

IFLN conference

State aid to Hypo in Austria and NLB in Slovenia - a case of unequal treatment of EU member states by the European Commission

Austria requests state aid to Hypo, Slovenia to NLB

- both the Hypo-Alpe-Adria Bank (Hypo) in Austria and the Nova Ljubljanska Banka (NLB) in Slovenia have been exposed by the crisis of 2008-2013 as short of liquidity and on the brink of insolvency, and both have been recapitalized by the respective states in the period 2008-2012
- both by national and EBA criteria, NLB is a systemic bank in Slovenia, while Hypo is not a systemic bank in Austria
- in the first half of 2013, both states asked the European Commission (EC) to allow further state aid, in form of recapitalization; Slovenia's restructuring plan submitted on 9 January 2013 asked for state capital injection into NLB of up to EUR 900 million, while Austria's plan submitted on 29 June 2013 asked for state capital injection into Hypo of up to 2.6 billion
- while EC decisions regarding state aid to banks typically take two to three months, in April 2013 there was still no decision on NLB; thus Slovenian authorities inquired about the decision in May, but were informed that the process is still ongoing
- Slovenian authorities inquired again in late June 2013, and were told by the EC that it is preparing a **new Communication modifying the rules for state aid to banks, and the aid to NLB will have to conform to these rules**; here we note again that Austria only submitted their restructuring plan for Hypo on 29 June 2013

Austria granted state aid, Slovenia told to wait for the Banking Communication and to comply

- on 30 July 2013 the EC published the Banking Communication, to be applied from 1 August 2013, which stated:
*"Adequate burden-sharing will **normally** entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders **must contribute** to reducing the capital shortfall **to the maximum extent**. Such contributions can take the form of **either a conversion into equity or a write-down of the principal of the instruments**."*
- Slovenian authorities then contacted the EC and noted that their request was submitted prior to the publication of the Banking Communication; in a teleconference with EC representatives on 19 September 2013, they were instructed to nonetheless comply with the Banking Communication, or have their request rejected and they will have to submit anew, after 1 August 2013, and the new request will have to comply with the Banking Communication
- in the meanwhile, on 27 August 2013, Austria modified the request for state aid to Hypo by taking into account Hypo's large additional losses in the first half of 2013, requiring state aid of up to 5.4 billion EUR; on September 2013, the EC approved the request, declaring such state aid compatible

with the internal market; despite the fact that the plan was amended after 1 August and approved after 1 August, it foresaw no conversion or write-down of Hypo's subordinated bonds, and neither have they been performed to date, despite Hypo receiving state aid in November 2013 and again in April 2014

Slovenia legalizes "haircuts", retroactively voids contracts and forbids lawsuits

- in the teleconference of 19 September 2013, the Slovenian authorities presented to the EC two legal opinions, one written by Clifford Chance LLP in London stating that a write-down of NLB's non-hybrid subordinated bonds would be in violation of the bonds prospectus and international banking regulations, and another by the Slovenian Institute of Comparative Law stating that such a write-down would be unconstitutional; they were told by the EC representatives that such opinions are often used as excuses by the countries in financial trouble, and that EC regularly disregards them
- so in late September 2013, the Slovenian Ministry of Finance drafted an amendment to the national banking legislation in which it authorized the national central bank (Bank of Slovenia) to declare a conversion into equity of a write-down of the principal for any hybrid or subordinated bond of a bank to be recapitalized by the state; the new law also declared all the provisions of the bonds' prospectuses void, and forbade any lawsuit of the affected bondholders
- despite three independent legal opinions that such encroachments are unconstitutional, written by the Slovenian Banking Association, Securities Market Agency, and Insurance Supervision Agency, this law was adopted by the Slovenian Parliament on 29 October 2013; the vote was taken under persistent warnings of the Slovenian government that this law is required for compliance with the EC's Banking Communication, and that according to the EC the failure to comply would violate the EU law and the Treaty of the EU, resulting in severe repercussions, including the blockage and subsequent collapse of the national financial system
- on 5 November 2013, the Slovenian Council of State vetoed the law, but on 22 November 2013 the Parliament adopted it again, citing again the government's assertions that according to the EC, the failure to comply with the Banking Communication would result in severe repercussions, including the collapse of the national financial system
- the Slovenian "haircut" law applied from 23 November 2013, and on 18 December 2013 the Bank of Slovenia declared the writing down to zero of all the hybrid and subordinated bonds of all the systemic banks in Slovenia (NLB, NKBM, and Abanka), and two further banks (Factor Banka and Probanka); these bonds thus ceased to exist, without any compensation, and without the right of the affected bondholders to sue the banks for the evident breach of contract

Slovenia granted state aid only after subordinated bonds write-off, constitutionality assessed

- on 4 December 2013, the **PanSlovenian Shareholders' Association**, in the name of 158 holders of NLB's non-hybrid subordinated bonds, submitted the request to the Slovenian Constitutional Court to assess the constitutionality of the "haircut" law; the Court made the first deliberation on 18 December 2013, deciding to assess the constitutionality as a priority, but not blocking the law,

citing again the assertions that the failure to comply with the EC's requirements would result in severe repercussions, including the collapse of the national financial system

- on 10 December 2013 and on 7 February 2014, the PanSlovenian Shareholders' Association filed two more such requests, in the name of further 118 and 74 bondholders of the five banks subject to "haircut", respectively; to date, eleven other parties have filed requests for the constitutionality assessment, including the Slovenian Ombudsman and Council of State

Conclusion

The contrast between the presented treatments by the EC of two states requesting state aid to banks is very stark. Slovenia requested state aid to a systemic bank in January 2013, and the EC only approved it in December 2013 after the complete write-off of all hybrid and subordinated bonds. Austria requested state aid to a non-systemic bank in June 2013, and the EC approved it already in September 2013 without requiring any write-down of any hybrid or subordinated bond, not to mention complete write-off of them all.

Not being treated as equal in a community of nations, Slovenia has already once opted to secede from such a community – from Yugoslavia in 1991. We are aware that we are a small country, and in proportional voting systems our role will always be smaller compared to the large countries. But the legislative acts and rules should nonetheless apply equally to all member countries. In contrast, the treatment of Slovenia's state aid to its largest systemic bank, forced to completely write off all its subordinated bonds, affecting pension funds that oversee savings of a quarter of Slovenian population, has not been applied to any other member state to date, and particularly not of the states that have never requested any financial aid. We hope that the EC will soon apprehend this unequal treatment as a mistake and take all the necessary steps to repair the resulting damage to the ordinary citizens that it so often claims to safeguard.