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The Impact of the EU Crisis-Related Framework on State Aids to Financial Institutions: From Past Practice to Future Prospects

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In the last five years of unprecedented financial and economic crisis, State aid control has gone through an incredible momentum in the EU as reflected by the huge amount of State support measures that were taken in order to avoid a systemic failure of the European economy. The article shows the measures taken in the last five years, the reasons for applying a special legal basis, Art 107(3)(b) TFEU, to grant such aids, and the criteria developed by the Commission to face them. To that extent, it is argued that the establishment of a crisis-related regime for aids to financial institutions has proved to be an effective instrument to calm down a systemic crisis for the banking sector and to grant cash flows to ailing firms also with specific regard to Programme Countries. The article shows that the financial sector requires a special treatment, that State aids granted shall primarily offset distortions of competition, and that a great number of remedies have been included to compensate the granting of aids. It is argued that the establishment of a new regulatory framework to supervise banks in the EU and the refinement of procedural rules in the financial sector would be highly beneficial to refine State aid rules for the financial sector in near future.

INTRODUCTION

As established by Art 107 of the Treaty on the Functioning of the European Union (the 'TFEU'), State aids are 'in principle incompatible with the internal market saved as provided by other provisions of the Treaties'. There are a number of conditions that need to be fulfilled in order to find State aid according to Art 107(1) TFEU.[1] Art 107(2) & (3) TFEU provide for *de jure* and *de facto* derogations to State aids which the Commission shall or can declare compatible with the internal market.

The European Commission is responsible for controlling State aids. It has taken a very active role, as demonstrated by the various initiatives to modernise State aid control in the last ten years. Before the outbreak of the financial crisis in 2008, there has been a demand for a refinement of State aid control as envisaged in the 2005 State aid Action Plan (hereafter 'SAAP'), which was aimed at developing a new stage of State aid policy.[2]

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1 Art 107 TFEU considers State aids when state measures are granted by a Member State (1) or through State resources (2) in any form whatsoever which distorts or threatens to distort competition (3) by favouring certain undertakings or the production of certain goods (4) shall, in so far as it affects trade between Member States (5), be incompatible with the internal market.

2 *State aid action plan - Less and better targeted State aid: a roadmap for State aid reform 2005-2009*, COM/2005/0107 final, 07.06.2005. The SAAP was published in 2005 and it was aimed at revising State aid control on four

This document traced a roadmap for State aid reforms from 2005 to 2009. As a result, great innovations to the rules applicable to State aids have been put forward.[3] For instance, the Common Principles on the compatibility of State aid measures under Art 107(3) TFEU were adopted in 2009.[4]

However, the "hand's on" approach of the Commission has been seriously questioned by the outbreak of the financial crisis in Europe. The European Union (hereafter the 'EU') and its Member States have been confronted with an unexpected scenario that has resulted in challenges to the applicability of State aid control in the financial sector. To that extent, the Commission has been prone to clear State aids in the affected sectors than in past. In this respect, it has adopted a number of policies that have created a crisis-related regime aimed at giving guidance to Member States to adopt compatible State aids in the financial sector.[5]

Nevertheless, the Commission has constantly underlined the need to progressively phase-out these crisis-related rules as already shown in the Agenda for Europe 2020.[6] At the same time, although the effects of the financial crisis are still present, the Commission has published a Communication aiming at reforming the rules on State aids in the coming years.[7] In the aftermath of the financial crisis, this document will drive the Commission's reforms on some essential elements of State aid policy in particular to 'better contribute both to the implementation of the Europe 2020 strategy for sustainable growth [and] to budgetary consolidation'.[8]

This article will try to assess the most critical challenges of EU State aid control in the financial sector. In particular, it aims at evaluating the applicable rules on State aids in the current process of (post) crisis banking sector taking steps from the measures adopted in the last five years. It comprises three parts which treat EU State aid law in the financial sector. Part I analyses the effects of the financial crisis on EU State aids with particular emphasis on the past five years and on the use of the new legal basis to solve the most critical banking cases. After having analysed the Temporary Framework adopted in the context of the banking and the financial market, Part II dives into a

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pillars: less and better targeted aids, a more refined economic approach, more effective procedures and a shared responsibility between the European Union and the Member States. On the SAAP see Ulrich Schwalbe, 'European State aid control – The State aid action plan', in Jürgen Basedow and Wolfang Wurmnest (eds.), *Structure and effects in EU competition law*, (Alphen: Kluwer, 2011), 162-191.

3 The main normative implementations of the SAAP have been the adoption of the *de minimis* Regulation, the General Block Exemption Regulation, the Community framework for Research and Development and Innovation.

4 *Common Principles for an Economic assessment of the Compatibility of State aid under Art.87.3*, 15.05.2009, available at http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf .

5 See *infra* I.3.

6 The European Commission adopted in 2010 the *Agenda for the Europe, a strategy for smart, sustainable and inclusive, growth*, COM(2010)2020, 3.3.2010. See, also, the Communication of the Commission to the European Council, *a European Economic Recovery Plan*, COM(2008) 800 final, 21.11.2008.

7 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *EU State aid Modernisation (SAM)*, COM/2012/0209 final, 08.05.2012.

8 *Ibid.*, para. 5.

commentary of the special State aid rules in the financial sector with particular emphasis on the specificities of the banking sector, the impact on distortion of competition, the measures taken to offset the granting of aid and the special situation of the so-called "Programme Countries". Finally, Part III examines three aspects that open up challenges for future State aid control in the financial sector.

I. The Financial Crisis and European State Aid Control: The Situation So Far

This part of the article is divided into two sections: the first reconstructs the impact of the financial crisis since 2008 until the adoption of the Modernisation Communication (SAM);[9] the second refers to the more extensive interpretation of the Treaty rules to grant compatible State aids both for ad hoc and scheme cases.

I.1 The background on State support measures in Europe in the financial crisis

Lehman Brothers filed for bankruptcy on 15 September 2008 and after such event the financial markets, the world economy and the real economy progressively plunged into the deepest crisis after the Second World War.

A spinoff of government support measures were adopted and redesigned the system of State intervention. The US Government took control of the American International Group (the 'AIG') after an injection of $85 billion. One week later, the US treasury secretary, Henry Paulson, finalised the details of a US $700 billion 'bad bank plan' which, after some time, was adopted by the Congress on 3 October 2008.

At the same time as this unprecedented intervention in the US, the financial crisis posed enormous challenges on the EU State aid regime. The collapse of Lehman Brothers proved to be the initial spinoff to challenge the rules on State aid.[10] Before the collapse, some banks were either supported or restructured in line with the EU's normal approach to State aid.[11] This was the case, among others, of WestLB,[12] Roskilde,[13] or Northern Rock.[14] Nonetheless, as the Commissioner Almunia put it, 'the early days of the crisis confirmed what we had anticipated; the EU lacked common tools to resolve banks with cross-border operations and to coordinate national measures'.[15]

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9 See *supra* note 7.

10 Karel Lannoo and Chris Napoli, Bank State aid in the Financial Crisis: Fragmentation or Level Playing Field?, (Brussels: CEPS Publications, 2010), 4.

11 Communication from the Commission, *Community Guidelines on State aid for Rescuing and Restructuring Firms in Difficulty*, O.J. (C 244), 2004 (hereafter the 'R&R guidelines').

12 Decision C 43/2008 (ex N 390/2008), *WestLB AG*, OJ L 345, 23.12.2009.

13 Decision NN 36/2008, *Roskilde Bank*, OJ C 238, 17.09.2008.

14 Decision C 14/2008 (ex NN 1/2008), *Northern Rock*, O.J. L 112, 05.10.2010. This can be considered as the last case where the European Commission took the traditional approach.

15 Joaquín Almunia, Restructuring EU banks: The role of State aid control, SPEECH/12/122, 24.02.2012.

Alongside the application of the normal regime of State aid, a guarantee scheme of some €400 million, which was solely planned to cover the Irish banks, began to challenge the integrity of the internal market.[16] The Commission finally approved the scheme under condition that it would eliminate all discriminatory elements. Thus, the scheme had to cover banks with systemic relevance for the Irish economy.[17] At the same time, it seemed unavoidable that some other big banks (e.g. Commerzbank, RBS, Dexia, Fortis, Hypo Real Estate, ING) had to be rescued and that other State aid instruments were essential to address the situation.[18]

The conclusions adopted during the 12th Euro Group in Paris allowed European governments to provide guarantees to bank debt crisis under specific conditions so that governments could take equity stakes in financial institutions and provide for recapitalisation to banks in trouble. Soon after, the European Council endorsed such conclusions and allowed for a broader interpretation of EU State aid rules based on 'speedy and flexible action'.[19]

The forms of State aids to banks have taken different approaches: guarantees on bank deposits; bank bonds or bank liabilities; equity support to enhance the capital base of financial institutions; the creation of 'bad banks' that delayed the reimbursement of creditors and assets recover; the nationalisation of banks where most or a large part of the assets was taken over by the State.[20] All these different support measures have forced the European institutions to take different steps to State aid control and has required them to consider new forms of intervention for State aids under special circumstances.

In 2008, the ECOFIN Council agreed on the common principles that would guide Member States actions and welcomed 'the Commission's continued commitment to act quickly and apply flexibility in State aid decisions'.[21] The same principles where affirmed by the European Council that encouraged the Commission to overcome the rigidity of the existing State aid rules while 'continuing to uphold the principles of the single market and of the State aid regime'.[22] Under these conditions, the Commission has published four Communications to maintain the principles underlying State aid control to banking sector while allowing some flexibility and celerity in the procedure.[23] The purpose of such intervention was to complement 'macro-financial stability oriented

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16 See the reconstruction of the case in Phedon Nicolaïdes and Ioana Eleonora Rusu, *State aid and the temporary rules in response to the crisis*, Antitrust Bulletin 55, no. 4 (2010): 759-782.

17 Decision NN 48/2008, *Guarantee Schemes for Banks in Ireland*, OJ C 312, 06.12.08.

18 Almunia, *supra* note 15.

19 European Council, *Presidency Conclusions,* Nr.14368/08, 16.10.2008, para.5.

20 For an overview on the different measures see Christoph Arhold, *Financial Sector*, in Leigh Hancher, Tom Ottervanger and Piet Jan Slot, *EU State aids*, (London: Sweet & Maxwell, 2012), 600-621.

21 Council of the European Union, *Immediate responses to financial turmoil Council*, 7.10.2008 available at www.consilium.europa.eu.

22 ECOFIN, *Declaration on a Concerted European Action Plan of the Euro Area Countries*, 12.10.2008, available at http://ec.europa.eu/economy_finance/publications/publication13260_en.pdf.

23 See the references in Lannoo and Napoli, *supra* note 10, 12.

policies', to tackle moral hazard and to neutralize zombie banks.[24] According to Commissioner Almunia,

> 'the State aid rules for banks in distress … still remain the best instrument in our hands … to manage and coordinate the rescue and restructuring operations of Europe's banks from an EU perspective'.[25]

This is a critical consideration because the European regulatory fragmentation for handling ailing banks left State aid control as the only instrument at EU level to deal with the negative spill-over effects among Member States, to protect the internal market and to reduce moral hazard and competitive distortions.[26]

As from the end of 2009, the European Commission was notified of an increasing number of State aid measures from the Member States. They include both national schemes and individual bank cases which mainly consisted of short term liquidity loans, state guarantees, equity and debt financing measures, support for bad bank schemes. Following the special crisis-related regime, the Commission has considered most of these measures as compatible aids.

So far three different periods in the treatment of State aid in the financial sector can be identified. The first was the "Subprime Crisis" period from September 2007 to September 2008 until Lehman Brothers bankruptcy, over which the Commission applied the traditional approach under Art 107(3)(c) TFEU.[27] The second was the "Temporary Frameworks" period, ideally beginning after the Lehman Brothers bankruptcy filing until the end of 2010. Confidence gradually dropped and interbank lending markets collapsed.[28] It was at that time that the Commission refused to drop State aid control policy and rather adopted a more effective and flexible approach both in the financial sector and in the real economy through crisis-related regimes.[29] The third period, the "Sovereign debt crisis", approximately from the end of 2011 and still on-going, has been showing the effects of the crisis-related framework in the financial sector as well as the consolidation of the compensatory decisions taken in the last four years under the special framework. In addition to the prolonged sovereign debt crisis in the EU, this third phase is characterised by the consolidation of restructuring programmes to banking sectors in the so-called "Programme Countries", the valuation of government bonds, the expiry of the special rules related to the real economy, the proposition of a new Modernisation document for State aid control and the calls for a system of prevention and early control over financial institutions.

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24 See Gert-Jan Koopman, *Competition in EU banking during the financial crisis: the role of State aid control*, 2011, available at http://ec.europa.eu/competition/speeches/text/koopman_cpi_7_2_en.pdf, 9.

25 Almunia, *supra* note 15.

26 See Lannoo and Napoli, *supra* note 10, 13.

27 Ibid.

28 Damien Gerard, Managing the Financial Crisis in Europe: Why Competition Law is Part of the Solution, Not of the Problem, in (2008),1, Global Competition Review, 6.

29 François-Charles Laprévote and Antoine Winckler, When the Watchmen must take the wheel – State aid Control of financial institutions and other political imperatives during the financial crisis in AA. VV., Competition policy in times of crisis, Concurrences, 2, special issue, (2009): 9.

Before the second half of 2011, some commentators have raised concerns about a possible excessive room given to State aid measures during the crisis.[30] However, in October 2011 the European Commission published a Working Paper (hereafter 'the Paper')[31] which evaluated the application of State aid policy in the framework of the temporary rules as adopted during the financial crisis. Published in the second half of 2011, this Paper provides a clear and useful view on the implementation of the temporary rules for aid control in the financial sector. Further, it highlights the effectiveness of the Commission intervention to avoid risks of systemic crisis in European markets.

As the most recent figures show, both the Commission paper of October 2011[32] and the December scoreboard of 2012, sums of State aids reached an unparalleled level during the crisis. Prior to the financial crisis, the amount of aid was around 0.5% of the EU Gross Domestic Product (GDP) per year.[33] By the end of 2009, the amount of money committed by Member States exceeded €3.63 trillion corresponding to around 29% of the EU GDP.[34] By December 2010, the amount reached €4.3 trillion, the equivalent to 36% of the EU GDP and a 10% of the EU banking sector assets. By the end of 2011, it reached €4.5 trillion, the equivalent of 36.7% of the EU GDP.[35] The difference between the amount devoted and the amount actually used, is mainly due to the extensive guarantee schemes put in practice that counted on 75% of the money committed (€3.23 trillion), but which were only marginally used (61% of the aid granted, or €0.76 trillion).[36] In the 2012 State aid Scoreboard, the Commission acknowledges that '[the] total amount of aid approved from 2008 until 1 October 2012 was €5,058.9 billion (40.3% of EU GDP)'.[37] However, the amount of aid actually used between 2008 and 2011 amounted to € 1,615.9 billion (12.8% of EU GDP). Further, the Scoreboard states that '[the] aid to the financial sector in 2011, totalling €714.7 billion or 5.7% of EU GDP, was mainly to provide guarantee support and liquidity support and was concentrated in a few Member States'.[38]

In sum, as of December 2012, the Commission has adopted more than 300 clearance decisions in more than 100 cases, of which 45 concerning State aid schemes and more than 60 concerning individual banks or credit institutions under the special applicable rules.[39]

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30 See e.g. Nicolaïdes and Rusu, *supra* note 16, 767.

31 Commission Staff Working Paper, The effects of temporary State aid rules adopted in the context of the financial and economic crisis, SEC (2011) 1126 final, , 5.10.2011, 36.

32 *Ibid.*, 19 and following.

33 European Commission, *State aid Scoreboard*, Autumn 2009 Update , SEC (2009) 1638, 07.12.2009.

34 Ibid..

35 'The Paper', *supra* note 31, 36.

36 *Ibid.*, 38.

37 European Commission, *Scoreboard on State aids update*, Autumn 2012, COM(2012) 778 final, 21.12.2012.

38 *Ibid.*

39 Data inferred from the European Commission, Overview of decisions and on-going in-depth investigations in the context of the financial crisis, MEMO/12/665, 13.09.2012.

Two general conclusions from the most recent data in the Scoreboard can be made. First, even if numbers are still impressive, the amount authorised does not correspond to the amount effectively used. Second, the biggest wave of State aids in the financial sector took place in 2008 during the early days of the crisis. Therefore, with the exception of some state guarantee schemes, the last two years have thus showed a decrease in the amount of aids authorised in the financial sector.

I.2 The new use of Art 107 TFEU to declare State aids to the financial sector compatible

The change of perspective in granting State aid and the creation of a special regime both to the financial sector did not come out in a vacuum, but was taken alongside the Treaty provisions.

State aid is incompatible under Art 107(1) TFEU, 'save as otherwise provided in this Treaty'. Art 107(2) & (3) TFEU contains a number of derogations that can be considered to assess the compatibility of a State aid. To this analysis two derogations are important: (b) refers to aid to remedy a serious disturbance in the economy of a Member State and (c) to aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. Many guidelines[40] refer to the derogation under (c). For instance, the Rescue and Restructuring (hereafter the 'R&R') guidelines affirm that 'the only basis on which aid for firms in difficulty can be deemed compatible is Article [107(3)(c) TFEU]'.[41] Such aids cannot act against the 'common interest or have adverse effects on trading conditions' and provide that unstable undertakings artificially remain in the market.[42] The Guidelines are applicable to any economic sector where there are not sector-specific rules. Thus, a strong link exists between Art 107(3)(c) TFEU and the R&R Guidelines.[43]

In contrast, the reference to the legal basis under (b) before 2008 was restrictively interpreted. The only case where the Commission used Art 107(3)(b) TFEU to declare an aid compatible to remedy a serious disturbance to the economy of a Member State was in 1991 when aid for privatization programme in Greece was approved.[44] Neither a sectorial crisis, nor the breakdown of an undertaking or a bank, not even the crisis of a region of the EU was enough to justify the use of such legal basis.[45] For instance, in the

[40] See the R&R guidelines, paras 19-20; Community Guidelines on State aid for environmental protection, OJ C 082, p.1, 01.04.2008, paras 71 and following; the Community framework for State aid for research and development and innovation, OJ C 323, 30.12.2006, p. 1, ss 4 and 5.

[41] See R&R Guidelines, para.19. Art.107(3) (c) TFEU provides that aid may be considered compatible when used to 'facilitate the development of certain economic activities'. As such this is the legal basis typically used to rescue and restructure ailing firms under normal conditions and the cornerstone of the R&R Guidelines.

[42] See also Charalambos Savvides and Daniel Antoniou, *Ailing Financial Institutions: EC State aid Policy Revisited*, World Competition 32, 3, (2009): 349.

[43] *Ibid.*, 350.

[44] SA NN 11/91, Greek Privatization Aid, 31.07.1991.

[45] See, similarly, the position of the Court of Justice in Case C-301/96, *Germany v. Commission*, ECR [2003], Page I-9919, para.106.

Crédit Lyonnais case, the aid at issue was not 'designed to remedy serious economic disruption, since its purpose is to resolve the problems of a single recipient, Crédit Lyonnais, as opposed to the acute problems facing all operators in the industry'.[46]

For these reasons, before the adoption of the crisis framework, State aid cases regarding financial institutions in difficulty were taken within the straitjacket of R&R guidelines.[47] For example, this was the case of *Sachsen LB*.[48] The Commission applied the principles of the R&R guidelines to assess the compatibility of the aid.[49] This meant that the Commission assessed whether the aid could restore the long-term viability of the bank while being limited to the minimum necessary, with a significant contribution of the bank, and complying with compensatory measures to reduce the potential distortions of competition.[50] The Commission cleared the measures and forced the company to a 50% contribution together with a substantial divestment of its activities in different markets. This decision raised the question of a change of the legal basis to adopt such aids.[51] In fact, the parties sought the application of Art 107(3)(b) TFEU, designed to respond to cases of 'a serious disturbance in the economy' to the case at issue. Nonetheless, the Commission concluded that the problem was company-specific and that a macro impact on the whole German economy was not proved. [52] The same stance was taken in the *WestLB*,[53] *Northern Rock*[54] and *Bradford and Bingley*[55] cases where the Commission appraised these aids under the traditional R&R guidelines.[56]

However, after the gloomy situation arising in October 2008, the Commission adopted a much more flexible attitude accepting Art 107(3)(b) TFEU as a new legal basis. Many Member States granted aids that were problematic to accept following the traditional interpretation and this situation induced the Commission to relax its approach under

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46 Commission Decision (98/490/EC), *Crédit Lyonnais* , OJ L 221, 08.09.1998, par. 28.

47 Commission Decision 2005/345/EC in C 28/02, *Bankgesellschaft Berlin,* OJ L 116, 4.5.2005, paras 153 and following; Commission Decision 2008/263/EC in C 50/06, *BAWAG*, OJ L 83, 26.3.2008, para.166. See also Commission Decision NN 70/07, *Northern Rock*, OJ C 43, 16.2.2008; Commission Decision NN 25/08, *Rescue aid to Risikoabschirmung WestLB*, OJ C 189, 26.7.2008 and Commission Decision C 9/08, *SachsenLB*, OJ L 104, 24.4.2009.

48 C 9/08, *Sachsen LB,* OJ L 104, 24.04.2009.

49 See European Commission, Commission adopts new rules governing aid to firms in difficulty, MEMO/04/172, 07.07.2004.

50 European Commission, State aid: Commission approves restructuring of Sachsen LB, IP/08/849, 04.06.2008.

51 Nicolaïdes and Rusu, *supra* note 16, 771.

52 C 9/08, *SachsenLB*, OJ L 104, 24.4.2009, paras 94-95.

53 NN 25/08, *West LB*, OJ C 189, 26.7.2008.

54 Case NN70/07, *Northern Rock*, OJ C 43, 16.2.2008. See European Commission, *State aid: Commission approves UK rescue aid package for Northern Rock*, IP/07/1859, 05.12.2007.

55 Case NN41/08, *Bradford and Bingley*, OJ C 290, 13.11.2008.

56 Also the initial approach to the NN44/20, *Hypo Real Estate Case*, OJ C 293, 15.11.2008, followed the traditional approach. Nonetheless, given its timing and the introduction of the special rules in the mean time the aid was considered under Art 107(3)(b) TFEU.

Art 107(3) TFEU rather than reject totally State aid control.[57] As D'Sa calls the 'Financial Institutions Exception' was allowed in order to address the situation through alternative legal basis allowing banks to receive a special legal treatment.[58] The risk of a fall of the European banking system could severally worsen the disturbance and result in the collapse of the entire financial market. Such scenario proved to be gloomy enough to use Art 107(3)(b) TFEU.

The changing approach of the Commission under Art 107(3)(b) TFEU for State aid to banks can be clearly illustrated by the *BAWAG-PSK*[59] and *Roskilde*[60] cases. In the former the Commission decided that Austria had not demonstrated the systemic implications for the whole Austrian economy of BWAG-PSK insolvency. In the latter the rescue aid for the Danish Roskilde bank was not accepted by the Commission for the same reasons. Nonetheless, the Commission changed its approach dramatically only three months later when two subsequent decisions for rescue aid to BAWAG-PSK and for liquidation aid to Roskilde were assessed under the provision of Art 107(3)(b) TFEU. The Commission argued that the significance of integration and interconnections of the banks in Europe needed to use such provision.[61]

These examples emphasize how necessary a broader interpretation of Art 107(3)(b) TFEU was. Nonetheless, the use of this legal basis will be progressively phased-out in the future because, as underlined by the Commission, the crisis-related measures are temporary in nature. Hence, it is clear that, in case another crisis will arise in future, the use of Art 107(3)(b) TFEU in granting State aids in cases of serious disturbances to the economy would provide only an *extrema ratio* to declare State aids compatible.

I.3 The Temporary Framework in the financial sector

As stated above, in a non-crisis scenario, the applicable rules to granting aids to firms in difficulties would have been either the use of the legal basis of Art 107 (3)(b) TFEU to ad hoc cases or of the horizontally applicable R&R Guidelines. This document, adopted in 2004 and under consultation for future reform in 2010, is still in force.[62] The R&R Guidelines set out a number of principles and rules applicable to rescuing and/or restructuring aids for firms "in difficulties". Among other aspects, they affirm that the beneficiary should be an "undertaking in difficulty", that this undertaking should contribute itself to restoration of its own financial difficulties, that the potential beneficiary should present restructuring plans to be endorsed by the Commission, that distortion of competition should be limited to the minimum, and that compensatory measures must be taken to minimize distortion of competition.

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57 Thomas Doleys, *Managing State aid in Times of Crisis: The Role of the European Commission*, 2010, available at http://www.jhubc.it/ecpr-porto/virtualpaperroom/084.pdf, 11.

58 Rose D'Sa, Instant State aid law in a Financial Crisis – A U-Turn?, EStAL 8, no. 2 (2009), 139.

59 C50/06, *BAWAG-PSK*, OJ L 83, 26.03.2008.

60 NN 36/08, *Roskilde bank*, OJ C 238, 17.09.2008.

61 See to that effect Decisions C3038/08, *BAWAG-PSK* para.26, and C6498/08, *Roskilde bank*, paras 72-74.

62 The Commission has decided to prolong its applicability until the moment of adoption of new Guidelines. See European Commission, *Prolongation of Community Guidelines*, OJ C 296, 02.10.2012, 3.

Although the Commission found the R&R Guidelines unsuitable for the financial sector, it relied on these rules to approve aids in it. Namely, the Commission relied on return to long-term viability, the principle of own contribution, burden sharing and avoidance of distortion of competition to approve such aids.

These principles are summarized as follows and crisis-related decisions take account of them:

> 'a. *Appropriateness*: The aid has to be well-targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy. It would not be the case if the measure were not appropriate to remedy the disturbance.
>
> b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. Thus it must be of the minimum amount necessary to reach the objective, and take the most appropriate form to remedy the disturbance.
>
> c. *Proportionality:* The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives.'[63]

On such basis, between October 2008 and July 2009, the Commission introduced a Temporary Framework for State aid to financial institutions which was motivated by the exceptional circumstances that allowed the granting of vast amount of State aids in the banking sector.

This is composed of Four Communications[64] widely known among academics[65] as the Banking, Recapitalisation, Impaired Assets and Restructuring Communications, subsequently complemented by two Prolongation Communications. These rules were accompanied by a 'Temporary Framework for State aid measures to support access to finance in the current financial an economic crisis', applicable horizontally in the real economy, which expired on December 2011.[66]

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63 See for instance SA.34820, Rescue measures in favour of BFA/Bankia – Spain, JOCE C/220/2012; SA. 34937 (2012/C) Second Recapitalisation of NLB and SA. 33229 (2012/C), Restructuring of NLB.

64 See *infra.*

65 Academic literature on the Temporary Framework for crisis-related measures is already vast. See, inter alia, Damien Gerard, EC Competition law enforcement at grips with the financial crisis: flexibility on the means, consistency with the principles, Concurrences, 1 (2009): 46-62; Editorial Comment, From rescue to restructuring: the role of State aid control for the financial sector, Common Market Law Review 47, no. 2, (2010): 313-318; Emily Adler, James Kavanagh and Alexander Ugryumov, State aid to banks in the financial crisis: the past and the future, Journal of European Competition Law and Practice, 1 (2010): 66-71; Marianne Dony, 'Quelle influence de la crise financière sur la politique de contrôle des aides d'Etat?', in Philippe Manin, L'Union européenne: Union de droit, Union des droits, Mélanges en l'honneur de Philippe Manin (Paris, Pedone, 2010): 377-390; Loïc Wagner, Aides d'État : l'art de la souplesse en temps de crise, Cahiers de droit européen, 1, (2011): 231-275; Hans Gilliams, Stress Testing the Regulator: Review of State aid to Financial Institutions after the Collapse of Lehman, European Law Review 36, 1 (2011): 3-25; Conor Quigley, Review of the temporary State aid rules adopted in the context of the financial and economic crisis, Journal of European Competition Law and Practice, 3 (2012): 237-247.

66 Although the Temporary Framework for the real economic cannot be analysed in this article, it has been object of interesting studies. See, *inter alia*, Ulrich Soltész and Christian Von Köckritz, *The Temporary Framework – The Commission's response to the crisis in the real economy*, European Competition Law Review, 2 (2010): 106-122.

Overall, these Communications are non-binding, but offer clear suggestions on the Commission's methodology to assess state support measure and its more flexible interpretation under Art 107(3)(b) TFEU. As such, these documents might be taken into account by the European Courts in case a judicial review of a decision.[67]

I.3.1 The "Banking Communication"

The first 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 was published on 13 October 2008.[68] This was the first Commission measure. Its aim was 'to ensure a level playing field across the EU' keeping State aid while making it less burdensome for Member States to act. It makes a difference between fundamentally sound and distressed institutions with endogenous problems.[69] The distinction was made dependent upon the risk profile of the bank.[70] The Communication refers to some guiding principles in assessing these State aid as measures that have to be well-targeted, proportionate and designed in such a way as to minimize negative spill-over effects on competitors, on the sectors and other Member States.[71]

The Communication sets out the need for non-discriminatory and proportionate provisions for aids according to objective criteria.[72] At the same time it affirms that these measures will apply primarily to 'illiquid but otherwise sound financial institutions in the absence of the current exceptional circumstances'.[73] Hence, the aid measures can receive the approval of the Commission through an accelerated procedure.[74]

Overall, this Communication diverges from the normally applicable principles and rules. In particular, it is submitted that the Commission expresses itself more extensively in terms of the own contribution and the burden sharing principles for the financial sector. As such, the Commission refers to the banks' 'particular business model or business practices whose weaknesses are exposed and exacerbated by the crisis in the financial markets' and requires them to make 'a far reaching restructuring of their operations'.[75]

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67 See Lannoo and Napoli, *supra* note 10, 31.

68 Commission Communication, The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, O.J. C 270, 25.10.2008.

69 *Ibid.*, para.14.

70 'The Paper', *supra* note 31, 27.

71 Banking Communication, *supra* note 68, para.15.

72 *Ibid.*, para.18.

73 *Ibid.*, para.14.

74 See Philipp Werner and Martina Maier, Procedure in Crisis? Overview and Assessment of the Commission's State Aid Procedure during the Current Crisis, EStAL 8, no.2 (2009): 180-181.

75 Banking Communication, *supra* note 68, para.2.

I.3.2 The "Recapitalisation Communication"

The Commission Communication on Recapitalisation of financial institutions was adopted on 5 December 2008.[76] Three recapitalisation schemes had already been approved by the Commission before the adoption of it, but, following the ECOFIN Council of 2 December 2008, the Commission considered that further guidance to Member States was needed.[77] Recapitalisations have mainly three objectives:

> '[they] contribute to the restoration of the financial stability and help to restore confidence needed for the recovery of inter-bank lending … moreover [they act as] a cushion in necessary time to absorb losses and limits risk of bank becoming insolvent'.[78]

The Communication aimed at restoring financial stability and to ensure loans to the economy by providing Tier 1 capital injections in order to allow beneficiaries to continue their lending activity. Its conditions refer to the limitation of the aid to the minimum necessary and safeguards against undue distortion of competition. So far it has played an important role for driving recapitalization in some schemes.[79] Its purpose is to price adequately the injections of capital in order to avoid distortions in trade or competition in the internal market.[80]

Furthermore, the Communication contains a distinction between banks that are fundamentally sound, received temporary support to enhance the stability of financial markets and restored lending to business and consumers from those banks that were deemed distressed and whose business activities brought insolvency risks and posed greater threats for distortion of competition.[81] This distinction was set under the presumption that only banks in trouble were affected by the crisis.

On general basis, this Communication highlights the principles of restoration of the financial stability and the need to recover inter-bank lending. These are the key principles applicable to the financial sector which differ from the other sectors.

I.3.3 The "Impaired Assets Communication"

The third Communication was introduced on 25 February 2009[82] in response to the fears spread among the markets due to the unknown location of toxic assets held by banks.[83] It builds on the recommendations of the Eurosystem.[84] This Communication

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[76] Commission Communication, The recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2-10.

[77] *Ibid.*, para.3.

[78] *Ibid.*, para.4.

[79] 'The Paper', *supra* note 31, 26.

[80] Koopman, *supra* note 24, 11

[81] 'The Paper', *supra* note 31, 26.

[82] Commission Communication, On the treatment of impaired assets in the Community banking sector, OJ C 72, 26.3.2009.

[83] 'The Paper', *supra* note 31, 29.

introduces guidance on the design and implementation of asset relief measures to safeguard financial stability and boost lending to the real economy.[85] It builds upon some principles in designing asset relief measures: (i) transparency and disclosure requirements; (ii) burden sharing between the State, shareholders and creditors; (iii) aligning incentives for beneficiaries with public policy objectives; (iv) principles for designing asset relief measures in terms of eligibility, valuation and management of impaired assets; and (v) the relationship between asset relief, other government support measures and the restructuring of banks.[86] The measures include asset purchases, through which assets change hands via above books transfer prices;[87] asset guarantees, by which the asset is kept by the ailing bank, but covered by a State guarantee in exchange for a fee.[88]

Overall, the principles set out in the Communication show that benefiting entities require a more extensive amount of restructuring measures and that detailed rules are needed to compensate the granting of the State aid.

I.3.4 The "Restructuring Communication"

The Restructuring Communication was adopted on 22 July 2009.[89] This Communication was adopted once the first restructuring plans were submitted in 2009 according to the Temporary Framework. It complements the criteria established in the other three Communications and sets out the essential conditions for the approval of restructuring plans. It relies on the principles of long-term viability since 'aided banks must be made viable in the long-term without further state support', burden sharing since 'aided banks and their owners must carry a fair burden of the restructuring costs', and limitation to distortion of competition.[90]

In general terms, the Communication aims at giving guidance to Member States on return to long-term viability through compensatory measures. It substantially "codifies" the principles on restructuring applied during the financial crisis and establishes de facto Restructuring guidelines to the benefit of Member States and beneficiaries.

I.3.5 The Exit and the Prolongation Communications

At the end of 2010 and of 2011 the Commission issued two other Communications.

The first Communication, which was adopted on 1 December 2010, provided for an exit step to the special rules in the financial sector. It established that, as from 1 January 2011, every bank in the European Union, both the fundamentally sound ones and the

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84 Impaired Assets Communication, *supra* note 82, para.3.

85 *Ibid.*, para.4.

86 *Ibid.*

87 'The Paper', *supra* note 31, 29.

88 *Ibid.*

89 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, O.J. C195, 19.8.2009.

90 European Commission, State aid: Commission presents guidelines on restructuring aid to banks, IP/09/1180, 23.07.2009.

distressed ones, having recourse to state support measures in the form of capital or impaired asset measures, will have to submit a restructuring plan.[91] In practice, this meant that within the Temporary Framework no more difference between distressed and non-distressed bank exist.

As stated in the Communication, the Commission ultimate goal is to prepare the groundwork for a new regime for the rescue and restructuring of banks based on Article 107(3)(c) of the Treaty on the basis of the experience gained during the financial crisis.[92]

Notwithstanding the attempt to phase-out the crisis-related special regime,[93] the Commission has adopted a Prolongation Communication on 1 December 2011.[94] Due to the exacerbation of tensions in the sovereign debt markets and the desire to access term funding markets, this Communication extends *sine die* the temporary framework for the financial sector. Furthermore, it clarifies and updates some rules pertaining to the Recapitalisation Communications and to pricing and conditions for state guarantees. In particular it gives guidance on remuneration for capital instruments[95] and for fees payable in return for guarantees on bank liabilities.[96]

I.4 State aids and Programme Countries: an overview

During the crisis some Member States have faced unprecedented difficulties in refinancing their public debts. Greece, Ireland, Portugal, Spain and more recently Cyprus have been granted international financial assistance from the EU, the European Stability Mechanism (the 'ESM'), the International Monetary Fund ("IMF") and bilateral loans from other Member States.[97] The assisted Member States have been defined as "Programme Countries" as specific assistance programmes financed by the Eurozone member States, the EU budget and/or the IMF have been implemented. Programme Countries constitute interesting case studies on the use of state aids to refinance and recapitalize the financial sector according to stricter rules on economic conditionality and tighter control of state finance.

Greece faced the most serious difficulties in refinancing the public sector during the crisis. Already in 2009 Greece requested for financial assistance to sustain its public

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91 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, OJ C329, 7.12.2010, para.14.

92 *Ibid.*, para.8

93 See also DG Competition Staff Working Document, The application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2011, European Commission, 1. It is clear that the "ultimate goal must be the return to the normal State aid regime for the rescue and restructuring of Banks", OJ C80/7, paras 72-73. See also Max Lienemeyer and Laurent Le Mouël, *The European Commission's phasing-out process for exceptional crisis-related measures*, EStAL 10, 1, (2011) 41-48: 47-48.

94 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, OJ C 356, 6.12.2011.

95 *Ibid.*, paras 6-14.

96 *Ibid.*, paras 15-22.

97 Outside the Eurozone, European and international assistance has also been granted to Hungary, Romania and Latvia.

finances. Two economic Adjustment Programmes have been signed between Greece and Eurozone Member with also the financial participation of the IMF.[98] Both the first and the second programme comprise a number of measures to foster competitiveness and to refinance the Greek bond market. Part of these funds has been destined to recapitalize distressed banks.

Ireland and Portugal have been given financial assistance to sustain their financial sector. Recapitalisation of Irish banks has been adopted at the end of 2010 and the Economic Adjustment Programme to Ireland comprised the objective of the immediate strengthening and comprehensive overhaul of the banking sector. Several decisions were adopted by the Commission to grant financial assistance to Irish banks between 2011 and 2013. Similarly, Portugal has been granted financial assistance in May 2011 also with a view to a financial sector strategy based on recapitalisation and deleveraging.

Cyprus asked for access to international funding markets and requested external financial assistance in June 2012. In April 2013 the ECB, the IMF and the Commission agreed on the economic Adjustment Programme to Cyprus[99] and in May 2013 the European Stability Mechanism ('ESM')[100] and Cyprus signed the Financial Assistance Facility Agreement.[101]

A special case refers to financial assistance to Spain where robust recapitalization to the banking sector has taken place in the last two years.[102] In July 2012 the EU and the ECB concluded a Memorandum of Understanding ('MoU')[103] for a sector programme which has made Spain subject to a rigorous stress-test over a three-year period and to strict rules of conditionality of intervention. The MoU comprises recapitalization with programme funds to banks which could not recapitalize with private resources as well as the strict application of restructuring rules under State aid law. The stress test showed a capital shortfall of around €60 billion in ten banks. Eight of these banks have been recapitalized with programme funds while restructuration or resolution is taking

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98 On 2 May 2010, the Eurogroup agreed to provide bilateral loans pooled by the European Commission (the so-called "Greek Loan Facility" – GLF). This resulted in the adoption of the First Economic Adjustment Programme to Greece. On 14 March 2012, euro area finance ministers approved financing of the Second Economic Adjustment Programme for Greece which has resulted in the disbursement of additional funds to Greece. See http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm

99 The Economic Adjustment Programme for Cyprus is available at http://www.esm.europa.eu/pdf/The%20 Economic%20Adjustment%20Programme%20for%20Cyprus.pdf

100 The ESM is a permanent international financial facility instrument established between the Eurozone Member States that will progressively replace the EFSF and aims at safeguarding the stability of the euro area as a whole. The ESM is able to grant assistance to Member States subject to "strict conditionality". This new rescue mechanism has the status of an intergovernmental organisation under public international law and has been recently considered compatible with EU law by the Court of justice in the *Pringle* judgment (Case C-370/12, *Thomas Pringle v Governement of Ireland, Ireland and The Attorney General*, [2012] nyr). Once an effective single supervisory mechanism involving the ECB is established, the ESM would be able to recapitalize euro-area banks directly.

101 http://www.esm.europa.eu/pdf/ESM%20FFA%20Cyprus%20publication%20version%20final1.pdf

102 See European Commission, Report on Competition Policy 2012, COM(2013) 257 final, 7.5.2013, 3-4.

103 Memorandum of Understanding on financial-sector policy conditionality to Spain, 20.07.2012, available at http://ec.europa.eu/economy_finance/eu_borrower/mou/2012-07-20-spain-mou_en.pdf

place in line with State aid rules. In particular, two groups of banks were identified: the first one comprised banks already under the control of Spanish authorities (*BFA/Bankia*, *Catalunya Caixa*, *NCG Banco* and *Banco de Valencia*) which submitted restructuring plans adopted on 28 November 2012.[104] The second group was composed of a number of Spanish banks (*Banco Mare Nostrum*, *Caja 3* and *Liberbank*) which needed State aids after the results of the stress test. Restructuring decisions were taken 20 December 2012.[105] Following the adoption of the Financial Assistance Facility Programme[106] and the approval of the Commission's decisions, public support to the Spanish banking system could be granted through the use of the *Fondo de Restructuración Ordenado Bancaria* (FROB), the bank recapitalization fund of the Spanish government.[107] Financial assistance could be established by use of the funds provided, first, in the European Financial Stability Facility ("ESFS") and, then, in the ESM which now serves as an intergovernmental facility to support Member States in financial difficulties. At the end of 2012, Spain expressly asked for the disbursement of the first tranche of funds which was then followed by a second and a third disbursement in the course of 2013.

II. THE IMPACT OF THE SPECIAL RULES FOR THE FINANCIAL SECTOR: WHAT LESSONS FOR THE FUTURE?

The Communications mentioned earlier can be considered as *lex specialis* in the application of the rules on State aid to the financial sector. As stated earlier, these measures were taken within the straightjacket of the derogation provided for under Art 107(3)(b) TFEU and have aimed at supporting Member States in granting State support measures in the financial sector. The impact of such rules has already been examined by many scholars.[108] In the following paragraphs a tentative assessment of some issues arising from the Temporary Framework will be made.

II.1. The specificity of financial institutions

In general terms, the Commission Communications have been a useful tool to tackle systemic risks, to avoid the collapse of the financial system and to prevent spill-over

104 "State aid: Commission approves restructuring plans of Spanish banks BFA/Bankia, NCG Banco, Catalunya Banc and Banco de Valencia" at http://europa.eu/rapid/press-release_IP-12-1277_en.htm. SA.33735 Restructuring of Catalunya Banc, SA.33734 Restructuring of NovaCaixaGalicia, SA.34053 Recapitalisation and Restructuring of Banco de Valencia, SA.35253 Restructuring and recapitalisation of the BFA Group.

105 "State aid: Commission approves restructuring plans of Spanish banks Liberbank, Caja3, Banco Mare Nostrum and Banco CEISS" at http://europa.eu/rapid/press-release_IP-12-1432_en.htm. SA.35490 Restructuring of Liberbank, SA.35489 Restructuring of Caja3, SA.35488 Restructuring of Banco Mare Nostrum, SA.34536 Restructuring and recapitalisation of Banco CEISS.

106 http://www.esm.europa.eu/pdf/FFA%20Spain_Main%20Agreement_Execution%20Version.pdf

107 See the MoU to Spain, point 10.

108 See, *inter alia*, Daniel Zimmer and Martin Blaschzok, *The role of competition in European State aid control during the financial market crisis*, European Competition Law Review 32, no. 1, (2011): 9-16; Christian Ahlborn and Daniel Piccinin, *The Great Recession and other mishaps: the Commission's policy of restructuring aid in time of crisis,* in Erika Szyszczak (eds.), *Research handbook on European State aid law*, (Cheltenham, Edward Elgar, 2011): 124-175; Georgios Psaroudakis, *State Aids, Central Banks and the Financial Crisis*, in European Capital Financial Review, no. 2, (2012): 194–220.

effects in the real economy.[109] This shows that a special legal framework was needed for the banking and the financial sector. Indeed, it is by now clear that financial markets present different dynamics which can only partially be reconciled with other economic sectors.

Hence, banks and financial institutions should be considered as special firms with rules applicable only to them. This is due to several reasons. First, banks are facilitators of the economy and they may serve the economy in different ways, e.g. as transmitters for monetary and fiscal policies or allocators of scarce capital.[110] Furthermore, they are strictly interconnected and domino or spill-over effects can arises far more easily than in other sectors.

Also the Commission recognizes the many differences of banks from ordinary firms. These are the following. The level of share of debt in their funding compared to equity, the speed in expanding and contracting their balance sheet and the volume of their business are far higher than other firms; the massive negative externalities that a bank failure generates on competitors and the economy on the whole are considerable.[111]

As further specified by the Commission,

> 'the negative externalities can arise through various channels. First, as banks have extensive exposures to one another, losses of one will be borne by others. … second pure informational contagion can arise such that the failure of one bank lead to an adjustment in the expectations regarding the viability of other banks perceived to be "similar"'.[112]

The reliance on finance by the other sectors in the economy shows how much important the survival of banks is for the economy. In fact, one can consider at least two aspects specific to the financial sector. First, there is a strong "endogenous" interconnectedness between financial institutions that would have repercussions in case of the failure of a bank with respect to other financial institutions. Second, the financial sector has an "exogenous" interconnectedness with the real economy that results in repercussions to operators in other sectors through external contagion repercussion.

In practice, the specificity of the banking sector has resulted in the Commission adopting only positive or conditional decisions in Phase II. No proposed aid in the financial sector has been considered incompatible.[113]

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[109] See to that effect 'The Paper', *supra* note 31, Executive Summary, points 1-3, p.6.

[110] Savvides and Antoniou, *supra* note 42, 350.

[111] 'The Paper', *supra* note, 31, 25. See also the OECD Roundtable Document on competition and finance, 232-234, DAF/COMP(2009)11 available at http://www.oecd.org/daf/competition/liberalisationand competitioninterventioninregulatedsectors/43046091.pdf

[112] *Ibid.*

[113] With the sole exception of the State Guarantee to Banco Privado Português. This measure had been found compatible with the internal market, the usual commitments having been made, but the beneficiary failed to submit a restructuring plan in due time. Hence, the Commission ordered the recovery of the approved aid.

II.2. Distortions of competition and "moral hazard" in the financial sector

Both distortion of competition and moral hazard have played a role in State aid policy for the financial sector. Distortion of competition is considered as being a central element for the assessment of state support measures to banks. As shown by the Banking Communication, avoidance of distortion of competition between financial institutions operating in the market is seminal for the proper issuance of State aids. This is one of the most serious tasks to accomplish in order to restore financial stability after the granting of aid. The Restructuring Communication affirms that a number of distortions of competition could take place if state support measures are not properly addressed. In particular:

> 'State aid prolongs past distortions of competition created by excessive risk-taking and unsustainable business models by artificially supporting the market power of beneficiaries. In this way it may create a *moral hazard* for the beneficiaries, while *weakening the incentives for non-beneficiaries to compete, invest and innovate*. Finally, State aid may *undermine the single market by shifting an unfair share of the burden of structural adjustment* and the attendant social and economic problems to other Member States, whilst at the same time *creating entry barriers and undermining incentives for cross-border activities'*.[114]

Thus, as the Commission affirms, the most relevant risks in evaluating State aid measures to financial institutions are: (i) that they can create forms of direct distortion of competition with particular regard to the reinforcement of market power for the benefiting institution; (ii) that they can distort the incentives of unassisted competitors and thus contribute to their exit from the market; (iii) that they can create moral hazard as future reliance on State aid; and (iv) that they can harm the internal market. In addition, remedy measures are determined case-by-case so as to address the specific distortion identified on the market where the bank operates.[115] Hence, it correctly points out that due account will be given to the amount of the given aid together with the conditions according to which it was granted and the characteristics of the market or the markets on which the bank runs its activity (position, scale, scope of the activity).[116]

Overall these considerations show a multifaceted theory of harm that the Commission follows in assessing the compatibility of State aid measures in the financial sector.

The most evident form of distortion of competition refers to the fact that some impaired market players have received aids that will benefit their market power to the detriment of other market players not receiving the aid. According to the Commission's practice, the granting of State aids is in itself a sufficient element that distorts the market, especially in case of ailing entities. This analysis is complex because the creation or the reinforcement of market power requires a proper theory of harm in order to

[114] Restructuring Communication, *supra* note 89, para.28 (emphasis added).

[115] *Ibid.*, para.30.

[116] *Ibid.*

evaluate whether the market player with or without the aid would exert a real competitive benefit.[117]

The fact that some other market players did not receive any similar State aid that could "offset" or at least minimize the non-reliance on similar State support measures constitutes another distortive element. As such, State support measures could harm competitors and could reduce their incentive to innovation, investments and competition. In other words, these measures risk harming the competition "on the merits" and the profits generated by other institutions not receiving the aid. Through the authorisation of strict compensatory measures, the Commission has avoided that aided banks could benefit from their 'safe' position and, more seriously, could exclude other competitors from entering or expanding in the market. In effect, the adoption of rigid compensatory measures has made it unlikely for the beneficiary to harm competitors in future. At the same time, the elimination of the distinction between sound and distressed banks introduced in the first Banking Communication has also tightened up the rigid conditions for approval of State aids.

"Moral hazard" is another key element in assessing the granting of State aid in the financial sector. It has been frequently cited by the Commission in a number of cases.[118] The concept can be summarized as follows: if State aid is granted without a proper form of compensation and control, the benefiting institution can rely on a "free-of-risk insurance policy" for future cases. As Krugman simply stated, moral hazard is 'any situation in which one person makes the decision about how much risk to take, while someone else bears the cost if things go badly'.[119] Thus, the benefiting institution might be willing to engage in a full-of-risk strategy that might make financial crisis more likely in the future.

When granting State aids, distortion of competition and moral hazard need to be reduced as much as possible. To that extent, the Commission has accepted State aid provided that Member States and beneficiaries agreed on some forms of remedies.

II.3. Remedies in restructuring plans

Remedies can be defined as measures proposed to bring to an end a violation or to remedy to a competition concern. In general terms, remedies can be found in antitrust, merger control and State aid law. Antitrust law contemplates remedies under Arts 7 and 9 of Regulation 1/2003.[120] Similarly, the 2008 Commission Notice[121] provides a

[117] See to that effect Christian Ahlborn and Daniel Piccinin, 'The application of the principles of restructuring aid to banks', in EStAL, 1, (2010): 59-60.

[118] See, SA.29338 (C 29/09) State aid granted by Germany to HSH Nordbank AG; and SA.32504 and C 11/10 (ex N 667/09) Anglo Irish Bank and Irish Nationwide Building Society and the implementation of its restructuring plan.

[119] Paul Krugman, *The Return of Depression Economics and the Crisis of 2008*, (New York: W.W. Norton, 2009), 63. See also the definition of moral hazard in John Eatwell, Murray Milgate and Peter Newman, *The New Palgrave: a dictionary of economics*, (London: MacMillan, 2008), 549.

[120] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty Official Journal L 1, 04.01.2003, p.1-25.

number of rules to remedy the competition concerns of a proposed merger. In State aid law the Commission can adopt conditional decisions in Phase II or can accept commitments by the Member State and/or the beneficiary and adopt a decision not to raise objections in Phase I. Thus, these decisions can contain a number of remedies that act as *compensatory measures* to offset the granting of the aid.

The nature of remedies in the three fields differs profoundly. In antitrust law they act as remedies attached to an infringement decision or proposed by the undertaking to make such commitments binding. These are brought forward either because the Commission has found an infringement under EU law or because the undertaking intends not to be sanctioned. In merger control they consist of measures to overcome the possible competition concerns assessed during the *ex ante* analysis of a proposed measures. Despite the different logics existing between antitrust law, merger control and State aid law, it is submitted that the use of remedies in competition policy is driven by the same rationale, namely the need to reduce competition concerns.

During the financial crisis, compensatory measures have been massively included in most of Commission's decisions. Their use was essentially needed to allow Member States to grant high amount of aid and to let the Commission address the distortion of competition arising from the granting of the aid.

As stated in the Restructuring Communication, the granting of relevant aids to banks is assured by compensatory measures for the beneficiary.[122] These measures are a guarantee that the benefiting entity will repay, in substance, the aid received. A reference to compensatory measures is already contained in the R&R guidelines where the Commission states that the granting of R&R aid can be considered only when credible restructuring plans with remedies are put forward by the benefiting institution.[123] Hence, in line with the principles of own contribution and restoration of long-term viability, these measures are intended to address competition concerns.[124]

Practice so far has shown that the Commission's authorisation decisions to financial institutions include three kinds of restructuring measures: *financial contribution*, *structural* and *behavioural* remedies.[125] They can interact with each other on condition that they respect the principles of the Restructuring Communication. Even if their nature does not differ profoundly from equivalent remedies in antitrust and merger control, they show complexities and specificities that are distinctive of the State aid field.

Financial contribution remedies consist of cost reductions, remuneration of State aid and any additional contribution by shareholders. These measures involve that the

[121] Commission Notice on remedies acceptable under the Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 OJ C 267, 22.10.2008, p. 1-27.

[122] Restructuring Communication, *supra* note 89, 12.

[123] The restructuring plan is not required when the beneficiary has received limited amount of recapitalization and asset relief aids. As from January 2011, every beneficiary of aids in the financial sector should submit a restructuring plan to the Commission.

[124] Restructuring Communication, *supra* note 89, para.9.

[125] For a more detailed picture see Arhold, *Financial Sector*, *supra* note 20, 702-707.

beneficiary of the aid directly pays for its own cost by direct repayment measures. They are specific to the State aid field as they primarily aim at repaying the advantage acquired by the beneficiary. The Commission's practice shows that the most common forms of financial contribution measures are cost reduction,[126] across-the board cost reductions[127] or savings targeted at certain administrative or IT expenditures.[128] Remuneration of State aid requires the pay-back of the aid received. The amount of remuneration should be calculated according to normal market conditions.

Furthermore, the Commission has considered contributions made by the bank shareholders or even by the debt-holders. For instance, the Commission has imposed limitations on the payment of dividends or coupon to shareholders and other investors as referred in para 26 of the Restructuring Communication. Nonetheless, as underlined by some authors, the general Commission approach to this kind of measures raises concerns as to the legal or contractual constraints that the payment of dividends poses. They also underline that the Commission has taken an objectionable 'case-by-case' approach.[129]

Structural measures consist of divestitures or reductions of activities. Similar to circumstances in antitrust and merger control,[130] these measures effectively address competition concerns in the given market.[131] This is because they attempt at reducing the market power of the benefiting entity by offsetting the imbalance created in the market structure by the aid. They can take different forms and will play a major role in restructuring plans as authorized by the Commission. As such, divestiture may take the form of the selling of an entire bank, branches, subsidiaries, portfolios of customers or business units, or to undertake other such measures.[132]

The most serious kind of measure is the liquidation or the winding down of a failed bank which cannot return to viability in the long term.[133] The existence of such scenario imposes a careful assessment of the situation and requires a finding that there are no alternative remedies. Other structural remedies might be the divesture of the ailing bank to other financial institutions and also the divesture of the most impaired activities and assets to a "bad" bank and sell the good part of the bank to a healthier

[126] E.g. NN244/09, *Commerzbank*, 07.05.2009; and SA.34539, *Amendment of restructuring plan of Commerzbank*, 30.03.2012.

[127] E.g. C9/2009, *Restructuring of Dexia*, 26.2.2010.

[128] E.g. N 256/2009, Restructuring aid to Ethias, 20.5.2010; C 32/2009, Restructuring of Sparkasse Köln/Bonn, 29.09.2010.

[129] François-Charles Laprévote, Selected Issues Raised by Bank Restructuring Plans under EU State aid Rules, EStAL, no.1 (2012): 93-112, at 100-101.

[130] See Wei Wang, *Structural Remedies in EU Antitrust and Merger Control*, World Competition 34, no. 4, (2011): 571–596, at 573.

[131] 'The Paper', *supra* note 31, 93.

[132] Restructuring Communication, *supra* note 89, para.35.

[133] E.g. SA.32504, *Anglo Irish Bank*, 29.06.2011; SA.33485, *Restructuring plan of Amagerbanken*, 25.01.2012; and SA.34115, *Resolution of T-bank*, 16.05.2012.

buyer.[134] In addition, a common form of remedy is the divestiture of assets or activities. Even if the Commission considers that 'divestments may generate adverse consequences and may not be necessary in order to achieve the desired outcomes',[135] it has authorised a number of assets sales.[136] Such divesture can have positive effects on competition because it may allow the entry of new competitors in concentrated markets.

Alternative structural remedies can take the form of limitations to new activities, to organic growth, to the amount of new loan products, or the prohibition to acquisitions during a certain period or even measures to facilitate mergers.[137] Contrary to some authors,[138] it is submitted that these remedies can have an effect on competition because they can alter the competitive position of the bank at issue and because they may induce the beneficiary to change its structure *vis-à-vis* other market players and Member States.

A further example of structural remedies is balance-of-sheet reductions, which often can act as the strongest structural remedies.[139] They may be deterrents for burden sharing, long-term viability and avoidance of distortion of competition.[140] In theory, they are reductions of the balance of sheet negotiated by the end of the implementing period of the restructuring plan. In practice, they drastically change the size and the structure of the bank. Hence, Commission's intervention has been cautious in indicating the percentage of reduction and the timeframe along which it takes place.[141] It is true that balance sheet reduction is a very powerful instrument in the hands of the Commission. However, it has been demonstrated that the envisaged reduction does not necessarily reflect the forms of the structural remedies undergone.[142]

Finally, even if not so common as structural remedies, behavioural remedies have been included in restructuring plans. Even if they share different logics from antitrust and merger control these remedies can contribute to impacting the beneficiary's activities.[143] They have taken the forms of price or margin limitations, acquisition bans, advertising

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134 Restructuring Communication, *supra* note 89, para.21. See e.g., *inter alia*, SA.29590, *Monitoring of winding down of WestLB,* 16.04.2012; SA.31945, *Rescue of EIK Bank*, 06.06.2011; SA.33485, *Restructuring plan of Amagerbanken*, 25.01.2012; SA.34539, *Amendment of restructuring plan of Commerzbank*, 30.03.2012; SA.34115, *Resolution of T-bank*, 16.05.2012.

135 Restructuring Communication, *supra* note 89 , footnote at para.32.

136 E.g. C37/2010, *Recapitalisation of FHB*, 22.02.2012; SA.26909, *Restructuring of BPN*, 27.03.2012.

137 E.g. SA.34423, Support for the merger of Vestjysk Bank and Aarhus Lokalbank, 25.04.2012.

138 Ahlborn and Piccinin, *supra* note 108, 153-154.

139 E.g. See SA.28264, Hypo Real Estate, 18.07.2011; SA.29338, Restructuring of HSH Nordbank AG, 20.09.2011. See also European Commission, State aid: Commission approves restructuring plans of Spanish banks BFA/Bankia, NCG Banco, Catalunya Banc and Banco de Valencia, IP/12/1277, 28.11.2012.

140 See Gilliams, *supra* note 65, 21.

141 'The Paper', *supra* note 31, 96.

142 Arhold, *supra* note 20, 693 and following.

143 In antitrust law regulation 1/2003 states that behavioural remedies should be preferred to structural remedies (Art.7 (1)). On the contrary, in merger control the 2008 Commission Notice affirms that structural remedies are preferred to the behavioural ones (see the 2008 Notice, para. 17)

bans or bans on the exercise of call option rights.[144] The first consists of the avoidance to the use of the aid to lower prices and to seize market shares. This measure has relevant consequences on the market behaviours of the restructuring undertaking. It takes the form of price leadership bans or minimal margin percentage either on each transaction or on average transactions. For instance, a price leadership ban imposes a certain price to the beneficiary to avoid that competitors are driven out of the market. The second is clearly aimed at reducing the buyer power of the aid recipient in the market by prohibiting the recipient to strengthen its position in the market. As such, this kind of measure is very robust as it contributes to limit the presence of the aid recipient in the market. The third is the ban to advertise the state support measures.

Overall, behavioural remedies have had a great impact on competition mainly because they restrict market activity of the financial institution. It has been submitted that the existence of such remedies is not properly beneficial to the economy as a whole essentially because one of the main functions of banking institutions, lending to the real economy or to consumers, is limited.[145] However, the Commission has limited the use of behaviour remedies to light measures which, apparently, have not seriously impaired confidence in the financial markets.

II.4. Programme Countries: a special case for State aid support?

As shown earlier,[146] Programme Countries have been granted financial assistance in the forms of loans from other Member States, the EU and/or the IMF. Financial assistance to Programme Countries opens up a number of interesting issues in relation to the special intervention within the context of the framework of State aids in the financial sector.

First of all, the degree and the target of financial assistance to Member States have considerably changed from country to country. The first intervention to Greece targeted primarily the public sector and the restructuring of public finances. The second interventions to Greece as well as those to Ireland, Portugal and Cyprus have had a wider scope as they concern both the restructuring of public finances and that of banks. As compared with the other Programme Countries, the Spanish case appears a different arrangement as it concerns specifically the restructuring of the banking sector.

Second, it should be considered whether financial assistance coming from international or European assistance funds shall still be considered as State aid. It is established in decisional practice and case law that only national support measures are covered by the prohibition of Articles 107 and 108 TFEU, while measures funded by the EU budget have not been considered to qualify as State aid. However, the Commission has considered these measures as State aid, even when such aid was granted in the context of schemes agreed under international assistance programmes. This position follows what the European Council's conclusions stated on the so-called 'banking package',

[144] E.g. SA.34539, Amendment of restructuring plan of Commerzbank, 30.03.2012; SA.26909, Restructuring of BPN, 27.03.2012.

[145] Ahlborn and Piccinin, *supra* note 108, 153.

[146] See *supra* Section I.4

according to which "[a]ny form of public support, *whether at a national or EU-level*, will be subject to the conditionality of the current special state aid crisis framework".[147] Hence, this means that the current State aid crisis framework and State aid conditionality will continue to apply where a bank is indirectly recapitalised by international arrangements such as the ESM.

Third, intervention in Programme Countries shows that there is a strong link between horizontal conditionality in granting financial support to a Member State and conditionality in assessing the granting of the aid in the specific financial sector. It appears that the Commission has adopted a wider approach to assess financial institutions located in Programme Countries with a view to recapitalize the single financial institution and has done so in order to respect the wider principle of conditionality. For instance, in the Irish MoU one of the objectives is the restructuration of the financial sector with a view to the banking system operating without the need of further State support. Conditionality is seen as a pre-condition to the granting of financial assistance.[148] Similarly, in the Spanish MoU it is affirmed that:

> 'conditionality will be financial-sector specific and will include both bank-specific conditionality in line with State aid rules and horizontal conditionality. In parallel, Spain will have to comply fully with its commitments and obligations under the EDP and the recommendations to address macroeconomic imbalances within the framework of the European Semester.'[149]

This statement shows that horizontal conditionality is taken into account in assessing the compatibility of state support measures. The targets set out in the MoUs should apply into the restructuring plans for individual banks and will surely become an essential element to orient the future business model of the financial institutions.

Fourth, the Commission has acted as the *de facto* regulator in assessing financial support measures to banking structures in each Programme Country. However, the position of the Commission should be considered in light of its wider role. First, the Commission acts as the "Eurogroup agent" in monitoring the countries' Economic Adjustment Programmes. Second, the Commission is part of the Troika, together with the ECB and the IMF. As such, the assessment of individual banks or the entire banking systems viability may overlap with the role that the Commission plays within the Eurogroup mandate or in following the Troika's recommendations or findings. The Troika typically does not conduct direct assessments of individual banks. On the contrary, the Commission acts as the main enforcer of state aid rules in order to avoid competitive distortions stemming from financial assistance to distressed banks in Programme Countries while ensuring the banks' financial viability.[150] Does this mean that the

[147] European Council conclusions of October 26, 2011, Annex 2 « Consensus on banking package », para. 6, available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/125644.pdf (emphasis added).

[148] Ireland Memorandum Of Understanding On Specific Economic Policy Conditionality, 03.12.2010

[149] See the Spanish MoU, *supra* note 103, p.1.

[150] Pisani-Ferry, Sapir and Wolff, EU-IMF assistance to euro-area countries: an early assessment, Bruegel, 2013, 87.

Commission has had far-reaching power to decide *de facto* the best measures to restructure the financial sector in Programme Countries? Or has it adopted a subordinate approach to the Eurogroup directions or to the Troika findings? Even if the Commission has been careful in addressing financial stability and distortion of competition concerns in assessing State aids in Programme Countries, it appears that it has acted with a balanced approach in following its different mandates.

Fifth, another issue relates to remedies required under State aid decisions and their coordination with remedies prescribed by the Troika in the context of Adjustment Programmes. In some cases it might occur that remedies will be compatible with Adjustment Programmes or even have the same objective. In some others there might be situations in which divergences in the adopted measures might conflict with the macroeconomic objectives to avoid a credit crunch or limit the cost of bank bail-outs for public finances. It has been argued that:

> 'interventions [by the Commission] have been instrumental in imposing restructuring on banks but have on occasion heightened macro-financial concerns. In particular there have been concerns about ... the impact of compensatory measures on financial stability and economic growth'.[151]

It is submitted that the Commission's decisional practice might show inconsistency with the wider objective of fostering economic growth and assuring financial stability in particular when robust structural or behavioural commitments have been adopted.

To conclude, this section has argued that state aids to financial institutions in Programme Countries constitute a special area of State aid enforcement to a certain extent. The Commission has considered larger objectives and has made a wider assessment in light of the macro-Adjustment Programmes. It remains to be seen whether the specific targets set in the Programmes will succeed in restoring confidence in the financial markets and in the banking structures.

III. FUTURE CHALLENGES FOR STATE AID POLICY IN THE FINANCIAL SECTOR

It is clear that the financial crisis and the unprecedented level of State aid support to banks have had an enormous impact on the EU State aid law applicable to this sector. In fact, a horizontal set of rules applicable both to financial institutions and to other entities is not conceivable anymore. This can be inferred in the SAM Communication where the Commission expressly considers that 'when market conditions permit, a new set of rules for rescuing and restructuring financial institutions will be put in place for the post-crisis environment, consistent with the future proposals for EU crisis management and resolution'.[152]

More generally, it is submitted that, at the moment of writing, three main issues raise fundamental interest for State aids in the financial sector: first, the link between state aid and the adoption of a crisis management and resolution framework at European

[151] IMF Publications, Country Report No. 13/67, March 2013, para.29.

[152] Modernisation Communication, *supra* note 7, para.18 (b).

level; second, procedural aspects for aids in the banking sector; third the content of new R&R guidelines for the financial sector. These will be discussed in turn.

III.1. The creation of the 'Banking Union' and State aid control

A remarkable evolution over banking activity and financial markets will come from the regulatory reforms for crisis management of financial institutions as foreseen in the future 'Banking Union'. This will be composed of three pillars: the creation of a Single Supervisory Mechanism ('SSM') for banks led by the European Central Bank ('ECB') in order to strengthen the Economic and Monetary Union; the establishment of a single bank resolution mechanism; and, the creation of a common deposit protection.[153] The Commission put forward the creation of the 'Banking Union' in May 2012[154] and reaffirmed the path toward its implementation in September 2012.[155] In December 2012 the ECOFIN Council endorsed in principle the establishment of the 'Banking Union'.[156]

As stated by the Commission Paper, the crisis has proven that the adoption and implementation of new and improved rules for bank regulation, supervision and resolution is the key to avoid further recourse to state support measures.[157] The proposal to create a SSM and the proposal to establish a system of banking resolution reply to the need for a regulatory framework to prevent the recourse to public support measures in the financial sector.

The SSM is aimed to establish the direct oversight of banks, to enforce prudential rules in a strict and impartial manner to perform effective oversight of cross border banking markets to the ECB. The Commission has proposed a regulation giving prudential powers to the ECB to oversight banks in the Eurozone which has been endorsed by the ECOFIN Council in December 2012.[158] The ECB would act as the single supervisor for significant banks or bank subsidiaries of the Eurozone.[159]

Further, a new Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD)[160] which, on the basis of the G20

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153 http://ec.europa.eu/internal_market/finances/banking-union/index_en.htm

154 See the Commission Communication, *Action for stability, growth and jobs*, COM(2012) 299, 30.05.2012, 4-5.

155 Commission Communication "Commission proposes new ECB powers for banking supervision as part of a banking union", IP/12/953, 12.09.2012

156 "Council agrees position on bank supervision" http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/134265.pdf, 13.12.2012.

157 The 'Paper', *supra* note 31, 108.

158 The Council's proposal was published on 14 December 2012: Council of the EU, 'Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions' [2012] Document 17812/12, 14 December 2012, http://register.consilium.europa.eu/pdf/en/12/st17/st17812.en12.pdf

159 For a detailed assessment of the SSM see Eilis Ferran and Valia Babis, *The European Single Supervisory Mechanism*, Legal Studies Research Papers Cambridge University, 2013, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2224538.

160 Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives

proposals,[161] has been proposed by the Commission,[162] would go in this direction. Although a detailed assessment of the proposal is not possible in this article, its content shows that the maintenance of financial stability and the avoidance of contagion are the primary objectives of this new regulatory framework. In particular, the proposal shows that state support measures will considerably be limited in future.[163] Crisis management will be the essential alternative to prevent systemic risks rather than the granting of state support measures.[164] The Commission recognizes that the aim of such policy would be to give the relevant authorities common and effective tools and powers to address banking crises pre-emptively, safeguarding financial stability and minimizing tax payers' exposure to losses. Hence, it is understandable that the use of public funds in future would probably be avoided through prevention, early intervention and resolution of financial institutions rather than the need to recur to *ex post* crisis State measures.

Nevertheless, these new arrangements are not without problems and many questions are still open to debate with regard to State aid control. It is unclear what role would the different institutions and authorities play in the system of resolution or rescue of financial institutions. Will this competence be shared between the Commission, the national authorities and the European Banking Authority (the EBA)? Which level-playing field will have the last wording on the early intervention mechanism? The last indications suggest that national authorities will be in charge of designating resolution and recovery plans at an earlier stage while the Commission will assess the compatibility of R&R aids in the crisis scenario.[165] Interestingly, the proposed directive on banks' recovery and resolution would make it easier for national authorities to intervene at a sufficiently early stage or to orderly and safely resolve financial institutions, in order to minimise taxpayer's risks of loss.[166] The proposal introduces a bank-specific resolution procedure in all Member States. The degree of harmonisation is minimal as the Directive "[ensures] a minimum capacity for resolution of institutions in all Member States and [facilitates] cooperation between national authorities when dealing with the failure of cross-border groups".[167] The proposal gives ground to national resolution authorities to make use of extensive use of powers of intervention and supervision. These include the limiting or ceasing of existing or proposed activities, the prevention of development of new business lines or products, and the issuing of convertible capital instruments. The national degree of discretion is not without problems as the role of

77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, COM/2012/0280, final.

161 See G20 Leaders' declaration of the Summit on financial markets and the world economy, April 2009, where it was stressed the "review of resolution regimes and bankruptcy laws in light of recent experience to ensure that they permit an orderly wind-down of large complex cross-border institutions".

162 See IP/12/570, 'New crisis management measures to avoid future bank bail-outs', available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/570&format=HTML&aged=0&language=EN&guiLanguage=en, 06.06.2012.

163 Proposal of Directive, *supra* note 160, 4.

164 *Ibid.*, 8.

165 Proposal of Directive, *supra* note 160, article 3.

166 Proposal of Directive, Impact assessment, p.4.

167 *Ibidem*, p.7

national authorities might conflict with the Commission's powers of State aid enforcement. The national authorities will require financial institutions to draw up recovery plans and resolution plans which will apply in case of financial distress while the Commission would enforce the compatibility of State aids to financial institutions in assessing restructuring plans. It remains open the problem to know whether the role of national authorities and that of the Commission will converge or diverge. It is still uncertain if supervisory authorities are given sufficient powers to impose prompt corrective measures on failing banks and financial groups.[168]

Another problem still open to debate is the relationship between the Commission power to assess State aids and the future ECB supervisor powers. The ECB's direct supervision within the SSM will be exercised on the biggest and most important Eurozone based banks. The ECB will dispose of numerous tasks such as authorisation, governance arrangements and sanctioning on credit institutions. This transferral of powers is motivated by the need to preserve the financial stability of the euro area as a whole. It appears that regulatory competition and differential treatment may arise in future if a differential treatment between Eurozone and non-Eurozone members is maintained. Furthermore, questions may arise as to the relationship between banking authorities – the ECB, the EBA or the national banking authorities – and the Commission as the traditional State aid controller. It was suggested that prudential tasks should be separated from influence on the market and competition concerns.[169] However, the future SSM implementation opens problems of accountability, independence and encroachment of powers when State aid to financial institutions is involved.

From this brief analysis, it is submitted that clearer answers are still needed in many different aspects concerning supervision and recapitalisation of financial institutions. At first view, it appears that the Commission will keep its central role of main enforcer of State aids in the internal market but only once the public support measures have been adopted, while national authorities will acquire extensive crisis prevention and *ex ante* crisis management powers. Overall, these recent initiatives show that the regulatory landscape will increasingly develop to establish a 'common toolkit and roadmap to manage the failure of banks'.[170] However, at the moment there are more questions than answers and the current scenario seems still "undefined".

III.2. Procedural challenges for State aids in the financial sector

Notwithstanding these developments in Europe, which are admittedly still difficult to foresee, State aid policy will still play a role for the assessment of aids to bank. Some proposals on existing procedural rules and the implementation of restructuring plans will be made.

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[168] Alexander Kern, *Enhancing European Bank Resolution and Recovery*, Maastricht Journal of European and Comparative Law 13, no.3 (2012): 465.

[169] Psaroudakis, *supra* note 108, 208.

[170] European Commission, Press Release - IP/12/570, *New crisis management measures to avoid future bank bail-outs*, 06.06.2012.

III.2.1. Aids in the banking sector and the Procedural Regulation

According to Art 108(3) TFEU new aids may be put into effect only after they have been approved by the Commission and, as such, they have to be notified and suspended until the Commission has not approved them. Procedural rules have been consolidated in a Procedural Regulation (the "PR")[171] adopted in 1999, far before the outbreak of the financial crisis. The procedure is divided into two phases: a preliminary investigation, Phase I, and a formal investigation procedure, Phase II. As provided in the regulation, the opening of Phase II, the formal procedure, is due only if the Commission has doubts on the compatibility of the aid.[172]

It is clear that the standard procedural framework could not apply for the granting of the vast amount of aids approved in the financial sector. The Commission needed to take action as soon as possible, even within 24 hours or over a weekend,[173] in order to avoid a systemic crisis in the banking sector. Most of the decisions were taken after Phase I without opening the formal procedure phase.

In the current legal scenario, however, some procedural rules need further investigation. Firstly, it is submitted that the introduction of a fast track procedure appears essential in situations where urgent decisions are needed. The Banking Communication has conceived swift authorisations of aid measures[174] and the Commission has envisaged a general simplified procedure.[175] From this practice, it can be inferred that a special procedural framework has been established in the financial sector. As such, it applies specifically to the financial sector and does not appear to abandon all procedural safeguards.[176] Hence, the establishment of a fast track procedure in the financial sector would be beneficial to assure that aid can be rapidly granted and systemic risks avoided. Nonetheless, a faster procedure, without extensive guarantees, still raises concerns in term of legal and economic scrutiny, legal certainty and impact on third parties.

These aspects need further reflections.[177] This is true, especially after the *ING* case before the General Court.[178] In 2012 Netherlands and ING brought action against the Commission to contest a decision to declare compatible some state aid adopted during the crisis.[179] The applicant contested the Commission's analysis and held that the

[171] Council Regulation N.659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 (now Art.108 TFEU) of the EC Treaty, OJ L 83/1, 27.03.1999.

[172] *Ibidem*, Art.4 (4).

[173] Banking Communication, *supra* note 68, par.53.

[174] *Ibidem*.

[175] Commission Notice on a Simplified procedure for the treatment of certain types of State aid, OJ C136, 16.06.2009, p. 3.

[176] See to that extent Werner and Maier, supra note 74, 182. In particular the authors highlight that the continuous monitoring over restructuring plans after the adoption of a conditional decision acts as an important procedural guarantee.

[177] Id., 183-186.

[178] Case T-29/10 and T-33/10, *Kingdom of the Netherlands and ING Groep NV v Commission*, [2012] nyr.

[179] Commission Decision 2010/608/EC of 18.11.2009 on State aid C 10/09 (ex N 138/09), *ING's Illiquid Assets Back Facility and Restructuring Plan*, OJ 2010 L 274,

examination of an additional capital injection repayment did not constitute aid. For the first time, the Court annulled a Commission decision taken for a crisis aid. It held that:

> 'the Commission could not limit itself to finding that the amendment to the capital injection repayment terms constituted State aid without first examining whether the amendment conferred on ING an advantage to which a private investor placed in the same situation as the Netherlands State would not have agreed'.[180]

This case emphasizes three points. First, the Commission cannot take with indulgency the analysis of the private investor test during its assessment. Second, the Commission shall conduct extensive economic analysis on the form of the measure to determine whether it constitutes aid as it will not escape judicial scrutiny over it. It appears that the General Court enjoys also a power to interpret economic data.[181] Third, the Commission shall conduct an analysis which 'must be carried out taking into consideration the information available and foreseeable developments'.[182] This requires the Commission to have access to a great number of information and data before conducting its state aid analysis.

On such basis, it is submitted that both the *ex-ante* and *ex-post* procedural phases need to be revised in near future to avoid situations that could lead to an *ING* scenario. The primary objective of the Commission should be the collection of most of the necessary market information even before receiving the notification of the measure.[183] For instance, a more detailed scrutiny in the pre-notification phase could be envisaged with a more vigorous exchange of information between the Commission and the Member States at an earlier stage as already envisaged in the Best Practices Code[184] or through sectorial enquiries to foresee the possible state intervention. As such, the strengthening of information network agreements or the establishment of an (in)formal body for procedural analysis could be envisaged. In such system, key market information and policy decisions would be exchanged both by the Commission and Member States already before the opening of the formal procedure.

Furthermore, the procedural investigative powers of the Commission could be reinforced following other sectors in competition policy. It is still difficult to have a detailed set of investigation powers equal to what happens in proceedings under Arts 101 and 102 TFEU and merger control. This is mainly because State aid law involves the substantial role of the Member States which can indeed be reluctant to get away their control on their resources. However, the new PR may be "inspired" by Regulation 1/2003 on requests of information or sector enquiry.

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[180] Case T-29/10 and T-33/10, supra note 178, para.110.

[181] *Id.*, para. 102

[182] *Id.*, para. 98.

[183] See Joaquín Almunia, The State Aid Modernisation Initiative EStAL – European State Aid Law Institute 10th Experts' Forum on New Developments in European State Aid Law, SPEECH/12/424, 07.06.2012.

[184] European Commission, *Code of Best Practice*, OJ C 136, 16.06.2009, paras 10-18.

To a certain extent the very recent proposal of the Commission on the reform of the PR[185] goes in this direction. In fact, it gives the Commission new powers of request of information to Member States and private market participants[186] and envisages enquiries into sectors of the economy and into aid instruments.

It remains to be seen if the European legislators will follow the proposal. As such, even if the Commission's approach shows some "self-restraint" as to the tools to be included in the new PR, these new powers would be helpful in assuring market information before the adoption of decisions.

III.2.2. Conditions and Commitments

The procedure applicable to *conditions* and *commitments* decisions requires clarification. The former are conditions the Commission can attach at the end of the formal investigation procedure.[187] The latter are proposals to amend the original notification of the measure to the Commission. In practice, commitment decisions operate as negotiated decisions not to raise objections in Phase I between the Commission, the Member State and the beneficiary.

The greatest part of the Commission's decisions in the financial sector has been secured by commitments.[188] These decisions have been increasingly popular in the last crisis years. Among other reasons, extensive use of commitment decisions is due to a number of factors: the urgency of the situation for the financial market; the Commission's intention to reduce the distortive effects on competition through concerted activities; the need to avoid excessive administrative efforts through the opening of Phase II procedures. However, these decisions raise at least two problematic issues yet unresolved: the risks of non-execution in the implementation phase by the beneficiary; and, the different degree of negotiating powers between the involved parties.

As to the former, it would be significant to assure a stronger enforceability to commitments. This is because, in case of non-compliance, the Commission shall re-open the investigation procedure and conduct a new assessment of the compatibility of the aid. In case of non-compliance to commitments, it is not clear what legal obligations arise for the Member State and for the beneficiary. It appears that the procedure on misuse of aid applies.[189] It appears that the aid is misused because it is not correctly implemented. Hence, the procedure on misuse of aid might be applied more vigorously in future. To that extent, the Commission should clarify what infringements allow the opening of the misuse of aid procedure and to what extent

[185] Proposal for a Council Regulation amending Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, COM(2012) 725 final, 5.12.2012

[186] The proposal contains also provisions on procedural penalty payments and fines applicable to the addressee of the request if it fails to submit correct information to the Commission. However, these fines cannot be issued to Member States or public authorities.

[187] According to Art 7(4) of the PR, the Commission can adopt a conditional decision at the end of Phase II.

[188] Hans Gilliams, *supra* note 65, 24

[189] Art.16 of the PR. See Case T-140/95, *Ryanair v Commis*sion, [1998] ECR II-3337, paras. 86–90; Case T-68/03, *Olympic Airways*, [2007] ECR II-2911, paras 92–99.

infringements might annul the first decision. Is a simple infringement of the rules sufficient to open the procedure on misuse of aid? As such, the misuse of aid procedure should be refined in order to deter beneficiaries from non-implementing commitments and to allow stronger enforceability to the Commission.

As to the latter, the Commission disposes great powers in conducting negotiations. The commitments requested by the Commission might be far-reaching and burdensome for the beneficiary. Given the limited judicial review of the European judicature,[190] commitment decisions might have resulted in an excessively intrusive instrument at the hands of the Commission. In fact, strong commitment decisions can be detrimental for the European financial markets as they will make beneficiaries less competitive as compared with other counterparts. Hence, although being a "fast option", commitment decisions risk being more a Commission's unilateral decision rather than a truly "negotiated" solution. It is submitted that commitment decisions may have resulted in a more burdensome measure than one might have expected.

III.2.3. The monitoring of restructuring plans

The monitoring of restructuring plans is an issue directly resulting from conditions and commitment decisions. In fact, the Commission, together with the Member States, shall duly monitor that proper implementation of State aid schemes and ad hoc restructuring plans are carried out. In this sense the Restructuring Communication affirms that detailed reports should be submitted regularly by the Member State concerned to the Commission to enable the latter to verify that the restructuring plan is being applied in accordance with the notified commitments.[191] Member States should carefully notify any change in schemes and report the activity of the aid recipient.

However, a question open to debate is whether the Commission will be put under "administrative" pressure by the supervision of restructuring packages. At the moment, most of the monitoring activity over decisions has been delegated to monitoring trustees exercising control on the correct implementation of the commitment decisions. However, this does not prevent the Commission from supervising a correct implementation of the restructuring plans. What happens if the restructuring package is not respected by the beneficiary? Is the commitment/conditional decision void *ipso jure* or does it need a fresh formal decision of the Commission? It is submitted that the decisions should be considered void *ipso jure* in order to avoid an excessive administrative burden on the part of the Commission. However, deviations from the original commitment/conditional decision result problematic as they place in anyway a burden on the Commission to assess the aid. Case law limits the possibility to maintain the original restructuring plan in conditional decisions only in cases of 'relatively minor deviations from the initial condition'.[192] Thus, it appears that in cases of very minor changes from the conditions submitted in the restructuring plan, the Commission shall

[190] See for instance Case T-301/01, *Alitalia*, [2008] ECR II-1753, paras 380 and 407. But see recently the case T-29/10 and T-33/10, *ING*, *supra* note 178, para.102.

[191] Restructuring Communication, *supra* note 89, para.46.

[192] Case T-68/03, *Olympiaki Aeroporia Ypiresies AE v Commission*, [2007], ECR II- 2911, para. 91.

not issue a new decision. On the contrary, in cases of substantial changes, comprising even minor deviations from the commitment/conditional decisions, the Commission should open a new formal investigation procedure. As such, this situation is not positive for the monitoring process because it is still uncertain what "relatively minor deviation" means. It appears that even the slightest change to the substance of the restructuring plan can jeopardize the outcome of all the procedure. Clarifications are needed in that respect, but it appears that the Commission shall declare void commitment/ conditional decisions only when important deviations from the original plan take place.

To conclude one might question whether the role of the Commission as controller of restructuring plans in the financial sector is changing. Has the Commission departed from the role of guardian of the Treaties through a more active attempt at regulating the banking market structure? A first answer seems positive because the Commission is now more than ever engaged in controlling European banks and in reshaping the market structure through compensatory measures. Hence, it seems that the Commission is exercising its power beyond its original mandate and acts as a de facto regulatory body for aids in the banking sector. Even if this approach can be criticized because of excessive administrative pressure put on the Commission, only a horizontal body dealing with competition is entitled to adopt such policy prerogative.[193] This shall be the Commission.

IV. CONCLUSION

Some time ago, during the most controversial days of the crisis, the former Commissioner Kroes affirmed that EU State aid rules are part of the solution to solve the crisis.[194] So far such declaration is still true given the impact of the temporary rules in the banking and financial sector. More recently, the Commissioner Almunia stated that 'the spirit of the [Modernization] reform is to help Europe's governments boost growth at a time when many of them need to consolidate their budgets'.[195]

Until now, two things are clear. First, thanks to an indulgent interpretation of Art 107(3) TFEU, the Commission's approach to state support measures in the banking sector has avoided the collapse of the financial sector. The Commission approach has been effective in assuring that Member States could support financial institutions. Second, on the basis of the experience gained, the Commission needs to pursue an ambitious reform to boost growth through a more focused enforcement policy on less and big aids while at the same time promote European legislation which realises enhance coordination between Member States, if not robust transferral of power at central level.

As affirmed by the Commission in the recent 2012 Annual Report on Competition Policy, 'State aid control continued to be used as a de facto resolution mechanism in

[193] See, similarly, Psaroudakis, *supra* note 108, 207-208.

[194] Neelie Kroes, *EU state aid rules – part of the solution*, SPEECH/08/679, 05.12.2008.

[195] Joaquín Almunia, Presenting the Annual Competition Report for 2011 ECON Committee, SPEECH/12/466, 19.06.2012.

anticipation of more comprehensive Single Market legislation'.[196] New rules on crisis management in the financial sector are required with a view to avoid expensive State support measures which would be detrimental for Member States and taxpayers. It will be interesting to see the future EU steps in revising procedural rules, monitoring restructuring plans and promoting legislation for the restructuring and resolution of financial institutions. As underlined by Almunia in a recent speech, a number of contentious decisions in the banking sector have been finally solved, but this does not stop the Commission from continuing to exercise its careful control on aids to banks.[197]

To conclude, it has been shown that the special regime to tackle the effects of the financial crisis has been effective in avoiding the collapse of the financial system while the Commission has continued to exercise its enforcement over State aids in the banking sector. Nonetheless, many challenges in EU State aid law remain open. As underlined by Almunia at the European Competition Forum in 2013, '[in] parallel with the new regulatory framework for financial markets that is being introduced and the banking union that is being built, the control of State aid by the European Commission will continue to ensure a level playing field in the internal market'.[198] It is hoped that the next steps to accommodate the crisis-related regime in the evolving legal scenario will follow such goal.

Addendum:

At the time of publishing a number of new legal and policy documents have been approved. The Commission has adopted a new Communication for State aids to the Banking Sector on 10 July 2013. The purpose of this document is to replace the 2008 Banking Communication and to supplement the remaining crisis rules. The new Communication defines the common EU conditions under which Member States can support banks with funding guarantees, recapitalisations or asset relief and the requirements for a restructuring plan. The overall Commission approach is to render more effective the restructuring process and to strengthen burden-sharing requirements. The objective of the Communication is to assure financial stability as the over-arching objective.

At the same time, the work on the creation of a Banking Union continues. The Commission has published a proposal for a Regulation to establish a Single Resolution Mechanism (SRM). Furthermore, the ECOFIN Council approved a document on 20 June 2013 on ESM direct recapitalisation of banks. Among others some critical issues remains to be seen in the near future. First, it is essential to see whether the new conditions to the granting of aids to banks in Europe will limit the involvement of taxpayers to the restructuring of banks. Second, the functioning of the Single Supervisory Mechanism next year will elucidate over time whether the centralized supervision of banks at European level would provide a better oversight on financial institutions. Third, it remains to be seen whether and to what extent the BRRD Directive will be approved before the 2014 European Parliament and Commission elections.

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[196] European Commission, Report on Competition Policy 2012, *supra* note 2.

[197] Joaquín Almunia, Statement on Antitrust and State aid issues Press conference, SPEECH/12/570, 27.07.2012.

[198] Joaquín Almunia, Relying on the Single Market for the future of Europe, SPEECH/13/168, 28.02.2013.