3. The asset relief measure

(21) The Lithuanian authorities introduced a mechanism for asset relief for banks in order to transfer bank assets to the State-controlled joint stock company AB Turto bankas, in exchange for a payment.

(22) Pursuant to the commitments of Lithuania to monitor the use of the scheme, set out in recitals 57, 59 and 60 of the original decision, Lithuania stated on 23 November 2011, and confirmed in the notification, that no bank has used any of the bank support measures to date.

(23) Lithuania undertakes to maintain all commitments made since the introduction of the recapitalisation and asset relief measures, which were taken into account by the Commission in the original decision and in the subsequent prolongation decisions.

[11] 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, 19.08.2009, p. 9.

(24) Those commitments include the obligation to submit a restructuring plan for any bank which benefits from a recapitalisation or asset relief measure within six months from the date of granting the recapitalisation measure and within three months from granting the asset relief measure[12].

(25) Lithuania also undertakes that the restructuring plan to be submitted will comply with the conditions set out in the Restructuring Communication in order to re-establish the individual bank's long-term viability without reliance on State support, while containing adequate burden-sharing measures and measures to limit distortions of competition.

(26) As regards behavioural constraints, they include the commitment of the Lithuanian authorities to impose upon banks subject to an obligation to submit a restructuring plan a ban on coupon/interest payments on hybrid capital instruments during the restructuring period, where the bank has no legal/contractual obligation to proceed with such payment. As regards buy-backs and the exercise of call options of Tier 1 or Tier 2 capital instruments – if envisaged by a beneficiary bank subject to restructuring – the Lithuanian authorities have undertaken to consult the Commission beforehand regarding the reasons and the terms of such transactions.

(27) As regards the asset relief measure, those commitments include, in particular, the obligation to amend the valuation method of the assets or of the haircut where the conditions detailed in the original decision are fulfilled.

2.4. The changes to the measures

(28) The budget for the measures has been maintained at LTL 1 billion (EUR 290 million) for the guarantee measure and at LTL 1 billion (EUR 290 million) for both the recapitalisation and asset relief measures. Save for the changes to the remuneration of the guarantees, set out in recitals (9)-(15) above, all other conditions of the scheme, as approved by the Commission in the original decision and as modified in the prolongation decisions, remain unchanged and continue to apply for the scheme.

3. POSITION OF LITHUANIA

(29) In line with the original decision, Lithuania accepts that the extended scheme constitutes State aid within the meaning of Article 107(1) TFEU.

(30) Lithuania requests the Commission to authorise the extension of the recapitalisation, the guarantee and the asset relief measures until 30 June 2012. According to the Lithuanian authorities, the measures are necessary and proportionate to maintain macroeconomic and financial stability in Lithuania and to enhance investors' confidence in the Lithuanian financial market.

(31) In that context, the Lithuanian authorities submitted that the Lithuanian banking system has so far withstood the economic crisis and even the bankruptcy of the country's fifth-largest bank, JSC SNORAS, without assistance from the government and the Bank of Lithuania. The situation within the banking sector remains sensitive. The confidence of residents and enterprises in the banking sector has decreased due to

[12] As regards the commitment for the beneficiaries of the asset relief measures to submit a restructuring plan within three months, see recital 51 of the original decision.

the bankruptcy of JSC SNORAS. Increased risk premiums and decreased willingness of investors to assume risks have narrowed the possibilities for the banks to attract additional medium-term funding in the markets. Seeking to ensure national macroeconomic and financial stability, as well as to enhance foreign investors' confidence in the national financial market, the Bank of Lithuania recommended prolonging the support measures for another six months (letter dated 20 December 2011).

(32) Lithuania undertakes to maintain all commitments made since the introduction of the scheme, which the Commission took into account in the original decision, as well as the conditions introduced in the prolongation decisions.

(33) As mentioned above, Lithuania undertook to consult with the Commission on the CDS data that it will use to calculate the fee, before approving an individual State guarantee. In addition, in line with the commitments in the prolongation decision, Lithuania undertook to report on the operation of the scheme and on guaranteed and non-guaranteed debt issuance by 15 April 2012. Lithuania also commits to report to the Commission the actual guarantee fee charged in relation to each issue of guaranteed bonds within three months following each issue of guaranteed bonds.

(34) The Lithuanian authorities claim that the prolonged measures, as the original scheme, are compatible with the internal market, since – due to the ongoing crisis – they are necessary to remedy a serious disturbance in the Lithuanian economy pursuant to Article 107(3)(b) TFEU.

4. ASSESSMENT OF THE MEASURE

4.1 State aid character of the Scheme

(35) As set out in 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.

(36) 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. Lithuania shares that position.

4.2 Compatibility

(37) In the original and the prolongation decisions, the Commission considered the notified measures compatible with the internal market under Article 107(3)(b) TFEU.

(38) In line with the Banking Communication, in order for such aid to be compatible, any aid or aid scheme must comply with the general criteria for compatibility under Article 107(3) TFEU. Viewed in the light of the general objectives of the Treaty, it implies that the measures have to be appropriate, necessary and proportionate.

(39) The Communications concerning State aid to banks and applicable to the instruments envisaged under the present scheme - the Recapitalisation Communication, the

Impaired Assets Communication[13] and the 2011 Prolongation Communication - translate those general principles into specific compatibility conditions depending on the instrument chosen.

(40) The Commission considers that the exceptional circumstances at the origin of the initially notified measures persist in Lithuania, as in other Member States, and therefore recognises the need for the extension of the scheme. The letter from the Lithuanian Central Bank endorses that necessity (see point (31) above). In particular, the Central Bank states that the situation within the banking sector remains sensitive. Lithuanian banks are in a fragile position due mainly to, first, the decrease in confidence of residents and enterprises in the banking system since the bankruptcy of JSC SNORAS and, second, the increased difficulties for the banks to attract additional medium-term funding in the markets, since risk premiums have increased and the willingness of investors to assume risks has decreased. Therefore, the Commission considers that the extension of the three measures is appropriate and necessary to remedy a serious disturbance of the Lithuanian economy.

(41) As regards the specific features of the scheme, in assessing the request for the extension, the Commission has to balance the scheme's positive effects for financial stability against the distortions of competition that the extension entails and the delay in the return to a normal functioning of the financial markets. The extended scheme thus should contain exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spillover effects on competitors and other Member States. The Commission considers that the conditions of the scheme comply with those requirements.

(42) The Commission notes that Lithuania undertook to align the minimum remuneration for the guarantee measure with the 2011 Prolongation Communication. In particular, the new pricing formula takes into account the greater differentiation by risk of banks' CDS spreads in recent times, by referring to median CDS spreads over a three-year period ending one month before the grant of guarantees. The increases in CDS spreads in recent years are partially due to influences that are not specific to individual banks; in particular, they are due to the growing tensions in sovereign debt markets and an overall increase in the perception of risk in the banking sector. Therefore, in principle, the formula for the guarantee fee calculation should isolate the intrinsic risk of individual banks from changes in CDS spreads of sovereigns and of the market as a whole.

(43) Further, the Commission notes that the remuneration set by Lithuania might be higher than the minimum rate required under the State aid rules (see recital (9) above). Given that in line with the commitments of Lithuania the resulting remuneration of the guarantees cannot fall below that envisaged in the 2011 Prolongation Communication, it can be deemed appropriate and proportional.

(44) Moreover, Lithuania committed to respect the reporting regulation described in point 22 of the 2011 Prolongation Communication and will communicate to the Commission, within three months following each issue of guaranteed bonds, the actual guarantee fee charged in relation to each issue of guaranteed loans.

13 Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector, OJ C 72, 26.3.2009, p. 1.

(45) The Commission also notes that Lithuania confirms that all the commitments made in relation to the original scheme and the prolongation decisions will continue to apply.

(46) In particular, the Commission notes positively the commitment of the Lithuanian authorities to impose a coupon ban on the banks subject to restructuring.

(47) The Commission also recalls that, in accordance with point 4 of Annex to the Restructuring Communication, any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period. 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). Thus, 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 that end, an individual ex ante notification is necessary.

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

(49) In addition to the above, Lithuania agrees to provide the Commission with a concise mid-term review of the operation of the scheme by 15 April 2012, and to complement such future reports with the data on guaranteed and non-guaranteed debt issuance. The reports on the operation of the scheme and the remuneration charged for the guarantees will allow the Commission to assess the appropriateness, necessity and proportionality of possible further prolongations of the scheme beyond 30 June 2012 and the conditions for such prolongations.

(50) In line with the Commission's decisional practise, the scheme is extended until 30 June 2012. 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.

(51) Therefore, the scheme remains an appropriate, necessary and proportionate measure to remedy a serious distortion of the Lithuanian economy.

(52) Based on those considerations, the prerequisites for the compatibility of guarantee, recapitalisation and asset relief measures are met. The notified extension therefore is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

5. DECISION

The Commission finds that the notified extension of the scheme is compatible with the internal market pursuant to Article 107(3)(b) TFEU. The Commission has accordingly decided not to raise objections.

The Commission recalls that, according to the commitment of the Lithuanian authorities, the approval of the scheme is limited in duration until 30 June 2012.

The Commission notes that Lithuania accepts exceptionally that the decision be adopted in the English language.

The Lithuanian authorities have indicated that the notification does not contain any confidential information. The Commission will therefore disclose this letter to third parties publishing its full text on the Internet site:

http://ec.europa.eu/eu_law/state_aids/state_aids_texts_en.htm

Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-President