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## Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis

(Text with EEA relevance)

(2010/C 329/07)

### 1. INTRODUCTION

1. Since the beginning of the global financial crisis in the autumn of 2008, the Commission has issued four communications which provided detailed guidance on the criteria for the compatibility of State support to financial institutions<sup>(1)</sup> with the requirements of Article 107(3)(b) of the Treaty on the Functioning of the European Union. The communications in question are the 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<sup>(2)</sup> (the Banking Communication); the Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition<sup>(3)</sup> (the Recapitalisation Communication); the Communication from the Commission on the treatment of impaired assets in the Community banking sector<sup>(4)</sup> (the Impaired Assets Communication) and the 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<sup>(5)</sup> (the Restructuring Communication). Three of those four communications, the Banking, Recapitalisation and Impaired Assets Communications, set out the prerequisites for the compatibility of the main types of assistance granted by Member States — guarantees on liabilities, recapitalisations and asset relief measures — while the Restructuring Communication details the particular features that a restructuring plan (or a viability plan) has to display in the specific context of crisis-related State aid granted to financial institutions on the basis of Article 107(3)(b) of the Treaty.

2. All four communications highlight the temporary nature of the acceptability of such aid measures; each states that any such aid measure can only be justified as an emergency response to the unprecedented stress in financial markets and only as long as those exceptional circumstances prevail. The Restructuring Communication is valid for restructuring aid notified by 31 December 2010 whilst the other communications do not have an expiry date.

3. This communication sets out the parameters for the temporary acceptability of crisis-related assistance to banks as from 1 January 2011.

<sup>(1)</sup> For the convenience of the reader, financial institutions are referred to simply as 'banks' in this document.

<sup>(2)</sup> OJ C 270, 25.10.2008, p. 8.

<sup>(3)</sup> OJ C 10, 15.1.2009, p. 2.

<sup>(4)</sup> OJ C 72, 26.3.2009, p. 1.

<sup>(5)</sup> OJ C 195, 19.8.2009, p. 9.

### 2. THE CONTINUED APPLICABILITY OF ARTICLE 107(3)(b) OF THE TREATY AND THE EXTENSION OF THE RESTRUCTURING COMMUNICATION

4. The Commission communications on crisis-related aid to banks, as well as all individual decisions on aid measures and schemes falling within the scope of those Communications, are adopted on the legal basis of Article 107(3)(b) of the Treaty, which exceptionally allows for aid to remedy a serious disturbance in the economy of a Member State. In the most acute stage of the crisis, the condition of a serious disturbance was unquestionably met across the Union in view of the extraordinary stress in financial markets, later combined with an exceptionally severe contraction in the real economy.

5. The economic recovery, which has slowly taken hold since the beginning of 2010, has been proceeding at a somewhat faster pace than expected earlier this year. While recovery is still fragile and uneven across the Union, some Member States are showing modest or even more robust growth rates. In addition, despite some pockets of vulnerability, in broad terms, the health of the banking sector has improved compared with the situation one year ago. As a result, the existence of a serious disturbance in the economy of all Member States is no longer as self-evident as in earlier stages of the crisis. While it is aware of those developments, the Commission still considers that the requirements for State aid to be approved pursuant to Article 107(3)(b) of the Treaty are fulfilled in view of the recent reappearance of stress in financial markets and the risk of wider negative spillover effects, for the reasons set out in this communication.

6. The re-emergence of tensions in sovereign debt markets forcefully illustrates the continued volatility in financial markets. The high level of interconnectedness and interdependence within the financial sector in the Union has given rise to market concerns about contagion. The high volatility of financial markets and the uncertainty about the economic outlook justifies maintaining, as a safety net, the possibility for Member States to argue the need to have recourse to crisis-related support measures on the basis of Article 107(3)(b) of the Treaty.

7. Therefore, the Banking, Recapitalisation and Impaired Assets Communications, which provide guidance on the criteria for the compatibility of crisis-related aid to banks on the basis of Article 107(3)(b) of the Treaty — most

notably in the form of government guarantees, recapitalisations and asset relief measures — need to stay in place beyond 31 December 2010. In the same vein, the Restructuring Communication, which addresses the follow-up to such support measures, also has to remain applicable beyond that date. The temporal scope of the Restructuring Communication — the only one of the four communications with a specified expiry date, 31 December 2010 — should therefore be extended to restructuring aid notified by 31 December 2011.

8. The communications, however, need to be adapted with a view to preparing the transition to the post-crisis regime. In parallel, new, permanent State aid rules for bank rescue and restructuring in normal market conditions will have to be drawn up and should, market conditions permitting, apply as of 1 January 2012. The possible continued need for crisis-induced extraordinary State aid to the financial sector has to be evaluated with that objective in mind. It must be addressed by setting the requirements for the compatibility of such assistance in a way that best prepares for the new regime for the rescue and restructuring of banks based on Article 107(3)(c) of the Treaty.

### 3. THE ADVANCEMENT OF THE EXIT PROCESS

9. The continued availability of aid measures pursuant to Article 107(3)(b) of the Treaty in the face of exceptional market conditions should not obstruct the process of disengagement from temporary extraordinary support measures for banks. At its meeting on 2 December 2009, the Economic and Financial Affairs Council concluded on the necessity to design a strategy for the phasing out of support measures which should be transparent and duly coordinated among Member States to avoid negative spill-over effects but take into account the different specific circumstances across Member States<sup>(1)</sup>. The conclusions further set out that, in principle, the phasing-out process concerning the various forms of assistance to banks should start with the unwinding of government guarantee schemes, encouraging the exit of sound banks and inducing other banks to address their weaknesses.

10. Since 1 July 2010, the Commission has applied tighter conditions for the compatibility of government guarantees

<sup>(1)</sup> These conclusions were endorsed by the European Council at its meeting on 11 December 2009. In the same vein, the European Parliament insisted in its Resolution of 9 March 2010 on the Report on Competition Policy 2008 (<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2010-0050>) that State support to financial institutions should not be unduly prolonged and that exit strategies should be elaborated as soon as possible.

under Article 107(3)(b) of the Treaty<sup>(2)</sup> by introducing an increased guarantee fee and the new requirement of a viability plan for beneficiaries that have recourse to new guarantees and exceed a certain threshold of total outstanding guaranteed liabilities both in absolute terms and in relation to total liabilities<sup>(3)</sup>. The Commission expressly limited the scope of such modified guarantee schemes to the second half of 2010. Considering the current market situation and given the limited time since the introduction of the new pricing conditions, no further adjustment of those conditions appears necessary at present. Government guarantee schemes for which State aid approval expires at the end of 2010 can therefore be authorised for another six months until 30 June 2011 on the basis of the conditions introduced as of July 2010<sup>(4)</sup>. In line with previous practice, the Commission will reassess the conditions for the compatibility of State guarantees beyond 30 June 2011 in the first half of 2011.

11. In the following paragraphs, the Commission will set out the steps of a gradual phasing out with regard to recapitalisation and impaired asset measures, as, for those measures, no such steps have yet been taken beyond the exit incentives already present through pricing.

### 4. REMOVAL OF THE DISTINCTION BETWEEN SOUND AND DISTRESSED BANKS FOR THE PURPOSES OF SUBMITTING A RESTRUCTURING PLAN

12. At the beginning of the crisis, the Commission established a distinction between unsound/distressed financial institutions and fundamentally sound financial institutions, that is to say, financial institutions suffering from endogenous, structural problems linked, for instance, to their particular business model or investment strategy and financial institutions whose problems merely and largely had to do with the extreme situation in the financial crisis rather than with the soundness of their business model, inefficiency or excessive risk taking. The distinction is defined in particular on the basis of a number of indicators set out in the Recapitalisation Communication: capital adequacy, current credit default swap (CDs) spreads, current rating of the bank and its outlook as well as, inter alia, the relative size of the recapitalisation. Regarding the latter, the Commission deems aid received under the form of recapitalisation and asset relief measures of more than

<sup>(2)</sup> See Directorate-General for Competition staff working document of 30 April 2010 on the application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2010 ([http://ec.europa.eu/competition/state\\_aid/studies\\_reports/phase\\_out\\_bank\\_guarantees.pdf](http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf))

<sup>(3)</sup> With a flexibility clause permitting a reassessment of the situation and appropriate remedies in the event of a severe new shock to the financial markets across the Union or in one or more Member States. None of the Member States that have notified an extension of their guarantee schemes until the end of 2010 have invoked this flexibility clause.

<sup>(4)</sup> The same applies for liquidity schemes.

2 % of the bank's risk weighted assets to be an indicator to distinguish between fundamentally sound and distressed banks. The recapitalisation of a distressed bank triggers the requirement to submit a restructuring plan to the Commission, while the recapitalisation of a sound bank triggers the requirement to submit a viability plan.

13. The original rationale for establishing that distinction and for setting a range of indicators, including a threshold of 2 % of the bank's risk weighted assets, was the fear that capital needs resulting from impairments, higher expectations of the markets as to the capital levels of banks and temporary difficulties in raising capital on markets would otherwise lead to sound banks diminishing their lending to the real economy in order to avoid having to submit a restructuring plan when having recourse to State resources. At present, however, the banking sector overall faces fewer difficulties in raising capital on the markets or, inter alia, through retained earnings<sup>(1)</sup> and can therefore meet their capital needs without recourse to State aid<sup>(2)</sup>. The amount of capital raised by financial institutions on the market has significantly increased over the course of 2009 and 2010, demonstrating renewed access for financial institutions to capital markets as well as anticipation of new regulatory requirements<sup>(3)</sup>.

14. The distinction between sound and distressed banks therefore no longer seems relevant in order to determine which banks should enter into a discussion about their

<sup>(1)</sup> In order to increase capital buffers, banks have decided to sell non-strategic assets such as industrial participations, or to focus on specific geographical sectors. See on this point European Central Bank, *EU Banking Sector Stability, September 2010*.

<sup>(2)</sup> According to the European Central Bank, banks' overall solvency ratio increased substantially in the course of 2009 in all Member States. In addition, information for a sample of large banks in the Union suggests that the improvement in capital ratios continued into the first half of 2010, supported by an increase in retained earnings as well as by further private capital raising and public capital injections for some banks. See European Central Bank: *EU Banking Sector Stability, September 2010*.

<sup>(3)</sup> The future regulatory environment drawn up by the Basel Committee on Banking Supervision (BCBS), so-called Basel III, sets a path for the implementation of the new capital rules which should allow banks to meet the new capital needs over time. In this context, it is interesting to note that, first, most of the largest banks in the Union have reinforced their capital buffers over the last two years to increase their loss absorption capacity and, second, the other banks in the Union should have sufficient time (up to 2019) to build up their capital buffer using, inter alia, retained earnings. It should also be noted that the 'transitional arrangements' provided by the new regulatory framework have established a 'grandfathering period' until 1 January 2018 for existing public sector capital injections. Moreover, a quantitative impact assessment done by the Basel Committee, confirmed by Commission calculations, points to a rather moderate impact on bank lending. Therefore, the new capital requirements are not expected to impact the proposal outlined in this communication.

restructuring with the Commission. As a result, banks which still have recourse to the State in 2011 for raising capital or for impaired assets measures should be required to submit to the Commission a restructuring plan showing the bank's determination to undertake the necessary restructuring efforts and return to viability without undue delay. Thus, as of 1 January 2011, a restructuring plan will be required from every beneficiary of a new recapitalisation or an impaired asset measure<sup>(4)</sup>.

15. In assessing the restructuring needs of banks, the Commission will take into consideration the specific situation of each institution, the degree to which such a restructuring is necessary to restore viability without further State support as well as prior reliance on State aid. As a general rule, the more significant the reliance on State aid, the stronger the indication of a need to undergo in-depth restructuring in order to ensure long-term viability. In addition, the individual assessment will take account of any specific situation on the markets and will apply the restructuring framework in an appropriately flexible manner in the event of a severe shock endangering financial stability in one or more Member States.

16. Requiring a restructuring plan for banks benefiting from structural aid (that is to say, recapitalisation and/or impaired asset measures) — while at the same time accepting that the mere use of refinancing guarantees would still not trigger the requirement to submit a restructuring plan<sup>(5)</sup> — conveys the signal that banks have to prepare for a return to normal market mechanisms without State support as the financial sector gradually emerges from crisis conditions. It provides an incentive for individual institutions that still need aid to accelerate the necessary restructuring. At the same time, it affords sufficient flexibility to duly take account of potentially diverse circumstances affecting the situation of different banks or national financial markets. It also caters for the possibility of an overall or country-specific deterioration in relation to financial stability, which cannot be excluded at present, given the residual fragility in the situation of financial markets.

<sup>(4)</sup> This will apply to all recapitalisation or impaired asset measures, irrespective of whether they are designed as individual measures or granted in the context of a scheme.

<sup>(5)</sup> However, the Directorate-General for competition staff working document on the application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2010 sets a threshold of 5 % of outstanding guaranteed liabilities over total liabilities and at a total amount of guaranteed debt of EUR 500 million above which a viability review is required.

## 5. TEMPORAL SCOPE, GENERAL OUTLOOK

17. The continued applicability of Article 107(3)(b) of the Treaty and the extension of the Restructuring Communication will be for one year until 31 December 2011 <sup>(1)</sup>. This extension under changed conditions should also be seen in the context of a gradual transition to a more permanent regime of State aid guidelines for the rescue and restructuring of banks based on Article 107(3)(c) of the Treaty which should, market conditions permitting, apply as of 1 January 2012.

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<sup>(1)</sup> Consistent with the Commission's previous practice, existing or new bank support schemes (irrespective of the support instruments they contain: guarantee, recapitalisation, liquidity, asset relief, other) will only be prolonged/approved for a duration of six months to allow for further adjustments, if necessary, in mid-2011.