

*An Assessment of the 'Exit Strategy' of the Temporary Framework of State Aid
Rules for Financial Institutions in the Light of the Financial and Economic Crisis.*

State Aid & Public Procurement

Dr. N.J. Philipsen

Dr. S.L.T. Schoenmaekers

Remi van de Calseijde | i408042

Joris Veenhuis | i257648

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I: Introduction

1: The Banking Sector and the Origins of the Current Financial and Economic Crisis.

Banks are essential institutions in the financial markets, as intermediators of funds between savers and borrowers.¹ In spite of the fact that the banking sector performs multiple functions, lending money is considered their core business and it is this business which is crucial for the rest of the economy.² The collapse of (part of) the banking sector would therefore be likely to have a major negative impact on the wider economy.³ The origins of the current global financial crisis can be traced back to 2006, when the bursting of a housing bubble sparked the US subprime mortgage crisis which developed further in 2007 and 2008. Banks feared potentially devastating losses due to the large numbers of securities (in which these subprime mortgages had been repackaged) they had acquired. This resulted in a significant plunge in interbank lending, because many banks were anxious of increased counterparty risk.⁴ In 2008, after the collapse of US bank *Lehman Brothers*, the global financial sector experienced an almost lethal cocktail of ‘write-downs on their assets, dried up liquidation in wholesale funding, and loss of consumer confidence.’⁵

2: Government Responses to the Emerging Crisis.

Many governments in the European Union (EU), fearing the consequences of a financial meltdown, responded to the imminent vulnerability by introducing various measures to support their financial services sectors as a whole and by supporting some

¹ CA Peláez and CM Peláez, *Globalization and the State: Volume 1* (Palgrave Macmillan, New York, 2008) pp. 46-49.

² D Van Hoose, *The Industrial Organization of Banking: Bank Behavior, Market Structure and Regulation* (Springer, Heidelberg, 2010) p. 7; E Carletti and X Vives, ‘Regulation and Competition Policy in the Banking Sector’, in X Vives (ed), *Competition Policy in the EU: Fifty Years on from the Treaty of Rome*, (Oxford University Press, Oxford, 2009) pp. 260 *et seq.*

³ J de Haan, S Oosterloo and D Schoenmaker, *European Financial Markets and Institutions* (Cambridge University Press, Cambridge, 2009) pp. 206 *et seq.*; E Adler, J Kavanagh and A Ugryumov, ‘State Aid to Banks in the Financial Crisis: The Past and the Future’, Vol. 1 No. 1. *Journal of European Competition Law & Practice* (2010), p. 66; T Beck, D Coyle, M Dewatripont, X Freixas and P Seabright, ‘Bailing out the Banks: Reconciling Stability and Competition – An Analysis of State-Supported Schemes for Financial Institutions’, *Centre for Economic Policy Research* (2010), http://www.cepr.org/pubs/other/bailing_out_the_banks.htm (last visited on 3 June 2012), pp. 10-12; B Lyons, ‘Competition Policy, Bailouts, and the Economic Crisis’, Vol. 5 No. 2 *Competition Policy International* (2009), p. 25.

⁴ T Clarke, ‘Corporate Governance Causes of the Financial Crisis’, in W Sun, J Stewart and D Pollard (eds), *Corporate Governance and the Financial Crisis: International Perspectives* (Cambridge University Press, Cambridge, 2011) pp. 28-36.

⁵ E Adler *et al.*, Vol. 1 No. 1. *Journal of European Competition Law & Practice* (2010), p. 66.

financial institutions on an individual basis.⁶ The main objective of these national policies was to prevent contagion of the real economy, caused by the bankruptcy of one (or more) systemically important banks.⁷ Nevertheless, the collapse of stock markets around the world and a global economic recession could not be avoided.⁸ These measures have, however, tempered the negative effects of the crisis somewhat, by preventing a ‘meltdown of the financial markets, (...) restoring confidence in both the financial markets and in real economy and [by] supporting the flow of credit to the real economy.’⁹

Bailing out of banks is a politically sensitive subject, primarily because it gives the public the impression that whilst profits in the financial sector are privatised by means of a bonus system, – which itself incentivised short-terminism, excessive risk taking, greed and the maximisation of shareholder’s wealth at the expense of other stakeholders, such as employees or consumers – the losses generated by that system are socialised.¹⁰ Another reason why bailouts are politically sensitive is that bailouts generate moral hazard; due to the fact that systemically important – *too big to fail* – banks might get the impression that a bailout will also be available for them in the future should they experience undercapitalisation.¹¹

⁶ S Donnelly, ‘The Public Interest and the Economy in Europe in the Wake of the Financial Crisis’, No.1 *European Political Science* (2011).

⁷ E Adler *et al.*, Vol. 1 No. 1. *Journal of European Competition Law & Practice* (2010), p. 66.

⁸ T Clarke, in W Sun, J Stewart and D Pollard (eds), *Corporate Governance and the Financial Crisis: International Perspectives*, pp. 28-36.

⁹ E Adler *et al.*, Vol. 1 No. 1. *Journal of European Competition Law & Practice* (2010), p. 66.

¹⁰ E Engelen, I Ertürk, J Froud, S Johal, A Leaver, M Moran, A Nilsson and K Williams, *After the Great Complacency: Financial Crisis and the Politics of Reform* (Oxford University Press, Oxford, 2011) pp. 27-32; A Wigger and H Buch-Hansen, ‘The Unfolding Contradictions of Neoliberal Competition Regulation and the Global Economic Crisis: A Missed Opportunity for Change?’, in B van Apeldoorn and H Overbeek (eds), *Neoliberalism in Crisis* (Palgrave Macmillan, Hampshire, 2012) pp. 38-43.

¹¹ C Ahlborn and D Piccinin, ‘The Application of the Principles of Restructuring Aid to Banks during the Financial Crisis’, Vol. 1 *European State Aid Law Quarterly* (2010), p. 47; M Dewatripont, J Rochet, J Tirole, *Balancing the Banks: Global Lessons from the Financial Crisis*, (Princeton University Press, Oxford, 2010) pp. 118-122; E Carletti and X Vives, in X Vives (ed), *Competition Policy in the EU: Fifty Years on from the Treaty of Rome*, pp. 260 *et seq.*; B Lyons, Vol. 5 No. 2 *Competition Policy International* (2009), p. 25; M Dewatripont, G Nguyen, P Praet and A Sapir, ‘The Role of State Aid Control in Improving Bank Resolution in Europe’, Bruegel Policy Contribution (2010), <http://www.bruegel.org/publications/publication-detail/publication/404-the-role-of-state-aid-control-in-improving-bank-resolution-in-europe/> (last visited on 3 June 2012).

3: State Aid.

Some of these measures, especially in those cases where governments supported individual financial institutions, could be considered ‘state aid’ under EU law. State aid is a term used to define those cases where aid is granted by Member States or through state resources to support public or private undertakings,¹² ‘resulting in a competitive advantage that could not have been obtained under normal market conditions, where recipients of the aid do not have to provide anything in return.’¹³ State aid is *prima facie* considered to be incompatible with the internal market, and therefore explicitly prohibited under the EU competition rules in the Treaties.¹⁴ Due to the fact that the *Treaty on the Functioning of the European Union* (TFEU) does not contain a specific definition of what state aid is, the European Commission and the European Court of Justice have taken a broad view, capturing an extensive field of government measures such as grants, loans and tax exemptions under the definition.¹⁵ A guiding principle for the establishment of aid seems to be that ‘the measure must confer an advantage to the recipient’, although general measures of economic policy will not be classified as aid.¹⁶ Some authors interpret the European Union Courts’ judgments to hold that aid ‘is any relief from the expenses which are normally borne by undertakings in their daily operations.’¹⁷

In spite of the general prohibition, state aid is exceptionally allowed in those instances where common policy aims are pursued and the amount of aid granted is not likely to cause an excessive distortion of competition. Member States are obliged to notify the Commission prior to granting the aid.¹⁸ The Commission has been given the exclusive jurisdiction to decide whether state aid is compatible with the internal market and its Decisions are only subjected to a limited judicial review by the European Union

¹² P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, (Fifth Edition, Oxford University Press, Oxford, 2011) pp. 1087 *et seq.*

¹³ P Nicolaides, ‘State Aid’, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, (Cambridge University Press, Cambridge, 2010) p. 354.

¹⁴ Article 107 (1) of The Treaty on the Functioning of the European Union (Consolidated Version), [2010] OJ C 83/47.

¹⁵ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1087 *et seq.*; P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 354 *et seq.*

¹⁶ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, p. 1088.

¹⁷ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, p. 354.

¹⁸ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 349 *et seq.*

Courts.¹⁹ The Courts' role is restricted to 'verifying that the Commission complies with the rules of procedure and the duty to give reasons; that the facts are accurate; that there is no manifest error in assessing facts, no error of law and no misuse of powers.'²⁰

The present financial and economic crisis has resulted in a significant boost in the amount of state aid, especially as regards aid granted to the financial sector.²¹ Member States have resorted to measures such as guarantees, recapitalisation measures and risk shields, all with objective of preventing contagion and kick-starting the lending process by banks that is so vital to the real economy.²² The total amount of the state aid granted to financial institutions in the EU since the beginning of the crisis until the fall of 2011 amounts to one third of the EU-27 GDP, in total a mindboggling sum of €4506.5 Billion.²³ The Commission supported the Member States' governments by adopting in record time a large number of positive Decisions, ensuring the swiftness and effectiveness of the process, while at the same time avoiding undue distortions of competition.²⁴

The magnitude and complexity of the increasing workload lead the Commission to the conclusion that in the light of the financial and economic chaos, the existing rules on state aid would not suffice.²⁵ Therefore, the Commission adopted a special Temporary Framework, incorporated in a number of Commission Communications, modifying the rules on rescue and restructuring aid.²⁶ These modifications enabled the

¹⁹ Article 108 of The Treaty on the Functioning of the European Union (Consolidated Version), [2010] OJ C 83/47.

²⁰ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 349 *et seq.*

²¹ C Quigley, *European State Aid Law and Policy*, (Second Edition, Hart Publishing, Oxford, 2009) pp. 180 *et seq.*

²² P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 350 *et seq.*

²³ FC Laprévote, 'Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules' Vol. 1 *European State Aid Law Quarterly* (2012), p. 93; K Lannoo, A Sutton and C Napoli, 'Bank State Aid in the Financial Crisis: Fragmentation or Level Playing Field?', *Centre for European Policy Studies* (2010), <http://www.ceps.eu/book/bank-state-aid-financial-crisis-fragmentation-or-level-playing-field> (last visited on 3 June 2012), pp. 11 *et seq.*

²⁴ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 351 *et seq.*

²⁵ P Nicolaides and IE Rusu, 'The Financial Crisis and State Aid', Vol. 55 No. 4 *The Antitrust Bulletin* (2010),

p. 759.

²⁶ S Gebski, 'Competition First? Application of State Aid Rules in the Banking Sector', Vol. 6 Issue 1

Commission to adopt almost 300 clearance Decisions in more than 100 separately notified cases.²⁷ The Commission's policy mainly pursued two interconnected objectives. The first was to promote financial stability, to stop the widespread unrest in the markets and to support a restoration of trust. The second was to safeguard the internal market, maintain a level playing field between banks and prevent undue distortions of competition.²⁸

4: Structure.

The paper will be structured in the following way: After this introductory chapter, the second chapter will provide the reader with an overview of the EU legislation and policy on state aid. The reader will be acquainted with the requirements of the 'test' that is utilised by the Commission to establish a finding of state aid that could be incompatible with the internal market. The chapter will introduce the adoption of the Temporary Framework that was specifically designed to deal with state aid in the light of the crisis.

The Competition Law Review (2009), p. 89; FC Laprévotte, Vol. 1 *European State Aid Law Quarterly* (2012), p. 93; C Ahlborn and D Piccinin, Vol. 1 *European State Aid Law Quarterly* (2010), p. 47; R Luja, 'State Aid and the Financial Crisis: Overview of the Crisis Framework', Vol. 2 *European State Aid Law Quarterly* (2009), p.145.

²⁷ Ibid.

²⁸ Commission Staff Working Paper, 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis', SEC (2011) 1126, p. 24; A Bomhoff, A Jarosz-Friis and N Pesaresi, 'Restructuring banks in crisis – overview of applicable State aid rules', No.2 *Competition Policy Newsletter* (2009) p. 3.

II: EU State Aid Law & The Crisis

1: The Internal Market & Competition.

The creation of an internal market has been a fundamental element of the EU's policies.²⁹ In Article 3 (3) of the *Treaty on European Union* (TEU) it is laid down that 'The Union shall establish an internal market. It shall work for (...) a highly competitive social market economy'.³⁰ Article 4 (3) TEU gives Member States the duty to 'facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives'.³¹ In Protocol 27 on the TEU and TFEU it is stipulated that Member States shall take necessary action to ensure that the internal market 'includes a system ensuring that competition is not distorted'.³² The continuing development of the internal market has led to a situation where Member States, being progressively less able to employ other measures of economic policy to favour their domestic companies, might experience increasing pressure to grant state aid.³³

2: Why and When State Aid is (In-)Compatible with the Internal Market.

There are many reasons why state aid is regarded as 'bad'. An overview of these reasons falls, however, outside the scope of this paper. Primarily, state aid interferes with the normal competitive process by favouring certain undertakings, indirectly harming their competitors operating in the same or different Member States. State aid in favour of domestic companies thus hampers the establishment of an internal market with free and undistorted competition.³⁴ It is also well established that this situation is likely to result in an ever aggravating 'downward spiral' because Member States feel

²⁹ D Chalmers, G Davies and G Monti, *European Union Law*, (Cambridge University Press, Cambridge, 2010) pp. 675 *et seq.*

³⁰ Article 3 (3) of the Treaty on European Union (Consolidated Version), [2010] OJ C 83/13.

³¹ Article 4 (3) TEU.

³² Protocol No. 27 of the Treaty on the European Union and the Treaty on the Functioning of the European Union on the internal market and competition, [2008] OJ C 115/309.

³³ C Quigley, *European State Aid Law and Policy*, pp. 177 *et seq.*; W Sauter and H Schepel, *State and Market in European Union Law: The Public and Private Spheres of the Internal Market before the EU Courts*, (Cambridge University Press, Cambridge, 2009) p. 193.

³⁴ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 349 *et seq.*; D Spector, 'State Aids: Economic Analysis and Practice in the European Union', in X Vives (ed), *Competition Policy in the EU: Fifty Years on from the Treaty of Rome*, (Oxford University Press, Oxford, 2009) pp. 185 *et seq.*; W Sauter and H Schepel, *State and Market in European Union Law: The Public and Private Spheres of the Internal Market before the EU Courts*, p. 193; HW Friederiszick, LH Röller and V Verouden, 'European State Aid Control: An Economic Framework', in P Buccirosi, *Handbook of Antitrust Economics*, (The MIT Press, London, 2008) p. 625.

compelled to grant their domestic companies more state aid, so they can continue to compete with firms from other Member States, who'll receive more state aid as well in response to the externalities caused by the granting of state aid to their competitors. Therefore, state aid is *prima facie* prohibited under Article 107 (1) TFEU, except for those cases where the treaty explicitly permits it, such as the public transport sector as is laid down in Article 93 TFEU, services of general economic interest as is laid down in Article 106 (2) TFEU, in as far as is necessary for the proper functioning of the Common Agricultural Policy as laid down in Article 42 TFEU, in the armaments industry as is provided in Article 346 TFEU and in exceptional cases for the rest of the economy as is laid down in Article 107 (2) and (3) TFEU.³⁵

Article 107 (2) TFEU declares three types of aid compatible with the internal market; aid having a social character and granted to individual consumers without discrimination, aid to compensate for the damage causes by natural disasters or exceptional occurrences and lastly aid to compensate for the economic disadvantages caused by the division of Germany.³⁶

Article 107 (3) TFEU subsequently exempts five categories of aid from the prohibition laid down in Article 107 (1) TFEU; aid that is intended to facilitate the economic development of certain disadvantaged regions, aid for the execution of a project of common European interest or to remedy a serious disturbance in the economy, regional aid that has no adverse effect on the internal market, aid to promote cultural and heritage conservation and lastly other kinds of aid that thus be captured by a 'safety net' clause under the exemption.³⁷

Unlike Article 107 (2) TFEU however, all exceptions mentioned under Article 107 (3) are subject to the discretionary power of the Commission, meaning that these categories *may* be deemed compatible with the internal market.³⁸ Outside of the aforementioned categories, which provide a basis for individual exemptions under Article 107 (2) and (3), the Commission has also exempted certain categories of aid

³⁵ P Nicolaidis, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 363-365.

³⁶ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, p. 1093.

³⁷ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1094-1099; C Quigley, *European State Aid Law and Policy*, pp. 181 *et seq.*

³⁸ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, p. 1094; C Quigley, *European State Aid Law and Policy*, pp. 181-185.

collectively in *Commission Regulation No. 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty*.³⁹

3: The Concept of State Aid: The Five Point ‘Test’.

However, it does not make sense to discuss the issue of *compatibility* of a measure with the internal market, before it has been established that the measure at hand constitutes state aid. After all, if a measure can not be defined as ‘state aid’ – thereby falling outside the *jurisdiction* of Article 107 (1) TFEU – there is no duty for the Member State to notify it to the Commission. In those cases, assessing the compatibility of the measure with exemptions for aid compatible with the internal market serves no purpose; there is after all no ‘aid’.

The concept of state aid has – as mentioned in the previous chapter – no clear cut definition under the Treaties, due to the fact that the legislator chose to refer to it by effect, rather than its cause, objective or even its form. Therefore, government interventions in the market in any shape or form could be interpreted as state aid in the light of this provision.⁴⁰ After all, the concept of state aid is defined by reference to its *effect*.⁴¹

Although it is normal for states to play some role in the market – in spite of modern economic thinking favouring a more restrained role for the state resulting in trends such as privatisation and deregulation – governments’ policies and actions continue to discriminatorily favour certain undertakings.⁴² To establish which state actions or measures fall under the prohibition of Article 107 (1) TFEU, the Commission and the Union Courts have developed a five point ‘test’ in their case law and decisional practice, distilling the criteria from the text of the provision. Only when all cumulative criteria of the test are fulfilled the measure is caught by the prohibition, unless it has

³⁹ Commission Regulation No. 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation), [2008] L 214/3.

⁴⁰ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 352 *et seq.*; P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1087 *et seq.*; HW Friederiszick, LH Röller and V Verouden, in P Buccirosi, *Handbook of Antitrust Economics*, pp. 626-629.

⁴¹ Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* [1961] ECR- 1.

⁴² P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, p. 1072.

been notified by the Member State to the Commission, as is obligatory under the duty to notify laid down in Article 108 (3) TFEU.⁴³

The first criterion is that the aid must be ‘granted by the state’ or ‘through state resources’ to an undertaking. The second criterion is that the aid confers ‘an advantage’ to the receiving party. The third criterion is that the aid is ‘selective’ or ‘specific’, meaning that the aid is not of a general nature and that it favours only certain undertakings or the production of certain goods or services. The fourth criterion is that the aid must have ‘an effect on trade between Member States’. The fifth and final criterion is that the aid threatens to ‘distort competition’.⁴⁴ The content and meaning of these five criteria have been shaped by the decisional practice of the Commission and the jurisprudence of the Union Courts over the years.

3 A: ‘Granted by the State’ or ‘Through State Resources’ to an ‘Undertaking’.

A critical first element of the test for state aid is the requirement that aid must be ‘granted by the state’ or ‘through state resources’ to an ‘undertaking’. ‘Granted by the state’ includes all public organs of the Member States, including central governments, ministries and other institutions at central state level but also governments or institutions at a lower regional or local level such as municipalities.⁴⁵ The definition of ‘through state resources’ is intended to capture aid granted by public as well as private bodies established by the state, distributing resources that belong to or are controlled by the state, thereby excluding aid given by wholly private entities such as companies in which the state has no stake of ownership.⁴⁶ An ‘undertaking’ is a natural or legal person engaged in an ‘economic activity’, a term used to define ‘any activity consists in offering goods and services on a given market’ in exchange for remuneration.⁴⁷

⁴³ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, p. 1088; P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 352-356.

⁴⁴ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1088-1093; P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 352 *et seq.*; HW Friederiszick, LH Röller and V Verouden, in P Buccirosi, *Handbook of Antitrust Economics*, pp. 627-629; P Nicolaides, *Essays on Law and Economics of State Aid*, Dissertation, (Maastricht University, 2008) p. 28.

⁴⁵ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 353 *et seq.*; P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1091 *et seq.*

⁴⁶ *Ibid.*

⁴⁷ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, p. 354.

3 B: ‘Aid’ Conferring an ‘Advantage’ to the Beneficiary: The Market Economic Investor Principle.

The second requirement is that the ‘aid’ must confer an ‘advantage’ to the recipients. In order to qualify as ‘aid’, a measure must ‘lighten the burdens normally assumed in an undertaking’s budget.’⁴⁸ This relief grants the receiving undertaking an economic – and thus competitive – ‘advantage’ it would not have enjoyed otherwise, because it could not obtain such a relief under normal market conditions.⁴⁹ This advantage can be a subsidy, loan agreement, guarantee, or capital injection, but also a relief from anything owed by the undertaking to the state, such as taxes or fines, or even a sale or purchasing agreement between the state and the undertaking at a price either higher or lower than under normal market conditions. One can therefore conclude that the definition of ‘aid’ is very wide, due to the fact that it is defined by its effect rather than by its form or objective.⁵⁰

To establish whether a measure whereby the injection of public capital into an undertaking constitutes aid, the ECJ has ruled that the critical issue is ‘whether the undertaking could have obtained the amounts in question on the capital market’.⁵¹ The Court has persisted in applying this test – known as the Market Economic Investor Principle (MEIP), or sometimes Private Investor Principle – to determine whether capital invested by a public investor indirectly constitutes aid.⁵² The essence of this principle is that if the public investment is more favourable for the recipient than a private investment under similar circumstances, there is an ‘advantage’ for the undertaking. A finding of state aid is then almost unavoidable.⁵³

The MEIP’s objective is not to ban public investment in private undertakings, but merely an obligation for public investors to behave in a similar way as private investors. The Principle does however not require public investors to pursue the most profitable investment, maximise return on investment or minimise risk, instead it

⁴⁸ Case T-157/01, *Danske Busvognmænd v. Commission*, [2004] ECR II-917.

⁴⁹ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 354 *et seq.*; P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1089 *et seq.*

⁵⁰ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 355 *et seq.*

⁵¹ Case C-142/87, *Re Tubemeuse: Belgium v Commission*, [1990] ECR I-959.

⁵² P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1089 *et seq.*; P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 356 *et seq.*

⁵³ P Nicolaides and IE Rusu, ‘Private Investor principle: What Benchmark and Whose Money?’, Vol. 2 *European State Aid Law Quarterly* (2011) p. 237; HW Friederiszick, LH Röller and V Verouden, in P Buccrossi, *Handbook of Antitrust Economics*, p. 628.

requires them to conform to an average that is conform the particular sector in which the investment is made.⁵⁴ However, there must always be some interest in long term profitability and an opportunity to make a profit may not be forgone without reason.⁵⁵ In cases of a failure of a public authority to collect or demand repayment of a debt that is due the same Principle applies, in those cases it is sometimes referred to as the Public Creditor Principle.⁵⁶

The MEIP has its origins in decisional practice of the Commission in the 1980's and the standard was subsequently adopted and developed further by the Union Courts.⁵⁷ It is important to realise that the MEIP is always applied without the benefit of hindsight and it is therefore irrelevant whether an investment has actually generated a profit for the hypothetical private investor, but that the burden of proof of conformity with the Principle lies with the public investor.⁵⁸

3 C: A 'Selective' or 'Specific' Advantage.

The third criterion, that of the 'selective' or 'specific' nature of the advantage must be read in the words of Article 107 (1) TFEU, where the article makes reference to 'certain undertakings' and 'certain products'. General measures of economic are hereby implicitly excluded by the provision.⁵⁹

3 D: 'An Effect on Trade between Member States' & 'Distortion of Competition'.

The two final criteria, 'an effect on trade between Member States' and a 'distortion of competition' are generally considered to be fulfilled if the aid is found to be of a 'selective' nature, e.g. after the third condition has been met, making their assessment rather rudimentary in most cases.⁶⁰ The two final criteria are also, in the opinion of the

⁵⁴ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 356 *et seq.*

⁵⁵ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, p. 1090; P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, p. 357.

⁵⁶ P Nicolaides, *Essays on Law and Economics of State Aid*, pp. 40 *et seq.*

⁵⁷ M Köhler, 'New Trends Concerning the Application of the Private Investor Test: The EDF Judgment of the General Court and its Consequences', Vol. 1 *European State Aid Law Quarterly* (2011) p. 21; E Szyzszak, 'The Survival of the Market Economic Investor Principle in Liberalised Markets', Vol. 1 *European State Aid Law Quarterly* (2011) p. 35; P Nicolaides and IE Rusu, 'Private Investor principle: What Benchmark and Whose Money?', Vol. 2 *European State Aid Law Quarterly* (2011) p. 237.

⁵⁸ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, p. 357.

⁵⁹ P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 357-359; HW Friederiszick, LH Röller and V Verouden, in P Buccrossi, *Handbook of Antitrust Economics*, p. 628.

⁶⁰ HW Friederiszick, LH Röller and V Verouden, in P Buccrossi, *Handbook of Antitrust Economics*, p. 628.

Union Courts, inextricably linked.⁶¹ Aid that is found to have an effect on trade between Member States is consequently always found to distort or threaten to distort competition.⁶²

Even reasonably small amounts of aid are found to be able to have an effect on trade between Member States,⁶³ a position that the Court reaffirmed in its landmark *Altmark* ruling.⁶⁴ As a general rule, the Court established in *Phillip Morris*⁶⁵ that if aid reinforces the financial position of an undertaking compared to its competitors, who are also engaging in intra-Union trade, it is found to have an effect on trade between Member States.⁶⁶ A notable exception for some small amounts applies if the amount of aid that is granted falls below the *de minimis* threshold,⁶⁷ laid down in *Commission Regulation No. 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid*.⁶⁸

4: The Legal Basis for Crisis State Aid and its Compatibility with the Internal Market.

Prior to the financial and economic crisis, in the period after the accession of new Member State from Central and Eastern Europe in 2004, the Commission sought to modernise the framework of rules applicable to state aid proceedings. In effect, it intended to complete a fundamental reform of the substantive and procedural rules regarding the compatibility of state aid with the internal market in the period between 2005 and 2009. The reforms had as its goal to ensure that by implementing a more economic approach to the substance of the cases and more efficient proceedings, less and better targeted state aid would be granted by the Member States in the future.⁶⁹ These reforms lead to the adoption of instruments such as the *Block Exemption Regulation*⁷⁰ and the *De Minimis Regulation*.⁷¹ Initially these reforms were a success,

⁶¹ P Nicolaides, *Essays on Law and Economics of State Aid*, p. 28.

⁶² Case T-288/97, *Regione Autonoma Friuli-Venezia Giulia v Commission*, [2001] ECR II-1169.

⁶³ Case T-214/95, *Het Vlaamse Gewest v Commission*, [1998] ECR II-717.

⁶⁴ Case C-280/00, *Altmark Trans GmbH & Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, [2003] ECR I-7747.

⁶⁵ Case C-730/79, *Philip Morris Holland BV v Commission*, [1980] ECR 2671.

⁶⁶ P Craig and G De Búrca, *EU Law: Text, Cases and Materials*, pp. 1092 *et seq.*; P Nicolaides, in I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 359 *et seq.*

⁶⁷ Case C-351/98, *Spain v Commission*, [2002] ECR I-8031.

⁶⁸ Commission Regulation No. 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid, [2006] L 379/5.

⁶⁹ C Quigley, *European State Aid Law and Policy*, pp. 179 *et seq.*

⁷⁰ Commission Regulation No. 800/2008, [2008] L 214/3.

resulting in a decline of the total amount of state aid, to about ~0.5% of the EU-27 GDP.⁷²

The incipient financial crisis led to a drastic reversal of that downward trend after mid-2007, when the fragile system of financial markets was confronted with a rapidly destabilising chain of events. The first government-backed takeovers of banks came shortly after a bank run on *Northern Rock* in the United Kingdom, a bank that was overly reliant on short term capital, and several German *Landesbanken* who also experienced difficulties.⁷³ The granting of state aid to banks really exploded after *Lehman Brothers* collapsed in the fall of 2008.⁷⁴ The Commission quickly realised that it was dealing with an exceptional situation, wherein potentially a large number of banks required capital injections or some other form of state support in a short timeframe to limit systemic risk and prevent contagion of the real economy.⁷⁵ What distinguishes banks from normal competing firms – apart from their social function as lenders to the rest of the economy – is the fact that their balance sheets are interconnected. Contrary to normal markets, the collapse of large bank is therefore likely to be harmful – instead of beneficial – for its competitors. Consequently, the distortion of competition of state aid to a systemically important bank is likely less grave than the impact of a collapse of that same bank might have on its competitors.⁷⁶

The Commission was concerned with the sudden increase in state aid, but was at the same time convinced that appropriate state aid control was part of the solution of the crisis.⁷⁷ Therefore, the Commission sought to provide Member States with the tools to effectively support the financial sector. To meet this goal, the Commission adopted

⁷¹ Commission Regulation No. 1998/2006, [2006] L 379/5.

⁷² C Quigley, *European State Aid Law and Policy*, pp. 179 *et seq.*

⁷³ J Vickers, 'The Financial Crisis and Competition Policy: Some Economics', Vol. 12 No. 1 *Global Competition Policy* (2008) p. 2; N Kroes, 'Competition policy and the Crisis – the Commission's Approach to Banking and Beyond', Vol. 55 No. 4 *The Antitrust Bulletin* (2010) p. 715.

⁷⁴ N Kroes, Vol. 55 No. 4 *The Antitrust Bulletin* (2010) p. 715.

⁷⁵ H Gilliams, 'Stress Testing the Regulator: Review of State Aid to Financial Institutions After the Collapse of Lehman', Vol. 1 *European Law Review* (2011) p. 3.

⁷⁶ Commission Staff Working Paper, 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis', SEC (2011) 1126, p. 25; B Lyons, Vol. 5 No. 2 *Competition Policy International* (2009), p. 25; RM D'Sa, 'Instant State Aid Law in a Financial Crisis – A U-turn?', Vol. 2 *European State Aid Law Quarterly* (2009) p. 139; E Adler *et al.*, Vol. 1 No. 1. *Journal of European Competition Law & Practice* (2010), p. 66; T Beck *et al.*, *Centre for Economic Policy Research* (2010), pp. 10-15.

⁷⁷ N Kroes, Vol. 55 No. 4 *The Antitrust Bulletin* (2010) p. 715; D Gerard, 'Managing the Financial Crisis in Europe: Why Competition Law is Part of the Solution, Not of the Problem', Vol. 1 *Global Competition Policy* (2008) p. 2.

four Communications between October of 2008 and July of 2009 – three Communications devoted to crisis aid to financial institutions and one on state aid to undertakings in the real economy – which sought to explain how the Commission would apply the state aid rules to state aid granted in response to ensuing financial crisis.⁷⁸ It is widely accepted that the approach adopted by the Commission was less strict than before.⁷⁹ The Commission acknowledged that the appropriate legal basis for these state aid in these was Article 107 (3) (B) TFEU, which declares aid to ‘remedy a serious disturbance in the economy of a Member State’ to be compatible with the internal market.⁸⁰

5: The Temporary Framework for State Aid to Financial Institutions adopted in 2008-2009.

With the aim of returning as many financial institutions to long term viability in and orderly and structured approach,⁸¹ the *Communication from the Commission of 13 October 2008 on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis* was adopted first.⁸² This Communication provided that state support schemes for financial institutions were eligible for an accelerated approval procedure by the Commission, provided they fulfil certain proportionality criteria.⁸³ In December of that year, after the lending possibilities for the actors in the real economy had been diminishing, the Commission decided to support the member States, who wanted to provide banks with capital injections, by adopting the *Communication from the Commission of 8 December 2008 on the recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue*

⁷⁸ N Kroes, Vol. 55 No. 4 *The Antitrust Bulletin* (2010) p. 715; S Gebski, Vol. 6 Issue 1 *The Competition Law Review* (2009), p. 89; P Nicolaidis and IE Rusu, Vol. 55 No. 4 *The Antitrust Bulletin* (2010), p. 759.

⁷⁹ P Werner and M Maier, ‘Procedure in Crisis? Overview and Assessment of the Commission’s State Aid Procedure during the Current Crisis’, Vol. 2 *European State Aid Law Quarterly* (2009) p. 177; P Nicolaidis and IE Rusu, Vol. 55 No. 4 *The Antitrust Bulletin* (2010), p. 75; D Gerard, ‘EC Competition Law Enforcement at grips with the Financial Crisis: Flexibility on the Means, Consistency in the Principles’, No. 1 *Concurrences* (2009) p. 46.

⁸⁰ S Gebski, Vol. 6 Issue 1 *The Competition Law Review* (2009), p. 89; P Nicolaidis and IE Rusu, Vol. 55 No. 4 *The Antitrust Bulletin* (2010), p. 759; E Adler *et al.*, Vol. 1 No. 1. *Journal of European Competition Law & Practice* (2010), p. 66; H Gilliams, Vol. 1 *European Law Review* (2011) p. 3.

⁸¹ Commission Staff Working Paper, SEC (2011) 1126, p. 23.

⁸² Communication from the Commission of 13 October 2008 on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis, [2008] OJ C 270/8.

⁸³ I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, p. 473; Commission Staff Working Paper, SEC (2011) 1126, p. 25.

distortions of competition.⁸⁴ The intentions of this second Communication were threefold; to restore banks' financial stability, to ensure lending to the real economy and to avoid the systemic risk of the insolvencies of banks that were *too big too fail*.⁸⁵ The aforementioned instruments were critical in coping with the ensuing crisis, but provided insufficient basis for resolving the complicated situations of banks coping with huge amounts of impaired assets, such as the 'toxic' derivatives. To cope with the specific issues these banks experienced, the Commission adopted a third instrument, the *Communication from the Commission of 25 February 2009 on the treatment of impaired assets in the Community banking sector*.⁸⁶ The Communication provided a basis for asset relief by the Member States, a measure whereby governments could directly deal with the uncertainty about the value of assets held by the banks, reviving confidence in the sector and thereby improving financial stability.⁸⁷ Those Communications were complemented by the *Communication from the Commission of 23 July 2009 on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the state aid rules*.⁸⁸ This communication was aimed at securing the long-term viability of financial institutions by requiring bailed out banks to submit a detailed restructuring plan and gave the Commission the a basis for the imposition of structural measures until after the timeframe reserved for the implementation of restructuring measures.⁸⁹ It is regarded as the most important instrument for the banking sector adopted in the light of the crisis, requiring far reaching measures to ensure a return to viability, such as

⁸⁴ Communication from the Commission of 8 December 2008 on the Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, [2009] OJ C 10/2.

⁸⁵ Commission Staff Working Paper, SEC (2011) 1126, pp. 26 *et seq.*; I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 475 *et seq.*

⁸⁶ Communication from the Commission of 25 February 2009 on the treatment of impaired assets in the Community banking sector, [2009] OJ C 72/1.

⁸⁷ Commission Staff Working Paper, SEC (2011) 1126, pp. 29 *et seq.*; I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 478 *et seq.*

⁸⁸ Communication from the Commission of 23 July 2009 on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the state aid rules, [2009] OJ C195/9.

Commission Staff Working Paper, SEC (2011) 1126, pp. 29 *et seq.*; I Kokkoris and R Olivares-Caminal, *Antitrust Law Amidst Financial Crisis*, pp. 479 *et seq.*

withdrawal from risky areas and loss making business sectors and forces banks to concentrate on their most profitable core business.⁹⁰

6: Extension of the Temporary Framework of Crisis Aid in 2010-2012.

Using the framework of Communications, the Commission was able to quickly and effectively deal with a vast amount of state aid notifications over the past few years.⁹¹ The vast majority of aid – an amount exceeding 30% of the EU-27 GDP – was granted during the period between October 2008 and December 2010 and accounted for over 10% of the total assets in the financial sector of the European Union. The majority of the aid was granted in those Member State which had the biggest banking sectors, the top three being the United Kingdom, France and Germany distributing about 60% of the aid.⁹² Despite the fact that the Commission took over 300 approval Decisions, in some of which it imposed strict restructuring requirements upon the recipients of the aid and the magnitude of the financial stakes, there have been relatively few – four – appeals to the European Union Courts, leaving the legal basis of Article 107 (3) (B) TFEU relatively untested.⁹³ Moreover, in two of those appeals, *ING*⁹⁴ and *ABN Amro*⁹⁵, the applicants only sought partial annulment of the Commission's respective Decisions.⁹⁶

As regards the phasing out of the aid, the transition of the financial crisis into an economic crisis followed by a sovereign debt crisis has made it clear that a complete phasing out of the Framework is still far away, despite the fact that the worst case scenario of a collapse of the financial markets was clearly avoided.⁹⁷ The possibility that banks in the near future could be exposed to a deepening of the Eurozone crisis,⁹⁸

⁹⁰ I Taylor, U Soltész, P Anestis and E Navarro, 'Recent Developments in the Application of State Aid Rules', Vol. 6 No. 2 *European Competition Journal* (2010) p. 491; Commission Staff Working Paper, SEC (2011) 1126, pp. 30 *et seq.*

⁹¹ FC Laprévotte, Vol. 1 *European State Aid Law Quarterly* (2012), p. 93; G Koopman, 'Stability and Competition in EU Banking during the Financial Crisis: The Role of State Aid Control', Vol. 7 No. 2 *Competition Policy International* (2011).

⁹² C Quigley, 'Review of the Temporary State Aid Rules Adopted in the Context of the Financial and Economic Crisis', Vol. 3 No. 3 *Journal of European Competition Law & Practice* (2012) p. 237.

⁹³ FC Laprévotte, Vol. 1 *European State Aid Law Quarterly* (2012), p. 93; C Quigley, Vol. 3 No. 3 *Journal of European Competition Law & Practice* (2012) p. 237.

⁹⁴ Cases T-29/10 and T-33/10, *Kingdom of The Netherlands v Commission and ING Groep NV v Commission*, Judgment of 2 March 2012, not yet reported.

⁹⁵ Pending Case T-319/11, *ABN Amro Group v Commission*, not yet reported.

⁹⁶ FC Laprévotte, Vol. 1 *European State Aid Law Quarterly* (2012).

⁹⁷ C Quigley, Vol. 3 No. 3 *Journal of European Competition Law & Practice* (2012) p. 237.

⁹⁸ DN Chorafas, *Sovereign Debt Crisis: The New Normal and the Newly Poor*, (Palgrave Macmillan, Hampshire, 2011) pp. 238-245.

and possibly a sovereign default of one of the Member States has lead the Commission to prolong the Framework by adopting the *Communication from the Commission of 1 December 2010 on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis*⁹⁹ and *Communication from the Commission of 6 December 2011 on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis*.¹⁰⁰

⁹⁹ Communication from the Commission of 1 December 2010 on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis, [2010] OJ C 329/7.

¹⁰⁰ Europa Rapid Press Release, *Commission extends crisis rules for banks*, 1 December 2011, IP/11/1488; Communication from the Commission of 6 December 2011 on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, [2011] OJ C 356/02.

III: Individual Phase-Outs of Banks.

1: A Total Collective Phase-Out seems Far Away.

In the final paragraphs of the last chapter it was already established that a total phase-out of the Framework is a matter for the not so near future as the Commission had hoped when it first implemented the Communications on state aid to financial institutions. The future of this Framework will be discussed in the fourth and fifth chapters. This third chapter aims to provide the reader with an overview of the issues raised by individual ‘early exits’ of banks. A complete overview of all phase-outs of aid can not be given due to the sheer magnitude of the aid measures taken in the light of the crisis. Alternatively, this chapter aims to highlight some noteworthy cases that deal with essential elements of individual phase-outs.

2: ‘Early Exits’

The temporary nature of the Framework and the need for an exit strategy has been emphasized time and again by the Commission as well as the Member States. In this respect, ‘early exits’ do not seem to be an issue of importance. One would almost be compelled to think that the sooner some banks repay the aid they received, the better. In literature, academics have distinguished two issues raised by these ‘early exits’. Firstly the possibility that an early exit will grant an extra advantage and secondly that early repayment will actually diminish the amount of aid granted, thereby warranting a reduction in the restructuring requirements imposed by the Commission. This second issue has, until now, not resulted in any decisional practice.¹⁰¹

3: ING: A First Judicial Review of an ‘Early Exit’

The possibility that an early repayment of a capital injection received by ING from the Dutch state could constitute an ‘additional advantage’ lay at the heart of the ING case. By an amendment to the agreement with the Dutch state, which gave the bank the opportunity to repay ahead of schedule, ING allegedly saved up to €2 billion. The

¹⁰¹ FC Laprévotte, Vol. 1 *European State Aid Law Quarterly* (2012), p. 93.

Commission adopted a Decision, finding additional aid of €2 billion had been granted without notification.¹⁰²

On appeal, the General Court disagreed with the Commission's finding of state aid, on the ground that the renegotiated deal gave the Netherlands a guaranteed return on investment which in all likelihood would be accepted by a private investor.¹⁰³ This Judgment is not only the first time one of the Union Courts has reviewed one of the state aid measures taken under the Framework, it has also confirmed that the pinnacle of state aid definition, the MEIP principle, is also at the heart of state aid assessment under the Framework. The Judgment gives banks and national governments some room to renegotiate agreements and therefore makes it easier for banks to seek an 'early exit'. However, a Commission appeal is currently pending at the European Court of Justice, so the final outcome of this case is still unknown.

¹⁰² Commission Decision of 18 November 2009 on the state aid implemented by The Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan C 10/2009 (ex N 138/2009), [2010] OJ L 274/139.

¹⁰³ Cases T-29/10 and T-33/10, *Kingdom of The Netherlands v Commission and ING Groep NV v Commission*, Judgment of 2 March 2012, not yet reported.

IV: Phasing Out of the Framework

1: Reasons for Phasing Out of the Framework.

Individual exit strategies for banks are not sufficient to phase out the Temporary Framework completely. The Commission plans to phase out the entire temporary framework because its continued existence causes a number of issues. Although the emergency Decisions that have been taken are in accordance with the basis of state aid rules and competition principles, they still amount to state aid and are therefore examples of government interventions in the market on an unprecedented scale.¹⁰⁴ Keeping the financial sector at this support level is a financial impossibility –with some reports suggesting an amount as high as one third of the EU-27 GDP was either guaranteed or injected into the banks – for the Member States. Moreover, it would also allow banks with structural problems to avoid necessary restructuring measures to cope with these problems and persist to rely on state aid. The distorted competition caused by such a situation would undermine the functioning of healthy banks on the markets and therefore in itself be a new impediment for the return to a normal financial services market.¹⁰⁵

The Framework was always meant to be temporary; one of its three main principles was that the implementing measures already needed to address the eventual return to a normal functioning market with a long-term viable financial sector and banks operating without state support as the eventual goals.¹⁰⁶

The temporary nature of the Framework is also evident from its automatic expiry at a certain date, instead of having the form of permanent legislative measures. The expiry has been prolonged two times already, as a more gradual phase-out was preferred due to the perseverance of the financial and economic crisis. Further state aid measures may be necessary in the near future, as several banks are exposed to the spill-over effects of the current European sovereign debt crisis. Yet each expiration date

¹⁰⁴ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 2, 39

¹⁰⁵ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 24;

Commission Staff Working Paper on *The effects of temporary State aid rules adopted in the context of the financial and economic crisis*, SEC(2011) 1126 final, 5 October 2011, p. 87-89

¹⁰⁶ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 6

provides for a moment of evaluation and allows for changes in the Framework that accommodate its gradual elimination.¹⁰⁷

Because just as the Temporary Framework itself was necessary to preserve a level playing field, a regulated phasing out of the whole system is now necessary¹⁰⁸ to maintain a level playing field, so banks in different stages of the phase-out are not causing unfair competition to each other and to healthy banks, irrespective of whether those banks have been continuously healthy or have been healthy since an injection of state aid. The phasing out is a particular tricky phase for banks that have been nationalised during the crisis and will have to be returned to private ownership in the near future.¹⁰⁹ As explained in the third chapter, exit strategies for individual banks can also include hidden state aid measures, and a collective phase-out of the whole system initiated by the Commission could prevent that.

2: Principles behind the Phase-Out.

The phase-out has to be gradual, since the financial crisis might slowly be coming to an end, but the continuing sovereign debt crisis is likely to have severe implications for the functioning of the market and the debt levels of banks as well.¹¹⁰ The phase out process also needs to be sufficiently flexible, to accommodate the specific situations in the different Member States (which are still in very different points at the recovery process)¹¹¹, to deal with set-backs in the recovery process, to be able to respond to unexpected market developments and the continued fragility of the market.¹¹²

Timing is of great importance during the phase out. A balance has to be sought between waiting for the markets to be strong enough again and returning quickly

¹⁰⁷ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 40; Communication from the Commission on *The application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis*, OJ C 329 / 7, 7.12.2010, no. 7, 17

¹⁰⁸ DG Competition, *Review of guarantee and recapitalisation schemes in the financial sector in the current crisis*, 10.8.2009, no. 5, 6; Campo 2011, p. 42

¹⁰⁹ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 38

¹¹⁰ F.C. Lapr evote, 'Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules', in: *European State Aid Law Quarterly*, Berlin: Lexxion 2012, p. 111.

¹¹¹ 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*, 30.04.2010, p. 1-4.

¹¹² *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 23, 44 (conclusion); Campo 2011, P. 42-44

enough to market conditions to avoid structurally unhealthy banks from creating risks of contagion and systemic risk.¹¹³

3: Start of the Phase-Out: Removal of Government Guarantees on Bank Liabilities.

The phase out of the scheme commenced when the Commission tightened the terms for government guarantees on bank liabilities in July 2010.¹¹⁴ Government guarantees on bank liabilities were chosen from the three main forms of aid used in the EU within the banking crisis because they addressed the access of banks to short-term funding, a problem that started in September 2008 but was already mostly over in the summer of 2009.¹¹⁵ Already in December 2009 the ECOFIN expressed its willingness to commence the abolishment of these measures,¹¹⁶ A number of Member States had already abolished their government guarantees on bank liability schemes,¹¹⁷ a process which was later backed up by empirical evidence showing the number of banks relying on these schemes was shrinking while it gave a significant economic advantage to those banks that still had a lower estimated creditworthiness.¹¹⁸

The tighter rules consisted of higher fees for government guarantees on bank liabilities and a viability review for the banks still relying heavily on them.¹¹⁹ The higher fees were meant to bring the guarantees closer to normal market conditions, decreasing the distortion of competition and making the step to switching to market-based funding smaller. Also the amount of the increase dependent on the credit rating of the individual banks, in order for the system to reflect market conditions more closely.¹²⁰ The viability review aimed, at the same time, at figuring out which of the

¹¹³ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 24

¹¹⁴ Announced by the Commission in May 2010

¹¹⁵ 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*, 30.04.2010, p. 2-4.

¹¹⁶ ECOFIN and Council of the European Union, *Council Conclusions*, Brussels, 2 December 2009, 16838/09.

¹¹⁷ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 28

¹¹⁸ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 29-30; 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*, 30.04.2010, p. 1-2.

¹¹⁹ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 32; Laprévote 2012 p. 97-99.

¹²⁰ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 33+35; DG Competition Staff Working Document on *The Application*

banks using the guarantee scheme were using it because of underlying structural problems, and which actually only had short-term funding problems. This could help the banks address these problems and force their hand bank exposing their problems to the market. The data could then later be used to decide on the individual banks and evaluate the whole scheme itself.¹²¹

The other two forms of state aid, recapitalisation and asset relief, could not be collectively phased out yet as they address more structural problems resulting from the actual decrease of bank capital leverage by the devaluation of bad assets.¹²²

4: Renewal of the Framework and Removal of the Difference between Sound and Unsound Banks.

The second stage in the phase-out of the Temporary Framework was engaged by the Commission in the end of 2010, when the framework was set to expire and had to be renewed in order to keep functioning. The Commission took this opportunity to combine the renewal with new measures to accommodate the phase-out.¹²³

The most important of these measures was the removal of the distinction between fundamentally sound and distressed banks, requiring all banks under state aid to submit a restructuring plan. This was a signal from the Commission to indicate to the market that it regarded the most critical part of the crisis to be over. In the view of the Commission it was not necessary anymore for healthy banks to rely on state aid as operating aid, meaning that it regarded any bank still relying on state aid as fundamentally unsound and in need of restructuring. This measure was intended to discourage healthy banks from ‘abusing’ the crisis aid to ask for government funding at lower-than-market prices and to encourage them to repay the aid as quickly as possible, to minimise the number of banks relying on state in some form or another.¹²⁴

Of State Aid Rules To Government Guarantee Schemes Covering Bank Debt To Be Issued After 30 June 2010, 30.04.2010, p. 2-4.

¹²¹ *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 34-35, 41.

¹²² *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, no. 26-27, 36

¹²³ *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 / 04, 19.08.2009.

¹²⁴ *Commission Staff Working Paper on The effects of temporary State aid rules adopted in the context of the financial and economic crisis*, SEC(2011) 1126 final, 5 October 2011, p. 106-107

As for government guarantees on bank liabilities, statistical analysis showed that the number of requests by banks had sharply decreased and the total amount of guaranteed liabilities had decreased as well. Only 9 Member States still had guarantee schemes for in place. However, macroeconomic factors – such as the sudden emergence of a sovereign debt crisis in Member States such as Greece and Ireland – and the fact that a large amount of bank debt would fall due in the second half of 2011, led the Commission to prolong the framework for these measures for six more months, until July 2011¹²⁵ and another time at a later moment by means of a Working Document until December 2011.¹²⁶

5: 2012: Adoption of the Renewal and Banking Package.

The Temporary Framework was set to expire again in December 2011 and although the Commission first planned to let it do so¹²⁷, the ongoing sovereign debt crisis and continued reliance of banks on the temporary aid measures forced it to reconsider, also in the light of the "Banking Package" adopted by the European Council, which forced banks to work towards a level of 9% Tier 1 capital before September 2012.¹²⁸ However, much like in the final months of 2010, the Commission took this opportunity to introduce some changes to the Framework. An eye catcher is the fact that instead of moving the deadline with another year just like last year's Communication, the new Communication has no expiry time. The Commission seems to have braced itself for a longer crisis and given certain permanence to some crisis measures.¹²⁹

Then there are some small measures expanding on the existing temporary framework.

¹²⁵ Communication from the Commission on *The application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis*, OJ C 329 / 07, 7.12.2010, no. 10.

¹²⁶ 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 2011*, 01.06.2011, p. 2-5.

¹²⁷ 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 2011*, 01.06.2011.

¹²⁸ Communication from the Commission on *The application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis*, OJ C 356 / 02, 6.12.2011, No. 3.

¹²⁹ Communication from the Commission on *The application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis*, OJ C 356 / 02, 6.12.2011, No. 4.

F.C. Laprévotte, 'Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules', in: *European State Aid Law Quarterly*, Berlin: Lexxion 2012, p. 93-112, addendum.

Firstly, there are new guidelines on remuneration of state aid in instruments that do not bear a fixed return (like stock).¹³⁰

Secondly, guidelines were created on government guarantees on mid-term funding for bank liabilities. Since most banks still relying on state guarantees to solve their funding needs were now considered to have structural problems their funding needs moved from short-term to mid-term (1-5 years) so additional rules on government guarantees on mid-term bank liabilities were necessary.¹³¹

¹³⁰ Communication from the Commission on *The application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis*, OJ C 356 / 02, 6.12.2011, no. 6-14.

¹³¹ Communication from the Commission on *The application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis*, OJ C 356 / 02, 6.12.2011, no. 15-22.

V: Post-Crisis: What Kind of Framework is Necessary?

The Commission is currently preparing new guidelines for the rescue and restructuring of financial institutions and bases itself for that on the Temporary Framework for state aid¹³² as part of its plan for the modernisation of the entire European state aid framework.¹³³ The first parts of the package are expected in the autumn of 2012 while the rest is to be progressively completed towards the end of 2012.¹³⁴

The Temporary Framework was put in place by means of in principle non-binding Communications, that indicated which forms of temporary state aid the Commission would approve under the existing framework for state aid and under which conditions. This is an attractive way of responding to crises that tackle whole business sectors instead of individual companies as it allows for fast decision making but offers some guarantees of equal treatment and transparency.

Then there are a couple of elements in the temporary crisis Framework that did not exist before its implementation and have proven their usefulness in fighting the crisis and were lauded by the European Commission.

One such element is the introduction of restructuring requirements. Restructuring as a requirement for state aid on the principle that state aid is not just a punishment; the result should always be a bank that is stable and competitive on the market again. The Director General for Competition coined it in the phrase "*While some banks may have been too big to fail, none are too big to restructure*".¹³⁵

A second element is the use of monitoring trustees. The use of monitoring trustees just like trustees in a merger case, to monitor individual banks and report back to the Commission at certain intervals.¹³⁶

¹³² Commission Staff Working Paper on *The effects of temporary State aid rules adopted in the context of the financial and economic crisis*, SEC(2011) 1126 final, 5 October 2011, conclusion.

¹³³ *Communication on EU State Aid Modernisation (SAM)*, 8 May 2012, COM(2012) 209 final, no. 18.

¹³⁴ *Communication on EU State Aid Modernisation (SAM)*, 8 May 2012, COM(2012) 209 final, no. 27.

¹³⁵ P Lowe, Speech on *The Eurofi Financial Forum 2009*, Göteborg, 29 September 2009.

¹³⁶ F.C. Lapr v te, 'Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules', in: *European State Aid Law Quarterly*, Berlin: Lexxion 2012, p. 107; *Round Table on Exit Strategies - Note by the delegation of the European Union*, DAF/COMP/WD(2010)38, No. 37

Guidelines for remuneration of state aid, also if the remuneration is in stock, so the state-aid, would be stopped from becoming a competitive advantage, at least in the long run.¹³⁷

Burden sharing, where the state requires the bank to be rescued to limit its bonuses to management, refrain from paying out dividend, and pay part of the restructuring efforts with own capital. The limiting of bonuses can still be problematic because of standing legal obligations and could possibly use some legal backup. This could be done at the European or national level but we saw no discussion at the European level as far as our research went.¹³⁸

Under the flexible approach of the Commission, banks and governments can scale up and down on the amount of aid depending on the progression on the crisis fairly easy.

Although these elements seem useful for the future, the Commission in her working papers also stresses the importance of effective financial sector regulation as a form of prevention, rather than to state aid rules as a form of damage control. It describes the relation between state aid rules and financial sector regulation as intertwined. We can see how close the two come together when you compare the 2011 stress tests under current financial sector regulations and the viability and restructuring plans under the state aid temporary framework.¹³⁹

¹³⁷ P. Lowe, Speech on *The Eurofi Financial Forum 2009*, Göteborg, 29 September 2009; Laprévote 2012 p. 99-100 (point b).

¹³⁸ F.C. Laprévote, 'Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules', in: *European State Aid Law Quarterly*, Berlin: Lexxion 2012, p. -100-101 (point c).

¹³⁹ Commission Staff Working Paper on *The effects of temporary State aid rules adopted in the context of the financial and economic crisis*, SEC(2011) 1126 final, 5 October 2011, p. 108.

VI: Analysis

The Temporary Framework has proven to be an essential toolbox in the hands of the Commission, who have successfully employed the instruments contained therein to cope with a waterfall of state aid notifications in the first years of the financial and economic crisis. It is widely accepted that the Commission's policy has been a success. The twin objectives of the Commission's policy *vis a vis* state aid granted to financial institutions were, firstly, to promote financial stability, stop widespread unrest in the markets and support a restoration of trust. The second objective was to safeguard the internal market, maintain a level playing field between banks and prevent undue distortions of competition.¹⁴⁰

The Commission has successfully accomplished both objectives, although most authors also agree that the Commission had adopted a flexible approach, distinctively different from its previously strict approach as regards state aid cases. At the same time, this approach reassured all parties that the primacy of state aid control was, as always, firmly in the hands of the Commission and not in the hands of the Member States themselves. By insisting that Member States, even in the hectic moments of bank's near-collapse, adhere to the principles of EU state aid law, the Commission has secured its position in a time when national governments were the most prominent actors. One author therefore described the Commission's policy as 'flexibility on the means, consistency in the principles'.¹⁴¹

It is currently too early for a collective phase-out of the complete Framework, although the Commission has tightened the requirements for some measures. It is more likely that the Framework will transform over time into an instrument with a more permanent character, possibly in conjunction with the adoption of new regulations for the financial sector. The recent ING Judgment has demonstrated that 'early exits' by individual banks are possible.

¹⁴⁰ Commission Staff Working Paper, 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis', SEC (2011) 1126, p. 24; A Bomhoff, A Jarosz-Friis and N Pesaresi, 'Restructuring banks in crisis – overview of applicable State aid rules', No.2 *Competition Policy Newsletter* (2009) p. 3.

¹⁴¹ D Gerard, No. 1 *Concurrences* (2009) p. 46.

VII: Conclusion

The Temporary Framework for the rescue of financial institutions that had been adopted over the past few years since 2008 has been considered a success. Many banks were saved and a collapse of the financial system has been avoided. But temporary measures have an end and in this paper we have tried to give an overview of exit strategies for individual banks and the European Union as a whole.

Neelie Kroes, who was European Commissioner for Competition in the first years of the crisis said, only a month before the framework was renewed for the first time in 2009, ‘if we don't end the Temporary Framework as planned at the end of the 2010, it could be a slippery slope back into protectionism’.¹⁴²

Two years later the framework has again been renewed, this time for an indefinite amount of time, the question is begging: are we sliding down that slippery slope?

We do not think this is necessarily correct. Although the financial crisis seemed to be under control after 2010 and financial markets were more or less stable, seamless transition into a sovereign debt crisis proved a new challenge for banks in the European Union, creating new problems for banks holding investments in Mediterranean countries and Ireland. Furthermore the Temporary Framework has not been renewed blindly. Tighter controls and further regulation on banking were introduced, although big changes were lacking in the latest prolongation.

Our main concern, however, is the lack of an expiry date in the last renewal. An expiration date creates a moment for evaluation, and not only to see if the entire Framework is still necessary, but also to see if small improvements or smaller steps towards an eventual phase out need to be taken.

As the Commission already has announced, it plans a permanent framework for rescuing and of restructuring financial institutions. In the future, it is therefore not unlikely that we might see the Temporary Framework seamlessly morph into a permanent role.

¹⁴² N Kroes, *Policy Keynote address*, European State Aid Law Institute, London, 27th November 2009, SPEECH/09/560.

