3. State aid and the financial sector: the evolution of the legal framework of State aid law

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1. INTRODUCTION

In mid-2008 the financial crisis hit the economies of EU Member States in an unprecedented way. Many EU governments took measures to support financial stability, to restore confidence in the financial markets and to minimize the risk of a credit crunch. Since the beginning of the crisis, the European Commission's objectives in applying the competition rules have been twofold. First, to support financial stability by giving, as quickly as possible, legal certainty to rescue measures taken by EU Member States and, second, to maintain a level playing field in Europe and ensure that national measures would not export problems to other Member States.

Early on in the crisis, the Member States decided to inject large amounts of State aid into the financial sector. The European Commission became involved, through its powers to scrutinize State aid under the competition provisions of the TFEU. From the beginning of the crisis, competition policy and advocacy played an essential role in preserving one of the EU's internal markets.

When the financial crisis erupted in Europe, there were no specific rules applying to State aid control in the financial sector. The aid granted for rescuing and restructuring financial institutions in difficulty was assessed using the Rescue and Restructuring Guidelines[1] dealing with restructuring aid to ailing companies and were based on Article 107(3)(c) of the TFEU. For example, the Commission assessed the aid provided to institutions like Crédit Lyonnais,[2] BAWAG-PSK,[3] Banco di Napoli,[4] Bankgesellschaft Berlin[5] and West Deutsche Girozentrale[6] under the Rescue and Restructuring Guidelines.

* The views expressed in this chapter are those of the author and may not in any circumstances be regarded as stating an official position of the European Commission.

1 Community Guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OJ C244/2, and the (new) Commission Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty [2014] OJ C249/1.

2 Commission Decision on aid granted by France to the Crédit Lyonnais group (Case C-47/1996) [1998] OJ L221/28.

3 Commission Decision on State guarantee granted to BAWAG-PSK by Austria (Case C-50/2006; ex NN 68/2006) [2008] OJ L83/7.

4 Commission Decision 99/288/EC giving conditional approval to the aid granted by Italy to Banco di Napoli (Case C(1998) 2495) [1999] OJ L116/36.

5 Commission Decision 2005/345/EC on restructuring aid implemented by Germany for Bankgesellschaft Berlin AG (Case C(2004) 327) [2005] OJ L116/1.

6 Commission Decision C(2008)1628 on Rescue aid to WestLB (Case NN 25/2008) [2008] OJ C189/3.

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In the new environment it became clear that the State aid rules which applied to banks' restructuring in normal times needed significant and rapid adaptation.

Since the beginning of the financial crisis, the Commission has acted quickly by flexibly adapting the application of State aid control to the special crisis context. Between 2008 and 2013, the Commission issued seven communications (referred to together as the 'Crisis Communications'), based on the exceptional legal basis of Article 107(3)(b) TFEU. This provision considers that State aid can be declared compatible with the internal market if it is granted to 'remedy a serious disturbance of the economy of a Member State'.

The seven Crisis Communications provide a comprehensive framework for common conditions at the EU level for access to public support and the requirements for such aid to be compatible with the internal market in light of State aid principles. These rules have been regularly updated where necessary to adapt to the evolution of the crisis. In chronological order, they include:

13 October 2008 – 2008 Banking Communication.[7] Established the general principles of supporting banks during the financial crisis and provided guidance on the pricing of guarantees, recapitalizations, winding-up, liquidity assistance and procedural aspects.
5 December 2008 – Recapitalization Communication.[8] Complemented the 2008 Banking Communication and refined the approach to recapitalization of banks.
25 February 2009 – Impaired Assets Communication.[9] Provided guidance on asset purchases, insurance and hybrid schemes.
14 August 2009 – Restructuring Communication.[10] Provided guidance on how to restore long-term viability of banks in difficulty while ensuring burden sharing and minimizing competition distortions.
1 December 2010 – 2010 Prolongation Communication.[11] Provided updates on conditions for guarantees to incentivize exit from State support.
1 December 2011 – 2011 Prolongation Communication.[12] Provided guidance on guarantees and equity, extended the crisis rules and linked the restructuring of banks to the sovereign crisis.
1 August 2013 – 2013 Banking Communication.[13] Replaced the 2008 Banking

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[7] Commission Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis [2008] OJ C270/8.

[8] Commission Communication on 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 C10/2.

[9] Commission Communication on the treatment of impaired assets in the Community banking sector [2009] OJ C72/1.

[10] 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 [2009] OJ C195/9.

[11] Commission Communication 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 [2010] OJ C329/7.

[12] Commission Communication 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 C356/7.

[13] Commission Communication on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis [2013] OJ C216/1.

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Communication, adapted and complemented the Recapitalization and Impaired Assets Communications, and supplemented the Restructuring Communication. Introduced a more effective restructuring process, strengthened burden sharing requirements and provided for the application of strict remuneration policies.

Public support granted to banks in difficulty takes the following forms: liquidity support, capital support and impaired assets measures.

(a) Liquidity Support

Liquidity support takes the form of State guarantees, direct lending by the State and other types of liquidity support and provision of liquidity by central banks.

The bulk of aid granted by Member States during the financial crisis to their respective banking systems was in the form of guarantees on liabilities. These are State guarantees on debt instruments newly issued by banks. In Member States with strong creditworthiness the banks were able, thanks to the State guarantee, to raise funding from the market. In Member States with low creditworthiness it was difficult to find investors ready to subscribe to banks' debt instruments, even if the instrument was guaranteed by the State. In those countries, banks often sought a State guarantee on a new debt instrument which they did not issue on the market but retained on their balance sheets. They then used the State guaranteed debt instrument as collateral to obtain financing from the European Central Bank (ECB). Between 1 October 2008 and 1 October 2014, the Commission authorized total aid of €3,892.6 billion (29.8 per cent of EU GDP in 2013) for guarantees on liabilities. The outstanding amount peaked in 2009 at €835.8 billion (6.39 per cent of EU 2013 GDP), and has decreased since.[14] This helped to re-establish confidence in the financial markets, while financial institutions effectively used less than a quarter of the amount approved. Since 2008, when the guarantees on liabilities programmes were put in place, only €3.13 billion of the total guarantees provided have been called in. The use of State guarantees on retained debt instruments is strongly decreasing; as of March 2015 the ECB no longer accepts such debt instruments not issued on the market as collateral.[15] However, they are still eligible as collateral for emergency liquidity assistance (ELA) and were used by the Greek banks in 2015 when the significant deposit outflows tightened the liquidity conditions.

Other than State guarantees, liquidity support can consist of direct senior lending by the State or lending of government bonds[16] to the banks that can use them as collateral to borrow from the central bank. Since 2008, the Commission has approved aid amount-

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[14] State Aid Scoreboard 2014 – Aid in the context of the financial and economic crisis. <http://ec.europa.eu/competition/state_aid/scoreboard/financial_economic_crisis_aid_en.html> accessed 5 October 2015 (State Aid Scoreboard 2014).

[15] Decision of the European Central Bank ECB/2013/6 on the Rules concerning the use as collateral for Eurosystem monetary policy operations of own-use uncovered government-guaranteed bank bonds [2013] OJ L95/22.

[16] Such a measure has been implemented by Greece in its bond loan scheme. See Commission Decision on the Support Measures for the Credit Institutions in Greece (Case N 560/2008) [2009] OJ C125/6.

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ing to €379.9 billion (2.9 per cent of EU 2013 GDP) for liquidity measures. However, Member States have practically used only a very small amount in comparison to the total approved. The outstanding liquidity measures peaked in 2009 reaching €70.1 billion (0.5 per cent of EU 2013 GDP). The EU 28 outstanding amount in 2012 dropped to €34.5 billion (0.26 per cent of EU 2013 GDP). Only some EU countries have granted liquidity support directly to the financial sector. Spain and the Netherlands account for more than half of the outstanding amounts in the peak year.[17]

As regards liquidity provided by central banks, the general principle is that State aid rules should not intervene in the normal monetary operations of central banks. However, the terms of providing that liquidity to banks may entail a State aid element when one or more of the five conditions established in Section 5 of the 2013 Banking Communication are not met: (i) at the time the support is provided, the bank must be solvent; (ii) the dedicated liquidity support must not be part of a larger package of support measure to the bank; (iii) the central bank must obtain collateral for the entire amount of the loan to the bank; (iv) the central bank must charge an interest rate significantly higher than the one charged for normal monetary refinancing operations; and (v) the central bank must not enjoy a State guarantee on its loan to the bank. Most of the time, the liquidity support provided by central banks constitutes State aid because there is a State guarantee involved.[18] Even if fully collateralized, a State guaranteed ELA aims to safeguard the central bank's claims against that credit institution and protect the central bank against any losses it may incur.

(b) Capital Support

Recapitalization is the second most used instrument to support the financial sector after guarantees on liabilities. The Commission has authorized overall aid of €821.1 billion (6.3 per cent of EU 2013 GDP) in the last six years. Not all aid authorized by the Commission was injected into the banks. From 2008 to 2013, Member States granted a total of €448 billion (34 per cent of EU 2013 GDP) in recapitalization measures. The four countries that supported their banks the most between 2008 and 2013 were the UK (€100 billion), Germany (€64 billion), Ireland (€63 billion) and Spain (€62 billion). The top receiving banks were Royal Bank of Scotland (RBS) (€50 billion), Anglo Irish Bank (€32 billion), and Bankia (€22 billion).[19] Capital support can take the form of ordinary shares – equity or hybrid capital instruments (preference shares, contingent convertible bonds, etc).

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17 State Aid Scoreboard 2014.

18 See s.7.1.2 on the existence of aid in the State guaranteed ELA in the Commission Decision C (2014) 4662 on the HFSF Recapitalization commitment to Alpha Bank (Case SA.34823 (2012/C)) [2015] OJ L80/1; Commission Decision C(2014) 5201 on the HFSF Recapitalization commitment to National Bank of Greece (Case SA.34824 (2012/C)) [2015] OJ L183/29; Commission Decision C(2014) 2933 on the HFSF Recapitalization commitment to EFG Eurobank (Case SA.34825 (2012/C)) [2014] OJ L357/112; Commission Decision C(2014) 5217 on the HFSF Recapitalization commitment to Piraeus Bank (Case SA.34826 (2012/C)) [2015] OJ L80/49.

19 State Aid Scoreboard 2014.

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(c) Impaired Asset Measures

Impaired assets represent a category of assets on which banks are likely to incur losses (e.g. US sub-prime mortgage-backed securities, real estate loans in Ireland in 2010 and in Spain in 2011). For that reason, Member States have put in place asset relief measures, which aim to transfer the risk related to those specific assets to the State. This can take the form of a purchase of the assets by a vehicle or institution owned, funded or guaranteed by the State (so-called 'bad bank' or 'asset management company' (AMC)). Such purchases took place for instance in Ireland or Spain, when NAMA and SAREP respectively bought real estate development loans from banks. Alternatively, the assets remain under the ownership and in the balance sheet of the bank, but the State commits to indemnify the bank if the cumulative credit losses on a well-identified set of assets exceed a certain amount. That type of guarantee was applied for instance in the case of the asset protection scheme put in place by the UK in favour of RBS[20] or in the case of HSH Nordbank AG[21] (HSH). More hybrid asset relief solutions involve bad bank partly owned by the beneficiary (like Royal Park Investment, which was partly capitalized by Fortis[22]) or cash flow swaps (as in the case of ING[23]). From 2008 to 2013, Member States provided asset relief measures amounting to €188.2 billion (1.4 per cent of EU 2013 GDP) while total aid approved was €669.1 billion (5.1 per cent of EU 2013 GDP).[24]

2. FROM ARTICLE 107(3)(C) TFEU TO ARTICLE 107(3)(B) TFEU – THE 2008 BANKING COMMUNICATION

On 13 October 2008 the Commission adopted guidance on the application of State aid rules to State support schemes and individual assistance for financial institutions – the 2008 Banking Communication. After the collapse of Lehman Brothers on 15 September 2008, important market players such as Fortis, Dexia, Bradford & Bingley and Hypo Real Estate were in need of emergency aid. Member States like Denmark and Ireland announced bank bail-outs or other measures to tackle the effects of the global financial crisis, like guarantee schemes.[25] In this environment, the 2008 Banking Communication provided Member States with guidance on how they could better support financial

[20] See s. 2.4.2 of the Commission Decision on the restructuring of Royal Bank of Scotland following its recapitalisation by the State and its participation in the Asset Protection Scheme, (Case N 422/2009 and N 621/2009) [2010] OJ C119/1 (Commission Decision on the restructuring of Royal Bank of Scotland).

[21] See recitals (42) *et seq* of the Commission Decision C(2011) 6483 on State aid granted by Germany to HSH Nordbank AG SA.29338 (Case C-29/09 (ex N 264/09)) [2012] OJ L225/1.

[22] See s. 2 as well as Annexes 1 and 2 of the Commission Decision of on the additional aid to Fortis Banque, Fortis Banque Luxembourg and Fortis holding (Case N 255/2009 and N 274/2009) [2009] OJ C178/2.

[23] See s. 2.3.2 of Commission Decision C(2009)9000 of on ING's Illiquid Assets Back Facility and Restructuring Plan (Case C-10/09 (ex N 138/09)) [2010] OJ L274/139.

[24] State Aid Scoreboard 2014.

[25] Report on Competition Policy 2009 <http://ec.europa.eu/competition/publications/annual_report/2009/en.pdf> accessed 15 June 2015, 12 (Report on Competition Policy 2009).

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institutions during the financial crisis while complying with State aid rules and so avoiding excessive distortions of competition.

The main change of the 2008 Banking Communication came with the application of Article 107(3)(b) TFEU. This legal basis was considered appropriate to deal with the aid measures undertaken to address the systemic financial crisis. Point 8 also clarified that application of this exceptional legal basis should be restrictive.

The 2008 Banking Communication provided guidance for the setting up of guarantee and recapitalization schemes, the winding up of financial institutions and the provision of other forms of liquidity assistance (like the ELA granted by the central banks). It also established the general principles for the provision of aid: non-discrimination among financial institutions (in order to protect the functioning of the internal market by making sure that eligibility for a support scheme is not based on nationality); limitation in time (conditions for granting support need to be reviewed and adjusted or terminated as soon as improved market conditions permit); that the aid should be limited to the minimum (the private sector needs to contribute and the guarantees must be properly remunerated); that banks should be subject to behavioural commitments (to make sure that they are not using the State guarantees to engage in aggressive expansion to the detriment of the other competitors which are not covered by that guarantee); and the provision of a restructuring or liquidation plan (in case of default or structural measures). The new rules departed from the normal rules applicable to the banks under the Rescue and Restructuring guidelines and allowed for a number of sector- and crisis-specific measures. One such measure was to allow liquidity support for longer than six months without triggering the restructuring obligation, recognizing that the need for such support may stem from liquidity stress in the markets and not from intrinsic weaknesses of individual banks. Another crisis-related innovation was to allow 'structural aid', i.e. State recapitalizations or asset protection measures, also as a form of rescue aid. This was done through temporary approvals, a new procedural type of no-objection decision which provided for legal certainty for aid measures needed to stabilize a bank in the rescue phase in exchange for respecting a minimum set of conditions, including the pricing of the aid measures and an obligation to present a restructuring plan within six months. This implied that the Commission could quickly approve urgent rescue measures for reasons of financial stability and that the compatibility assessment of restructuring was postponed to the post-rescue phase. The Commission was thus able to adopt decisions within 24 hours and over a weekend.

3. BANKS' RECAPITALIZATION DURING THE FINANCIAL CRISIS: NOT AT ANY PRICE – THE RECAPITALIZATION COMMUNICATION

While the quick and effective intervention of national governments stabilized the financial system at the beginning of the financial crisis, the credit crunch started to affect the real economy. Banks found themselves in a situation where it was difficult to lend to companies and they needed capital to continue supporting the economy. After in-depth discussions with the ECB and the Member States, the Commission adopted the Recapitalization Communication on 5 December 2008. The Recapitalization Communication provided guidance as to how Member States could recapitalize banks during the financial crisis in

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order to ensure adequate levels of lending to the rest of the economy and stabilize financial markets while avoiding excessive distortions of competition, in line with EU State aid rules. The changes introduced by the Recapitalization Communication were built on the distinction between fundamentally sound and distressed banks. Fundamentally sound banks could receive temporary support to enhance the stability of financial markets and foster undisturbed access to credit for citizens and companies. Distressed banks are those banks whose business models caused a risk of insolvency. State support for distressed banks carries a greater risk of competition distortion, so safeguards must be stricter and a thorough restructuring is necessary. The Annex of the Recapitalization Communication provides four indicators that the Commission should take into account when assessing the risk profile of a bank: (i) the bank's prospective capital adequacy; (ii) the size of the recapitalization (below or higher than 2 per cent of the bank's risk weighted assets); (iii) Credit Default Swap (CDS) spread (a bank with a lower risk profile would have a spread equal or inferior to the average); and (iv) the bank's rating and its outlook (a bank with a lower risk profile would have a rating of A or above and a stable or positive outlook).

With the Recapitalization Communication, the Commission established guidance for the pricing of State capital injections which were based on the Recommendations of the Governing Council of the ECB.[26] Thus, for fundamentally sound banks, the pricing of State capital injections is based on base rates set by central banks to which a risk premium is added that has to reflect the risk profile of each beneficiary bank, the type of capital used and the level of safeguards accompanying the recapitalization to avoid abuse of the public funding (point 28). The pricing mechanism needs to carry sufficient incentive to keep the duration of State involvement to a minimum, for example through a remuneration rate that increases over time (point 29). Point 27 of the Recapitalization Communication clarifies that, depending on the seniority of the instrument, the coupon should be in a range of between 7 and 9.3 per cent for instruments issued by fundamentally sound banks, to which the Commission added a top-up as an exit incentive.

Banks in distress that face a risk of insolvency should in principle be required to pay more for State support and to observe stricter safeguards. The use of State capital for such banks can be accepted only on the condition of far-reaching restructuring restoring their long-term viability, including where appropriate a change in management and in corporate governance (point 44).

The Recapitalization Communication also provided guidance on the establishment of State recapitalization schemes. At that time, the Commission had only approved recapitalization schemes in three Member States (the UK, Germany and Greece) and the new recapitalization schemes envisaged varied considerably in terms of their nature, scope and conditions (point 3 of the Recapitalization Communication). This is why both Member States and potential beneficiary institutions called for more detailed guidance as to whether specific forms of recapitalization would be acceptable under State aid rules. The Commission clarified that such recapitalization schemes: (i) should not give banks recapitalized in one Member State an undue competitive advantage over banks in other Member

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[26] Recommendations of the Governing Council of the European Central Bank on the pricing of recapitalisations of 20 November 2008 <http://www.ecb.eu/pub/pdf/other/recommendations_on_pricing_for_recapitalisationsen.pdf> accessed 15 September 2015.

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States and thus create a subsidy race among those Member States (point 8); (ii) should differentiate between the beneficiary banks according to their risk profiles (point 9); and (iii) should not crowd out other market participants that did not have recourse to a State recapitalization (point 10). The recapitalization schemes were also subject to monitoring and review. Six months after an individual measure or after the introduction of a recapitalization scheme, the Member State concerned had to report to the Commission on how the State capital had been used (point 40). The report also had to include an exit strategy for fundamentally sound banks and a restructuring plan for distressed banks (point 42).

4. CLEANING THE BANKS' BALANCE SHEETS – THE IMPAIRED ASSETS COMMUNICATION

Despite the fact that recapitalization schemes had been put in place in many Member States, in early 2009 investors were not showing signs of confidence in the system. Bank guarantees and recapitalizations did not translate into credits flowing to the economy and uncertainty remained over undisclosed losses on assets that had lost value. Confronted with this situation, some Member States proposed asset protection schemes. The UK government put forward a proposal for a £500 billion protection scheme, while the Dutch announced a US$40 billion asset protection for ING.[27] On 25 February 2009, after detailed discussions with the Member States, the Commission adopted the Impaired Assets Communication. The Communication responded to a growing consensus on the need to tackle the root causes of the crisis in the form of toxic assets on bank balance sheets. In this Communication the Commission set out how it would assess asset relief measures for financial institutions under State aid rules. The Communication is based on the principles of transparency and disclosure, adequate burden sharing between the State and the beneficiary, and prudent valuation of assets based on their real economic value.

The Impaired Asset Communication clarifies in footnote 2 of point 20(a) that the amount of aid is the difference between the value at which the assets are transferred to the State and the market price of the transferred assets. Indeed, if the bank were to try to sell the assets in the market, it would receive the market price. Therefore, the premium paid by the State above the market price represents the amount by which the State overpays on the assets.

Point 40 of the Impaired Asset Communication defines the cornerstone concept of 'real economic value' as the long-term economic value of the assets, on the basis of underlying cash flows and longer-term horizon. In case of stress and uncertainty affecting their valuation, the real economic value of certain assets will be significantly above market value, since the latter is then supposed to be depressed by a high-risk premium reflecting the uncertainty and by an illiquidity discount reflecting the lack of liquidity and tradability of the assets concerned. When uncertainty recedes and liquidity increases, the market price will converge with the real economic value. The real economic value could therefore be defined as the expected market value of the assets in a context where uncertainty is low (i.e. good long-term visibility on the expected cash flow of the assets) and liquidity/

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27 Report on Competition Policy 2009, 14.

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tradability is high. Therefore, for government bonds, for instance, the real economic value will nearly always be equal to the market price.

Assuming there is no observable and tradable market price, the real economic value of loans and securities can be determined on the basis of the expected cash flows of those assets in a prudent base line scenario. Those cash flows should be discounted using an interest rate which includes a risk premium reflecting the uncertainty around that base line scenario and aimed at remunerating the State. The importance of remunerating the State for the risk it takes is repeated at point 21 of the Impaired Asset Communication. Alternatively, the real economic value can be assessed by using the expected cash flows in a more stressed scenario, but then using a discount rate closer to the risk-free rate, i.e. a discount rate integrating a smaller risk premium.

The Impaired Asset Communication provides, in point 41, that the assets should be transferred to the State at their real economic value. The rationale is that the asset relief measure should not shelter the bank against the losses which are expected to occur on the assets concerned. Those losses should be borne by the bank and its shareholders and the aim of the asset relief measure should be only to shelter the bank against the unexpected losses. In that context, if the assets are transferred at a price exceeding their real economic value, it is considered an aggravating factor triggering the need for the bank to implement a deeper restructuring. In addition, the difference with the real economic value should be clawed back from the bank over time.

In case the asset relief measure does not take the form of a sale, the assets remain in the bank and the State commits to indemnify the bank for credit losses exceeding a certain amount ('attachment point'). The same rules would apply: the attachment point should be determined on the basis of a prudent assessment of the expected credit losses on the assets subject to the asset relief measure. In line with point 21 of the Impaired Asset Communication, including at footnote 1, the bank should pay to the State a yearly fee proportionate to the size of the capital relief it enjoys thanks to the State guarantee. More precisely, the fee has to be higher than the coupon the bank should have paid on such an amount of capital if it had been provided in the form of a hybrid instrument. For such impaired assets guarantee, if the credit losses exceed the attachment point, the bank should retain a part of the losses. That residual loss sharing, e.g. 10 per cent of the losses exceeding the attachment point, aims to incentivize the bank to continue to try to minimize losses on the guaranteed assets after the attachment point has been reached, even if most of the losses are then borne by the State.

5. HOW TO MAKE BANKS RECEIVING STATE AID VIABLE AGAIN? THE RESTRUCTURING COMMUNICATION

As time passed, the Commission started to look at the medium term, at the way beneficiaries of aid could start paying back the money borrowed and stand on their own feet. Hence, on 14 August 2009, the Commission adopted the Restructuring Communication which was supposed to apply until the end of 2010 (when the normal rules on Rescue and Restructuring guidelines were to resume).

The Restructuring Communication reflected the Commission's thinking for a future beyond the financial crisis, with a viable banking sector. It set out the principles appli-

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cable to those beneficiaries that were not only in need of short-term rescue aid, but required aid to implement structural changes to their business models. The Restructuring Communication retained the main principles of the Rescue and Restructuring guidelines, but adjusted the Commission's practice in particular in the following five areas:

(i) The type of information that the Commission requires to determine whether the proposed restructuring measures are apt to restore a bank's long-term viability. The restructuring plan will need to include a thorough diagnosis of the bank's problems, including a stress test and, where applicable, details on treatment of impaired assets. This information is necessary to devise sustainable strategies for a return to viability.
(ii) Given the overriding goal of financial stability and the prevailing difficult economic outlook throughout the EU, special attention will be given to ensuring sufficiently flexible and realistic timing of the necessary restructuring measures. Implementation of the restructuring plan could last up to five years, compared to the usual practice of two to three years. This would allow in particular more time for finalizing certain structural measures, notably to avoid depressing the markets through precipitated asset sales.
(iii) The bank's own contribution to the costs of restructuring could be lower than the 50 per cent threshold fixed in the Rescue and Restructuring guidelines, on a case-by-case assessment. Given the difficulties of gaining access to private capital and the difficulty of calculating restructuring costs, the Restructuring Communication chooses not to operate with a fixed threshold for own contribution. Adequate burden sharing can be achieved mainly through the pricing of the State intervention and through restrictions on coupon and dividend payments to bondholders and shareholders. Where significant burden sharing is not immediately possible due to the market circumstances at the time of the rescue, this would need to be addressed at a later stage of implementation of the restructuring plan, for example through claw-back clauses.
(iv) Measures aimed at limiting distortions of competition should be designed so as to support the primary objective of restoring the long-term viability of the banking sector, while limiting any disadvantage for other banks. Where the immediate implementation of structural measures is not possible due to market circumstances (for example where finding buyers for divested assets is objectively difficult), the Commission could extend the time period for implementation of these measures. Intermediate behavioural safeguards would need to be put in place where necessary.
(v) The Commission would not necessarily apply the 'one-time-last-time' rule of the Rescue and Restructuring guidelines (meaning that a company may receive rescue and restructuring aid only once within a ten year period) to restructuring aid to banks in times of crisis, reflecting inter alia the uncertainty about the recovery outlook.

The Restructuring Communication provides the requirements for assessing restructuring aid given by Member States to banks. The three pillars of assessing the compatibility of the restructuring aid are long-term viability, burden sharing, and limitation of competition distortion.

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(a) Long-term Viability

Banks should become viable in the long term and capable of operating without State aid. In practice, a viability assessment entails:

(i) a review of the bank's business model: clarifying the root of the bank's difficulties and weaknesses and determining the final goal/establishing a future business model;
(ii) identification of the best path to a new model: discontinuation of problematic activities/run-off of non-core activities; concentration on core areas, products and markets; simplification and de-risking, reduction of complexity, cost cutting (branches closures, personnel reduction); and
(iii) technical feasibility analysis: assessment of solvency/liquidity/profitability/asset quality and stress test or sensitivity analysis along critical parameters.

Given that the sources and the magnitude of the banks' problems varied significantly, the restructuring measures proposed to make the banks viable again differed considerably. In certain cases, the problems came to some extent from the fact that the banks invested several billion euros in structured credits, the value of which decreased dramatically and became uncertain (KBC,[28] Fortis[29] and ING[30]). In such cases, since the bank was destabilized by those assets, the restructuring plan had to address that uncertainty. Regularly, the solution took the form of an impaired asset relief measure, by which the assets were transferred to the State. This put a limit on future losses which could be generated by those assets.

If the difficulties and need for State aid stems from loan losses due to excessive and risky lending to the real estate sector and to households to finance the purchase of houses (Bank of Ireland,[31] Allied Irish Banks,[32] RBS,[33] several Spanish and Slovenian banks), the restoration of viability usually requires a deeper restructuring. The plan not only needs to try to bring an end to the uncertainty regarding the future losses those bad loans can create (which can be achieved through a transfer of the most risky assets to the State), but to deeply improve the way the bank underwrites new loans and manages its risk. The restructuring plans of those banks included changes in the new lending policy, risk management and corporate governance.

Some banks relied excessively on short-term wholesale funding, rendering them vulnerable to the drying up of the wholesale funding market in 2008. For instance, this

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[28] Commission Decision on the State aid C18/09 (ex N 360/09) implemented by Belgium for KBC [2010] OJ L188/24.

[29] Commission Decision on the restructuring aid to Fortis Bank and Fortis Bank Luxembourg [2009] OJ C80/7.

[30] Commission Decision C(2009)9000 on ING's Illiquid Assets Back Facility and Restructuring Plan (Case C-10/09 (ex N 138/09)) [2010] OJ L274/139.

[31] Commission Decision on the restructuring of Bank of Ireland (Case N 546/2009) [2011] OJ C40/9.

[32] Commission Decision on the restructuring of Allied Irish Banks plc and EBS Building Society (Case SA.29786 (ex N 633/2009), SA.33296 (2011/N), SA.31891 (ex N 553/2010), N 241/2009, N 160/2010 and C25/2010 (ex N 212/2010)) [2015] OJ L44/40.

[33] Commission Decision on the restructuring of Royal Bank of Scotland.

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was the case for Lloyds TSB[34] following the acquisition of HBOS, as for RBS[35] and for several German Landesbanken.[36] In those circumstances, the restructuring plan should provide that the bank is reducing its reliance on wholesale funding (for instance by deleveraging the loan books' size – so that the bank has fewer assets to fund) and increasing customer deposits, which represents a more stable source of funding. A commitment to decreasing the loan-to-deposit ratio of the bank below a certain level was usually introduced.

(b) Burden Sharing

Aided banks and their owners must carry a fair burden of the restructuring cost. Burden sharing means that the restructuring aid is kept to the minimum, and the bank and its capital holders contribute to the costs of restructuring as much as possible with their own resources. This should contribute to addressing moral hazard and to creating appropriate incentives for their future behaviour. In practice, burden sharing translates into a heavy dilution or write-down for shareholders, conversion or write-down, no coupon payments and ban on buy backs for junior creditors (including subordinated debt holders) and capital accretive sales of assets and restrictions on management remuneration for the beneficiary bank.

(c) Limitation of Competition Distortion

The restructuring plan has to include measures to ensure that any undue distortion of competition caused by the restructuring aid is limited. In point 30 of the Restructuring Communication, the Commission provides some indications as to the manner in which it assesses the appropriateness of the measures to limit distortions of competition which should be tailor-made to each case:

> The nature and form of such measures will depend on two criteria: first, the amount of the aid and the conditions and circumstances under which it was granted and, second, the characteristics of the market or markets on which the beneficiary bank will operate.

Point 31 of the Restructuring Communication adds further elements that the Commission has to consider in its assessment of measures to limit distortions of competition: the degree of burden sharing and the pricing of the aid.

In practice, measures for limiting distortions of competition include structural measures[37] (sales of assets, subsidiaries) and behavioural constraints[38] (acquisition ban,

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[34] Commission Decisions C(2009) 9807 on the Restructuring of the Lloyds Banking Group (Case N 428/2009) [2010] OJ C46.

[35] Commission Decision on the restructuring of Royal Bank of Scotland.

[36] Commission Decision C(2011) 5157 on Restructuring aid for Hypo Real Estate (Case SA.28264) [2012] OJ L60, Commission Decision C(2011) 9395 for the Restructuring of WestLB (Case C-40/2009 and C-43/2008) [2013] OJ L148/1.

[37] See Restructuring Communication, point 35 *et seq*.

[38] Ibid., point 38 *et seq*.

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price leadership ban, ban on advertising on the back of State support). Those measures are designed not only to limit distortions between aided and not-aided banks, and between banks in different Member States, but also to create conditions which foster the development of competitive markets after the crisis.

6. INCENTIVIZING EXIT FROM STATE SUPPORT – THE 2010 PROLONGATION COMMUNICATION

As a result of policy intervention, the severe shortage of bank funding that occurred in autumn 2008 was overcome relatively quickly. However the sovereign crisis which struck in the first half of 2010 clearly showed that, although there was some improvement compared to the peak of late 2008, the level of stress in financial markets still required targeted crisis-related support beyond 2010.[39]

On 1 December 2010, the Commission adopted the 2010 Prolongation Communication which tackled three main aspects:

(i) the prolongation of the Restructuring Communication until 31 December 2011 and the continued applicability of Article 107(3)(b) TFEU;
(ii) the advancement of the exit process; and
(iii) the removal of the distinction between sound and distressed banks for the purposes of submitting a restructuring plan.

(a) Prolongation of the Restructuring Communication until 31 December 2011 and the Continued Applicability of Article 107(3)(b) TFEU

Of the first four Communications, only the Restructuring Communication had a specified expiry date – 31 December 2010. The other Communications, also adopted on the basis of Article 107(3)(b) TFEU, had no expiration date but in practice they would apply until the serious disturbance in the economy of Member States ceased to exist. The 2010 Prolongation Communication extended the expiry date of the Restructuring Communication until 31 December 2011. The Commission also explained that there were still grounds to deem the requirements for application of Article 107(3)(b) TFEU fulfilled.

(b) The Advancement of the Exit Process

The 2010 Prolongation Communication made clear the objective of gradual disengagement from the temporary extraordinary support. Although the situation in the financial markets remained fragile, the Commission recognized that a gradual phasing out of support encouraged the restructuring of banks.

This approach began with the tightening of conditions for new government guarantees

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[39] Report on Competition Policy 2010 <http://ec.europa.eu/competition/publications/annual_report/2010/part1_en.pdf> accessed 12 October 2015, 12.

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from July 2010 through a fee increase and closer scrutiny of the viability of heavy guarantee users.[40]

The Commission noticed that, while access to market financing generally improved, banks which had been downgraded were still benefiting from their pre-Lehman credit rating and perceived creditworthiness. Moreover, banks with low rating benefited disproportionately from guarantees than banks with higher rating because they would normally pay a higher market price due to their low rating. This increased the likelihood of competition distortions. In order to address such distortions, the Commission came to the conclusion that the pricing of government support should be brought closer to market conditions, better reflecting individual banks' creditworthiness, and thus increased. Therefore, after 30 June 2010, the fees payable for eligible liabilities incurred under a guarantee scheme would increase by at least 20 to 40 basis points (bp) above the pricing formula recommended by the ECB in October 2008, depending on the rating of the participating bank.

The Member State concerned should present a viability review for any bank that requests new guarantees under a scheme which takes or keeps the total amount of the bank's outstanding guaranteed liabilities above 5 per cent of its total liabilities and above the absolute amount of €500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication within three months of the granting of the guarantees. Banks which are already in restructuring or subject to a pending viability review on the basis of a restructuring or viability plan are exempt. In those circumstances the award of additional State aid is assessed within the framework of the ongoing restructuring/viability review process.

(c) The Removal of the Distinction between Sound and Distressed Banks for the Purposes of Submitting a Restructuring Plan

As of 1 January 2011, the 2010 Prolongation Communication required that any bank in the EU having recourse to State support in the form of capital or impaired asset measures would have to submit a restructuring plan. The previous rule provided that the obligation to submit a restructuring plan was limited to distressed banks, i.e. banks that, in particular, received support above 2 per cent of their risk weighted assets. All other banks receiving a smaller amount of State aid were subject to a viability review.

7. DEALING WITH THE SOVEREIGN DEBT CRISIS – THE 2011 PROLONGATION COMMUNICATION

The fragile signs of economic recovery in 2010 and early 2011 were not sustained throughout 2011. In fact the last months of 2011 were marked by increasing instability and

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[40] See Directorate-General for Competition staff working document of 30 April 2010 on the application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2010 <http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf> accessed 28 September 2015.

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difficulties in the public sector. Member States continued to assist financial institutions, many of which had to receive liquidity support from central banks. Public deficits became a source of concern regarding sovereign risk, which led to disturbances in financial markets. Thus, the financial crisis turned into a sovereign debt crisis in parts of the euro area, threatening the banking sector and the fiscal sustainability of many European governments. In Greece, the banks suffered from the effects of the unsustainable public debt of the Greek State. The Greek government lost access to financial markets and finally had to negotiate an agreement with its domestic and international creditors. Consequently, Greek banks also lost access to the wholesale funding market and became entirely reliant on liquidity provided by the central bank. From an initial budget of €15 billion approved in 2008, the budget of the Greek Guarantee Scheme increased by an additional €15 billion on 12 May 2010, €25 billion on 30 June 2010 and €30 billion on 4 April 2011.[41] Unlike Greece, Ireland's debt crisis originated from the banks yielding massive losses after the property bubble burst.

The worsening of the sovereign debt crisis during the summer of 2011 prompted the Member States and the Commission to react quickly. On 26 October 2011 Member States acknowledged that measures for restoring confidence in the banking sector were urgently needed and were necessary to strengthen the prudential control of the EU banking sector. The measures included in the banking package had as their objective to ensure the medium-term funding of banks, in order to avoid a credit crunch and to safeguard the flow of credit to the real economy, and the need to enhance the quality and quantity of banks' capital.[42]

On 1 December 2011 the Commission adopted the 2011 Prolongation Communication which introduced four main changes to the State aid rules for the banking sector:

(i) extended the rules beyond 31 December 2011;
(ii) provided clarifications on the remuneration of State support in the form of recapitalizations;
(iii) provided explanations of the Commission's assessment of the 'proportionate assessment' of the long-term viability of banks affected by the sovereign debt crisis; and
(iv) introduced a revised methodology on pricing of guarantees on bank liabilities.

(a) Extension of Rules Beyond 31 December 2011

In light of the significant uncertainty as to how the sovereign crisis would develop, the Commission prolonged the Restructuring Communication beyond 31 December 2011, providing no further expiry date. However, its stated aim was to return to more permanent rules for banks based on Article 107(3)(c) when market conditions permitted.

41 See Commission Decision C(2015) 4452 on the Prolongation of the Greek financial support measures (art. 2 law 3723/2008) (Case SA.42215) [2015] OJ C277, fn. 19.

42 Statement of EU Heads of State or Government of 26 October 2011 <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125621.pdf> accessed 12 August 2015.

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(b) Remuneration of State Support in the Form of Recapitalizations

The 2011 Prolongation Communication clarified the remuneration of ordinary and hybrid instruments used by Member States to recapitalize banks.

If a Member State intends to grant capital support by subscribing to new shares to be issued by the bank in difficulty, the issue price of the shares should comply with the requirements laid down in points 8–12 of the 2011 Prolongation Communication. In particular, shares should be subscribed by the State at an appropriate discount to the latest share price, depending, among other things, on the size of the capital injection compared to the bank's existing capital and whether or not the shares carry voting rights.

As regards the changes introduced in the remuneration of hybrid instruments, they were based on the conclusions observed on the bank's payment, or more specifically its non-payment, of coupons on hybrid instruments. If a bank does not make enough profit or does not have enough capital to proceed with the distribution of coupons, its payment is automatically waived. In addition, for some instruments, the payment of coupons is discretionary which means that the management of the bank has the right to decide not to pay it. As a consequence, on several hybrid instruments injected by Member States, the bank did not pay any coupon to the State. In order to remedy that situation, the Commission tightened its requirements in point 13 of the 2011 Prolongation Communication. Thus, new hybrid instruments subscribed by the State would have to contain an alternative coupon satisfaction mechanism (ACSM) whereby coupons which could not be paid in cash would be paid to the State in the form of newly issued shares. As a consequence of that stricter requirement applicable to hybrid instruments as well as a consequence of higher regulatory requirements towards the quality of capital instruments, hybrid instruments have become a much less popular form of granting capital aid than they were at the end of 2008.

(c) Proportionate Assessment of the Long-term Viability of Banks Affected by the Sovereign Debt Crisis

Given that banks in certain Member States encountered difficulties because of their exposure to the sovereign risk of their domestic country, the Commission provided, at point 14 of the 2011 Prolongation Communication, for a lightening of the restructuring requirements. In order to determine if a bank established in a Member State affected by sovereign crisis can be viable in the long term without the need for significant restructuring, the Commission is considering the following elements in its assessment:

(i) whether the capital shortage is essentially linked to a confidence crisis on sovereign debt;
(ii) whether the public capital injection is limited to the amount necessary to offset losses stemming from marking-to-market sovereign bonds of the Member States of the European Economic Area (EEA) in banks which are otherwise viable; and
(iii) the analysis shows that the bank in question did not take excessive risk in acquiring sovereign debt.

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For instance, this approach was taken in the restructuring decisions of the four Greek banks in 2014 (Alpha Bank,[43] Eurobank,[44] Piraeus Bank,[45] and National Bank of Greece[46]) where the Commission concluded that a significant part of the banks' losses and the need for aid fell within point 14 of the 2011 Prolongation Communication.

(d) Revised Methodology on Pricing of Guarantees on Bank Liabilities

The Commission has also reviewed guidance on the fees that banks must pay for guarantees to ensure that aid is limited to the minimum necessary and to reflect the risk to public finances. The revised methodology establishes the minimum fees that should apply where the guarantees are granted on a national basis. The new rules applied to guarantees covering debt with a maturity of between one and five years (seven in the case of covered bonds). The rules for shorter maturities of less than one year remained the same.

8. CLOSING THE CIRCLE – THE 2013 BANKING COMMUNICATION

On 10 July 2013 the Commission adopted the 2013 Banking Communication which entered into force on 1 August 2013. The 2013 Banking Communication introduced two main changes to the existing rules:

(i) a more effective restructuring process, and
(ii) strengthened burden sharing requirements.

Apart from the two main changes, the Commission also clarified in the 2013 Banking Communication that financial stability remained the overarching objective of its assessment, how it reflected macro-economic considerations, and what the changes meant for aid schemes. It also codified its case practice, for example on liquidation aid. Another amendment to the existing State aid rules provided that failed banks should apply strict executive remuneration policies. The 2013 Banking Communication sets a cap on total remuneration, as long as the entity is under restructuring or relying on State support. This should give the bank's management the proper incentives to implement the restructuring plan and repay the aid. The 2013 Banking Communication established that the Crisis Communications would apply as long as required by market conditions. The rules would be revised as necessary, in particular, in light of the evolution of the EU regulatory framework for the banking sector.

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[43] Commission Decision C(2014) 4662 on the HFSF Recapitalisation commitment to Alpha Bank (Case SA.34823 (2012/C)) [2015] OJ L80/1.

[44] Commission Decision C(2014) 2933 on the HFSF Recapitalisation commitment to EFG Eurobank (Case SA.34825 (2012/C)) [2014] OJ L357/112 (Commission decision on Eurobank).

[45] Commission Decision C(2014) 5217 on the HFSF Recapitalisation commitment to Piraeus Bank (Case SA.34826 (2012/C)) [2015] OJ L80/49.

[46] Commission Decision C(2014) 5201 on the HFSF Recapitalisation commitment to National Bank of Greece (Case SA.34824 (2012/C)) [2015] OJ L183/29.

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The introduction of the two main changes came as a follow-up to case practice and the experience gained by the Commission during the financial crisis.

(a) A More Effective Restructuring Process

At the beginning of the financial crisis, the Crisis Communications were designed to allow for immediate injections of large amounts of capital for reasons of financial stability. Those immediate injections contributed to the stabilization of markets at the height of the crisis in 2008–09. State aid was approved on a temporary basis as rescue aid and under the condition that a restructuring plan would subsequently be submitted for assessment and approval by the Commission. That approach was successful in averting panic, but it sometimes delayed recognition of the banks' difficulties and, consequently, led to postponement of the necessary restructuring, with some cases pending from 2009. Once their bail-out had been achieved, the aid beneficiaries did not always have sufficiently strong incentives to implement the restructuring measures aimed at limiting the use of public money and avoiding similar problems in the future. As the crisis evolved, the need for immediate rescue measures decreased. In Spain, the Memorandum of Understanding between Spain and the Eurogroup[47] provided that the disbursement of aid in 2012 could only occur after the Commission's approval of State aid for banks' restructuring plans. That method enabled the banking sector in Spain to be restructured in a more decisive and rapid way and was key to restoring market confidence and enabling banks to regain access to funding markets on affordable terms. The Spanish programme under which each of the eight restructuring plans was agreed in less than four months[48] demonstrated that the process could be streamlined.

In view of this experience, the Commission amended its rules with the 2013 Banking Communication and decided that it would no longer approve public recapitalization or asset protection measures on a temporary basis as rescue aid. Such approval would only be granted after the Commission had approved a restructuring or liquidation plan. The Commission considered that large capital shortfalls should no longer come as a surprise to the competent authorities but should be detected early enough for Member States to be able to negotiate and agree a restructuring or liquidation plan with the Commission. Point 34 of the 2013 Banking Communication provided that the Commission 'will authorise any recapitalisation or impaired asset measure as restructuring aid only after agreement on the restructuring plan has been reached'.

However, the option of rescue aid has not been totally abandoned. A recapitalization or impaired asset measure can exceptionally be authorized by the Commission on a temporary basis as rescue aid before a restructuring plan is approved, provided that the conditions in point 50 are met. First, the measure must preserve financial stability and be invoked on those grounds by the Member State. Then, the Commission requires an *ex ante* analysis from the competent supervisory authority which has to confirm fulfillment

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[47] Memorandum of Understanding on financial sector policy for Spain <http://ec.europa.eu/economy_finance/eu/countries/pdf/mou_en.pdf> accessed 3 August 2015.

[48] Capital shortfalls were revealed at the end of September 2012, restructuring plans were approved in November and December 2012 and final recapitalization measures granted by Q1 2013.

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of the second condition (that there is an exceptional risk to financial stability which cannot be averted with private capital within a sufficiently short period of time or by any other less distorting temporary measure such as a State guarantee on liabilities) and the third condition (that a current (not prospective) capital shortfall exists, which would force the supervisor to withdraw the institution's banking licence immediately if no such measures were taken). For example, in the case of Abanka,[49] the Commission found that those conditions were met. Point 52 adds a further condition for rescue recapitalization to be approved: it must not prevent implementation of the burden sharing requirements. Finally, if temporary approval is given by the Commission, the 2013 Banking Communication shortens the deadline by which a restructuring plan must be submitted from six to two months from the authorization date.

(b) Strengthened Burden Sharing Requirements

In the first phase of the financial crisis, no Member State went beyond the burden sharing requirements provided by the applicable State aid rules. In some cases burden sharing has been introduced *ex post*, i.e. after State aid had been approved by the Commission and granted by the Member State (e.g. the buy-back of junior debt at deep discounts in Ireland) but this has always been done on the basis of private law contractual arrangements. Thus, the State aid minimum requirements also constituted in practice the maximum burden sharing imposed by Member States (with some limited exceptions). As a result, during the first phase of the crisis, bail-outs came with largely the same degree of private participation across the internal market.

As the financial crisis evolved into a sovereign crisis that situation changed, particularly for Member States in which the cost of bank bail-outs would have significantly weakened their fiscal position. Indeed, some Member States had to go beyond minimum requirements and enforce by way of public law stricter *ex ante* burden sharing requirements. The Eurogroup increasingly insisted on contributions from owners and creditors in the context of assistance programmes. While burden sharing in non-programme countries was thus still closely aligned with the minimum requirements under State aid rules (with the exception of bail-in of subordinated debt holders in the Netherlands, and bail-in of junior and senior creditors in Denmark), burden sharing requirements for banks in program countries were strengthened. In Cyprus, the bail-in of senior debtors partially financed the cost of liquidation and restructuring of its major banks and limited the size of the programme assistance to levels considered bearable from the point of view of public debt sustainability. In Spain, the programme conditionality required full contribution from shareholders and junior debt holders before any programme funds would be disbursed. As a result, in a short period of time, all shareholders were wiped out and all junior bondholders saw their claims converted into shares, thus contributing to covering the capital needs of the Spanish banks. Moreover, the measure did not cause any specific market turbulence. However, markets reacted by taking into account the new developments in burden sharing. As a result, funding costs for banks in countries with (perceived) weaker sovereigns have increased.

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[49] See Commission Decision C(2013) 9633 on Rescue aid to Abanka (Case SA.37690) [2014] OJ C37.

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Building on this experience, the Commission decided to strengthen the burden sharing requirements under State aid rules. The 2013 Banking Communication provides that before granting any public restructuring aid (recapitalization or impaired asset protection), all capital generating measures including the conversion of junior debt should be exhausted. This means that equity, hybrid capital and subordinated debt holders must fully contribute to restoring the capital position of the entity via write-down and/or conversion before an injection of public support. The central principle according to which such a write-down or conversion has to take place is that of 'no creditor worse off', implying that no creditor should be economically worse off after the conversion than if the bank had not have received State aid in the first place. In order to implement these new burden sharing requirements, Member States have to have in place specific legislation to allow for such mandatory conversion as a pre-condition for granting State aid, especially when those contracts do not foresee any conversion clauses. The burden sharing requirements were first implemented in the case of five Slovenian banks,[50] for which the Commission approved aid on 18 December 2013.

In order to tackle any concerns about potential bail-in of depositors, point 42 clarifies that the Commission will not require contribution from senior debt holders (in particular from insured deposits, uninsured deposits, bonds and all other senior debt). However in the context of the new Greek programme of 2015, Eurogroup requested in its statement of 14 August 2015 the bail-in of senior debt bondholders[51] in order to cover the capital needs of the Greek banks. This commitment, which went beyond the minimal State aid requirements of the 2013 Banking Communication, was implemented for the National Bank of Greece[52] in 2015, together with the normal application of the burden sharing requirements required by 2013 Banking Communication. It would also have been implemented in 2015 in the case of Piraeus Bank,[53] but the bank managed to voluntarily exchange all its junior and senior notes into shares.

Under the 2013 Banking Communication, the Commission can make two exceptions to the burden sharing requirements, that is, when the implementation of writing down or conversion of subordinated creditors would lead to disproportionate results or would endanger financial stability (point 45). This could cover cases where the aid amount to be

[50] Commission Decision on Restructuring of NLB which Slovenia is planning to implement for Nova Ljubljanska banka d.d. (Case SA.33229) (2012/C) (ex 2011/N) [2014] OJ L246/28; Commission Decision on Restructuring of Nova Kreditna Banka Maribor d. d. (NKBM) (Case SA.35709) (2013/N) [2014] OJ C120/3; Commission Decision on Orderly winding down of Probanka d. d. (Case SA.37642) (2013/N) [2014] OJ C69/18; Commission Decision on Orderly winding down of Factor Banka d. d. (Case SA.37643) (2013/N) [2014] OJ C69/18; Commission Decision C(2013) 9633 on rescue aid to Abanka (Case SA.37690) [2014] OJ C37.

[51] See Eurogroup statement on the ESM program for Greece of 14 August 2015 <http://www.consilium.europa.eu/en/press/press-releases/2015/08/14-eurogroup-statement/> accessed 15 August 2015.

[52] Commission Decision C(2015) 8930 of 4 December 2015 on the Amendment of the restructuring plan approved in 2014 and granting of new aid to National Bank of Greece (Case SA.43365), not yet published (Commission decision on National Bank of Greece).

[53] Commission Decision C(2015) 8626 of 29 November 2015 on the Amendment of the restructuring plan approved in 2014 and granting of new aid to Piraeus Bank (Case SA.43364), not yet published (Commission decision on Piraeus).

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received is small in comparison to the bank's risk-weighted assets and the original capital shortfall has been significantly reduced through capital raising measures.

At the time of writing, no such exception on grounds of financial stability had been granted in the decision-making practice of the Commission. The disproportionate results exception was invoked in very few cases. The Commission considers that when the aid is granted in the form of an underwriting/commitment to provide public funds, which is subsequently fully covered by private investors, the mandatory conversion of subordinated debt and hybrid capital would lead to disproportionate results. This approach was adopted in State aid decisions on the Greek bank Eurobank in 2014[54] and 2015,[55] and Alpha Bank[56] in 2015. Another case refers to the Spanish bank CEISS-Unicaja.[57] In this case, the burden sharing exercise completed in CEISS in 2012 was fully compliant with the burden sharing requirements which were subsequently laid down in the 2013 Banking Communication. This aspect, in combination with the very small amount of aid enabling the sale (only 0.75 per cent of risk weighted assets of CEISS-Unicaja) was considered as justifying the use of 'disproportionate results' exception and not asking for the conversion of junior creditors of the buyer.

9. STATE AID RULES UNDER THE RESOLUTION FRAMEWORK (BANK RESOLUTION AND RECOVERY DIRECTIVE AND SINGLE RESOLUTION MECHANISM)

In response to the financial crisis that emerged in 2008, the Commission pursued a number of initiatives to create a safer and sounder financial sector for the single market. Those initiatives included stronger prudential requirements for banks[58] and improved depositor protection.[59]

In the absence of EU recovery and resolution rules, State aid rules for the banking sector effectively determined the conditions for the resolution of banks at EU level. Since 2008, State aid policy has been used to coordinate the response of Member States, preserve a level

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[54] Commission decision on Eurobank.

[55] Commission Decision C(2015) 8486 of 26 November 2015 on the Amendment of the restructuring plan approved in 2014 and granting of new aid to Eurobank (Case SA.43363), not yet published.

[56] Commission Decision C(2015) 8488 of 26 November 2015 on the Amendment of the restructuring plan approved in 2014 and granting of new aid to Alpha Bank (Case SA.43366), not yet published.

[57] Commission Decision on the Amendment of the Restructuring of CEISS through integration with Unicaja Banco (Case SA.36249) (2014/N-3) [2014] OJ C141/1.

[58] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance [2013] OJ L176/338; and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance [2013] OJ L176/337.

[59] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes Text with EEA relevance [2014] OJ L173/149.

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playing field in the banking sector, and make sure that bail-outs were carried out according to similar conditions across the EU. The level of State support during the financial crisis was unprecedented. While this may have been necessary to prevent widespread disruption to financial markets and the real economy, it squeezed public finances significantly. The high-profile national and cross-border bank failures during the financial crisis (e.g. Fortis, Anglo Irish Bank and Dexia) revealed serious shortcomings in the existing tools available to authorities for preventing or tackling failures of systemic banks, e.g. those that are intrinsically linked to the wider economy and play a central role in financial markets.

Thus, the need to limit the cost of bank restructuring to taxpayers to a minimum, and to agree on a common European resolution framework, became increasingly evident. That insight underpinned the Commission's proposal for common rules to manage failing banks – and led to the adoption of the Bank Recovery and Resolution Directive[60] (BRRD) in May 2014. The BRRD's core principle is that in the future banks, their owners and creditors should bear the costs of bank restructuring and resolution. Therefore its main aim is to prevent future bail-outs.

The BRRD entered into force on 1 January 2015, except for the bail-in provisions that Member States could choose to apply only from 1 January 2016 when they become mandatory.

The new regulatory framework for banks form the so-called 'single rulebook' for all financial actors in the 28 Member States of the EU. As the financial crisis evolved and turned into the Eurozone debt crisis it also became clear that, for those countries which shared the euro and were therefore even more interdependent, deeper integration of the banking system was needed. That is why, on the basis of the Commission roadmap for the creation of the Banking Union,[61] the EU institutions agreed to establish a Single Supervisory Mechanism (SSM)[62] and a Single Resolution Mechanism (SRM) for banks.[63]

The Regulation on the SRM, agreed by the co-legislators on 20 March 2014, entered into force on 19 August 2014. In essence, the SRM mirrors the provisions of BRRD for participating Member States, with some exceptions.[64] The SRM applies to all banks supervised directly by the SSM.

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[60] Directive 2014/59/EU of the European Parliament and the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council [2014] OJ L173/190.

[61] Communication from the Commission to the European Parliament and the Council: A Roadmap towards a Banking Union, COM/2012/0510 final.

[62] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/63.

[63] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/90. In fact, the SRM is established and governed by two texts: the SRM regulation covering the main aspects of the mechanism and an intergovernmental agreement related to some specific aspects of the SRF.

[64] Government Financial Stabilization Tools (GFSTs) are such an exception. While BRRD allows for their use, they are not included in the SRM. Thus GFSTs will not be available for

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The Single Resolution Board (the Board) became operational as an independent EU Agency from 1 January 2015. The Board is responsible for all resolution schemes involving the use of financial resources from the Single Resolution Fund (SRF). During 2015, the Board worked on developing resolution plans for credit institutions. On 30 November 2015, the EU Council confirmed that a sufficient number of Member States had ratified an intergovernmental agreement on the transfer and mutualization of contributions to the SRF. Therefore, the SRM entered into force as foreseen on 1 January 2016 when the Board became fully operational, with a complete set of resolution powers, including the bail-in, as specified under the BRRD. This signaled completion of the second pillar of Europe's banking union.

(a) Application of State Aid Rules under BRRD and SRM

Given the aim of preventing future bail-outs, or in other words the use of public resources to resolve failing banks, the question arises as to whether State aid rules for aid to banks in difficulty will still be relevant in the context of the new resolution framework designed by BRRD and SRM, and if so to what extent.

The BRRD requires Member States to set up financing arrangements, which can be used for the purposes provided for in the directive, including the provision of liquidity, the recapitalization of banks and loss absorbance. The use of those funds by National Resolution Authorities (NRAs) in favour of banks constitutes State aid pursuant to Article 107(1) TFEU. Without a prior State aid decision by the Commission, the resolution authority cannot go ahead with a bank's resolution where resolution financing is involved. Moreover, the BRRD also provides for so-called 'Government Financial Stabilization Tools' (GFSTs) which are likely to be financed from the national budgets, qualifying as State aid. GFSTs are not resolution tools, but a way to resolve a bank using State resources, rather than resolution funds. However, GFSTs trigger the resolution of an institution under Article 32 BRRD, and the provision of GFSTs takes place in resolution. Recital (8) of the BRRD specifies that the resolution of an institution which maintains it as a going concern may, as a last resort, involve GFSTs. This provision seems to limit the use of GFSTs to going concern resolutions. Therefore, according to Article 108 TFEU, Member States have to notify the Commission of the use of resolution funds or the use of GFSTs. Without a positive decision by the Commission, those funds cannot be used.

At the time of negotiating the SRM Regulation and the provisions on the SRF, it was clear that in its final form the SRF would most likely not constitute State aid in the strict legal sense of Article 107 TFEU. In particular the criterion of imputability was not met, given that under the SRM Regulation the use of the SRF depends on the decision(s) of EU bodies, notably the Board and in some instances the Commission and the Council. This would mean that use of resolution funds would be subject to State aid control for the Member States outside the Banking Union but not for participating Member States, and would thus run counter to the objective that the same conditions and rules apply to the resolution of banks throughout the EU.

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the Member States of the Banking Union from 1 January 2016 when the SRM will be fully implemented.

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However, in order to ensure that resolutions takes place on the same terms for those both inside and outside the Banking Union, the co-legislators decided that the Commission would assess the use of the SRF 'in analogy' with State aid rules. In that respect, Article 19(3) of the SRM Regulation provides that: 'The Commission shall apply to the use of the SRF the criteria established for the application of State aid rules as enshrined in Article 107 TFEU'. Article 19(1) of the SRM Regulation also provides that:

> Where resolution action involves the granting of State aid pursuant to Article 107(1) TFEU or of Fund aid in accordance with paragraph 3 of this Article, *the adoption of the resolution scheme under Article 18(6) of this Regulation shall not take place until such time as the Commission has adopted a positive or conditional decision concerning the compatibility of the use of such aid with the internal market* [emphasis added].

This sequencing ensures that resolution aid under the SRM will be treated equivalent to the use of national resolution financing under the BRRD. Similar to NRAs, the Board cannot use the SRF prior to a Commission decision under State aid rules.

Therefore, Article 19 of the SRM Regulation ensures that substantively and procedurally the same rules apply to the use of all resolution aid (the Fund, national resolution funds etc.) and thus the resolution of banks is effected the same way across the entire EU.

The SRM gave the Commission a new competence, i.e. State aid control over the use of the SRF. This new competence makes the Board a new interlocutor for the Commission in State aid procedures. More specifically, the Board will replace the rights and obligations of a Member State in a State aid procedure, including the obligation to provide to the Directorate-General for Competition of the Commission all the necessary information in cases where the SRF is used.

Although the BRRD aims to minimize losses for society, in particular to avoid as far as possible the use of taxpayers' money during a bank failure, the framework does not prohibit the use of public funds to finance bank resolution. The State aid case practice has proved that State aid is involved, for example, in the event of a transfer of assets of an institution under resolution to a bridge bank[65] or to an asset management vehicle when the assets are transferred at a price above their market value. As from 1 January 2015, Member States intending to provide financial support to a bank will have to comply with both the BRRD requirements as well as with the State aid rules, including burden sharing requirements under the 2013 Banking Communication. The same applies in cases where the Board uses the SRF. State aid rules will apply to any public support to a bank whether in resolution or outside resolution.

(b) Granting State Aid in Resolution

Article 32(4) BRRD introduces the principle that the provision of extraordinary public support to prevent a bank failure triggers its resolution. Article 2(28) BRRD defines

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[65] See for example Commission Decision C(2013) 2689 on State aid to TT Hellenic Postbank S.A. through the creation and the capitalisation of the bridge bank 'New TT Hellenic Postbank S.A.' (Case SA.31155 (2013/C) (2013/NN) (ex 2010/N)) [2013] OJ C190, recitals (52) and (57).

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extraordinary public support as 'State aid within the meaning of Article 107(1) TFEU, or any other public financial support at supra-national level.'

In case resolution funds are used both BRRD provisions on bail-in and conversion of capital instruments and State aid requirements on burden sharing apply. Given that both frameworks pursue the objective of limiting costs to a minimum, their simultaneous application gave rise to some questions. In examining their interaction, the periods from 1 January 2015 and from 1 January 2016 need to be addressed separately.

Starting with 1 January 2015, Article 59 BRRD gives the resolution authority the power to write down and convert capital instruments (i.e. Common Equity Tier 1 (CET1), Additional Tier 1 (AT1) and Tier 2 (T2)), when public support has been provided for a bank's resolution. The power to write down or convert relevant capital instruments may be exercised either independently of resolution action or together with a resolution action. Article 59 BRRD does not foresee any exception. Therefore, from 1 January 2015, for public recapitalizations carried out in resolution, both State aid rules and BRRD provisions apply. In such circumstances, if there is a capital shortfall to be covered by State aid after the conversion and writing down of capital instruments under Article 59 of the BRRD, the conversion or write-down of subordinated debt instruments (which are not AT1 or T2) must also be exercised prior to injection of public funds in order to comply with State aid rules. In addition, the exceptions to burden sharing requirements (in the case of disproportionate results or reasons of financial stability), provided for in the 2013 Banking Communication, can no longer be claimed by Member States for capital instruments covered by Article 59, as those exceptions are not included in the BRRD. Nevertheless, Member States can request, and the Commission will examine on a case-by-case basis, such exceptions only in relation to the portion of subordinated debt not covered by the scope of the BRRD (e.g. subordinated debt instruments that are not capital instruments).

From 1 January 2016 at the latest, the provisions related to the bail-in will enter into force. A number of Member States had already decided to transpose the bail-in tool of the BRRD in 2015 (e.g. Denmark). Therefore, from 1 January 2016 onwards, when an institution is put under resolution and requires public financial support, the write-down or conversion of capital instruments under Article 59 BRRD will be undertaken first prior to the bail-in being conducted. If the write-down or conversion of capital instruments under Article 59 is not sufficient to absorb the losses, the conversion or write-down of debt instruments up to and including uncovered depositors (i.e. the bail-in) must be undertaken. When and before any public resources are used, the absorption of losses by shareholders and creditors must amount to a minimum of 8 per cent of total liabilities (including own funds) of the institution under resolution. All liabilities are subject to bail-in, except for secured, collateralized and guaranteed liabilities, covered deposits and some specific unsecured liabilities, as defined under Article 44(2) BRRD. Also, Article 44(3) BRRD provides for some exceptional circumstances when certain liabilities can be excluded or partially excluded. This means that as of 1 January 2016, the burden sharing requirements of State aid rules will only be applied in the very limited situations when all capital instruments have been bailed in (in line with Article 59 of the BRRD) and the total bail-in has reached 8 per cent of total liabilities (including own funds) but certain subordinated debt instruments which are not considered capital instruments under Article 59 BRRD remain untouched. Those subordinated debt instruments would then also have to be converted or written down in order to comply with State aid rules.

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(c) Granting State Aid Outside Resolution

The same Article 32 BRRD which establishes as a rule that provision of extraordinary public support triggers a bank's resolution also provides for three important exceptions according to which extraordinary public support should not lead to qualifying a bank as failing or likely to fail. These exceptions are as follows:

> (d) [...] when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes any of the following forms:
> (i) a State guarantee to back liquidity facilities provided by central banks according to the central banks' conditions;
> (ii) a State guarantee of newly issued liabilities; or
> (iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution, where neither the circumstances referred to in point (a), (b) or (c) of this paragraph nor the circumstances referred to in Article 59(3) are present at the time the public support is granted.
>
> In each of the cases mentioned in points (d)(i), (ii) and (iii) of the first subparagraph, the guarantee or equivalent measures referred to therein shall be confined to solvent institutions and shall be conditional on final approval under the Union State aid framework. Those measures shall be of a precautionary and temporary nature and shall be proportionate to remedy the consequences of the serious disturbance and shall not be used to offset losses that the institution has incurred or is likely to incur in the near future.
>
> Support measures under point (d)(iii) of the first subparagraph shall be limited to injections necessary to address capital shortfall established in the national, Union or SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by the European Central Bank, [the European Banking Authority (EBA)] or national authorities, where applicable, confirmed by the competent authority.

The first two exceptions enable Member States to grant some liquidity support to solvent banks that encounter liquidity shortages, provided that the Commission's final approval under State aid rules has been obtained. The Commission has already used the exception under Article 32(4)(d)(ii) to approve prolongation of existing guarantee schemes in 2015 (the Cypriot,[66] Greek,[67] Polish,[68] and Portuguese[69] guarantee schemes).

Article 32(4)(d)(iii) BRRD defines the terms under which banks in difficulty can be recapitalized 'outside' resolution. Provided that all conditions listed in Article 32(4)(d)(iii) BRRD are met, the recapitalization of a bank can be considered a 'precautionary' recapitalization and the competent authority is unlikely to determine that a bank is failing or likely to fail. Therefore, a precautionary recapitalization will not automatically trigger resolution and State aid rules will have to be complied with, including burden sharing requirements.

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[66] Commission Decision C(2015) 4819 on the Sixth Prolongation of Cypriot guarantee scheme for banks H2 2015 (Case SA.42080) [2015] OJ C277.

[67] Commission Decision C(2015) 4452 on the Prolongation of the Greek financial support measures (Art. 2 law 3723/2008) (Case SA.42215) [2015] OJ C277.

[68] Commission Decision C(2015) 5892 of 24.8.2015 on the Twelfth prolongation of the Polish bank guarantee scheme – H2 2015 (Case SA.42560), not yet published.

[69] Commission Decision C(2015) 5084 on the Twelfth Prolongation of the Portuguese Guarantee Scheme (Case SA.42404) [2015] OJ C369.

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Article 32(4)(d)(iii) BRRD is an exception and should be interpreted restrictively. The first application of precautionary recapitalization was in relation to two Greek banks, Piraeus Bank[70] on 29 November 2015, and National Bank of Greece[71] on 4 December 2015. The numerous requirements of the precautionary recapitalization are explained below.

(i) The aid is required 'in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability'. That wording quotes Article 107(3)(b) TFEU, which suggests that the exception will no longer be applicable when the Commission decides that Article 107(3)(b) TFEU can no longer be used, for instance because the financial crisis is over.

(ii) The aid is granted 'at prices and on terms that do not confer an advantage upon the institution'. The Commission interpreted this advantage as an undue advantage for the bank, i.e. an advantage incompatible with the internal market under State aid rules. That outcome can be ensured by compliance with the compatibility conditions for restructuring aid, in particular the level of remuneration for the aid which should be in line with the requirements under State aid rules, and the depth of the bank's restructuring.

(iii) The aid 'shall be confined to solvent institutions'. Obviously, this condition can be easily confirmed by the competent supervisory authority (for instance by a letter issued in that respect). However it is highly likely that neither the Commission nor the Member State is able to obtain such confirmation at the time of the State aid decision. Compliance with this condition must be assessed in its specific context, where a bank complies with the capital requirements when the aid measures are granted, following a private capital increase or other capital actions carried out (like voluntary liability management exercises), as assessed by the competent supervisory authority

(iv) The aid 'shall be conditional on final approval under State aid framework'. This means that temporary approval (or an approval as rescue aid) is not sufficient for compliance. The Commission can only approve a precautionary recapitalization if the Member State intending to inject capital has already submitted a restructuring plan in compliance with the Restructuring Communication, and has implemented the necessary burden sharing by shareholders and subordinated debt holders in accordance with the 2013 Banking Communication. In practice, the actual burden sharing of subordinated debt holders usually takes place immediately after the State aid decision is adopted and in any case before State aid is injected into the bank. Thus, it seems that the Commission is ready to accept a commitment of the national authorities to allocate the residual amount of the capital shortfall of a credit institution to the holders of its capital instruments and other subordinated liabilities, prior to any injection of public funds, in line with points 41 and 44 of the 2013 Banking Communication. In any case that commitment needs to be implemented before public funds are injected into a bank. In the case of the National

[70] Commission decision on Piraeus.
[71] Commission decision on National Bank of Greece.

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Bank of Greece, the Cabinet Act implementing that commitment was adopted on 7 December 2015, after the State aid decision of 4 December 2015 and the pay-out of the public recapitalization on 8 December 2015.

(v) The aid 'shall be of a precautionary and temporary nature'. The term 'temporary' implies that a Member State has two options to grant such aid. It can either choose a hybrid instrument with a predetermined maturity date (e.g. contingent convertible bonds) or it can choose a recapitalization in shares, but then it would have to take a binding commitment that the shares would be sold at a certain point in time. The term 'precautionary' suggests that the aid will result in the creation of prudential buffers in the bank.

(vi) The aid 'shall be proportionate to remedy a serious disturbance in the economy of the Member State'. This condition seems to duplicate condition number (i). Despite the partial overlapping, condition number (i) refers to the situation when the aid is granted to 'remedy a serious disturbance in the economy of a Member State and preserve financial stability', while in this case the focus is on the proportionality of the aid.

(vii) The aid 'shall not be used to offset losses that the institution has incurred or is likely to incur in the near future'. Stress tests usually include two scenarios against which the capital adequacies of the participating banks are tested: a likely 'base case' scenario and an adverse case (unlikely) scenario. The wording 'not to offset losses that the bank is likely to incur in the near future' implies that a precautionary recapitalization in the meaning of that provision cannot be used to cover the losses projected in the base case scenario, as they are indeed likely to occur. Thus, it would seem that the exception is only applicable to recapitalizations that would boost a bank's capital ratio so that it can withstand an 'unlikely' adverse case scenario.

(viii) The aid is 'limited to injections necessary to address capital shortfall established in the national, Union or SSM-wide stress tests, asset quality reviews or equivalent exercises conducted by the European Central Bank, EBA or national authorities'. That wording restricts the applicability of that provision to stress tests and similar supervisory exercises. Given that the EBA published on 22 September 2014 the relevant guidelines on the types of tests, reviews or exercises that may lead to support measures under Article 32(4)(d)(iii) BRRD, those stress tests must also comply with those guidelines. Although this provision seems to imply that the co-legislators had the EBA-SSM stress test of 2014/5 in mind when deciding to include such a condition, it was only in case of the stress test carried out by the SSM exclusively for the Greek banks that the precautionary recapitalization was put into practice for the first time. In order to qualify for a precautionary recapitalization and thus avoid resolution, State aid can cover only the capital shortfall stemming from the adverse scenario of the stress test, while capital needs stemming from the asset quality review (AQR) and baseline scenario have to be covered by private means. The public recapitalizations of the two Greek banks were carried out in the form of ordinary shares and contingent convertible bonds and were limited to the injections necessary to cover the capital shortfall arising under the adverse scenario of the stress test, as identified by the ECB and disclosed on 31 October 2015, after the capital shortfall arising under the AQR and the baseline scenario of the stress test had been covered by private means (i.e. capital raising from private investors and

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capital actions approved by the SSM, including voluntary and mandatory liability management exercises carried out in October and November 2015).

(ix) The circumstances referred to in points (a), (b) or (c) of Article 32(4)(d) BRRD and the circumstances referred to in Article 59(3) BRRD are not met. Verifying compliance with points (a), (b) and (c) of Article 32(4)(d) BRRD is a difficult task for the Commission. Given that those conditions are likely to fall more under the scope of the competent supervisory authority, the Commission can only carry out its assessment based on the available information and the specific context of the aid measure.

(d) Assessment of State Aid under BRRD and SRM

The Commission cannot deem a State aid measure compatible if the measure or the method of its financing breaches intrinsically linked provisions of Union legislation.[72] Therefore, procedurally under EU law, in addition to assessing compliance of public recapitalization with State aid rules (including burden sharing requirements), the Commission will have to examine whether any public recapitalization respects the intrinsically linked conditions of the BRRD before it can authorize such recapitalization (including the conditions for precautionary recapitalization). The intrinsically linked provisions of BRRD with State aid rules need to be interpreted narrowly. The TFEU lays down the rules for State aid procedures for the specific purpose of examining the existence of State aid and assessment of its compatibility. State aid procedures can therefore be used as an instrument to enforce other norms of EU law when the measure in question is highly likely to breach those norms. Since the beginning of 2015 the Commission has assessed some relevant articles of the BRRD as intrinsically linked with State aid rules, depending on the specificity of each State aid measure. The Commission assessed those provisions regardless of the Member States having transposed BRRD or not. For example, the Commission found the following provisions to be intrinsically linked with State aid rules: Article 32(4)(d)(ii) BRRD (for existing guarantee schemes prolonged in 2015); Article 32(4)(d)(iii) (for the qualification as precautionary recapitalization in the case of Piraeus Bank and National Bank of Greece); Article 44(5), Article 59(3) and Article 109 (for the Danish winding up scheme[73] where Denmark transposed the bail-in provisions from 1 June 2015 on). In the case of resolution of the Greek Panellinia Bank[74] in April 2015, although Greece had not yet transposed BRRD at that time, the Commission found the provisions of Article 100(5) and Article 34(1) BRRD to be intrinsically linked with State aid rules. The resolution measure corresponded to the 'sale of business tool' provided in Articles 38 and 39 BRRD. Greece had already had in

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[72] See for example Commission Decision C(2015) 816 on the Reintroduction of the winding-up scheme, compensation scheme, Model I and Model II – H1 2015 (Case SA.40029) [2015] OJ C136, 25.

[73] Commission Decision C(2015) 6452 of 18.9.2015 on the Prolongation of the Danish winding-up scheme, compensation scheme, Model I and Model II – H2 2015 (Case SA.42405), not yet published, 37–41.

[74] Commission Decision C(2015) 2606 on the Resolution of Panellinia Bank through a transfer order to Piraeus Bank (Case SA.41503) [2015] OJ C325, 111–4.

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place a resolution fund since 2011 which covered the funding gap related to the transfer of assets and liabilities from the bank to the buyer, Piraeus Bank. Therefore, the funding of the aid measure complied with Article 100(5) BRRD. As regards the assessment of the second intrinsically linked provision, Article 34(1) BRRD, the Commission noted that Panellinia Bank had not had any outstanding subordinated debt instruments at the time of resolution. The equity of the bank was left in the liquidated entity, thus ensuring that shareholders were fully wiped out and suffered 100 per cent losses. Therefore, the measure was also in line with Article 34(1) BRRD.

In the case of GFSTs, recital (57) BRRD is rather prescriptive and indicates the elements that the Commission needs to assess in its State aid decision:

> When the Commission undertakes State aid assessment under Article 107 TFEU of the government stabilisation tools referred to in this Directive, it should separately assess whether the notified government stabilisation tools do not infringe any intrinsically linked provisions of Union law, including those relating to the minimum loss absorption requirement of 8% contained in this Directive, as well as whether there is a very extraordinary situation of a systemic crisis justifying resorting to those tools under this Directive while ensuring the level playing field in the internal market. In accordance with Articles 107 and 108 TFEU, that assessment should be made before any government stabilisation tools may be used.

GFSTs trigger the resolution of a bank and can be implemented only after the 8 per cent bail-in has taken place. However, GFSTs are an exception to the overarching principles of reducing taxpayers' money and preventing bail-outs which are at the core of the new resolution framework. This is why the BRRD limits their use to exceptional circumstances, and only after maximum consideration and exploitation of other resolution actions. If GFSTs are ever used, the BRRD requires the Commission to assess in its State aid decision whether the very extraordinary situation of a systemic crisis exists and whether it justifies the use of GFSTs. As of December 2015, GFSTs had not been used.

Depending on the circumstances of the case and the use of resolution funds, the Commission's depth of assessment of the resolution aid can be differentiated under four cases.

First, there are cases in which no resolution fund is used. For example, the application of resolution tools suffices to resolve a bank without any capital aid (for example when bail-in would suffice to provide the capital needed), and the fund does not have to provide any liquidity to the bank, the bridge bank or the bad bank. In those cases, no aid will be notified, assessed or approved.

Second, there will be a subset of cases in which the entire bank that is resolved will disappear from the market. In such cases, if the fund does give liquidity or capital to finance the orderly winding up, given that the risk of distortions of competition is minimal, the Commission's assessment will mainly be limited to checking whether the winding up process is performed in a manner that does not lead to distortions and that the bank exits the market fully. This is in practice a light assessment.

Third, there will be situations in which the resolution fund merely provides liquidity, for example to fund a bank that continues to operate on the market after the bail-in was used and cannot initially obtain market funding. The Commission limits its assessment in such cases (except when the liquidity provided exceeds certain thresholds) to verifying whether the aid provided is kept to the minimum necessary and whether certain remuneration requirements are met. Again, this is in practice a light and straightforward assessment.

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Fourth, there might be cases in which all or a part of the resolved bank continues to operate on the market, and the resolution fund will recapitalize that part of the bank, for example because the bail-in tool is not sufficient to restore the capital ratio of the bank to a viable level, or there is aid to the bank included in the pricing of the assets transferred to a fund-supported bad bank. In that subset of cases, the Commission's assessment will have to verify notably whether: (i) the burden sharing requirements – and the bail-in of subordinated creditors in particular – are met; (ii) the part that continues to operate on the market is viable; and (iii) the distortions of competition resulting from the recapitalization are limited to the minimum.

10. CONCLUSION

The Crisis Communications have not only provided guidance on the use of public support (guarantees, recapitalizations or impaired asset measures), but have also imposed tough conditions for financial institutions which receive such aid. The Commission's State aid control aimed to ensure that aided financial institutions were adequately restructured to become viable again or – if viability could not be restored – were taken out of the market (like Dexia, WestLB, Hypo Alpe Adria, Kommunalkredit, Anglo Irish and others). In the same vein, State aid control has dealt with the distortions of competition created by the aid received while at the same time maintaining financial stability, safeguarding the internal market and protecting the interests of taxpayers.

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