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Creditor Participation in the Recapitalization of the Greek Banking System—Part I

By Yiannis Bazinas and Yiannis Sakkas*

In December 2015, the third phase of the Greek banking system recapitalizations was concluded. Unlike the first round of recapitalizations in 2013, this recent series of transactions featured a higher degree of creditor participation. By evaluating the legal aspects of the process and by focusing on the framework of bank resolution in the EU, this two-part article will analyze the transition from public bailouts to creditor bail-ins and demonstrate the importance of a full European Banking Union in achieving a creditor-oriented bank resolution framework. This first part of the article discusses the first round of bank recapitalizations, developments in European financial regulation, and the recent recapitalizations. The second part of the article, which will appear in an upcoming issue of The Banking Law Journal, *will examine creditor participation in the bank capitalizations, public bailouts and creditor bail-ins, and the role of the banking union in fostering creditor participation.*

The perils of the Greek banking system have been front-page news for a long time. Even though Greek credit institutions escaped the worst from the global economic meltdown of 2008,[1] the sovereign debt crisis that ensued revealed serious deficiencies in the banking system. Being major holders of Greek sovereign debt, banks suffered extensive losses as Greek Government Bonds ("GGBs") rapidly declined in value when the full extent of Greece's fiscal discrepancies came to light. The fiscal adjustment measures that followed the First and Second Economic Adjustment Program for Greece[2] took a heavy toll on the real economy and led to a severe reduction in real wages and a massive increase in unemployment figures.[3] As the economic recession deepened even

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[1] Kouretas and Vlamis, "The Greek Crisis: Causes and Implications," Panoeconomicus (2010), Volume 57, Issue 4, at p. 391.

[2] For an overview of the story of financial assistance to Greece from 2010 onwards see, http://ec.europa.eu/ economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm.

[3] Unemployment rates are reported to have risen from 7.2 percent in 2008 Q3 to 23.6 percent in 2012 Q3, while real wages to have dropped 8.9 percent in 2010, 4.7 percent in 2011 and 7.6 percent in 2012. Bank of Greece "Report of the Governor of the Bank of Greece," 2012, p. 76.

further, banks began facing pressures from multiple sides; on the one hand, the growing number of non-performing loans[4] ("NPLs"), combined with a depreciation of their security interests (mostly comprised of real estate) diminished the banks' capital and placed a tight strain on the their balance sheet, while on the other hand uncertainty about the country's future in the Eurozone resulted in a flight of deposits abroad[5] and a pressing liquidity crunch that "dried up" the market even further. The Greek sovereign debt restructuring of February 2012 and the resulting 53.5 percent haircut of the nominal value of GGBs, was the final nail in the coffin: the fiscal debacle had eventually sunk the banks and their recapitalization was suddenly an urgent and vital priority for the country's rescue.

A SYSTEM IN DISARRAY

The Greek Private Sector Involvement ("PSI"), the largest debt restructuring in the world, may have resulted in a 106bn EUR nominal reduction of Greek sovereign debt but also imposed severe losses on banks' portfolios, amounting to 37.7bn EUR.[6] The Second Economic Adjustment Program for Greece had set aside 50bn EUR in order to strengthen and recapitalize the banking system. Following a qualitative assessment by the Bank of Greece ("BoG") four banks were identified as viable and therefore eligible to receive public financial assistance:[7] Alpha Bank ("Alpha"), Eurobank, Piraeus Bank ("Piraeus"), and the National Bank of Greece ("NBG"). This viability test was crucial for the initiation of the process, since recapitalization was not considered a resolution-like measure but was viewed instead as extraordinary capital support to solvent credit institutions. For this reason the rest of the Greek banks, the majority of which were relatively small in size and controlled a negligibly small size of the market,[8] would not take part in the process and would have to raise the needed capital exclusively from the private sector; in case they failed, they would need

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[4] The ratio of NPLs to total loans stood at 22.5 percent in 2012, having risen from 16 percent in 2011. *Ibid* p. 200.

[5] Deposits in Greek banks amounted in December 2012 to 165 bn EUR, having been reduced by 33 percent since December 2009, *ibid* p.180.

[6] Bank of Greece, "Report on the recapitalization and restructuring of the Greek banking sector," December 2012, p. 8, *available at* http://www.bankofgreece.gr/BogEkdoseis/Report_on_the_recapitalisation._and_restructuring.pdf.

[7] Systemic bank losses from the PSI amounted to 28.2bn EUR, almost 75 percent of total losses. *Ibid*, p.8.

[8] The market share of the five largest banks in Greece stood at 80 percent in 2012, having risen 10 percentage points since the beginning of the crisis. ECB, "Banking Structures Report," November 2013 p. 13.