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Recapitalization of Greek Systemic Banks

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Introduction

In General

The Greek economic collapse erupted in the autumn of 2009. At the start, the crisis was predominantly fiscal[1] in nature with uncontrolled external imbalances. Very quickly, the turmoil unfolded beyond public finances and claimed the entire Greek banking sector.

All domestic systemic lenders faced a looming liquidity crunch and action was required to avert bank failure. Following long deliberations amid European Union (EU) legal, institutional, and political constraints, Euro area Member States agreed to provide financial support and rescue an errant peer, safeguarding at the same time financial stability in the Euro area as a whole.

As part of the Greek rescue plan, the government undertook to establish an independent Hellenic Financial Stability Fund (HFSF).[2] The Fund aims to provide equity support to banks, operating within an

1 Greece's fiscal position had been over-estimated in the data reported in the European Union for the most part of the last decade; Featherstone, "The Greek Sovereign Debt Crisis and EMU: A Failing State in a Skewed Regime", *JCMS* (2011), Volume 49, Number 2, at p. 199.

2 Law Number 3845/2010 (*State Gazette* A 65, 6 May 2010), Annex III, Greece — Memorandum of Economic and Financial Policies, 3 May 2010. The law has been repeatedly amended: Law Number 4021/2011 (State Gazette A 218, 3 October 2011), Law Number 4051/2012 (*State Gazette* A 40, 29 February 2012), and Law Number 4056/2012 (*State Gazette* A 52, 12 March 2012) and the Act of Legislative Content of 19 April 2012 (*State Gazette* A 94, 19 March 2012).

EU legal framework that is evolving to keep pace with a prolonged global and intra-European banking system instability.

Greek Banking Sector: Symptom, Not Cause, of Crisis

Domestic credit institutions escaped the worst of the recent international banking rout. A decisive factor for that was the limited exposure of Greek banks to the 2007 United States subprime mortgage loan market crisis and the reduced effect that the Lehman Brothers' default had locally.[3]

However, Greek banks did not have the same resilience to domestic economic conditions. The fiscal debacle eventually sunk the banking sector. Not the other way around, as in Ireland, Spain, and Cyprus, where the banking problems related to the property boom and bust were the key moving part of the crises there.[4]

The public debt crisis and the prolonged recession of the Greek economy therefore rendered credit institutions extremely vulnerable. This can partly be justified by the percentage of Greek Government Bonds (GGBs) that the banks held as assets.[5]

In 2011, Greek banks suffered a steep haircut on their GGBs in the Greek sovereign debt restructuring through the Private Sector Involvement (PSI).[6] The debt exchange resulted in significant losses and capital needs for the local banks. At the same time, the adverse economic conditions increased the number of non-performing loans, while deposit outflows, precipitated by talks of Greece leaving the Monetary Union, continued at alarming rates.

The quality of bank assets inevitably deteriorated with the institutions falling short of required indexes. These factors heaped pressure on the liquidity and capital base of domestic credit institutions, threatening the long-term sustainability of several banks.[7]

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

4 Blundell-Wignall and Slovik, "A Market Perspective on the European Sovereign Debt and Banking Crisis", *OECD Journal: Financial Market Trends*, Number 1, Volume 2010, Issue 2, at p. 10.

5 Georgikopoulos, "The Impact of the Financial and Fiscal Crisis on the Greek Banking System", see http://bponline.amcham.gr/?p=806.

6 Greek Ministry of Finance Budget 2013 Executive Summary, at p. 60, see http://www.minfin.gr/?q=en/node/6976.

7 *Report of the Bank of Greece (Eurosystem) on the Recapitalization and Restructuring of the Greek Banking Sector* (December 2012), at p. 5.