State Aids Policy in the EU: With Reference to the Banking Sector in the Post 2008 Crisis

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Abstract: This thesis analyzes the state aids policy in EU especially by taking the post-2008 crisis implementations in the banking sector into consideration. The main goal of the thesis is to examine the questions about how the EU directs the considerably strict state aids policy in the crisis term and whether or not there has been a turn in state aids policy tradition during the crisis. For this purpose, the study, first, evaluates the competition policy as the umbrella title for state aids policy, the definition and components of state aids and international rapprochements to state aids policy. Then, the tradition of state aids policy in EU is explained by taking the history and sources of this policy into consideration. Under the light of this advance information, actions of the Union during the post-2008 financial crisis related to the banking sector are tried to be evaluated.
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Regulations for the Financial Sector

At the beginning of the autumn 2008, the financial crisis hit the economies of EU Member States in a systemic manner. Many EU governments took measures to support financial stability, to restore confidence in the financial markets and to minimize the risk of a serious credit crunch. In the field of competition policy – and of State aid control in particular – the role of the Commission has been to support financial stability by promptly giving legal certainty to the measures taken by Member States. The Commission also contributed to maintaining a level playing field and ensuring that national measures would not simply export problems to other Member States.The EU's competition policy played a central role in finding solutions to the financial crisis. In compliance with State aid rules, the Commission approved and coordinated Member States' extraordinary measures taken to safeguard financial stability, such as the guarantee umbrellas, recapitalization measures and *ad hoc* rescue and restructuring measures in favour of individual financial institutions. It set out the conditions for granting these special state aids and monitored if these conditions and the relevant EC Treaty rules were being observed. The Commission oversight was aimed at maintaining the level playing field by limiting as much as possible competitive distortions, fighting protectionism and preserving the functioning of the Single Market.

Since the beginning of this crisis, Member States have announced unprecedented support measures for the financial sector, ranging from increased (or even unlimited) deposit guarantees, inter-bank credit guarantees, direct capital injections and partial nationalization through to individual rescue packages. Many of these measures fall under European State aid rules. So the Commission introduced several crisis-specific communications to assess state aids granted to financial institutions.

In its Communications, the Commission recognized that the severity of the crisis justified the granting of aid under Article 107(3)(b) of TFEU which allows aid ‘to remedy a serious disturbance in the economy of a Member State’. It also set out a framework for the provision of public guarantees, recapitalization measures, and impaired asset relief, whether granted by States to individual banks or as part of a wider national scheme.

The importance of maintaining State aid rules was confirmed again in the Communication adopted by the Commission on 26 November 2008, *A European Economic Recovery Plan* (“the Recovery Plan”). This document constitutes a global action plan to drive Europe’s recovery from the current financial crisis. This plan rests on two pillars:

- a boost to purchasing power that increases demand and confidence in the economy; and
- immediate actions that will boost long-term competitiveness, such as investing in a greener economy through technology.

Although issued specifically in response to the crisis and only for aid granted to financial institutions, the Communications are based on the same three general principles set out in the 2004 ‘Community Guidelines on State aid for rescuing and restructuring firms in difficulty’ (the ‘R&R guidelines’). Those principles require the following.

- Restoration of long-term viability—the aid should lead to the restoration of viability of the beneficiary in the longer term without State aid.

- Avoidance of undue distortions to competition—the aid should be accompanied, to the extent possible, by measures to minimize distortions to competition.
- Ensuring appropriate burden sharing—the aid should be limited to the minimum required and accompanied by adequate burden-sharing.

Contents and main principles of these Communications are tried to be summarized as follows:

The Banking Communication

While the exceptional circumstances prevailing at the moment have to be duly taken into account when applying the State aid rules to measures addressing the crisis in the financial markets the Commission has to ensure that such measures do not generate unnecessary distortions of competitions between financial institutions operating in the market or negative spillover effects on other Member States. It is the purpose of this Communication to provide guidance on the criteria relevant for the compatibility with the Treaty of general schemes as well as individual cases of application of such schemes and ad hoc cases of systemic relevance. In applying these criteria to measures taken by Member States, the Commission will proceed with the swiftness that is necessary to ensure legal certainty and to restore confidence in financial markets.

In order to assist Member States in their efforts to design support schemes that are in line with State aid rules, the European Commission has published the Communication on how the State aid rules apply to measures taken in relation to financial institutions in the context of the current global financial crisis. The Commission acknowledges in this Communication the exceptional circumstances and the systemic risks inherent to a financial crisis and takes them into account when dealing with support schemes. Coordinated action by Member States and the Commission has ensured that support measures could be implemented with minimal spillover effects and distortions of competition.

The European Commission published this guidance on how Member States can best support financial institutions in the current financial crisis whilst respecting EU state aid rules and so avoiding excessive distortions of competition. The guidance is based in particular on EC Treaty rules allowing for aid to remedy a serious disturbance in the economy of a Member State (Article 87.3.b of the EC Treaty).

The Commission's guidance (in the form of a Communication) indicates how the Commission intends to apply EC Treaty state aid rules to state support schemes and individual assistance for financial institutions in the current crisis.

Given the scale of the crisis, now also endangering fundamentally sound banks, the high degree of integration and interdependence of European financial markets, and the drastic repercussions of the potential failure of a systemically relevant financial institution further exacerbating the crisis, the Commission recognizes that Member States may consider it necessary to adopt appropriate measures to safeguard the stability of the financial system. Due to the particular nature of the current problems in the financial sector such measures may have to extend beyond the stabilization of individual financial institutions and include general schemes.

Support schemes such as guarantees or recapitalization schemes can be cleared by the Commission very quickly if they fulfill conditions which guarantee that they are well-targeted and proportionate to the objective of stabilizing financial markets and contain certain safeguards against unnecessary negative effects on competition. The specific conditions include:

- Non-discriminatory access in order to protect the functioning of the Single Market by making sure that eligibility for a support scheme is not based on nationality
- State commitments to be limited in time in such a way that it is ensured that support can be provided as long as it is necessary to cope with the current turmoil in financial markets but will be reviewed and adjusted or terminated as soon as improved market conditions so permit
- State support to be clearly defined and limited in scope to what is necessary to address the acute crisis in financial markets while excluding unjustified benefits for shareholders of financial institutions at the taxpayer's expense
- An appropriate contribution of the private sector by way of an adequate remuneration for the introduction of general support schemes (such as a

guarantee scheme) and the coverage by the private sector of at least a significant part of the cost of assistance granted

- Sufficient behavioural rules for beneficiaries that prevent an abuse of state support, like for example expansion and aggressive market strategies on the back of a state guarantee
- An appropriate follow-up by structural adjustment measures for the financial sector as a whole and/or by restructuring individual financial institutions that had to rely on state intervention.

The Recapitalization Communication

The Banking Communication recognizes that recapitalization schemes are one of the key measures that Member States can take to preserve the stability and proper functioning of financial markets. It is recognized that recapitalization contributes to financial stability and restores confidence needed for inter-bank lending, ensures lending to real economy, and may provide a solution for financial institutions facing insolvency.

The assessment of any recapitalization scheme or measure must take into account possible distortions of competition at three different levels.

- Ensuring fair competition between Member States
- Ensuring fair competition between banks.
- Ensuring a return to normal market functioning

Any proposed recapitalization has cumulative competitive effects at each of these three levels. However, a balance must be struck between these competition concerns and the objectives of restoring financial stability, ensuring lending to the real economy and dealing with the risk of insolvency. On the one hand, banks must have sufficiently favourable terms of access to capital in order to make the recapitalization as effective as necessary. On the other hand, the conditions tied to any recapitalization measure should ensure a level playing field and, in the longer-term, a return to normal market conditions. State interventions should therefore be proportionate and temporary and should be designed in a way that provides incentives for banks to redeem the State as soon as market circumstances permit, in order for a competitive and efficient European banking sector to emerge from the crisis.

The Impaired Assets Communication

The Communication takes account of the recommendations of the European Central Bank and takes into account the extensive discussions with Member States over the last two months on the appropriate way to deal with impaired assets. It addresses the rationale for asset relief as a measure to safeguard financial stability and underpin bank lending; the longer-term considerations of banking-sector viability and budgetary sustainability to be taken into account when considering asset relief measures; and the need for a common and coordinated EU approach to asset relief, notably to ensure a level playing field.

This Communication focuses on issues to be addressed by Member States in considering, designing and implementing asset relief measures. At a general level, those issues include the rationale for asset relief as a measure to safeguard financial stability and underpin bank lending, the longer-term considerations of banking-sector viability and budgetary sustainability to be taken into account when considering asset relief measures and the need for a common and coordinated Community approach to asset relief, notably to ensure a level playing field.[164]

The guidance for the application of the State aid rules is based on a number of principles:

- full transparency and disclosure of impairments, which has to be done prior to government intervention;
- coordinated approach to the identification of assets eligible for asset relief measures through development of eligible categories of assets ("baskets");
- coordinated approach to valuation of assets ex-ante, based on common principles such as valuation based on real economic value (rather than market value), implemented by independent experts and certified by bank supervisors,
- validation by the Commission of the valuation of the assets, in the framework of the State aid procedures on the basis of uniform assessment criteria;
- adequate burden-sharing of the costs related to impaired asset between the shareholders, the creditors and the State,
- adequate remuneration for the State, at least equivalent to the remuneration of State capital
- coverage of the losses incurred from the valuation of the assets at real-economic-value by the bank benefiting from the scheme
- aligning incentives for banks to participate in asset relief with public policy objectives, through an enrolment window limited to six months during which the banks would be able to come forward with impaired assets;
- management of assets subject to relief so as to avoid conflicts of interests; appropriate restructuring including measures to remedy competition distortion, following a case by case assessment and taking into account the total aid received through recapitalization, guarantees or asset relief, with a view to the long-term viability and normal functioning of the European banking industry.

The Restructuring Communication

The Commission has to deal with a large number of individual cases of bank restructuring, which follow from bank rescue aid measures approved on the condition that a restructuring plan would be submitted within six months. In order to foster transparency, predictability and equality of treatment between Member States, the Commission has issued guidelines to clarify its approach, the criteria it will base its assessment upon and the type of information required to guide this assessment. These guidelines are based on Article 107 of TFEU, which authorizes state aid in case of a serious disturbance in the economy. They will be temporary and apply until the end of 2010. After that date, the normal rules on rescue and restructuring, based on Article 107.3(c) of TFEU of the Treaty (aid for the development of certain economic activities or areas where such aid does not adversely affect trading conditions to an extent contrary to the common interest) should resume.

This Communication explains how the Commission will examine aid for the restructuring of banks in the current crisis, taking into account the need to modulate past practice in the light of the nature and the global scale of the crisis, the systemic role of the banking sector for the whole economy, and the systemic effects which may arise from the need of a number of banks to restructure within the same period:

- The restructuring plan will need to include a thorough diagnosis of the bank's problems. In order to devise sustainable strategies for the restoration of viability, banks will therefore be required to stress test their business. This first step in the restoration of viability should be based on common parameters which will build to the extent possible on appropriate methodologies agreed at Community level. Banks will also be required, where applicable, to disclose impaired assets.
- Given the overriding goal of financial stability and the prevailing difficult economic outlook throughout the Community, special attention will be given to the design of a restructuring plan, and in particular to ensuring a sufficiently flexible and realistic timing of the necessary implementation steps. Where the immediate implementation of structural measures is not possible due to market circumstances, intermediate behavioural safeguards should be considered.
- The Commission will apply the basic principle of appropriate burden sharing between Member States and the beneficiary banks with the overall situation of the financial sector in mind. Where significant burden sharing is not immediately possible due to market circumstances at the time of the rescue, this should be addressed at a later stage of the implementation of the restructuring plan.
- Measures to limit distortion of competition by a rescued bank in the same Member State or in other Member States should be designed in a way that limits any disadvantage to other banks while taking into account the fact that the systemic nature of the current crisis has required very widespread State intervention in the sector.
- Provision of additional aid during the restructuring period should remain a possibility if justified by reasons of financial stability. Any additional aid should remain limited to the minimum necessary to ensure viability.

Regulations for the Real Sector

By the end of 2008, the impact of the crisis in the real economy was becoming more obvious, feeding into a serious downturn affecting businesses and jobs. As a consequence and following the announcement of the Recovery Plan, the Commission adopted on 17 December 2008, in record time, a new Temporary framework containing additional State aid measures aimed at facilitating companies' access to finance. This Communication169 thus focuses on the "economic crisis" and its effects on the real economy. By this Communication, the Member states are temporarily enabled to grant state aids under specific conditions caused by the financial crisis.

The financial sector should be supported to maintain that banks can carry on their normal lending activities. By this way not only the financial sector is normalized but also the reel sector is saved from the worsening effects of the crisis.

This framework prepared in light of these view points focused on three objectives:

- to immediately unblock bank lending, thereby preserving continuity in companies' access to finance;
- to ensure that limited amounts of aid reach the recipients in the most rapid and effective way;
- to encourage companies to continue investing in a sustainable future, including the development of green products.

This approach is fully in line with the Council requirement that application of the competition rules be maintained. The Commission did not modify the existing State aid rules but provided additional possibilities for granting State aid tailored to exceptional circumstances.There are two other communications amending this Communication. The first amendment regulates a separate compatible limited amount of aids applicable to undertakings active in the primary production of agricultural products as the former communication did not include the aids for these undertakings. On the other hand, while the previous Framework had limited the calculation of the maximum loan just on the basis of the total annual wage bill of the beneficiary for 2008, the second amendment brought the option to determine this amount also on the basis of the annual EU 27 average labour costs

Relevant Case Examples

The consistent methodology set out in the guidance documents mentioned above has enabled the rapid design and approval of a large number of national schemes and individual measures to tackle the crisis, whilst avoiding harmful economic imbalances between banks and between Member States.

Since the beginning of the crisis effects in Europe, 150 cases related with the financial sector have been the object of a Commission decision under Article 107(3)(b) of TFEU on aid to remedy a serious disturbance in the economy. 47 of these cases are ad hoc cases*, 24 are individual application cases** and 79 are about aid schemes A few important cases of each types may be mentioned here as examples. Each case is selected by attending their specific importance in equivalents. The example of ad hoc cases is one of the first cases of the type notified in crisis term, it is also referred as a good guide for following interventions aiming to strengthen the financial sector. The example of individual application case is selected as it is one of the first decisions about a financial institution damaged by the financial crisis. The scheme type's example is also a preliminary case of its category. It displays the Commissions role of monitoring and supervising the Member States' granting activities in crisis term. Finally apart from the case types, one more example is thought appropriate to mention to draw the attention to the Commission's rapprochement about nationalization.

Liquidity Support Scheme for Banks in Denmark

As an ad hoc case, by its decision dated October 10th 2008 , the European Commission approved under EC Treaty state aid rules a Danish scheme180 aimed at restoring confidence in the Danish financial markets in order to remedy a serious disturbance in the economy of Denmark. The scheme would provide liquidity facilities for banks operating in Denmark and protect depositors and ordinary creditors in case of insolvency. The Commission found the scheme to be compatible with EU state aid rules because it is the most appropriate means to address the risk of a severe disturbance in the Danish economy, while keeping potentiall distortions of competition to a minimum through effective safeguard mechanisms. The Commission took into particular account that the guarantee scheme is limited to fundamentally sound financial institutions while insolvent banks need to be immediately unwound, that it is open to all banks established in Denmark but that it requires a significant financial contribution which ensures that an adequate premium is paid for the guarantee. Moreover, the scheme ensures that the participating banks can neither on an individual nor on an aggregate level significantly expand their activities, as measured against established benchmarks The scheme will be remain in force for two years.
According to Competition Commissioner Neelie Kroes this scheme is an excellent example of the type of intervention that can strengthen financial markets in the current financial turmoil, without making the situation worse in other countries.

Capital Injection into Commerzbank

The case of capital injection into Commerzbank is an important example of individual application case type. By this case, the Commission approved the EUR 18 billion recapitalization of Commerzbank AG ("Commerzbank"). It was one of the first decisions the Commission has taken on a restructuring case originating from the financial crisis. It anticipated what was subsequently set out in the 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 ("the Restructuring Communication").
On the basis of the German financial crisis scheme, Germany already granted €8 billion of capital to the bank in December 2008 and intends to grant another €10 billion of capital. Germany notified this second tranche to the Commission for reasons of legal certainty so that the Commission could verify the compatibility of the measure with state aid rules. On the basis of the notified plans, the Commission is satisfied that Commerzbank's long term viability has been demonstrated, and that the aid is kept to the minimum and will not lead to undue distortions of competition. It has therefore declared the aid compatible.

Guarantee Scheme for Banks in Ireland

The case of ‘Guarantee scheme for banks in Ireland’ is an important example of scheme type as it laid out the Commission’s role in crisis period.
The Irish announcement to cover only six Irish banks by a state guarantee scheme presented a serious risk of a large outflow of capital from non-eligible competitors operating in Ireland. Upon the Commission's insistence the Irish Government confirmed within days that the guarantee scheme would be available to all banks with subsidiaries or branches in Ireland with a significant presence in the domestic economy.
The scheme intended to stabilize the financial markets in Ireland by providing guarantees was approved by the Commission on 13.10.2008. The Commission found the revised scheme to be compatible with EU state aid rules, because it was an appropriate means to remedy a serious disturbance in the Irish economy (Article 87.3.b of the EC Treaty), while avoiding unnecessary distortions of competition. In particular, it now provides for non-discriminatory access to banks with systemic relevance for the Irish economy, regardless of their origin, fair remuneration of the guarantee, is limited in time and contains appropriate safeguards to avoid abuses.

Conclusion

When the 2008 financial crisis hit the European economy, the Union could act in a quick manner to take the necessary measures. In doing this, mainly the Commission as the key authority issued several communications to guide the Member States and dealt with many related cases.
In fact, these communications are also the products of the normative tradition of the Union in the area of competition. Differently, the rules set up by these communications have been designed temporarily and specific to sectors in order to focus on the solutions against the crisis problems.
As the origin of the crisis began to develop in financial sector the communications have mostly formed to address this sector’s problems. Even the communication of temporary framework focusing on real sector contributes to the healthy progressing of financial sector by supporting the continuity in the lending process.
When the cases during the crisis period are overviewed, drastic increase in notification number can be interpreted as a clear indicator of the predicted trend in the way of granting state aids. So Commission’s immediate actions towards softening strict state aids rules in a controlled manner against this trend can be considered to be an accurate strategy. In this way potential imbalances could be avoided among the financial institutions and among the Member States.

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