



FACULTY OF LAW

Lund University

Nathalja Héloïse Amanda Nolen

State aid in the financial sector during the  
financial crisis in Europe;  
Lessons to learn?

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## **Preface**

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I am very grateful to all staff, including teachers and coordinators, at the Faculty of Law at Lund University who contributed to my education in many different ways while participating in the Master Programme of European Business Law.

I also would like to thank my family for their support and positive attitude towards this thesis and my education at Lund University.

## **List of abbreviations**

European Commission: Commission

European Banking Authority: EBA

European Union: EU

Gross domestic product: GDP

Treaty of the Functioning of the European Union: TFEU

## **Definition of a term**

Moral hazard:

'Moral hazard refers to someone's willingness to take excessive risks just because they know someone else will come and save them from the possible negative consequences.'<sup>1</sup> In the domain of economy this occurs when there is 'asymmetric information, where one entity (the principal) does not know how another (the agent) will behave in the future'.<sup>2</sup>

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<sup>1</sup> Titus Sucio, *Financial Innovation and Moral Hazard*, (2011) 4 Bulletin of the Transilvania University of Brasov 177, 177

<sup>2</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 135

## **Summary**

### **The legal framework of EU State aid law**

In Article 107 (1) TFEU the concept of State aid under EU law is defined. Criteria for State aid are described in the Case law. Article 107 (2) and (3) TFEU define when aid is compatible with the internal market. Article 107 (3) TFEU provides for exemptions to the aid prohibited under Article 107 (1) TFEU. For State aid in the financial sector Article 107 (3) (b) and (c) TFEU are particularly important.

The rules on State aid are applicable to the financial sector. The four types of aid measures are funding guarantees, liquidity measures, recapitalization and asset relief measures. The “private investor test” is used as a tool to determine whether a measure meets the criteria of State aid or not.

### **The commission’s response to the financial crisis**

In response to the financial crisis the Commission approached the questions concerning national State aid to financial institutions, by developing a new legal framework with Article 107 (3) (b) as its legal basis. There was a switch from using Article 107 (3) (c) to Article 107 (3) (b) to approve State aid.

The response to the financial crisis can be summarized as follows:

1. Before October 2008, all Cases were dealt with under Article 107 (3) (c).
2. Between October 2008 and late February 2009 Article 107 (3) (b) was used as a legal base.
3. Since late February 2009 Article 107 (3) (b) was applied and there was a return to the application of the Rescue and Restructuring Guidelines.
4. Between July 2009 and December 2009 the Commission started to use the Financial Restructuring Guidelines.
5. In July 2013 the 2008 Banking Communication was replaced by the 2013 Banking Communication.

Prior to and in the early stages of the crisis the Rescue and Restructuring Guidelines and Article 107 (3) (c) were used to approve State aid. The distortion of the aid under the Rescue and Restructuring Guidelines could only be justified by other social and economic benefits.

The new legal framework consisted of the 2008 Banking Communication, the Recapitalization Communication, the Impaired Assets Communication, the Restructuring Communication and the 2013 Banking Communication. The 2008 Banking Communication

and the 2013 Banking Communication have financial stability as its aim, while at the same time keeping distortions of competition to the minimum.

### **Balancing between advantages and disadvantages of State aid in the financial sector**

There are economic and social advantages to State aid in the financial sector. The economic advantages of State aid in the financial sector are the preservation of the integrity of the internal market, ensuring financial stability, avoiding a total collapse of the financial system, decreasing the chance of a continuation and deepening of the financial crisis and protecting the national economy as a whole. During the financial crisis the Commission also used State aid measures with the aim of protecting a competitive market and to increase competition in the market. A social advantage is the protection of employment.

Negative consequences of State aid in the financial sector are possible distortions of competition and moral hazard.

In the Cases decided under the Crisis Framework, the social and economic benefits of the aid measures were increasingly seen in the protection of a competitive market and an increase in competition.

The legal framework provides for a balancing between economic and social benefits and negative economic effects. In particular, there needs to be a balance between the restoration of financial stability on one hand and possible undue distortions of competition and fragmentation of the internal market on the other hand.

The legal framework shows the need to limit distortions of competition. The Commission developed several manners and used basic legal principles such as proportionality and burden sharing to maintain or in certain circumstance increase competition in the banking sector through State aid. One important means of limiting distortions of competition is keeping the aid to the minimum amount necessary and that it must be of temporary nature.

Throughout the legal framework the importance of burden sharing and a minimum own contribution are considered to be an important means of limiting distortions of competition. The principle of proportionality is used to assess the minimum burden sharing and the appropriate own contribution.

In the beginning of the crisis the Commission distinguished between sound and unsound banks in its measures to limit distortions of competition. Less-performing banks needed less restructuring than well-performing banks. In the first prolongation of the Restructuring

Communication, the distinction between fundamentally sound and unsound banks was taken away.

The Cases show that in the beginning of the crisis when the decisions were taken under the Rescue and Restructuring Guidelines and under Article 107 (3) (b), the Commission referred to social objectives of the aid such as the need to protect employment. In contrast, in the Cases which were decided in a later phase under Article 107 (3) (c), the Commission focused more on the objectives of protection of financial stability and economic stability in the wider economy.

In the Case law the Commission applied the means to prevent undue distortions of competition as developed in the legal framework. In all Cases the Commission took the relative amount of aid and its form into account when deciding about the appropriate measures to limit distortions of competition. This means that the principle of proportionality was applied in addressing the problem of distortions of competition.

In highly concentrated markets, the creation of a new entity and divestments with the result of a reduction in market shares, were used as a means to increase competition and to avoid undue distortions of competition.

Reductions in balance sheets and a ban on acquisitions during a certain amount of time, were frequently used measures to avoid distortions of competition. Furthermore, disincentives for aggressive commercial behavior such as the obligation to refrain from mass marketing were imposed on banks. The concern about moral hazard was addressed through a change in management of the banks.

In the beginning of the crisis in 2008, a lesser degree of restructuring was required than at a later stage. With the introduction of the Restructuring Communication, the Commission became tougher with its structural measures and behavioral constraints. In the Case law, this resulted in an increasing degree of divestments and a stricter stance towards divestment periods.

The most significant difference in the approach of restructuring banks for the purpose of limiting distortions of competition was the removal of the distinction between fundamentally sound and unsound banks. This can be seen in the Case law by the increasing degree of restructuring required for all banks.

Overall, the legal framework and the Case law stressed the importance of limiting distortions of competition. There was a development towards stricter and tougher requirements for restructuring during the financial crisis, with the aim of limiting distortions.

### **Balancing between short-term and long-term consequences of State aid**

In the legal framework the following long-term consequences of State aid can be identified: restoring long-term viability of the company; restoring financial stability; a return to normal market conditions; limitations of undue distortions of competition; avoiding fragmentation of the internal market and avoiding moral hazard.

In the legal framework the following short-term objectives of State aid can be identified: restoring trust in the financial sector and thereby decreasing the likelihood of a total collapse of the financial system and avoiding moral hazard.

At the beginning of the crisis there was slightly more focus on the short-term consequences of the aid, whereas by the end and after the crisis, notably in the 2013 Banking Communication, there was more attention to the long-term objectives.

State aid was approved as an emergency measure with the objective of restoring confidence in the financial market and avoiding the risk of a disturbance of the national economy as a whole, with possible negative spill-overs to the whole EU economy.

The Commission applied the compensatory measures as developed in the legal framework in the Case law. The avoidance of moral hazard played an important role in the design of compensatory measures and the approval of State aid in the Commission's decisions. Limiting the aid to the minimum necessary and an appropriate own contribution (burden sharing) to the costs were the main means through which the Commission aimed at restoring financial stability in the long-term.

It is not possible to say that long-term impact prevailed over short-term impact, or the other way around. However, the Case law shows that when taking measures with a short term objective, the long term consequences were also taken into account. Furthermore, the Case law shows a gradual shift from short-term impact to long-term impact.

There is a clear connection between the development of the balancing between short-term and long-term consequences between the Legal Framework and the Case Law. This flows from the application of the legal framework to the Case law.

Both the legal framework and the Case law responded to the changing situation of the financial crisis, from a very severe situation in the financial sector at the beginning of the crisis in 2008 to one that became less harsh, by 2009. In the beginning of the financial crisis the legal Framework and the Case law focused more on short-term objectives, whereas at a later stage during the crisis, the long-term objectives became more a focal point for the Commission. The objective of avoiding moral hazard remained a short-term as well as a long-term objective throughout the crisis.

### **Evaluation of State aid measures**

State aid to banks during the financial crisis was beneficial because State aid helped to restore financial stability in some Member States. However, State Aid did not prove to be an effective tool for equal and enduring recovery across Europe, as the economic recovery was very fragile and unequal in the EU.

By using effective tools to limit distortions of competition, State aid was also successful in maintaining competition between the banks. Based on the Commission's analysis of the market structure of the banking sector, there were no significant distortions of competition as a consequence of the State aid.

### **Possible solutions to handling similar problems which occurred during the financial crisis: the formation of a European Banking Union**

Prior and during the crisis the banking sector was regulated on a national level which meant that it was difficult for EU authorities to respond to the crisis in a coordinated manner. The lack of a supranational regulatory body was mentioned as one of the causes of the financial crisis.

The creation of a Banking Union with a single supervisory and resolution mechanism could be a possible solution to handle similar problems in the future. Especially due to the relatively large proportion of cross border activities of banks, it is important to have a supranational body governing European Banking. With a supranational body in place, such as a European Banking Union, it will be possible to act in a coordinated manner in response to crisis situations.

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# 1 Introduction

## 1.1 Topic

As a response to the financial crisis and the serious threat to the banking sector, almost all Member States gave aid to rescue the banks. Between October 2008 and March 2010 a total amount of nearly 10% of EU gross domestic product (GDP).<sup>3</sup> Between 2008 and 2011, more than 1,6 trillion Euro<sup>4</sup> was given as State aid to the financial sector.<sup>5</sup>

The European Commission (hereafter Commission) made more than 200 decisions in the financial services sector in the period between October 2008 and October 2010.<sup>6</sup> 'Seldom have the Community rules on State aid been applied so frequently. Seldom has the definition of State aid presented more difficulty.'<sup>7</sup>

This thesis focuses mainly on problems relating to State aid in the financial sector in the European Union (hereafter EU) during the financial crisis. It is interesting to investigate how the Commission approached the questions concerning approval or disapproval of national State aid to financial institutions during the crisis. It is especially interesting to analyze how the Commission balanced the interests of economic and financial stability and social benefits in the EU with market oriented disadvantages, such as distortion of competition between financial institutions in the EU. It is also interesting to investigate how distortions of competition were limited. Furthermore, it is useful to analyze the balancing between long-term and short-term consequences of State aid, to see whether measures aimed at long-term or short-term impact prevailed.

The question arises whether State aid under the temporary State aid rules resulted in a distortion of competition. This question will be investigated through an evaluation of the effects on competition as a result of State aid measures taken during the financial crisis. If State aid resulted in distortions of competition, it is interesting to analyze to what extent and how market oriented disadvantages could have been prevented.

Finally, I will investigate options for improvement in handling a similar situation, including the creation of a European banking Union. The European Banking Union might be a solution for the negative consequences in the financial sector. I will also look at which lessons can be drawn from this in the future, in order to minimize negative market oriented effects.

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<sup>3</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 127

<sup>4</sup> This is to 13% of total EU GDP.

<sup>5</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 400

<sup>6</sup> Thomas Jerstaedt and Marcus Pollar, 'The Application of European Competition Law in the Financial Services Sector' [2011] 2, *Journal of European Competition Law & Practice*, 371, p.372

<sup>7</sup> Phedon Nicolaides, 'State Aid', in Ioannis Kokkodoris and Rodrigo Olivares-Caminal *Antitrust Law amidst Financial Crisis* (Cambridge University Press 2010) 349, Quote by Andrea Biondi, Prof. Piet Eeckhout & James Flynn

## **1.2 Method and Demarcation**

The research is based on an analysis of relevant journal articles, books, Case law and legislation. A traditional legal dogmatic method is applied, with the respect for the hierarchy of norms and specific nature of Union law.

For this analysis, I will make an assessment on how the Commission handled State aid for banks including an assessment of the legal framework used in order to balance the negative market oriented effects with the positive financial, economic and social effects of the State aid granted.

I will also analyze a number of Cases from different Member States. As there are hundreds of Cases on State aid in the financial sector, a selection of Cases needs to be made. I choose the Cases based on their importance in terms of the amount of State aid granted and the time period in which they were decided. The focus will be on the period between 2008 and 2009 as the most significant developments in the domain of State aid to the financial sector took place during this period. Attention is also given to the period after 2009 to see the effects of the decisions taken in 2008 and 2009. I will also address the 2013 Banking Communication which replaced the 2008 Banking Communication.

Regarding the doctrine, an important starting point has been a chapter by Christian Ahlborn and Daniel Piccinin called 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' from the 'Research Handbook of European State Aid Law'.

Based on the research I am expressing my own point of view on the issues as well.

## **1.3 Structure**

In order to understand the Commission's decisions on State aid in the financial sector it is necessary to give an overview of the legal framework in relation to State aid to firms in difficulty. Secondly the legal framework in relation to State aid in the financial sector, established by the Commission to handle the negative consequences of the financial crisis, is described and analyzed. This is followed by an overview and analysis of the legal framework and Case law addressing the short-term and long-term impact of the State aid.

The advantages and disadvantages of state aid in the financial sector are addressed. This includes an outline on how State aid can have a negative effect on the economy such as distortion of competition between banks. Then an overview of the manner in which the

Commission balanced social and economic benefits against market oriented disadvantages is given.

This is followed by an evaluation of the effects of State aid, which includes a review and investigation of the means used by the Commission to limit the negative consequences of State aid such as undue distortions of competition.

I will also look for alternative ways in order to prevent market oriented disadvantages as much as possible and maximize the positive economic and social effects of State aid. This includes an investigation of the option and possible effects of the creation of a European Banking Union.

In the conclusion the question on how the Commission approached the approval of State aid to national banks during the financial crisis will be answered. This will include the final conclusion regarding the balancing of the advantages and disadvantages of State aid and the balancing between short-term and long-term consequences. The question on whether a European Banking Union is a possible solution to deal with State aid during a financial crisis will also be addressed.

Descriptive chapters will finish with a summary capturing the main points of the chapter. Chapters which are both descriptive and also contain an analysis will finish with a summary and a conclusion. Chapters which are mainly comprised of an analysis will only have a conclusion at the end.

## **2 Legal framework of EU State aid law**

The general rules on EU State aid are relevant for State aid given in the financial services sector. Therefore they are presented underneath. Furthermore, an outline is given of what is considered State aid in the financial services sector. The Commission`s discretion in the field of EU State aid law is also discussed.

### **2.1 Rules on EU State aid**

In Article 107 (1) of the Treaty of the Functioning of the European Union (hereafter TFEU) the concept of State aid under EU law is defined.

‘Save as otherwise provided in the Treaties, any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.’

This Article shows that aid is incompatible with the internal market, unless the aid is permitted by other Treaty provisions. Article 107 (2) and (3) TFEU define when aid is compatible with the internal market.<sup>8</sup>

There is no definition of State aid. However, the Court`s interpretation of Article 107 (1) TFEU provides criteria for a measure to fall within Article 107(1) TFEU. Based on Case Law these criteria can be summarized as follows:

- a) ‘There must be aid in the sense of an economic advantage;
- b) The aid must be granted directly or indirectly through State resources and must be imputable to the State;
- c) The measure must favor certain undertakings or the production of certain goods and;
- d) The measure must be liable to distort competition and affect trade between Member States.’<sup>9</sup>

### **2.2 General principles under Article 107 (3) in relation to firms in difficulty**

State aid rules are the most extensively used available policy of the EU. State aid to private firms is covered by Article 107 TFEU. This Article is important as it lays down the test for State aids.<sup>10</sup>

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<sup>8</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 20

<sup>9</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 20-21

<sup>10</sup> Paul Graig and Gráinne De Burca, *EU Law, text, cases and materials*, (5<sup>th</sup> edition, Oxford University Press 2011) 1087

Under Article 107 (3) TFEU the Commission is given the power to give exemptions to the aid prohibited under Article 107 (1) TFEU. The Commission has a wide discretion in the application of Article 107 (3) TFEU.<sup>11</sup>

For State aid in the financial sector Article 107 (3) (b) and (c) TFEU are particularly important. This Article says:

1. Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.
3. The following may be considered to be compatible with the internal market:
  - (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
  - (c) 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;

In case aid is not covered by a block exemption, the Commission applies guidelines, to assess whether the aid may be approved. If no guidelines are applicable, then the Commission applies Article 107 (3) directly.<sup>12</sup>

One feature of the application of Article 107 (3) (c) is that aid can be justified as judged by national criteria. However, the impact of the aid on EU trade, and its sectoral repercussions at EU level should still be considered.<sup>13</sup>

The Commission has applied the principle of compensatory justification in the application of Article 107 (3). This means that the aid should lead to a contribution of the Union objectives as contained in the derogations from Article 107 (3).<sup>14</sup>

Every decision that the Commission makes under Article 107 (3) includes a balancing test in which the positive effects of the aid measure are balanced against the possible negative effects, in particular distortion of trade and competition. In the balancing test the following questions are asked:

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<sup>11</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 100

<sup>12</sup> Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 100-101

<sup>13</sup> Paul Graig and Gráinne De Burca, *EU Law, text, cases and materials*, (5<sup>th</sup> edition, Oxford University Press 2011) 1096

<sup>14</sup> Paul Graig and Gráinne De Burca, *EU Law, text, cases and materials*, (5<sup>th</sup> edition, Oxford University Press 2011) 1085.

- a) 'Is the aid measure aimed at a well-defined objective of common interest?
- b) Is the aid well designed to deliver the objective of common interest? In particular:
  - Is the aid measure an appropriate instrument?
  - Is there an incentive effect?
  - Is the aid measure proportionate?
- c) Are the distortions of competition and effect on trade sufficiently limited, so that the overall balance is positive?<sup>15</sup>

### 2.3 What is State aid in the banking sector?

The rules on State aid are applicable to the banking sector. Before the financial crisis, in the nineties the Commission approved State aid to *Crédit Lyonnais*<sup>16</sup> and *Banco di Napoli*<sup>17,18</sup>.

Four types of aid measures can be classified under the so called crisis framework: funding guarantees, liquidity measures, recapitalization and asset relief measures.<sup>19</sup>

Government measures were adopted to combat the financial crisis. They can fall under State aid if 'they could not have been obtained from private market participants under normal market conditions'.<sup>20</sup> The 'private investor test' is used to determine whether a measure can be qualified as State aid or not. Under the 'private investor test', an assessment is made whether the same advantage conferred to by a State to a firm could have been given by a private investor under the same conditions. Applying the 'private investor test' on the measures taken by States to combat the financial crisis, almost all state support in the financial sector is considered as State aid.<sup>21</sup>

Sometimes private investors and the State intervene alongside in the financial sector. In some Cases, depending on the situation of the private participation, the measure may fall outside Article 107 (1) TFEU. Two Cases in which the Commission had to decide on whether there was State aid, were the *Hypo Steiermark Case*<sup>22</sup> and the *Dexia Case*<sup>23</sup>, in which two different conclusions were reached. In the *Hypo Steiermark Case* the Commission concluded that there was no aid as the private investor was responsible for 75% of the capital increase.<sup>24</sup> In the *Hypo Steiermark Case* the private investor contributed to the same extent

<sup>15</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 101-102

<sup>16</sup> *Crédit Lyonnais* (Case 95/547/EC), Commission Decision [1995] 95/547/EC OJ 1995 L308/92 and *Crédit Lyonnais* (Case 98/490/EC), Commission Decision [1999] OJ 1999 L221/28

<sup>17</sup> *Banco di Napoli* (Case 1999/288/EC), Commission Decision [1999] OJ 1999 L116/36

<sup>18</sup> Conor Quigley & Anthony M. Collins, *EC State Aid Law and Policy*, (Hart Publishing 2003) 167

<sup>19</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 403

<sup>20</sup> Ulrich Soltész and Christian Köckritz, 'From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks' [2010] *European Competition Journal* 6 285, 286

<sup>21</sup> Ulrich Soltész and Christian Köckritz, 'From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks' [2010] *European Competition Journal* 6 285, 286.-287

<sup>22</sup> *Hypo Steiermark* (Case NN40/2009) Commission Decision [2009], C206/02

<sup>23</sup> *Dexia* (Case 2010/606) Commission Decision [2006] OJ L274/54

<sup>24</sup> *Hypo Steiermark* (Case NN40/2009) Commission Decision [2009], C206/02 and Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 404-405

as in the *Dexia* Case, but the Commission came to the opposite conclusion, as the private investor, intervened to rescue the bank under entirely 'abnormal conditions'. As a consequence they could not be considered a private investor as this principle can only be applied under normal market circumstances.<sup>25</sup>

State aid can exist if the bank is partly or completely sold. According to the Commission there is no aid if the deal occurs under non-discriminatory competitive conditions and at a market price. However, the Commission takes the special circumstances of the crisis into account. This was done in the Cases of *Fortis Bank* and *Fortis Bank Luxembourg*<sup>26</sup>. These Cases concerned the sale of Fortis Banque to BNP Paribas.<sup>27</sup> These Cases will be further analyzed in the following chapters.

## **2.4 The Commission`s discretion in State aid in the financial sector**

The Commission has a large degree of discretion in allowing or prohibiting State aid. This discretion is only scrutinized to a limited extent by the Community Courts. During the financial crisis the Commission used its important position to change the operations of the European banking system.<sup>28</sup>

The Commission imposed its objectives on Member States and aid beneficiaries through Commission Communications and Commitment Decisions. Commission Communications form a guidance on the manner in which the Commission will use its discretion concerning certain aid measures. They contain the conditions that the aid measures need to fulfil, in order to receive a clearance decision from the Commission.<sup>29</sup>

Commitment Decisions were used by the Commission to impose behavioral restraints on banks. In addition, the Commission required banks to change their business structure and activities in the future.<sup>30</sup>

## **2.5 Summary of the legal framework of EU State aid law**

In Article 107 (1) TFEU the concept of State aid under EU law is defined. Criteria for State aid are described in the Case law. Article 107 (2) and (3) TFEU define when aid is compatible with the internal market. Article 107 (3) TFEU provides for exemptions to the aid

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<sup>25</sup> *Dexia* (Case 2010/606) Commission Decision [2006]OJ L274/54, para 126 and Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 404-405

<sup>26</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 - Netherlands) Commission Decision (2008) OJ C80/7

<sup>27</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 405-406

<sup>28</sup> Ulrich Soltész and Christian Köckeritz, *From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks* [2010] 6 *European Competition Journal*, 285, 289

<sup>29</sup> Ulrich Soltész and Christian Köckeritz, *From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks* [2010] 6 *European Competition Journal*, 285, 289

<sup>30</sup> Ulrich Soltész and Christian Köckeritz, *From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks* [2010] 6 *European Competition Journal*, 285, 290

prohibited under Article 107 (1) TFEU. For State aid in the financial sector Article 107 (3) (b) and (c) TFEU are particularly important.

The rules on State aid are applicable to the financial sector. The four types of aid measures are funding guarantees, liquidity measures, recapitalization and asset relief measures. The “private investor test” is used as a tool to determine whether a measure meets the criteria of State aid or not.

The Commission has a large degree of discretion in allowing or prohibiting State aid. The Commission uses Commission Communications and Commitment Decisions to impose its objectives on Member States and aid beneficiaries.

### **3 The EU legal framework on State aid in the banking sector during the financial crisis**

The Commission developed a legal framework on State aid rules during the financial crisis. An overview of the legal framework for State aid control in the banking sector during the financial crisis is given below.

#### **3.1 Pre-crisis, Article 107 (3) (c) and the Rescue and Restructuring Guidelines as a legal basis for State aid**

In general, for transparency and predictability reasons, the Commission develops Guidelines for cases that are not covered by a block exemption. The Commission is bound by these guidelines, provided they do not depart from the rules in the Treaty and do not affect the scope of secondary legislation.<sup>31</sup>

Before the crisis started, the Rescue and Restructuring Guidelines<sup>32</sup> and Article 107 (3) (c) were used to approve State aid. These rules continued to be applied in the early stages of the financial crisis, such as in the Cases of *Roskilde Bank*<sup>33</sup>, *Sachsen LB*<sup>34</sup> and *Northern Rock*<sup>35</sup>.<sup>36</sup> A more detailed overview of the Rescue and Restructuring Guidelines and their application in the financial services sector is presented underneath.

The Commission developed the Guidelines<sup>37</sup> on Restructuring aid. The objectives of aid as stated in these guidelines are as follows:

1. viability is restored;
2. the aid is in proportion to the restructuring costs and benefits;
3. undue distortions of competition should be avoided;
4. and the restructuring plan should be fully implemented.<sup>38</sup>

The Commission has quite a large degree of discretion to the approach to State aid. This became noticeable in the adjustment of State aid rules in relation to the banking sector during the financial crisis.<sup>39</sup>

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<sup>31</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 105-106.

<sup>32</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2

<sup>33</sup> *Roskilde Bank* (Case NN36/2008) Commission Decision (2008) OJ C32/2008

<sup>34</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14

<sup>35</sup> *United Kingdom Rescue aid to Northern Rock* (Case NN 70/2007 ex CP269/07) Commission Decision [2007] OJ C43/2008

<sup>36</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011)

<sup>37</sup> Also called Commission Communication

<sup>38</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2

Under the Rescue and Restructuring Guidelines, restructuring aid can only be justified if the distortion caused by State aid, can be justified by other social and economic benefits. Three criteria are used for the assessment of aid and the restructuring plan. Firstly, the Commission is focusing on viability of the company in the long-run. This means that the company should not ask for aid again. Secondly, the aid and the plan should not lead to distortions of competition. Thirdly, the aid should be as minimum as possible and the company should contribute as well.<sup>40</sup>

Aid with the objective of development of certain economic activities can be aid given to individual undertakings. For State aid to private undertakings to be approved, it must be in line with the common market. In general, aid for rescue and restructuring purposes, is normally not considered to be in the common interest of the EU.<sup>41</sup> It is the Commission's duty to assess whether aid for rescue and restructuring purposes is not against the common interest.<sup>42</sup>

There is a distinction between 'rescue' and 'restructuring' aid. Rescue aid is temporary whereas restructuring aid is aimed at financing recapitalization and reorganization and has long-term consequences.<sup>43</sup>

### **3.2 The application of Article 107 (3) (c)**

Normally rescue and restructuring aid is granted under Art. 107 (3) (c) TFEU. Under this Article aid is allowed to 'facilitate the development of certain activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest'.<sup>44</sup>

As noted above, in the first phase of the financial crisis Art. 107 (3) (c) TFEU and the Rescue and Restructuring Guidelines were used by the Commission.<sup>45</sup> In this phase the Commission did not consider the aid to be necessary to 'remedy a serious disturbance in the Economy of a Member State', which is needed to use Article 107 (3) (b). Therefore in the first Cases

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<sup>39</sup> Paul Graig and Gráinne De Burca, *EU Law, text, cases and materials*, (5<sup>th</sup> edition, Oxford University Press 2011) 1085-1086.

<sup>40</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39, 44

<sup>41</sup> Peter L. Vesterdorf & Mogens Uhd Nielsen, *State Aid Law of the European Union* (1st edition 2008, Sweet & Maxwell) 33-34

<sup>42</sup> Peter L. Vesterdorf & Mogens Uhd Nielsen, *State Aid Law of the European Union* (1st edition 2008, Sweet & Maxwell) 34

<sup>43</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39, 42

<sup>44</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39, 41

<sup>45</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 138-139

decided by the Commission (e.g Northern Rock, Sachsen LB and IKB), Article 107 (3) (c) was applied.<sup>46</sup>

The Rescue and Restructuring Guidelines were not specific and detailed enough to deal with the problems as a result of the crisis.<sup>47</sup> Due to problems in a number of banking Cases, the Commission had to develop a new and more specific legal framework 'outside the strict application of the Rescue and Restructuring Guidelines'.<sup>48</sup>

### **3.3 Article 107 (3) (b) as the legal basis for state aid**

Until 2008, only under exceptional circumstances, aid was approved by the Commission under Article 107 (3) (b). Under Article 107 (3) (b), aid to remedy a serious disturbance in the economy of a Member State, may be authorized by the Commission. To be able to rely on this Article, the serious disturbance had to affect the economy of a Member State as a whole and aid should have benefited more than one operator or sector. Aid which only benefited one operator or one sector could not fall within this exception.<sup>49</sup>

Since the financial crisis started in 2008, the Commission changed its approach on the applicability of Article 107 (3) (b). Since then, Article 107 (b) could also be relied on for measures taken to support financial undertakings and other undertakings as a result of the financial crisis.<sup>50</sup>

The Commission's initial objectives were identified as follows; 'to preserve financial stability and deal with the risk of insolvencies and restore lending'. The main aim was 'to preserve the single market, to protect competitors when rivals receive aid, and to move towards eliminating state support'.<sup>51</sup>

In the 2008 Banking Communication it is stipulated that, a crisis which affects the stability of individual banks or the banking system as a whole, and creates a risk that the whole economy of a Member State will be affected in a negative way, may be a sufficient reason to rely on Article 107 3 (b).<sup>52</sup>

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<sup>46</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 139

<sup>47</sup> Philipp Werner and Martina Maier, 'Procedure in Crisis? Overview and Assessment of the Commission's State Aid Procedure during the Current Crisis [2009] 2 European State Aid Law Quarterly 177, 179

<sup>48</sup> Philipp Werner and Martina Maier, 'Procedure in Crisis? Overview and Assessment of the Commission's State Aid Procedure during the Current Crisis [2009] 2 European State Aid Law Quarterly 177, 179

<sup>49</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 109

<sup>50</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 109

<sup>51</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39, 41

<sup>52</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 9 & Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 109

### 3.4 The Crisis Framework

The European Commission's State aid policy between 2008 and 2010 consisted of four main objectives. The Commission wanted to:

1. have a well organized rescue and restructuring process for banks and no discrimination in the granting of deposit guarantees;
2. allow the recapitalization of fundamentally sound banks in an impartial manner;
3. avoiding distortions of competition;
4. and review the State aid measures and their exit.<sup>53</sup>

In response to the financial crisis, the so called Crisis Framework was developed by the Commission, with Article 107 (3) (b) as its legal basis.<sup>54</sup> The Commission adopted five Communications<sup>55</sup> in order to deal with the problems as a result of the crisis.<sup>56</sup> These five Communications are the:

1. 2008 Banking Communication;
2. Recapitalization Communication;
3. Impaired Assets Communication;
4. Restructuring Communication;
5. And the 2013 Banking Communication which replaced the 2008 Banking Communication.

#### 3.4.1 The 2008 Banking Communication

The 2008 Banking Communication was introduced on the 13<sup>th</sup> of October 2008. Article 107 (3) (b) was used as a legal basis for the 2008 Banking Communication.<sup>57</sup> During the crisis, the 2008 Banking Communication was used to 'give guidance on the application of State aid rules to State support schemes and individual assistance for financial institutions'.<sup>58</sup> In this Communication, it was noted that the measures taken should not lead to unnecessary distortions of competitions between financial institutions or negative spillover effects on other Member States.<sup>59</sup> Apart from minimizing competition, all support measures needed to be 'well-targeted in order to be able to achieve effectively the objective of remedying a serious

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<sup>53</sup> Phedon Nicolaides, 'State Aid', in Ioannis Kokkodoris and Rodrigo Olivares-Caminal *Antitrust Law amidst Financial Crisis* (Cambridge University Press 2010) 351-352

<sup>54</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 400

<sup>55</sup> Sometimes referred to as Guidelines

<sup>56</sup> Phedon Nicolaides and Ioana Eleonora Rusu, 'The financial crisis and state aid' [2010] 55 *The antitrust bulletin*, 759, 762

<sup>57</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 9

<sup>58</sup> Phedon Nicolaides and Ioana Eleonora Rusu, 'The financial crisis and state aid' [2010] 55 *The antitrust bulletin*, 759, 765

<sup>59</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 5

disturbance in the economy and proportionate to the challenge faced, not going beyond what is required to attain this effect.<sup>60</sup>

By applying these criteria, compliance with State aid rules and the fundamental freedoms in the Treaty, such as non-discrimination, needed to be taken into account.<sup>61</sup> This was emphasized under paragraph 18 of the 2008 Banking Communication in which it said that all institutions in the Member State concerned should be covered by the guarantee aid scheme. This is also related to minimizing distortions on competition as this might arise when certain financial institutions are excluded from the guarantee aid scheme.<sup>62</sup> In addition, measures based on Article 107 (b) could only be taken as long as it could be justified by the specific situation of the financial crisis.<sup>63</sup>

In the 2008 Banking Communication it was stipulated that recapitalization of vulnerable systemically relevant financial institutions was important with the aim of protecting the depositors' interests and the stability of the system. The national level remained relevant as public intervention had to be decided on a national level but there needed to be a coordinated framework taking EU principles into account.<sup>64</sup>

One important characteristic of this Communication as well as of the Restructuring Communication, was that a distinction was made between banks that were suffering from liquidity effects as a result of the financial crisis, referred to as 'fundamentally sound' banks, and the banks that had endogenous problems, referred to as 'fundamentally unsound banks'. According to the 2008 Banking Communication 'fundamentally sound' banks did not need much restructuring.<sup>65</sup>

The 2008 Banking Communication says that 'under the prevailing circumstances, the crisis equally affects financial institutions that are fundamentally sound and whose difficulties stem exclusively from the general market conditions which have severely restricted access to liquidity. Long-term viability of these institutions may require less substantial restructuring.'<sup>66</sup>

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<sup>60</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 15

<sup>61</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 16

<sup>62</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 18

<sup>63</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 12

<sup>64</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 3

<sup>65</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 14 & Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 139-140

<sup>66</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 2.

### 3.4.2 The Recapitalization Communication

The 2008 Banking Communication was primarily used to ensure lending to the real economy, rather than a rescue measure. Therefore the Commission introduced the Recapitalisation Communication, which contains a more detailed framework for recapitalization measures.<sup>67</sup>

According to this Communication, recapitalization schemes were recognized as one of the main measures that Member States could take to preserve financial stability and a well functioning financial market.<sup>68</sup> One of the aims of this document was to make sure that the financial stability of the banks was restored. It is important to note that 'state interventions must be proportional, temporary and distinguishes between fundamentally sound and less-well-performing banks'.<sup>69</sup> This distinction was used in the balancing between the objectives of financial stability and competition. Furthermore, this separation was taken into account when determining the recapitalization measures.<sup>70</sup> Fundamentally sound banks did not require any restructuring under the Recapitalisation Communication.<sup>71</sup>

Banks with a higher risk profile had to pay more. Entry criteria based on the different risk profiles, had to be considered by the Member States. Hereby the situation of banks which face difficulties due to the crisis had to be taken into account. Furthermore, distressed banks may accept lower remuneration in the short term whereas financially sound banks had to be entitled to relatively low rates of entry into any capitalization.<sup>72</sup>

Like the 2008 Banking Communication, the Recapitalization Communication emphasized the need to prevent distortions of competition.<sup>73</sup> Furthermore, as stipulated in the 2008 Banking Communication, recapitalizations are subject to regular review.<sup>74</sup>

### 3.4.3 The Impaired Assets Communication

The Impaired Assets Communication gives a detailed framework for asset relief measures. It was introduced as a reaction to the problems in the economy, which had not been solved through the measures taken since 2008. Due to the uncertainty about the valuation and

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<sup>67</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 401 & Nicolaidis and Ioana Eleonora Rusu, 'The financial crisis and state aid' [2010] 55 *The antitrust bulletin*, 759, Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, para 3

<sup>68</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, par

<sup>69</sup> Phedon Nicolaidis and Ioana Eleonora Rusu, 'The financial crisis and state aid' [2010] 55 *The antitrust bulletin*, 759, 766.

<sup>70</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, paras 12-13

<sup>71</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) p 140

<sup>72</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, paras 13- 15

<sup>73</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, paras 35-39

<sup>74</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, para 40

localization for impaired assets, these measures did not lead to an increase in lending in the real economy. Therefore, Member States were considering relief for impaired bank assets.<sup>75</sup>

The Impaired Assets Communication can be seen as a return to the Rescue and Restructuring Aid Guidelines, as in two decisions made in this phase, *Commerzbank*<sup>76</sup> and *West LB*, the remedies imposed on the banks were similar to the ones imposed under the Rescue and Restructuring Guidelines.<sup>77</sup>

Apart from measures aimed at immediate effects, this Communication also stressed the need to take long term considerations into account by implementing asset relief measures. Furthermore, like the other two Communications as described above, distortion of competition should be avoided when taking asset relief measures.<sup>78</sup> In addition, when taking asset relief measures, the budgetary situation of Member States was taken into account.<sup>79</sup>

One important difference with the previous Communications was that there was no difference between 'fundamentally sound' and 'unsound' banks. Banks could not profit from having the status of being 'fundamentally sound' under the Recapitalization Guidelines to avoid the obligation to restructure. Since the Impaired Assets Communication, the Commission started to point out the need for deep restructuring.<sup>80</sup>

#### **3.4.4 Financial Restructuring Communication**

The Financial Restructuring Communication was finished in July 2009.<sup>81</sup> Under these guidelines the Commission became tougher in its position towards the restructuring obligations of banks. The recipients of aid were under the obligation to restructure in such a way that it would increase competition in the banking sectors. This was done through compensatory measures which required banks to divest in national markets.<sup>82</sup> These

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<sup>75</sup> Communication from the Commission 2009/C 72/01 of 26 March 2009 - on the treatment of impaired assets in the Community banking sector [2009] OJ C72/01, paras 5-7

<sup>76</sup> *Commerzbank Germany* (N 244/2009) Commission Decision [2009] OJ C147/4

<sup>77</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 140-141

<sup>78</sup> Communication from the Commission 2009/C 72/01 of 26 March 2009 - on the treatment of impaired assets in the Community banking sector [2009] OJ C72/01, para 7

<sup>79</sup> Communication from the Commission 2009/C 72/01 of 26 March 2009 - on the treatment of impaired assets in the Community banking sector [2009] OJ C72/01, para 11

<sup>80</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 140-141

<sup>81</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 141

<sup>82</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 32 & Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 141

measures were applied in the Cases of *LBG*, *ING*, *RBS* and *KBC*.<sup>83</sup> These Cases will be further analysed in the next chapters.

The Restructuring Communication stipulated the assessment of the restructuring requirements for banks that received aid in the financial crisis. This assessment was done in three steps:

- a) An analysis was made of the bank's problems in order to create a policy with the aim of restoring viability.
- b) The design of the restructuring plan was analyzed to make sure there is realistic timing to make the necessary implementation steps.
- c) The principle of appropriate burden sharing/ own contribution between the Member State and the beneficiary banks was applied, keeping the whole situation of the financial sector in mind.
- d) The enforcement of compensatory measures aimed at limiting distortions of competition by a rescued bank and to limit any competitive advantage for banks that were not aided.<sup>84</sup>

The Restructuring Communication, in association with the other Communications were prolonged twice. In the First Prolongation the distinction between 'fundamentally sound' and 'unsound' banks was taken away.<sup>85</sup>

### **3.4.5 The 2013 Banking Communication**

The 2008 Banking Communication was replaced by the 2013 Banking Communication on the first of August 2013. This Communication forms the most important source of guidance in terms of the procedure for granting of State aid to banks and for the requirements as to own contribution and burden sharing by the recipient and their stakeholders.<sup>86</sup>

Like in the other Crisis Communications, financial stability, while at the same time keeping distortions of competition to the minimum, remains the objective of the 2013 Banking Communication.<sup>87</sup>

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<sup>83</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 141

<sup>84</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 7 & Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 402

<sup>85</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 402

<sup>86</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 402

<sup>87</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 7

The new Communication takes the unequal economic recovery of Member States, the fragility of the financial markets and the difficulties in the autonomous debt market into account. In addition, the integrity of the internal market is addressed.<sup>88</sup>

In the 2013 Banking Communication, it is noted that the previous Banking Communications did not lead to financial stability in the long term, as Member states did not go beyond the minimum requirements for burden sharing. Therefore in this Communication, it is argued that the minimum requirements for burden sharing should be raised.<sup>89</sup>

Furthermore, when applying State aid rules to individual cases, the Commission takes the specific situation in each Member State into account. It will also undertake a proportionate assessment of the long-term viability of the banks.<sup>90</sup>

The 2013 Banking Communication addresses the weaknesses of the earlier 2008 Banking Communication in the sense that restructuring efforts for individual beneficiaries were often delayed which resulted in higher costs for the taxpayers. One way to solve this problem, was to approve the bank's restructuring plan, before the approval of recapitalization and impaired assets measures.<sup>91</sup>

### **3.5 Summary of the response to the financial crisis**

The response to the financial crisis can be summarized as follows:

1. Before October 2008, all Cases were dealt with under Article 107 (3) (c).
2. Between October 2008 and late February 2009 Article 107 (3) (b) was used as a legal base.
3. Since late February 2009 Article 107 (3) (b) was applied and there was a return to the application of the Rescue and Restructuring Guidelines.
4. Between July 2009 and December 2009 the Commission started to use the Financial Restructuring Guidelines.<sup>92</sup>
5. In July 2013 the 2008 Banking Communication was replaced by the 2013 Banking Communication.

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<sup>88</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 13 & Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 402

<sup>89</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, paras 17-19

<sup>90</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 9

<sup>91</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 23

<sup>92</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 138-139.

Prior to and in the early stages of the crisis the Rescue and Restructuring Guidelines<sup>93</sup> and Article 107 (3) (c) were used to approve State aid. The distortion of the aid under the Rescue and Restructuring Guidelines could only be justified by other social and economic benefits.

From October 2008, the Commission developed a new and more specific legal framework consisting of the 2008 Banking Communication, the Recapitalization Communication, the Impaired Assets Communication, the Restructuring Communication and the 2013 Banking Communication.

Under the 2008 Communication, State aid should not lead to unnecessary distortions of competitions between financial institutions or negative spillover effects on other Member States. Furthermore, all measures had to be proportionate and effective as a remedy to the serious disturbance in the economy. There was a distinction between 'fundamentally sound' and 'fundamentally unsound' banks.

The Commission introduced the Recapitalisation Communication, under which recapitalization schemes were recognized as one of the main measures that Member States could take to preserve financial stability and a well functioning financial market. Measures taken under the Recapitalization Communication should prevent distortions of competition.

The Impaired Assets Communication was introduced as a reaction to the problems in the economy, which had not been solved through the measures taken since 2008.

Under the Financial Restructuring Communication the Commission became stricter in its position towards the restructuring obligations of banks. The recipients of aid had to restructure so that it would increase competition in the banking sectors, which was done through compensatory measures.

The 2008 Banking Communication was replaced by the 2013 Banking Communication. Financial stability, while at the same time keeping distortions of competition to the minimum, remains the objective of the 2013 Banking Communication.<sup>94</sup> In this Communication the unequal economic recovery of Member States was taken into consideration and it was argued that the minimum requirements for burden sharing were raised.

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<sup>93</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2

<sup>94</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 7

### **3.6 Conclusion**

In response to the financial crisis the Commission approached the questions concerning national State aid to financial institutions, by developing a new legal framework with Article 107 (3) (b) as its legal basis. This legal framework was more detailed and specific to deal with the crisis situation than the Rescue and Restructuring Guidelines.

The Commission switched from using Article 107 (3) (c) to Article 107 (3) (b) in approving State aid. Decisions were made using the 2008 Banking Communication which was later replaced by the 2013 Banking Communication. In the latter more attention was given to uneven recovery between Member States. Both Communications have financial stability as its aim, while at the same time keeping distortions of competition to the minimum. With the introduction of the Financial Restructuring Communication, the Commission became tougher towards companies' restructuring obligations. The 2013 Communication also shows a stricter approach towards the approval of State aid, as it was noted that the minimum requirements for burden sharing should be raised and to approve the bank's restructuring plan, before the approval of recapitalization and impaired assets measures.

## **4 Market oriented disadvantages and social and economic advantages of State aid in the financial sector**

State aid in the financial sector has economic and social advantages as well as economic disadvantages. These have played a role in the Commission's decisions and legal framework and will therefore be presented below.

### **4.1 Economic and social advantages of aid to firms in difficulty in general**

State aid for rescue and restructuring purposes is a very sensitive political area of State aid policy. Therefore it is considered to be an area of concern for the Commission.<sup>95</sup>

In general, the effect on social welfare is more likely to be negative than positive. However, under special circumstances, there are strong social policy justifications, that would outweigh the economic considerations.<sup>96</sup> Therefore State aid may be used for economic and social purposes. This is particularly true for companies in difficulty that are important providers of employment in certain regions. The collapse of such a company would lead to unemployment, thereby creating negative social and economic consequences, which would outweigh the negative consequences for the tax payers and competitors.<sup>97</sup> Therefore, in some circumstances, State aid may serve to prevent a business from closing, which would have led to negative social consequences such as unemployment, as well as negative effects on the local economy. The closing of one company may also lead to the creation of a monopoly or oligopoly situation. This would result in anti-competitive effects on the market. Therefore political, social and economic consequences should be balanced in State aid policy.<sup>98</sup> In general, whether the social and economic benefits outweigh the negative effects on competition and for the tax payers should be assessed on a case by case basis, taking the social and economic context into account.<sup>99</sup>

Due to the reasons as outlined above, the Rescue and Restructuring Guidelines, only allow for restructuring aid in certain very limited situations. It may be justified under 'social or regional policy considerations, the need to take into account the beneficial role played by small and Medium- Sized companies in the economy' or in order to maintain 'a competitive

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<sup>95</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 264

<sup>96</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 134

<sup>97</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 134

<sup>98</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 264

<sup>99</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 134

market structure when the demise of firms would lead to a monopoly structure or a tight oligopolistic situation'.<sup>100</sup>

## **4.2 Economic and social advantages of rescue and restructuring aid in the banking sector**

Banking is considered to be a very vulnerable sector, as problems in one major financial institution, can possibly lead to a collapse of the whole banking system and in turn can lead to a financial crisis.<sup>101</sup> In some instances, the social costs of rescuing a bank can be less than the costs of a failing bank.<sup>102</sup> The social and economic advantages of State aid will be discussed underneath.

### **4.2.1 Integrity of the internal market and financial stability**

One of the main objectives of State aid control in the financial sector is to preserve the integrity of the internal market and to ensure financial stability. Economic stability is one important objective of State aid to the banking sector. A functioning banking system is considered to be crucial for the performance of the economy.<sup>103</sup>

### **4.2.2 Protection of the wider economy and prevention of a deepening of the financial crisis**

A well-functioning banking system is a prerequisite for the performance of the economy as a whole. State aid in the financial sector has been used to avoid a total collapse of the financial system and to decrease the chance of a continuation and deepening of the financial crisis.<sup>104</sup> Protecting the national economy as a whole has also been mentioned by the Commission as one of the aims and positive effects of the state aid measures in the Case law. This can be seen from the *Bank of Ireland Case*, in which an avoidance of a risk of a serious disturbance in the Irish economy was seen as a justification for the aid measures.<sup>105</sup>

Similar to in the *Bank of Ireland Case*, the objective of protecting the economy as a whole and maintaining confidence in the financial sector has also been mentioned in the Case of *Maxbank*. In contrast to the *Bank of Ireland Case*, which concerned a big bank in Ireland, this

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<sup>100</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2, para 8

<sup>101</sup> Conor Quigley & Anthony M. Collins, *EC State Aid Law and Policy*, (Hart Publishing 2003) 166; Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] Journal of Industry Competition and Trade 41

<sup>102</sup> Phedon Nicolaides, 'State Aid', in Ioannis Kokkodoris and Rodrigo Olivares-Caminal *Antitrust Law amidst Financial Crisis* (Cambridge University Press 2010) 421

<sup>103</sup> Francesco de Cecco, *State Aid and the European Economic Constitution*, (Hart Publishing 2013) 40; Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 143

<sup>104</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 143

<sup>105</sup> *Recapitalisation by the Bank of Ireland by the Irish State Case* (Case N149/2009) Commission Decision [2009] OJ C234/2009 paras 60-61

Case was about rescue aid of a small bank in Denmark. It was argued by the Commission that the bankruptcy of a small bank could lead to a significant decrease in trust in the financial system and could have a negative effect on the Danish economy.<sup>106</sup> The recapitalization Case of *Dexia*<sup>107</sup> which involved a capital injection of 6,4 billion Euro's, also shows that the approval of large-scale rescue measures are approved by the Commission with the aim of preventing a continuation of the financial crisis.<sup>108</sup>

The *Cyprus Popular Bank* Case also shows the need to protect the national economy through State aid measures. Cyprus Popular Bank is the second-largest banking institution in Cyprus and is a systematically important bank for Cyprus. The Commission argued that bankruptcy would lead to a serious disturbance in the Cypriot economy. Therefore, the Commission notes that the measure was appropriate.<sup>109</sup>

#### **4.2.3 Protection of employment**

From the two Cases that were decided under the Rescue and Restructuring Guidelines and Article 107 (3) (c), it becomes clear that social consequences have played a major role in the Commission's decisions. The *Northern Rock* Case shows that the aid measures were important to remedy negative consequences. Due to the State aid measures unemployment was avoided. Here the Commission balanced the aid against the possible negative effect of aggressive behavior by the bank.<sup>110</sup> In the Case of *Sachsen LB*, the State aid measure was justified based on serious social difficulties. Without these measures Sachsen LB would be liquidated which would have resulted in unemployment. This was balanced against the negative effects of the aid. Like in the *Northern Rock* Case, the Commission noted that negative spillover effects would be avoided as the bank was not capable of acting aggressively.<sup>111</sup>

#### **4.2.4 Protection of a competitive market and increase in competition**

Since the introduction of the Restructuring Communication, the Commission used State aid measures to increase competition on the market. The existing Case law decided under the Restructuring Communication, shows that an increase in competition was an important motive for the Commission in approving the aid measures. One example was the *ING* Case in which the measures taken resulted in an increase in competition on the Dutch retail market. In ING's restructuring plan it was stipulated that ING would carve out an entity,

<sup>106</sup> *Rescue Aid for Max Bank* (Case SA 33639) Commission Decision [2011] OJ C 343/2011, para 59

<sup>107</sup> *Dexia* (Case 2010/606) Commission Decision [2006] OJ L274/54

<sup>108</sup> Yassine Boudghene, Laurent Le Mouél, Martin Löffler, Sandrine Scheller, & Guillaume Schwall, 'The Dexia Reconstruction Decision' (2010) <[http://ec.europa.eu/competition/publications/cpn/2010\\_2\\_11.pdf](http://ec.europa.eu/competition/publications/cpn/2010_2_11.pdf)> accessed 2 September 2014, 63,66

<sup>109</sup> *Rescue Recapitalisation of Cyprus Popular Bank* (Case SA.34827) Commission Decision 2012/NN [2012] OJ C341/2012 para 48

<sup>110</sup> *United Kingdom Rescue aid to Northern Rock* (Case NN 70/2007 ex CP269/07) Commission Decision NN 70/2007 [2007] OJ C43/2008, para 49

<sup>111</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 para 103

WUH/Interadvies, in the Dutch retail market. Given the highly concentrated market, the good market share in the mortgage business and consumer loans of the newly created entity, there would be an increase in competition in the Dutch retail banking market.<sup>112</sup>

Other Cases in which the restructuring plans contributed to the increase in competition were *KBC* and *Lloyds*.<sup>113</sup> In the Case of *Lloyds*, the divestment entailed 600 branches in the UK market, representing 4,6% in the personal current account market. The newly created business would be viable and would be capable of competing in the retail banking business in the UK. It was seen as an appropriate means to increase competition in the highly concentrated UK retail market.<sup>114</sup>

In a restructuring Case of the *Royal Bank of Scotland*, the Commission mentioned that a divestment helped to increase competition, as the divested business would be a viable business in the future and would be a competitor on the highly concentrated UK banking market.<sup>115</sup>

### **4.3 Market oriented disadvantages of Rescue and Restructuring aid in general**

Rescue and Restructuring aid is among the type of aid that is most likely to lead to distortions and has led to several controversial State aid decisions in the past. Therefore the Commission noted that State aid under the Rescue and Restructuring Guidelines should remain limited.<sup>116</sup>

#### **4.3.1 Distortions of competition**

Rescue and Restructuring aid might lead to distortions of competition.<sup>117</sup> Firstly State aid can lead to a decreased incentive to compete, invest and succeed. Companies might have the perception that they will not be able to completely profit from their investments, as their competitors will receive aid from the State. Furthermore, even when there is no aid given but only an expectation of receiving aid, companies will be less likely to invest and to compete. As a consequence, State aid to firms in difficulty can have negative consequences for the market and the economy.<sup>118</sup>

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<sup>112</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 145-147

<sup>113</sup> Karen Lanno and Chris Napoli, *Bank State Aid in the Financial Crisis: Fragmentation or Level Playing Field?* (A CEPS Task Force Report, October 2010) Centre for European Policy Studies, 20

<sup>114</sup> United Kingdom Restructuring of Lloyds Banking Group (N428/2009) [2009] C46/2010 paras 184 & 188

<sup>115</sup> Restructuring of Royal Bank of Scotland following its recapitalization by the state and its participation in the Asset Protection Schemes, (N 422/2009) [2009] para 244

<sup>116</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2, para 4

<sup>117</sup> Conor Quigley & Anthony M. Collins, *EC State Aid Law and Policy*, (Hart Publishing 2003) 167

<sup>118</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39, 42 & Christian Ahlborn and Daniel Piccinin,

Rescue and restructuring aid can lead to distortions of competition through an increase in market power. However, this is unlikely to happen as the recipient does not always have the capability for aggressive expansion.<sup>119</sup>

#### 4.3.2 Moral hazard

State aid may also lead to moral hazard. 'Moral hazard refers to someone's willingness to take excessive risks just because they know someone else will come and save them from the possible negative consequences.'<sup>120</sup> In the domain of economy this occurs when there is 'asymmetric information, where one entity (the principal) does not know how another (the agent) will behave in the future'.<sup>121</sup> If companies notice that other companies receive aid, they might engage in risky activities as well, as they might think that the aid would also be available to them.<sup>122</sup>

The creation of moral hazard is expected to have more serious and long-lasting consequences than minor distortions of the market. The repetition of State aid may sooner or later lead to the assumption that 'certain undertakings are "too big to fail" (or too politically important to fail), and thus perpetuate overly risky or inefficient business practices.'<sup>123</sup>

Moral hazard has played a key role in the creation of the financial crisis.<sup>124</sup> Examples of moral hazard from the financial industry are:

- Selling a financial product to someone, knowing that it is not in the interest of that person to buy it. An example is a mortgage.
- Paying excessive bonuses out of funds that are managed on another person's behalf.
- Take risks that others have to bear.<sup>125</sup>

Moral hazard had an immense affect on the financial sector, particularly due to the manner the employees were paid by the financial institutions. In the years preceding the crisis,

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'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 134

<sup>119</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 134; Conor Quigley & Anthony M. Collins, *EC State Aid Law and Policy*, (Hart Publishing 2003) 162

<sup>120</sup> Titus Sucio, '*Financial Innovation and Moral Hazard*', (2011) 4 Bulletin of the Transilvania University of Brasov 177, 177

<sup>121</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 135

<sup>122</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 135

<sup>123</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 10

<sup>124</sup> Titus Sucio, '*Financial Innovation and Moral Hazard*', (2011) 4 Bulletin of the Transilvania University of Brasov 177, 179

<sup>125</sup> Kevin Dowd, '*Moral Hazard and the Financial Crisis*' (2009) 29 *Cato Journal* 141, 142

bonuses had expanded aggressively. All big investment banks<sup>126</sup> paid increasingly higher bonuses. This bonus system, which was aimed at short-term profits within one year, triggered risky behavior with catastrophic effects. Some companies nearly collapsed.<sup>127</sup>

These moral hazards are part of the financial system and the economy. It is crucial to keep them under acceptable control by means of institutional control. If there is no proper control of moral hazards, this might lead to excessive risk taking, as many moral hazards include increased risk-taking behavior.<sup>128</sup>

The importance of controlling moral hazard during the financial crisis is mentioned in the 2009 Restructuring Communication.

‘The current scale of the public intervention necessary for financial stability and the possible limits to normal burden sharing are bound to create even greater moral hazard that needs to be properly corrected to prevent perverse incentives and excessively risky behavior from reoccurring in the future and to pave the way for a rapid return to normal market conditions without State aid support.’<sup>129</sup>

The 2013 Banking Communication mentions the issue of moral hazard in connection with the authorization of liquidation aid.

#### **4.4 Market oriented disadvantages of Rescue and Restructuring aid in the banking sector**

As State aid can lead to distortions of competition, this was also one of the main concerns by the Commission. In the Restructuring Communication the negative impacts on competition were outlined in detail. It says that State aid is considered to be supporting banks that relied on unsustainable business practices and those which accumulated excessive risk. In normal market circumstances these companies would exit the market. ‘State aid prolongs past distortions of competition created by excessive risk-taking and unsustainable business practice’.<sup>130</sup> State aid is supporting the market power of those receiving aid, while discouraging the incentives to invest, compete and innovate for non-beneficiaries. Furthermore, State aid will have consequences for the functioning of the single market, as other Member States can get an unfair share of the burden of structural adjustment and

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<sup>126</sup> Examples of these investment banks are: Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers and Bear Stearns.

<sup>127</sup> Titus Sucio, *Financial Innovation and Moral Hazard*, (2011) 4 Bulletin of the Transilvania University of Brasov 177, 179-180

<sup>128</sup> Kevin Dowd, *Moral Hazard and the Financial Crisis* (2009) 29 Cato Journal 141, 142-143

<sup>129</sup> <sup>129</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 29

<sup>130</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 28

accompanying social and economic problems. In addition, this will lead to decreased incentives for cross-border activities.<sup>131</sup>

The Commission also expressed its concern about moral hazard. This was also mentioned in the Case law.<sup>132</sup> The Commission was worried that if State aid would be granted without any compensatory measures, banks would work with risky strategies which could arise in a new financial crisis.<sup>133</sup> In other words, banks would continue to take excessive risks as they are expected to receive future bail-outs.<sup>134</sup> This is addressed in several Cases such as in *Real Estate Hypo* in which the Commission notes that burden sharing is for the purpose of limiting distortions of competition and avoiding moral hazard.<sup>135</sup> In the Case of *Sachsen LB*, it says that the fact that the old management and owners of the bank are not involved in the bank's activities is a good sign against moral hazard.<sup>136</sup> However, others noted that it is very unlikely that State aid will lead to moral hazard, as the impact of the crisis has been destructive for all banks.<sup>137</sup>

The Commission was also concerned about aid sustaining market power. However, it is very difficult to analyze market power concerns in the case of State aid in the financial sector. This is because a traditional analysis under Article 102 TFEU has an additional complication, due to the fact that the assessment involves a comparison between the level of competition with the bank receiving aid and the situation in which the bank would exit the market.<sup>138</sup>

When companies in difficulty were granted restructuring aid, they were usually required to take compensatory measures to compensate for the negative effects on competition. This has also been the case in the decisions in the financial sector.<sup>139</sup> These measures included balance sheet reductions and behavioral constraints, divestment of core assets and divestment of non-core assets.<sup>140</sup> These compensatory measures will be discussed in more

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<sup>131</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 28

<sup>132</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 148

<sup>133</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 148

<sup>134</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 422

<sup>135</sup> *State aid which Germany implemented and is planning to implement for Hypo Real estate* (Case C15/2009) [2009] Commission Decision OJ L60/2012 para 114c

<sup>136</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ L104/2009 para 126

<sup>137</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 148

<sup>138</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 149

<sup>139</sup> Daniel Zimmer & Martin Blaschczok, 'The role of competition in European state aid control during the financial market crisis' (2011) 32 *European Competition Law Review* 9, 4

<sup>140</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 152

detail in the next chapter.

#### **4.5 Summary of the advantages and disadvantages of Rescue and Restructuring aid**

In summary, State aid might lead to significant distortions of competition in the market and moral hazard. These consequences can be limited through compensatory measures. On the other hand, in some circumstances, State aid might be used to preserve and maintain financial stability in a certain sector and the economy as a whole. It can also serve as a means to protect the competitive structure of the market and even increase competition.

State aid might also be used for the protection of employment. During the financial crisis, the Commission assessed whether the positive consequences stemming from the aid, would outweigh the negative impact that the aid might have, in particular on competition.

#### **4.6 Conclusion**

In conclusion, the economic advantages of State aid in the financial sector are the preservation of the integrity of the internal market, ensuring financial stability, avoiding a total collapse of the financial system, decreasing the chance of a continuation and deepening of the financial crisis and protecting the national economy as a whole. The Commission also used State aid measures with the aim of protecting a competitive market and to increase competition in the market. A social advantage is the protection of employment.

Negative consequences of State aid in the financial sector are possible distortions of competition and moral hazard. Compensatory measures were used to limit possible distortions of competition and moral hazard.

It is interesting to see that in the Cases decided under the Crisis Framework, the social and economic benefits of the aid measures are increasingly seen in the protection of a competitive market and an increase in competition. This is especially the case under the Financial Restructuring Communication. There is limited reference to the objective of protection of employment in the Cases which were decided under the 2008 Banking Communication. However, I think the protection of a competitive market could imply other social and economic benefits such as the protection of employment.

## **5 Balancing between long term and short term effects of State aid**

When the Commission decided on the approval of State aid measures and compensatory measures, the long-term impact and the short-term impact of the aid were taken into account by the Commission. It is interesting to see how the Commission balanced the short-term impact against the long-term impact of the State aid, as this had major consequences for the functioning of the financial sector during and after the financial crisis. The principle of long-term viability plays an important role in the Commission's balancing between short-term and long-term impact of aid. Long term viability is defined as 'when a bank is able to cover all its costs including depreciation and financial charges and provide an appropriate return on equity, taking into account the risk profile of the bank'.<sup>141</sup> Therefore the manner in which the Commission used this principle in its decisions will be analyzed below.

### **5.1 Analysis of the legal framework**

#### **5.1.1 The Rescue and Restructuring Communication**

The principle of restoring long-term viability is outlined in the Rescue and Restructuring Communication. The aid should not be used to keep firms artificially alive and in principle can only be granted once. This means that firms can only receive aid once every ten years, although there are exceptions to this rule.<sup>142</sup>

#### **5.1.2 The 2008 Banking Communication**

The 2008 Banking Communication was especially designed to combat the consequences of the financial crisis. Under this Communication, ad-hoc interventions such as structural emergency interventions, protection of rights of third parties and rescue measures that would go beyond 6 months, were allowed.<sup>143</sup>

In its assessment of a restructuring plan, the long term impact of the State aid measures was taken into account. The restructuring plan required ensuring the restoration of long-term viability of the financial institution and an avoidance of undue distortions of competition.<sup>144</sup>

#### **5.1.3 The 2009 Impaired Assets Communication**

The Impaired Asset Guidelines had a strong focus on the long-term impact of asset relief measures. The long term-viability of the banking sector and the budgetary sustainability were

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<sup>141</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 paras 5 and 13

<sup>142</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2 paras 5 & 73

<sup>143</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 10

<sup>144</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08, para 31.

taken into consideration.<sup>145</sup> However, short-term considerations, such as safeguarding financial stability and underpinning bank lending were also mentioned as an objective of asset relief measures.<sup>146</sup>

Apart from measures aimed at immediate effects this Communication also stressed the need to take long term considerations into account by implementing asset relief measures. Furthermore, like the other two Communications as described above, distortion of competition should be avoided when taking asset relief measures.<sup>147</sup>

#### **5.1.4 The 2009 Recapitalisation Communication**

The Recapitalisation Communication aimed at positive short-term as well as long-term impact of recapitalization measures. One of the short term objectives was to avoid possible insolvency. Additional capital injections were used as a means to limit the risks of banks becoming insolvent.

Long term objectives were restoring financial stability and increasing inter-bank lending. In the longer-term, recapitalization should have led to a return to normal market conditions. Therefore the requirements of recapitalization measures should have ensured that banks would return to normal market conditions and a competitive and efficient banking system would emerge from the crisis.<sup>148</sup>

#### **5.1.5 The 2009 Restructuring Communication**

In the restructuring Communication, it is noted that once the crisis would be over, European banks should be in a strong global position based on a single European market.<sup>149</sup> One could argue that hereby the Commission refers to a limitation and avoidance of the fragmentation of the internal market, which I think can be considered a long term impact.

For the Commission to assess the long term viability of the bank, each Member State was under the obligation to provide a restructuring plan. This shows how the bank would restore long-term viability based on a restructuring plan.<sup>150</sup> The Commission noted that the restructuring period should be as short as possible. However, due to the special

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<sup>145</sup> Communication from the Commission 2009/C 72/01 of 26 March 2009 - on the treatment of impaired assets in the Community banking sector [2009] OJ C72/01, para 4

<sup>146</sup> Communication from the Commission 2009/C 72/01 of 26 March 2009 - on the treatment of impaired assets in the Community banking sector [2009] OJ C72/01, para 8

<sup>147</sup> Communication from the Commission 2009/C 72/01 of 26 March 2009 - on the treatment of impaired assets in the Community banking sector [2009] OJ C72/01, paras 8-9.

<sup>148</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] O.J. 2009 C10/2, para 11

<sup>149</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 6

<sup>150</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 9

circumstances of the crisis, time to complete the restructuring plan could be extended. In general the restructuring plan should be implemented within 5 years.<sup>151</sup>

Furthermore, in the light of the crisis, the Commission made an exception to the rule that aid could only be granted, once every ten years. If justified by financial stability, aid could be granted more often during the restructuring period.<sup>152</sup> This was applied in the Cases of *Bank of Ireland*<sup>153</sup>, and the *National bank of Greece*.<sup>154</sup>

It was stipulated that restructuring measures should not undermine the internal market. According to the 2009 Restructuring Communication State aid can be seen as a positive measure for keeping the internal market open, where the aid is conditional upon the bank to lending targets in other Member States.<sup>155</sup> This can be seen as a long term impact of the restructuring of banks.

As it is important to restore financial stability in the short term, it was important to fight moral hazard. The prevention of moral hazard could be seen as a short term impact of the aid granted under the restructuring guidelines. Moral hazard needed to be corrected to avoid risky behavior and to ensure a fast return to normal market conditions.<sup>156</sup> Apart from a fast return to normal market condition, the prevention of moral hazard also has long-term effects, which will be explained in the next section.

From the above, it can be concluded that the restructuring required under the Restructuring Communication is mainly aimed at restoring long term viability, but at the same time restoring financial stability in the short term through the avoidance of moral hazard. Therefore both long-term impact as well as short term impact of the aid measures, play a role in the Restructuring Communication.

### **5.1.6 The 2013 Banking Communication**

Under the 2013 Banking Communication, financial stability is the main overarching objective. Financial stability can only be achieved when there is a healthy financial sector. 'Capital raising plans should be assessed in close collaboration with the competent supervisory

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<sup>151</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 9

<sup>152</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/2 para 27

<sup>153</sup> *Second restructuring plan of Bank of Ireland* (Case SA.33443) Commission Decision OJ C246/2012

<sup>154</sup> *Recapitalization of National Bank of Greece by the Hellenic Financial Stability Fund* (Case SA 34824) 2012 OJ C359/2012, paras 61, 75 and 79

<sup>155</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 33

<sup>156</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 29

authority with a view to ensuring that viability can be regained within a reasonable time frame and on a solid and lasting basis'.<sup>157</sup>

The long term impact of aid measures are mentioned in the light of burden sharing. The Member States did not go beyond the minimum degree of burden sharing. As a result financial stability in the long-term could not be achieved. Furthermore, it was a threat to the integrity of the internal market as some Member States had stricter requirements than other Member States, which led to fragmentation of the internal market. Therefore, in the 2013 Communication, it is mentioned that the minimum requirements for burden sharing should be raised. It is noted by the Commission that when these requirements are raised, there is less need for measures to limit distortions of competition. The raising of the minimum requirements can be considered as having long term impact as it aims at long term financial stability and protecting the integrity of the internal market.<sup>158</sup>

Due to the changes in market conditions, the 2013 Banking Communication, favours in-depth assessment of a restructuring plan. This is in contrast to the 2008 Banking Communication, under which decisions were made solely on the basis of a preliminary assessment. These ad-hoc interventions contributed to the prevention of a collapse of the financial system. However, the restructuring efforts were often delayed and resulted in higher costs for the tax payers.<sup>159</sup> One could argue that due to the changing condition in the market by 2013 compared to the beginning of the crisis, there is a shift from short term impact to a more long term impact of the State aid measures.<sup>160</sup>

### **5.1.7 Conclusion based on the legal framework**

Based on the legal framework long-term impacts of the aid were: restoring long-term viability of the company; restoring financial stability; a return to normal market conditions; limitations of undue distortions of competition; avoiding fragmentation of the internal market and avoiding moral hazard.

Restoring trust in the financial sector and thereby decreasing the likelihood of a total collapse of the financial system and avoiding moral hazard are the main short-term objectives of State aid in the legal framework.

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<sup>157</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1 para 8

<sup>158</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, paras 17-20.

<sup>159</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, paras 22-23.

<sup>160</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, paras 22-23.

Apart from being a long-term objective, measures aimed at avoiding certain types of behavior which fall under moral hazard can be also be considered a short-term objective, as it aims at keeping banks away from risky behavior in the short-term such as risky actions aimed at short-term profits.

I think the Commission established a good and effective legal Framework to improve the financial situation in the short-term. The 2008 Banking Communication allowed for ad-hoc emergency interventions which were not allowed under the Rescue and Restructuring Guidelines. In addition, without the possibility of aid being granted more than once every ten years, which became allowed under the Restructuring Communication, it would have been more difficult to achieve financial stability in the short-term.

Assessing the Commission Communications throughout the crisis, it can be argued that the Commission paid special attention to the restoration of long term viability of the banks. I think the new legal framework provided a relatively good and detailed guidance in assessing the amount of State aid and appropriate measures to be taken to solve the problems in the long-term. Restructuring and recapitalisation measures were taken with a long-term perspective. Even though the return to financial stability in the long term is an important goal, some short-term objectives such as avoiding moral hazard and restoring trust in the financial sector are also included in the legal framework.

By looking at the development of the objectives of the Crisis Framework, one could argue that at the beginning of the crisis there was slightly more focus on the short-term consequences of the aid, whereas by the end and after the crisis, notably in the 2013 Banking Communication, there was more attention to the long-term objectives. This can possibly be explained by the evolution and severity of the crisis. When the crisis started in 2008 there was more need to intervene with short term objectives as it was important to avoid a complete collapse of the financial system.

As the situation gradually stabilized and when the effects of the aid became clear, it became more important to look at the long-term objectives. However, from my point of view the avoidance of moral hazard remained one of the short-term objectives during the crisis. Companies had to be corrected from moral hazard as it avoided them from engaging in risky behaviour which would lead to more financial stability in the short-term and a faster return to 'healthy' market conditions in the short run.

In my opinion, although it was important to solve the problems in the short-term, the Commission should have been more aware of and should have focused more on the long-term consequences when developing its legal framework at the beginning of the crisis. The Commission should have been stricter with their assessment of restructuring plans, by including an in-depth assessment of the companies' restructuring plan in its legal framework starting with the 2008 Banking Communication. It could be expected that without an in-depth assessment, restructuring plans would be delayed. In addition, I would like to argue that it could be expected that Member States would not go beyond the minimum requirements of burden sharing, which did not result in financial stability in the long-term.

However, I think that the Commission learned from the crisis and improved its legal framework by focusing more on the long-term objectives, in particular with the introduction of the 2013 Banking Communication and the 2009 Restructuring Communication under which the Commission took a more in-depth assessment of restructuring obligations. With a more in-depth investigation it will be more likely that the restructuring is completed within the required time-frame with a higher chance of restoring long-term financial stability.

## **5.2 Analysis of the Case law**

In the analysis of the Case law I will look at which long-term and short-term consequences were taken into account and whether long-term or short-term consequences prevailed. I have chosen the Cases based on their importance in terms of the amount of State aid granted and the time period in which they were decided, so as to cover decision under the entire legal framework developed by the Commission.

### **5.2.1 Measures aimed at restoring long-term viability in the Case law**

The Commission accepted a number of measures aimed at ensuring long-term viability. Examples from the Case law are:

- a reduction of financial institutions' activities;
- cost cutting measures;
- change on management and Corporate Governance;
- price leadership bans;
- and sale of the financial institution.<sup>161</sup>

### **5.2.2 Decision under Article 107 (3) (c) TFEU and the Rescue and Restructuring Communication: The Case of *Sachsen LB***

One of the first State aid Cases which was decided under the Rescue and Restructuring Communication and under Article 107 (3) (c), during the financial crisis, was the Case of

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<sup>161</sup> Kelyn Bacon, *European Union Law of State Aid*, (2<sup>nd</sup> edn, Oxford University Press 2009) 421

*Sachsen LB*. Sachsen LB was acting as a central bank in Saxony (Germany), with a group balance sheet of 67,8 billion Euro and own capital of 880 million Euro. Sachsen LB was not able to refinance itself and was not able to provide liquidity of 17,1 billion Euro. In August 2007 Sachsen LB was sold to LBBW, which is the Landesbank of the Federal State of Baden-Wurttemberg. The Free State of Saxony granted a guarantee of 2.75 billion, up to an amount of 8.75 billion Euro.<sup>162</sup>

The Commission assessed whether the restructuring of Sachsen LB would restore the long term viability of Sachsen LB. The Commission mentioned that the sale of Sachsen LB would contribute to the long-term viability. With the sale to LBBW, Sachsen LB would be able to compete on its own merits.<sup>163</sup>

Furthermore, the change in ownership structure would contribute to the restoration of long-term viability. The previous ownership structure was considered to be one of the key problems of the financial problems of Sachsen LB.<sup>164</sup>

The Commission pointed out that Sachsen LB would be able to compete on its own merits and that the reduction in activities as mentioned in the restructuring plan would be essential to avoid mistakes that happened in the past.<sup>165</sup>

According to the Commission, 'the restructuring will restore the long term viability of Sachsen LB'.<sup>166</sup> The Commission pointed out that Sachsen LB would be able to compete on its own merits and that the reduction in activities as mentioned in the restructuring plan will be essential to avoid mistakes that happened in the past. In addition, the divestments made would also contribute to the bank's long-term viability as the bank had abandoned its loss making activities.<sup>167</sup>

Based on the Commission's decision in Sachsen LB it can be concluded that the long-term impact of the restructuring plan on the viability of the financial institution was important for the approval of the State aid measures.

### **5.2.3 Decision under the 2008 Banking Communication and Article 107 (3) (b) TFEU: The Case of *Fortis Bank and Fortis Bank Luxembourg***

A Case which involved a huge amount of State aid is the *Fortis Case*. This Case concerned measures taken in favour of Fortis Bank and Fortis Luxemburg, between the 29<sup>th</sup> of

<sup>162</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 paras 11,12, 16 and 35

<sup>163</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 para 106, 108

<sup>164</sup> Phedon Nicolaides and Ioana Eleonora Rusu, 'The financial crisis and state aid' [2010] 55 The antitrust bulletin, 759, 774

<sup>165</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 para 108

<sup>166</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 para 108

<sup>167</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 paras 107-108

September and the 5<sup>th</sup> of October by The Netherlands, Belgium and Luxemburg.<sup>168</sup> The measures consisted of capital injections, liquidity assistance and the sale of the Dutch operations of Fortis Bank.<sup>169</sup>

In the restructuring Case of Fortis AB, the Commission analyzed whether the targeted aid would restore long term viability. This was assessed under the 2008 Banking Communication.<sup>170</sup>

The Commission considered whether the sale of part of the Dutch operations of the bank to BNP Paribas, which accounted for 40% of the size of the bank, helped to restore the long term viability of the financial institution.<sup>171</sup>

Regarding long term viability, the Commission noted that 'BNP Paribas had a positive rating, which reflected its financial soundness'<sup>172</sup>. Therefore it was expected that once Fortis Bank would become part of BNP Paribas, the problems of raising finance would be solved. Based on this, the Commission concluded that the measures taken met the criteria of restoring long-term viability and were well targeted.<sup>173</sup>

In its proportionality assessment, the Commission noted that the recapitalization measures were necessary to restore market and public confidence and to stop the bank run. This was an emergency measure with the aim of restoring market and public confidence in the short term.<sup>174</sup>

Before the recapitalization took place, many customers withdrew, and interbank lending was impossible. As a result the liquidity situation of the bank was tragic. The purchase of FBN (Fortis Bank Nederland) by The Netherlands, improved the liquidity situation of Fortis Bank. Furthermore, there had been a lot of uncertainty about the value and financing of the acquisition of ABN AMRO. The purchase helped to improve the trust in the bank.<sup>175</sup> It can be

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<sup>168</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 paras 1-4

<sup>169</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 paras 9-12

<sup>170</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 73, 76-78

<sup>171</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 para 81

<sup>172</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 para 83

<sup>173</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7, paras 83-85

<sup>174</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7, para 86

<sup>175</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7, para 88

argued that the improvement of the liquidity situation was one with an impact on the short term as this resulted in a rapid restoration of trust in the bank.

In addition, compared to a scenario of nationalization, the Commission noted that the sale of BNP Paribas to a private actor made it possible to limit future aid.<sup>176</sup>

The *Fortis Case* shows that, in the Commission's assessment of the restructuring plan, both long-term and short-term consequences of the aid were taken into consideration. Hereby the emergency situation as to the bank's liquidity problems was a crucial factor in approving the restructuring measures with a short-term impact.

#### **5.2.4 Decisions under the 2008 Banking Communication and Recapitalisation Communication and the Rescue and Restructuring Communication: The Cases of the Recapitalization of The Bank of Ireland and Commerzbank**

One Case which illustrates that the public intervention was aimed at restoring short term confidence and financial stability in the financial sector and the wider national economy, is the *Bank of Ireland Case*, which was decided in March 2009. The situation in Ireland was extraordinary as the Irish retail banking sector was extremely concentrated. Only two banks, the Bank of Ireland and the Allied Irish bank, had a market share of 65%.<sup>177</sup>

The Bank of Ireland, was one of the two largest banks in Ireland, and had a balance sheet that had approximately 100% of the Irish GDP. The Irish authorities noted that the Bank of Ireland was of major importance for maintaining stability in the Irish financial sector.<sup>178</sup>

The Commission stipulated that the loss of confidence in the Irish financial bank could have formed a serious risk for a crisis in the Irish financial sector, with negative consequences for the wider economy. The Commission pointed out that the public sector intervention in the form of a capital injection of 3,5 billion Euro, was important to restore market confidence in the Irish financial sector, in order to avoid the risk of a serious disturbance in the Irish economy.<sup>179</sup>

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<sup>176</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7, para 90

<sup>177</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 142

<sup>178</sup> *Recapitalisation by the Bank of Ireland by the Irish State Case* (Case N149/2009) Commission Decision [2009] OJ C234/2009 paras 2,5

<sup>179</sup> *Recapitalisation by the Bank of Ireland by the Irish State Case* (Case N149/2009) Commission Decision [2009] OJ C234/2009 paras 60-61

The Commission also assessed the limitation of the aid to the strict necessary. This decision had been taken under the Recapitalisation Communication, in which it says that there should be sufficient incentives to stop the State participation, when market conditions allow. In this Case the Commission said that the level of remuneration which is further complemented by redemption clauses and the presence of Warrants provided for such incentive.<sup>180</sup>

Another important Case that was decided under the 2008 Banking Communication and Recapitalization Communication was the Case of *Commerzbank*. This Case concerned the aid granted by the German government of 18 billion Euro in the form of new capital.<sup>181</sup> In order for Commerzbank to receive the aid granted by the German government, several measures were undertaken. The Commission assessed these measures to see whether they were compatible with the requirements under Article 107 (3) (b).<sup>182</sup>

The Case of *Commerzbank* was taken in a phase in which the Commission went back to the Rescue and Restructuring Guidelines.<sup>183</sup> In this Case the Commission explicitly mentioned the Rescue and Restructuring Communication and assessed the restructuring measures under the Rescue and Restructuring Communication. Hereby the Commission took the crisis situation in the financial markets into account. This was especially applicable to the rules for own contribution as set out in the Rescue and Restructuring Communication.<sup>184</sup>

In the Case of *Commerzbank*, the Commission's assessment of the plan in terms of restoring long-term viability, had been positive. Measures undertaken by Commerzbank with the aim of reducing its market presence included the transfer and selling of shareholdings and assets, the reduction of market presence by cutting the number of branches, divestments of risk-weighted assets, a cutback in costs and a reduction in the balance sheet. The focus on the core areas of the bank had already resulted in the growth of Commerzbank, even during the crisis.<sup>185</sup>

Commerzbank's liquidity was stable during the crisis and they had sufficient liquidity reserves to survive. Furthermore, the bank had learned from its mistakes by improving its corporate governance and changed its risk management strategy for a less vulnerable future. By ensuring to use the aid to supply the credit to the real economy, the bank also complied with

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<sup>180</sup> *Recapitalisation by the Bank of Ireland by the Irish State Case* (Case N149/2009) Commission Decision [2009] OJ C234/2009 para 78

<sup>181</sup> European Commission 'State aid: Commission approves recapitalisation of Commerzbank' Press Release IP/09/711 (2009)

<sup>182</sup> *Commerzbank Germany* (Case N 244/2009), Commission Decision (2009) OJ C147/4

<sup>183</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 140-141

<sup>184</sup> *Commerzbank Germany* (Case N 244/2009), Commission Decision (2009) OJ C147/4, para 85

<sup>185</sup> *Commerzbank Germany* (Case N 244/2009), Commission Decision (2009) OJ C147/4, para 77

the objective under the Recapitalization Communication of ensuring lending to the economy.<sup>186</sup>

From the above, it becomes clear that the restructuring plan was mainly assessed on long term impact such as lending to the real economy. However, the change in the governance of the bank can also be considered as having an impact on the functioning of the bank and its financial stability in the short term.

#### **5.2.5 Decision under the Impaired Asset Communication, the Restructuring Communication and 2008 Banking Communication: the Case of *ING Bank***

The Case of *ING Bank* was decided under the Impaired Asset Communication and the Restructuring Communication.<sup>187</sup> The *ING Bank* was one of the biggest financial institutions in the world.<sup>188</sup> At the time the decision was taken, it had more than 70 individual businesses and operated in more than 50 countries. *ING* received a capital injection of 10 billion Euro from the Dutch State.<sup>189</sup>

The Commission assessed *ING*'s restructuring plan. *ING* needed to restructure considerably as *ING* had received aid which exceeded 2% of the total bank's risk-weighted assets (RWA).<sup>190</sup> In its assessment the Commission looked at whether long-term viability would be restored, *ING*'s own contribution and the measures addressing distortions of competition.<sup>191</sup>

The Commission noted that the restructuring plan showed that long term viability could be achieved, even in stress scenario's with a continued global recession.<sup>192</sup> *ING* would also improve its capital structure, which would decrease its exposure to higher risk asset classes. Furthermore *ING* did not aim at increasing its real estate exposure, had initiated a risk reduction policy and cost cutting programme and would adapt to the lessons learned from the crisis. One of the long term effects achieved through restructuring would be the generation of excess capital, which would strengthen the capital basis of *ING*. In the Commission's view, this was sufficient to restore long term viability.<sup>193</sup>

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<sup>186</sup> *Commerzbank Germany* (Case N 244/2009), Commission Decision (2009) OJ C147/4, paras 99, 102-103

<sup>187</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19, paras 109, 117

<sup>188</sup> European Commission, 'State aid: Commission approves *ING* restructuring plan and illiquid assets back-up facility' Press Release P/09/1729, 2009

<sup>189</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 12, 32

<sup>190</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 119

<sup>191</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 120, 131 and 140

<sup>192</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 123

<sup>193</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 123-130

The Commission addressed the concept of moral hazard in connection with burden sharing. An appropriate burden sharing would decrease the chance of moral hazard.<sup>194</sup> Furthermore, to limit the aid to the minimum necessary, ING was not allowed to do any acquisitions.<sup>195</sup>

From the Commission's assessment of ING's restructuring plan it can be argued that in order to regain long-term viability and to have an appropriate own contribution to the restructuring costs, most of the measures were taken with a long term impact.

#### **5.2.5 Conclusion based on the Case law**

Based on the Cases as described above, it is possible to conclude that both short-term and long-term objectives of the aid were taken into consideration when approving the State aid and the conditions under which the aid was approved.

State aid was approved as an emergency measure with the objective of restoring confidence in the financial market and avoiding the risk of a disturbance of the national economy as a whole, with possible negative spill-overs to the whole EU economy. In my opinion this can be seen as a short-term emergency objective, as it was a way to rescue the national economies of Member States and the EU as a whole from a total collapse of the financial system and a deepening of the financial crisis. Short-term consequences were one of the objectives of these emergency measures as these measures were specifically targeted at a fast return to financial stability.

The Commission applied the compensatory measures as developed in the legal framework in the Case law. The avoidance of moral hazard played an important role in the design of compensatory measures and the approval of State aid in the Commission's decisions. Limiting the aid to the minimum necessary and an appropriate own contribution (burden sharing) to the costs were the main means through which the Commission aimed at restoring financial stability in the long-term.

From my point of view the avoidance of moral hazard in the Case law is both a long-term as well as a short-term objective. It is a short-term objective in the sense that if banks are aware of State aid granted to other banks, it might be more likely that banks take more risks as they expect to receive State aid as well. Avoiding moral hazard through compensatory measures can prevent banks from risky behaviour in the short-term. The assumption which might be created that certain banks are politically and economically too important to collapse, can also

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<sup>194</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 131

<sup>195</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 137

have long-term impact as this might lead to continuous risky behaviour in the long term. In this sense the avoidance of moral hazard has a long-term objective.

It is not possible to say that long-term impact prevailed over short-term impact, or the other way around. However, the Case law shows that when taking measures with a short term objective, the long term consequences were also taken into account. Furthermore, the Case law shows a gradual shift from short-term impact to long-term impact. According to my assessment, the reason might be found in the severity of the financial crisis and the increased expertise and experience in dealing with State aid Cases at a later stage during the financial crisis. Furthermore, the Commission could learn from its decisions that were taken at the beginning of the crisis in 2008, as some of the effects of these decisions were already visible.

I think it has been important that the Commission approved aid based on the minimum amount necessary. In this manner it was more likely that financial stability would be restored in the long-term and risky behavior, which could fall under moral hazard, would be reduced or eliminated. If the Commission would not have granted State aid to the strict minimum, I would expect that banks might continue with their risky behavior because they know they would be granted State aid which would be beneficial for them.

The measures applied to restore long-term viability in the banking sector could be successful. I think the change of corporate governance was a necessary measure, as this was often the cause of financial problems. The measures taken in the Case of *Commerzbank* which were aimed at long-term impact to reduce its activities and its market presence, already proved to be successful in the short-term so I would expect these measures to be positive in the long-term as well.

### **5.3 Conclusion based on the legal framework and the Case Law**

There is a clear connection between the development of the balancing between short-term and long-term consequences between the Legal Framework and the Case Law. This flows from the application of the legal framework to the Case law.

Moreover, both the legal framework and the Case law responded to the changing situation of the financial crisis, from a very severe situation in the financial sector at the beginning of the crisis in 2008 to one that became less harsh, by 2009. In the beginning of the financial crisis the legal Framework and the Case law focused more on short-term objectives, whereas at a

later stage during the crisis, the long-term objectives became more a focal point for the Commission.

I think the Commission focused more on the short-term objectives in the beginning because it was crucial to return as quickly as possible to normal market circumstances, which could be done by focusing on the short-term. Nonetheless, the objective of avoiding moral hazard remained a short-term as well as a long-term objective throughout the crisis in the legal framework as well as in the Case law.

The Commission responded well by developing and applying a new legal framework, based on Article 107 (3) (b) to solve the problems in the short-term, as under the new framework emergency ad-hoc interventions could be used to restore confidence in the financial institutions and thereby avoiding a collapse of the financial sector as a whole, which would have been more difficult under the Rescue and Restructuring Guidelines and with Article 107 (3) (c) as its legal basis.

## **6 Balancing between positive social effects and negative market oriented effects and how competition distortions were limited**

When the Commission decides on a State aid measure, the positive and negative effects deriving from the aid are balanced against each other. The manner in which the Commission balanced the positive and negative effects in the legal framework and the Case Law during the financial crisis will be outlined below.

### **6.1 How the Commission is balancing the economic and social advantages against the market oriented disadvantages**

When the Commission decides on a State aid measure, the positive and negative effects deriving from the aid are balanced against each other. First the Commission makes an assessment on the contribution of the aid measures to the promotion of a public interest mentioned in Article 107 (3) TFEU. Secondly, the Commission examines whether the potential benefits of the aid outweigh the possible distortions of competition deriving from this aid.<sup>196</sup>

The balancing test can be summarized using the three conditions that need to be fulfilled:

- “1. The aid must be an appropriate means to attain an objective mentioned in Article 107 (3) TFEU. In other words, an aid measure must be “well targeted” to effectively achieve its public policy aim, and it must provide sufficient incentives for the aid recipient to change its behavior in order to attain the pursued public policy interest. Aid should not be used to subsidize the beneficiary’s “operating costs” and allow the beneficiary to simply continue its activities in the same manner as before the granting of the aid.
2. The aid must be limited to the minimum amount necessary to effectively achieve its objective, and it must be the “least distortive” form of aid to attain this objective; and
3. The aid must be proportionate, i.e. it must be designed so as to minimize negative spill-over effects on competitors, other sectors and other Member States and thus to limit distortions of competition to the unavoidable minimum.”<sup>197</sup>

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<sup>196</sup> Ulrich Soltész and Christian Köckritz, ‘From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks’ [2010] European Competition Journal 6 285, 288

<sup>197</sup> Ulrich Soltész and Christian Köckritz, ‘From State Aid Control to the Regulation of the European Banking System – DG Comp and the restructuring of banks’ [2010] European Competition Journal 6 285, 288

In balancing the positive and negative effects of State aid the Commission considers the short-term re-stabilization of the economy and the long term development of competition.<sup>198</sup>

In order to minimize the negative effects on competition, the Commission developed market presence and reduction of entry barriers. Furthermore, the aid should be proportionate to the distortive effects, taking the size and selective importance of the firm in its market into account.<sup>199</sup>

## **6.2 Assessment of the legal framework: Balancing between economic and social advantages against the market oriented disadvantages and measures to minimize undue distortions of competition**

### **6.2.1 The Rescue and Restructuring Guidelines**

As mentioned earlier, the Rescue and Restructuring Guidelines, allow for restructuring aid only if it can be justified by other social and economic benefits. Benefits flowing from the aid should outweigh the distortions of competition. Employment problems and the formation of a monopoly or a tight oligopoly situation are mentioned as possible negative social and economic effects. Compensatory measures in favor of competitors are necessary to prevent distortions of competition. These measures must be proportionate to the distortive effects.<sup>200</sup> Furthermore, the amount of aid and the form in which it is granted must not lead to aggressive, market-distorting activities as this can lead to distortions of competition.<sup>201</sup>

### **6.2.2 The 2008 Banking Communication**

In the 2008 Banking Communication, which is now replaced by the 2013 Banking Communication, the measures aimed at limiting distortions of competition in the case of guarantee schemes were outlined. These measures included behavioral constraints such as restrictions on commercial conduct, limitations to the size of the balance sheet, a minimum private contribution to the costs of the restructuring and a limitation of the aid to the minimum. Additionally, it also contained provisions that enabled Member States to enforce behavioral constraints on the beneficiary.<sup>202</sup>

Aid measures were assessed on the safeguard that there was no distortion of competition deriving from the aid. Hereby the Commission took experience from past State aid Cases

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<sup>198</sup> Phedon Nicolaides, 'State Aid', in Ioannis Kokkodoris and Rodrigo Olivares-Caminal *Antitrust Law amidst Financial Crisis* (Cambridge University Press 2010) 390

<sup>199</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OJ C244/2 paras 38-39

<sup>200</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OJ C244/2 paras 31, 38 & 40

<sup>201</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OJ C244/2 para 45

<sup>202</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] O.J. 2008 C 270/08 para 27

into account and distinguished between sound and unsound banks. Banks that needed restructuring as a result of their internal business model or investment strategy, raised more serious concerns, than banks that needed restructuring as a result of the financial crisis situation.<sup>203</sup>

The above also applied to capital injections. To limit distortions of competition, the capital injections must be limited to the minimum necessary and should not lead to aggressive behavior of the financial institution.<sup>204</sup>

### **6.2.3 The 2009 Recapitalization Communication**

The Recapitalization Communication sets out the possible competition concerns of recapitalization and the balancing between the economic benefits and the negative effects on competition. Recapitalizations could have the objectives of restoring financial stability, ensuring lending to the real economy and dealing with the systematic risk of possible insolvency.<sup>205</sup>

These objectives were balanced against possible distortions on competition. Three different levels of distortions of competition were identified. Firstly, in the absence of an appropriate risk-based justification, access to capital at lower rates than competitors from other banks in other Member States, could confer a competitive advantage to the beneficiary of the aid in the internal market. Secondly, recapitalization schemes could give an undue advantage to distressed or less-performing banks, which could lead to distortions of competition. Thirdly, recapitalization should not put banks that do not have access to public funding in a less competitive position.<sup>206</sup>

In its assessment of the recapitalization scheme the Commission balanced the objectives of restoring financial stability, ensuring lending to the real economy and dealing with the risk of insolvency with the possible distortions of competition as outlined above. In order to limit distortions of competition, the aid should be proportionate and temporary. Moreover, the form and amount should be in such a way as it encourages banks to stop being dependent on state interventions as soon as market conditions allow. This will allow a competitive and efficient banking structure to emerge from the crisis.<sup>207</sup>

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<sup>203</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] OJ 2008 C 270/08 para 33

<sup>204</sup> Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global crisis [2008] OJ 2008 C 270/08 para 38

<sup>205</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ 2009 C10/2 paras 4-6

<sup>206</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ 2009 C10/2 paras 8-11

<sup>207</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ 2009 C10/2 para 11

In the balancing a distinction between well-performing (fundamentally sound) and less performing banks was made. As already mentioned in chapter 2, banks with a higher risk profile should pay more. Less performing banks were subject to stricter requirements than well-performing banks.<sup>208</sup>

In relation to recapitalization schemes, the 2008 Banking Communication, said that safeguards against possible abuses and distortions of competition may be necessary. Capital injections should be kept to the minimum so the beneficiary would not be capable to get involved in destructive commercial behavior.<sup>209</sup>

The Recapitalization Communication stressed the importance of preventing aggressive commercial growth by the recipient. In order not to favor institutions that received financial aid to the detriment of competitor, mergers and acquisitions should be based on a competitive tendering process. In determining the extent of the behavioral safeguards, a proportionality assessment was used, which took all relevant factors into account, notably the risk profile of the beneficiary.<sup>210</sup>

#### **6.2.4 The 2009 Restructuring Communication**

The Restructuring Communication outlined the different types of distortions of competition caused by restructuring measures. Firstly State aid can prolong past distortions of competition caused by unsustainable business practice and risk taking behavior. Without State aid, companies which have unsustainable business practice and take excessive risks, will eventually lose market share, which can possibly result in the exit of the market. Secondly, State aid may have a negative effect on the functioning of the internal market. This can be caused by a shift of an unfair share of the burden and structural adjustment and the possible accompanying social and economic problems to other Member States.<sup>211</sup>

Measures aimed at restoring financial stability in the short-term should not lead to a negative impact on competition in the long term. Therefore, when State aid is granted, it is essential to take measures aimed at limiting distortions of competition. Due to differences in financial resources between Member States, State aid may have an effect on the single market. Furthermore, State aid may have a negative impact on banks that are fundamentally sound, which will also have consequences for financial stability. Furthermore, as national interventions during the crisis had a focus on national markets, the single market could have

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<sup>208</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ 2009 C10/2 paras 12-13, 43

<sup>209</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ 2009 C10/2 para 35

<sup>210</sup> Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition [2009] OJ 2009 C10/2 paras 37-38

<sup>211</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 28

been fragmented. For the protection of European business and consumers it was important to assess the market presence of beneficiaries to ensure effective competition and to avoid entry barriers and obstacles for cross-border activities.<sup>212</sup>

In the application of the measures limiting distortions of competition, several factors were taken into account, notably the size, scale and scope of the activities of the bank. Measures to limit distortions of competition could either be in respect of passive or assets. The nature and form of these measures was determined by the amount of the aid, and the conditions and circumstances under which the aid was given. Greater burden sharing and a higher own contribution would result in fewer negative effects deriving from moral hazard. The higher the own contribution and the greater the burden sharing the fewer behavioral measures were required. It also depended on the structure of the market in which the beneficiary was operating. Here the Commission looked at the relative size and the relative importance of the bank on the market. The need for behavioral commitments depended on the market presence of the bank after restructuring. Where the bank had a high market presence it was more likely that behavioral constraints in the form of divestments were needed than when the market presence was lower.<sup>213</sup>

Measures used to limit distortions of competition or increase competition could be in the form of divestments. Banks may also be required to limit expansion in certain business or geographical areas. In addition, banks should not be engaged in anti-competitive behavior such as using the State aid for the acquisition of competing businesses. Another general means to limit distortions of competition was through adequate remuneration.<sup>214</sup>

### **6.2.5 The 2013 Banking Communication**

The 2013 Banking Communication stresses the importance of burden sharing to limit competition between banks. The limitation of the aid to the minimum necessary and an appropriate own contribution, are two measures mentioned as contributing to a limitation in the distortions of competition.<sup>215</sup>

According to the 2013 Banking Communication, the minimum requirements for burden sharing should be raised. Under the previous Communications, some Member States limited themselves to the minimum requirements of State aid rules, whereas others have gone beyond the minimum requirements, which resulted in diverging approaches between the

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<sup>212</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 para 29

<sup>213</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 paras 30-31

<sup>214</sup> Communication from the Commission 2009/C 195/04 of 19 August 2009 - on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ 195/04 paras 34-41

<sup>215</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1 para 15

Member States. Therefore, a higher degree of burden sharing will decrease the need for measures addressing distortions of competition.<sup>216</sup>

In contrast to the previous Communications, a distinction is made between small and big banks. Aid to big banks is more likely to have effect on competition than aid granted to big banks. Therefore, small banks have a simpler procedure than big banks.<sup>217</sup>

Attention is given to the methods to limit distortions of competition of liquidation aid. Firstly, the winding-up phase should be as short as possible for the orderly liquidation. Secondly, 'the operations must in principle be limited to continuing and completing activities pending for existing customers.' In addition, 'the pricing policy of the credit institution to be wound down must be designed to encourage customers to find more attractive alternatives'.<sup>218</sup>

#### **6.2.6 Conclusion based on the Legal framework**

The legal framework provides for a balancing between economic and social benefits and negative economic effects. In particular, there needs to be a balance between the restoration of financial stability on one hand and possible undue distortions of competition and fragmentation of the internal market on the other hand.

The legal framework shows the need to limit distortions of competition. The Commission developed several manners and used basic legal principles such as proportionality and burden sharing to maintain or in certain circumstance increase competition in the banking sector through State aid. One important means of limiting distortions of competition is keeping the aid to the minimum amount necessary and that it must be of temporary nature. The Recapitalisation and the Restructuring Communication in particular, provide for measures to limit distortions of competition.

Throughout the legal framework the importance of burden sharing and a minimum own contribution are considered to be an important means of limiting distortions of competition. The principle of proportionality is used to assess the minimum burden sharing and the appropriate own contribution. In my opinion it is important that there is an appropriate own contribution by the banks as this will make it more likely that banks will use the aid granted effectively. It will also be more likely that the aid granted will not lead to a significant advantage to the receiver of the aid.

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<sup>216</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1 paras 18- 20

<sup>217</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1 para 54

<sup>218</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1 paras 73-75

In the beginning of the crisis the Commission distinguished between sound and unsound banks in its measures to limit distortions of competition. Less-performing banks needed less restructuring than well-performing banks. In the first prolongation of the Restructuring Communication, the distinction between fundamentally sound and unsound banks was taken away. It can be argued that by abandoning this distinction, the Commission became stricter on the requirements for restructuring by requiring more restructuring for fundamentally sound banks.

I think the Commission established a good legal framework addressing the need to limit distortions of competition while at the same time pursuing its public policy interest. By using the principles of proportionality, keeping the aid to the minimum amount necessary and of temporary nature and by putting restrictions on the banks' behavior the risk of State aid measures having distortive effects on competition were reduced. I also think it was good that the behavioural measures depended on the relative market size and relative importance of the bank. In this way the Commission treated the banks in a fair manner and also limited possible distortions of competition.

### **6.3 Analysis of the Case Law**

#### **6.3.1 Decisions in the pre-crisis phase under the Rescue and Restructuring Communication and Article 107 3 (c) TFEU: the Cases of *Northern Rock* and *Sachsen LB***

*Northern Rock* is an interesting Case as this was one of the first banks affected by the European crisis.<sup>219</sup> *Northern Rock* was the fifth biggest UK mortgage bank. Its primary activity was mortgage lending, which represented 90% of all outstanding loans to customers. In 2007 *Northern Rock* got into trouble due to its dependence on wholesale funding as the market securitization market collapsed.<sup>220</sup> It had severe liquidity problems. Therefore, the Bank of England gave emergency liquidity assistance to the bank. Due to the bank run after the news about the news came out that the Bank of England had provided emergency liquidity assistance, *Northern Rock's* difficulties intensified even more. Therefore the Bank of England announced guarantee arrangements for all existing accounts on the 17<sup>th</sup> of September. On the 9<sup>th</sup> of October, the guarantee was extended to cover all new retail deposits.<sup>221</sup>

The Commission noted that the aid could be justified on the grounds of avoiding serious social difficulties, as the liquidation of the bank would have led to unemployment.

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<sup>219</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39,66

<sup>220</sup> *United Kingdom Rescue aid to Northern Rock* (Case NN70/2007) Commission Decision (2007) OJ C43/1 paras 2-4

<sup>221</sup> *United Kingdom Rescue aid to Northern Rock* (Case NN70/2007) Commission Decision (2007) OJ C43/1 paras 9-11

Furthermore, as Northern Rock would not have been in the position to behave aggressively on the market, any negative spill-over effects would have been avoided.<sup>222</sup>

In the Rescue and Restructuring Communication it said that the aid, the amount of and form of the aid should not lead to aggressive and market-distorting activities.<sup>223</sup> In the Case of *Northern Rock*, this condition had been fulfilled, by granting Northern Rock only the cash needed, one week ahead. This made it impossible for the bank to behave aggressively on the market.<sup>224</sup>

As noted earlier, in the Case of *Sachsen LB* the aid measures were justified on grounds of serious social difficulties, as without the measure, Sachsen LB would have been liquidated and this would have resulted in unemployment. Furthermore, the measure did not lead to undue distortions of competition and did not have any negative spill over effects to other Member States.<sup>225</sup>

The Commission also assessed the compensatory measures taken by Sachsen LB to limit undue distortions of competition. The commission pointed out that the compensatory measures, such as a reduction in LB's financial market activities, in particular the major divestments made Sachsen LB which accounted for more than 25% of their profits in 2008, were proportionate in comparison to the distortive effects created by the survival of Sachsen LB.<sup>226</sup>

### **6.3.2 Decision under the 2008 Banking Communication and Article 107 (3) (b) TFEU: The Case of *Fortis Bank* and *Fortis Bank Luxembourg***

A Case which involved a huge amount of State aid was the *Fortis* Case. This Case concerned measures taken in favor of Fortis Bank and Fortis Luxembourg, between the 29<sup>th</sup> of September and the 5<sup>th</sup> of October by The Netherlands, Belgium and Luxembourg.<sup>227</sup> The measures consisted of capital injections, liquidity assistance and the sale of the Dutch operations of Fortis Bank.<sup>228</sup>

In the *Fortis* Case the Commission assessed the effects on competition. The Commission noted that the rescue aid to Fortis bank would cause significant distortions of competition.

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<sup>222</sup> *United Kingdom Rescue aid to Northern Rock* (Case NN70/2007) Commission Decision (2007) OJ C43/1 paras 43, 49

<sup>223</sup> Communication from the Commission 2004/C 244/02 of 1 October 2004 Community guidelines on State aid for rescuing and restructuring firms in difficulty [2004] OC C244/ para 45

<sup>224</sup> *United Kingdom Rescue aid to Northern Rock* (Case NN70/2007) Commission Decision (2007) OJ C43/1 para 49

<sup>225</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 para 103

<sup>226</sup> *State aid implemented for Sachsen LB* (Case C9/2008) Commission Decision [2008] OJ C71/14 paras 121, 125, 127

<sup>227</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 - Netherlands) Commission Decision (2008) OJ C80/7 paras 1-4; European Commission 'Staatssteun: Commissie zet licht op groen voor reddings- en herstructurereingssteun aan Fortis Bank en Fortis Banque Luxembourg' press release IP/08/1884 (2008)

<sup>228</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 - Netherlands) Commission Decision (2008) OJ C80/7 paras 9-12

However, the position of Fortis Bank changed after the measures were taken. In particular, the sale of the Dutch operations, significantly reduced the size of Fortis bank, which made it possible to limit the distortions of competition which would have been caused by the aid. Hereby the significant reduction in market presence and a decrease in the risky behavior of the bank were stressed. The bank had taken greater risks than most other banks did which caused the major problems.<sup>229</sup>

One of the behavioral constraints was the ban on acquiring assets bought by The Netherlands which would recreate Fortis bank. Furthermore, the bank was sold to a competitor, which was seen as a compensation for the possible undue distortions of competition.<sup>230</sup>

In addition, moral hazard would most likely be prevented as the former shareholders of Fortis Bank and the management which took the decisions leading to the financial difficulties were not involved anymore. This would also limit distortions of competition.<sup>231</sup>

### **6.3.3 Decisions under the 2008 Banking Communication and Recapitalisation Communication and the Rescue and Restructuring Communication: The Cases of the Recapitalization of *The Bank of Ireland* and *Commerzbank***

In the recapitalization of the Bank of Ireland by the Irish state, which was decided under the Recapitalization Guidelines, the Commission did not make a detailed assessment on how the capital injection would lead to a distortion in competition, but saw the terms and conditions imposed on the bank through the Guarantee Scheme as sufficient proof that the measure would not lead to a distortion in competition. The Commission mentioned the bank's commitment to refrain from mass marketing and a dividend as positive commitments to avoid distortions of competition.<sup>232</sup>

The Case of *Commerzbank* was decided in a phase in which the Commission went back to the Rescue and Restructuring Guidelines.<sup>233</sup> In this Case the Commission explicitly mentioned the Rescue and Restructuring Guidelines and assessed the restructuring

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<sup>229</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 paras 92-93

<sup>230</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 paras 93, 95.

<sup>231</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands) Commission Decision (2008) OJ C80/7 para 95

<sup>232</sup> *Recapitalisation by the Bank of Ireland by the Irish State Case* (Case N149/2009) Commission Decision [2009] OJ C234/2009 para 79

<sup>233</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 140-141

measures under the Rescue and Restructuring Guidelines, taking the crisis situation in the financial markets into account.

To avoid undue distortions of competition, Commerzbank had to take a number of measures, which included a ban on growth through acquisitions and the obligation not to offer more favorable terms to its competitors in its core business areas. Furthermore, Commerzbank had to reduce its balance sheet by 45%. Commerzbank also needed to sell Eurohypo which would result in a significant reduction of market share in Germany and the rest of Europe. The Commission stipulated that this would limit any distortions of competition.<sup>234</sup> Commerzbank was given a divestment period of five and a half years.<sup>235</sup>

#### **6.3.4 Decisions under the Impaired Asset Communication and the Restructuring Communication: the Case of *ING Bank***

A Case which has been decided under the Impaired Asset Communication and the Restructuring Communication is the *ING Case*.<sup>236</sup> ING was considered to be one of the biggest financial institutions in the world.<sup>237</sup> It had more than 70 individual businesses and operated in more than 50 countries.<sup>238</sup> ING received a capital injection of 10 billion Euro from the Dutch State.<sup>239</sup>

The Commission assessed ING's restructuring plan. ING needed to restructure considerably as ING had received aid which exceeded 2% of the total bank's RWA (Risk Weighted Assets).<sup>240</sup> In its assessment the Commission looked at whether long-term viability would be restored as well as ING's own contribution and measures which would address distortions of competition.<sup>241</sup>

It is particularly interesting to see how the Commission assessed the restructuring plan with the aim of minimizing distortions of competition. As ING received a very large amount of aid,

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<sup>234</sup> *Commerzbank Germany* (Case N 244/2009), Commission Decision (2009) OJ C147/4 paras 111-113

<sup>235</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 155

<sup>236</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 109, 117

<sup>237</sup> European Commission 'Staatssteun: Commissie geeft groen licht voor herstructureringsplan en illiquid asset Back-up faciliteit ING' Press Release IP/09/1729 (2009)

<sup>238</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 12

<sup>239</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 32

<sup>240</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 119

<sup>241</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 120, 131, 140

ING needed to take significant measures in order to avoid possible undue distortions of competition.<sup>242</sup>

Measures taken by ING included a reduction in the balance sheet of 45%. Furthermore, in ING's restructuring plan it was stipulated that ING would carve out an entity<sup>243</sup> in the Dutch retail market. The creation of this entity would increase competition in the Dutch retail banking market. Hereby it is important to note that in The Netherlands, the retail market was highly concentrated, with ING as one of the leading players, who would be able to maintain its high market share through State aid. The Commission's assessment was based on ING's commitments to ensure that the newly created business would be viable and that it could compete in the future. Considering the know-how and the human resources of the new entity, it would be capable to further develop its business. These measures ensured that competition in the Dutch retail market would increase.<sup>244</sup> ING was required to divest within a period of four years.<sup>245</sup>

Furthermore, ING was prevented from acquiring attractive businesses. Moreover, ING and the Dutch authorities had opted for a price leadership ban in which ING would not offer more favorable prices than its best three competitors. In addition, The Netherlands committed that ING would refrain from mass marketing and also opted for a general price leadership ban.<sup>246</sup>

The Commission finally concluded that all measures were proportional to the distortive effects on competition.<sup>247</sup>

### **6.3.5 Decision decided under the 2008 Banking Communication and the 2009 Restructuring Communication: The Case of United Kingdom Restructuring of Lloyds Banking Group**

Another Case which involved a divestment of an entity of a significant size, as part of the restructuring plan, was the Restructuring of Lloyds Banking Group (LBG). According to the Restructuring Plan, LBG would divest 600 branches in the UK retail market, which would represent a significant share of the UK PCA market and LBG's share in the mortgage market. As the UK retail market was very concentrated the divested entity had the capability

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<sup>242</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 142

<sup>243</sup> The entity was called WUH/Interadvies

<sup>244</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 143-147

<sup>245</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 155

<sup>246</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 paras 148-151

<sup>247</sup> *State aid implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan* (Case C10/09) Commission Decision [2009] OJ L274/1 19 para 156

to increase competition. Furthermore, the divested entity was important to address the competition concerns that were created by a merger between Lloyds TSB and HBOS.<sup>248</sup>

In addition, as regards competition geographically, the divested entity targeted the geographical markets in which LBG had the strongest position in terms of market shares.<sup>249</sup>

Like ING, Lloyds Banking Group had a divestment period of four years.<sup>250</sup>

Other measures taken to limit possible distortions of competition were balance sheet reductions and a commitment to an acquisition ban. The Commission concluded that the measures were an appropriate means of addressing distortions of competition generated by the aid.<sup>251</sup>

### **6.3.6 Conclusion based on the Case analysis**

The Cases show that in the beginning of the crisis when the decisions were taken under the Rescue and Restructuring Guidelines and under Article 107 (3) (b), the Commission referred to social objectives of the aid such as the need to protect employment. In contrast, in the Cases which were decided in a later phase under Article 107 (3) (c), the Commission focused more on the objectives of protection of financial stability and economic stability in the wider economy. I think the reason that the Commission did not focus much on social objectives, like unemployment, in a later phase during the crisis, was because returning to a financial and economic stable situation was considered as more important than the social objective of maintaining a certain employment level. However, I think the objectives of protection of financial stability and economic stability in the wider economy could also imply other social objectives.

From the Cases as presented above it can be shown that the Commission applied the means to prevent undue distortions of competition as developed in the legal framework, in particular the measures from the Restructuring Communication.

In all Cases the Commission took the relative amount of aid and its form into account when deciding about the appropriate measures to limit distortions of competition. In other words, the principle of proportionality is applied in addressing the problem of distortions of competition. I think it is important and necessary to do a proportionality assessment, when deciding about the amount of aid and the type of measures to be taken. Without a proper proportionality assessment it would be likely that the wrong amount of State aid would be

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<sup>248</sup> *United Kingdom Lloyds Banking Group* (Case N428/2009) Commission Decision [2009] OJ C45/2010 paras 185 -188

<sup>249</sup> *United Kingdom Lloyds Banking Group* (Case N428/2009) Commission Decision [2009] OJ C45/2010 para 187

<sup>250</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 155

<sup>251</sup> *United Kingdom Lloyds Banking Group* (Case N428/2009) Commission Decision [2009] OJ C45/2010 paras 191- 194

granted or the wrong type of measures taken, which could have significant distortions of competition.

In highly concentrated markets, like the UK and The Netherlands, the creation of a new entity and divestments with the result of a reduction in market shares, were used as a means to increase competition and to avoid undue distortions of competition.

Reductions in balance sheets and a ban on acquisitions during a certain amount of time, were frequently used measures to avoid distortions of competition. Furthermore, disincentives for aggressive commercial behavior such as the obligation to refrain from mass marketing were imposed on banks. In addition, the concern about moral hazard had been addressed through a change in management of the banks.

An interesting development in the Case law was the degree of restructuring required. At the beginning of the crisis in 2008, a lesser degree of restructuring was required than at a later stage. With the introduction of the Restructuring Communication, the Commission became tougher with its structural measures and behavioral constraints.

The increasingly tougher stance of the Commission towards restructuring can be seen in the Case law, as it shows that divestments are increasingly required in national as well as in other EU Member States.<sup>252</sup> This difference can clearly be seen by comparing the restructuring obligations between Fortis Bank and the Lloyds Banking Group. The latter had to comply with much further restructuring obligations than Fortis Bank.

Likewise, the Commission became increasingly strict towards the divestment periods. In the Cases of ING and Loyds Banking Group the divestment period was four years compared to five and a half years for Commerzbank.

The most significant difference in the approach of restructuring banks for the purpose of limiting distortions of competition was the removal of the distinction between fundamentally sound and unsound banks. This can be seen in the Case law by the increasing degree of restructuring required for all banks.

From my point of view, for the creation of economic stability in the financial sector it was necessary that the Commission became stricter towards the requirements for restructuring

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<sup>252</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 154

and the duration of divestment periods. Furthermore, I see the removal of the distinction between fundamentally sound and unsound banks as a positive step towards decreasing any possible distortions of competition and a more stable economic situation.

#### **6.4 Conclusion based on the Legal Framework and the Case law**

In conclusion, both the legal framework and the Case law stressed the importance of limiting distortions of competition. The compensatory measures, aimed at limiting distortions of competition, developed in the legal framework were applied in the Case law. Both show the development towards stricter and tougher requirements for restructuring during the financial crisis, with the aim of limiting distortions.

## **7 Evaluation of the effects on competition as a result of the State aid measures taken during the financial crisis**

I will evaluate the Commission's State aid policy during the financial crisis using the extent to which the State aid caused distortions of competition as a criterion. I will describe the positive effects of the Commission's approach. This is followed by an assessment of the effects on competition. Then I will make an assessment of the measures used to avoid distortions of competition giving a positive as well as a negative approach. Finally, an overall assessment is made weighing the positive effects of the aid against the negative effects.

### **7.1 Assessment of the EU State aid policy and legal framework on distortions of competition**

#### **7.1.1 Avoiding a collapse of European financial institutions and restoring financial stability**

The European Commission noted that by the end of 2010 State aid measures avoided the collapse of the European financial institutions.<sup>253</sup> The chance for a prolonged and deep economic recession was also reduced.<sup>254</sup> Furthermore, State aid also contributed to restoring confidence in the financial sector. Between mid-2008 and the end of 2010, the State aid granted resulted in a normal functioning of the financial markets and restored financial stability. State aid also helped to preserve the single market.<sup>255</sup> By 2010 there had been less recapitalization schemes and a decrease in ad hoc capital injections. This illustrates that most banks were not dependent on State support or could raise it in the market. This pointed towards an exit of State aid support by 2010.<sup>256</sup>

On the other hand, by the end of 2010, the Commission decided to continue assessing State aid under Article 107 3 (b), for one more year. This demonstrates that there was still a serious disturbance of the economy. Furthermore, the sovereign debt crisis in Ireland, Greece and Portugal in 2010 and 2011 showed that the improvements in financial stability and the functioning of the financial markets were not everywhere and always enduring.<sup>257</sup>

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<sup>253</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the financial and economic crisis', 2011, 76

<sup>254</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 143, 151

<sup>255</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the financial and economic crisis' 2011, 76

<sup>256</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the financial and economic crisis' 2011, 105

<sup>257</sup> Commission, 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis - Commission Staff Working Paper', October 2011, 105

Economic recovery remained very fragile and uneven across the EU.<sup>258</sup> Negative comments also came from German officials, who accused the Commission of undermining the cohesion of the internal market.<sup>259</sup>

Based on the above it can be argued that State aid to banks during the financial crisis was beneficial.<sup>260</sup> However, as noted before, State aid did not prove to be an effective tool for equal and enduring recovery across Europe, as the economic recovery was very fragile and unequal in the EU.

### **7.1.2 Avoiding distortions of competition**

When taking State aid measures, the Commission had to balance the objective of ensuring long-term financial stability with the objective of maintaining effective competition in the European banking sector in the medium- and long-term.<sup>261</sup>

By the end of 2010, the Commission made an analysis of the market structure of the banking sector, with the aim of identifying any significant changes which would point at any distortions of competition as a result of the State aid granted during the financial crisis. The following indicators were used in their analysis:

- size
- concentration
- consolidation
- interdependence and
- contestability at the top of the market.

As will be explained below, these indicators did not show any significant changes in the structure of the banking sector compared to the period prior to the crisis.<sup>262</sup>

By looking at the factor size, because of the financial crisis, the rapid expansion of the banking sector slowed down.<sup>263</sup>

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<sup>258</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1 para 7

<sup>259</sup> Phedon Nicolaides, 'State Aid', in Ioannis Kokkodoris and Rodrigo Olivares-Caminal *Antitrust Law amidst Financial Crisis* (Cambridge University Press 2010) 491-492

<sup>260</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 143

<sup>261</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 89

<sup>262</sup> Commission, 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 90

<sup>263</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 90

In some Member States, State Aid resulted in a concentration of the market, whereas in other Member States, there was a de-concentration. This suggests that there is no correlation between State aid and changes in concentration of the market.<sup>264</sup>

By looking at the factor of consolidation, there has been no difference in the consolidation trend during the crisis as compared to the period before the crisis. In the US many small- and medium-sized banks failed, whereas in the EU there were very few liquidation Cases of small banks.<sup>265</sup>

The crisis did not have much impact on the internal market 'to the extent that banks do not seem to have retrenched behind national borders'.<sup>266</sup>

By looking at the top 20 of banks in the EU, only 4 banks exited the top 20. The division by nation also remained quite steady. Despite the financial crisis, the banking sector remained relatively stable.<sup>267</sup>

Based on the stability of the market structure of the banking sector as analyzed by the Commission, it is possible to conclude that State aid did not cause significant distortions of competition.

However, according to the Commission 'The stability of the structure of the European banking market and the key trends affecting the sector is only an indication that State aid did not provide an undue advantage to aided banks that would have structurally altered competition on the market.'<sup>268</sup> Therefore, the Commission also analyzed the relative performance of aided banks as compared to non-aided banks throughout the crisis. Aided banks decreased their profitability much more than non-aided banks. In terms of profitability, non-aided banks performed better than aided banks. On the other hand, the aided banks recovered much faster than non-aided banks.<sup>269</sup>

In 2010 it was difficult to assess whether the Commission had been able to avoid distortions of competition. However, Member States had not been allowed to treat their own national

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<sup>264</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 98

<sup>265</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, p. 99.

<sup>266</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 100

<sup>267</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 100

<sup>268</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 101

<sup>269</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 102

banks differently from other banks. Furthermore the amount of aid was limited. They also had to restructure which resulted in the sale of beneficiaries or their exit.<sup>270</sup>

The most effective way in which the Commission minimized the risks of distortions of competition was by means of requiring restructuring obligations. In case of big amounts of aid received, the banks had to provide a detailed restructuring plan. Furthermore, measures with the aim of restoring long-term viability and burden sharing also contributed to limiting distortions of competition. Burden sharing helped to limit distortions of competition, as banks would be less likely to engage in risky behavior and to compete on incentives that derive from moral hazard.<sup>271</sup>

According to the Commission, structural measures such as divestments of stand-alone viable business or carve outs of business entities potentially able of entering as a new market player are considered to be the best manner to address competition concerns. Examples from the Case law are the sale of Fortis Bank to BNP Paribas which had the potential of limiting distortions of competition<sup>272</sup>; the divesture of Europhypo by Commerzbank and the carve out of the SME; and the sale of mid-corporate banking business in the UK which created a new entity which would be a competitor in the SME and mid-corporate banking business in the UK<sup>273 274</sup>.

Furthermore, behavioral measures have helped to reduce moral hazard, which also contributes to limit distortions of competition.<sup>275</sup> Competition distortions were also limited due to the proportionality requirement. The measures taken had to be proportionate to the objectives pursued.<sup>276</sup>

The CEPS Task Force Report notes that all financial players and actors benefited from the measures taken to stabilize the financial sector. However, some financial institutions or sectors would have needed more support. National support schemes that supported the entire banking system in a specific country had been more successful in avoiding a decrease

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<sup>270</sup> Phedon Nicolaides, 'State Aid', in Ioannis Kokkodoris and Rodrigo Olivares-Caminal *Antitrust Law amidst Financial Crisis* (Cambridge University Press 2010) 370

<sup>271</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 90-91

<sup>272</sup> *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 - Netherlands) Commission Decision (2008) OJ C80/7 93

<sup>273</sup> *Restructuring of Royal Bank of Scotland* (Case 2009, 10112 Final) Commission Decision [2009] OJC 119, para 244

<sup>274</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 93

<sup>275</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 93

<sup>276</sup> Commission 'Commission Staff Working Paper - The effects of temporary state aid rules adopted in the context of the economic and financial crisis', 2011, 103

in competition, than states providing support to individual banks. The French banking scheme was assessed as non-discriminatory as it was imposed on all large banks.<sup>277</sup>

### 7.1.3 Negative stance on the Commission's approach

The Commission's decisions and the legal framework which was developed by the Commission, to deal with the financial crisis through State aid, was not without criticism. It was criticized by academics as well as governmental officials<sup>278</sup>.

'The choice of remedy does not seem to be affected by the specific circumstance of the case; nor does the magnitude of the remedy seem to be correlated with factors which are likely to affect the extent of competition distortions'.<sup>279</sup> In its choice of remedies to limit distortions of competition, the Commission focused on a reduction in the market presence of the beneficiary. Many of these remedies reflect the companies' business plans. The company might have planned to divest that part of the business already. In addition the Commission had not shown in its decisions, the main factors which provide an understanding of the remedy on social welfare.<sup>280</sup>

According to Ahlborn and Piccinin the Commission's assessment and its policy of imposing 'compensatory measures' had not been so beneficial. The main cause of this can be ascribed to a general aid and restructuring aid policy aimed at a reduction in market presence of the aided company through capacity reductions and divestments. These measures were not suitable to deal with the problems during the financial crisis and contributed to the worsening of the bad economic situation.<sup>281</sup>

Other scholars note that structural measures, such as forced divestments or reduction in business fields and limits to expansion, which are often required by the Commission, have a significant effect on the market structure and significantly restricts the favored undertaking in its behavior. Consequently, the market is to some extent driven by public authorities. These measures should remain an exception.<sup>282</sup>

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<sup>277</sup> Karen Lanno and Chris Napoli, *Bank State Aid in the Financial Crisis: Fragmentation or Level Playing Field?* (A CEPS Task Force Report, October 2010) Centre for European Policy Studies, 20-23

<sup>278</sup> Particularly by the German officials, see Weber Hits out at Brussels, Financial Times, April 22, 2009.

<sup>279</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 167

<sup>280</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 165-167

<sup>281</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 167

<sup>282</sup> Daniel Zimmer & Martin Blaschczok, 'The role of competition in European state aid control during the financial market crisis' (2011) 32 *European Competition Law Review* 9, 5

A similar negative stance towards the restructuring measures also came from the CEPS Task Force Report, by pointing out that there is a danger that the Commission will have too much influence on the structure of the market.<sup>283</sup> They noted that 'it is surely unprecedented for the Commission to take responsibility for dictating the 'business model' of private enterprise in the EU, even in the name of ensuring fair competition.'<sup>284</sup> The Commission justified its approach by avoiding moral hazard and to guarantee long term viability of the bank.<sup>285</sup>

In addition, according to some scholars, the Commission should only use rescue and use restructuring aid control to restore balanced competition instead of controlling moral hazard. According to them the Commission does not have the expertise to decide on measures which will limit future moral hazard.<sup>286</sup>

One way to increase the protection of competition is by means of developing a framework for harm to competition. Furthermore, the Commission needs to design its remedies imposed to address the harm to competition. According to some critics moral hazard needs to be addressed with different remedies than competition concerns.<sup>287</sup>

#### **7.1.4 Overall assessment: Balancing the positive and negative effects of the Commission's State aid policy aimed at limiting distortions of competition**

Balancing the positive and negative effects of the Commission's Crisis Framework, I think the prevention of a total collapse of the financial system and the reduction of a chance for a deep and prolonged economic recession were the most important achievements of the Commission's legal framework developed during the financial crisis. In addition, it is positive that the Commission's approach resulted in no significant distortions of competition.

The Commission's decisions to limit distortion of competition had a major impact on the structure of the market. However, I think that in these circumstances, it is difficult to avoid making decisions which have an impact on the structure of the market. Furthermore, I agree too much government influence on the behavior of private companies and the market structure is not a good result of the legal framework developed by the Commission, but in my

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<sup>283</sup> Karen Lanno and Chris Napoli, *Bank State Aid in the Financial Crisis: Fragmentation or Level Playing Field?* (A CEPS Task Force Report, October 2010) Centre for European Policy Studies 40

<sup>284</sup> Karen Lanno and Chris Napoli, *Bank State Aid in the Financial Crisis: Fragmentation or Level Playing Field?* (A CEPS Task Force Report, October 2010) Centre for European Policy Studies 40, footnote 31

<sup>285</sup> Karen Lanno and Chris Napoli, *Bank State Aid in the Financial Crisis: Fragmentation or Level Playing Field?* (A CEPS Task Force Report, October 2010) Centre for European Policy Studies 40, footnote 31

<sup>286</sup> Bruce Lyons and Minyan Zhu, 'Compensating Competitors for Restoring Competition? EU Regulation of State Aid for Banks During the Financial Crisis' [2013] *Journal of Industry Competition and Trade* 39, 64

<sup>287</sup> Christian Ahlborn and Daniel Piccinin, 'The Great Recession and other mishaps: the Commission's policy of restructuring aid in a time of crisis' in Erika Szyszczak (ed) *Research Handbook on European State Aid Law* (Edward Elgar Publishing Limited, 2011) 168

opinion maintaining a financial system, restoring and maintaining confidence in the financial system and maintaining a certain level of competition is more important.

Ideally the Commission should not use State aid rules aimed at limiting distortions of competition to combat moral hazard. However, moral hazard was one of the causes of the financial crisis, which made it necessary to fight moral hazard to prevent a further deepening and duration of the financial crisis. In the future the Commission can consider developing different remedies to fight moral hazard than for addressing competition concerns.

Even though some decisions to limit distortions of competition were taken with the companies' business plans in mind, they still helped to limit distortions of competition. Therefore, I do not regard this as a negative aspect of the Commission's policy on State aid.

Overall, the Commission's impact on the prevention of a total collapse of the financial system and the prevention of a longer and deeper economic crisis should not be underestimated. Therefore, balancing the positive and negative effects of the Commission's State aid policy and its developed legal framework, the positive effects on the economy as a whole and the limited consequences on competition outweigh the negative effects.

## **7.2 Conclusion**

In conclusion, State aid to banks during the financial crisis was beneficial because State aid helped to restore financial stability in some Member States. However, State aid did not prove to be an effective tool for equal and enduring recovery across Europe, as the economic recovery was very fragile and unequal in the EU.

By using effective tools to limit distortions of competition, State aid was also successful in maintaining competition between the banks. Based on the Commission's analysis of the market structure of the banking sector, there were no significant distortions of competition as a consequence of the State aid. From the Commission's assessment comparing the performance between aided and non-aided banks it can be concluded that State aid did not give a significant advantage to the aided banks because their relative performance was not better than that of non-aided banks. The fact that aided banks recovered much faster than non-aided banks, points at an advantage for the aided banks. However, I think that balancing the speed of recovery with the stability of the market structure and the relative performance of aided versus non-aided banks, the positive effects of the aid still outweighs the negative effect it might have had on competition.

I agree with the Commission that structural measures leading to new entities entering the market and smaller entities remaining, is a good way to address competition concerns

because by having more players in the market it would be less likely that competition would be distorted. In line with Ahlborn and Piccinin, I would like to argue that the Commission's choice of divestments as a compensatory measure might be influenced by the companies' business plans, and could therefore not be considered as targeting factors which are likely to affect the extent of competition distortions. However, these measures were a tool to limit distortions of competition and I think it's not wrong to use tools which reflect the companies' business plan as long as they are successful in maintaining competition in the market.

As mentioned in the CEPS Task Force Report structural measures have a significant impact on the market structure. Therefore, in line with Daniel Zimmer & Martin Blaschczok, I would like to suggest that these measures can only be used in exceptional circumstances. However, as mentioned by the Commission, these structural measures are considered to be the best manner to address competition concerns. Therefore, they should still be applied, but only in exceptional circumstances.

In conclusion, State aid was successful in maintaining and restoring confidence in the financial sector and thereby avoiding a collapse of this sector. Balancing the positive consequences of State aid on the stability and confidence in the financial sector with the negative consequences on the market structure and to a lesser extent on competition, I would like to conclude that the positive effects of the State aid outweighed the negative effects on the market structure.

## **8 Possible solutions to handling similar problems which occurred during the financial crisis: the formation of a European Banking Union**

In response to the financial crisis, there have been several solutions to handle similar problems in the future, in particular the formation of a European Banking Union. Its structure and the process and challenges leading to its establishment are explained below.

### **8.1 The need for a supranational regulatory body at EU level**

In Europe, banking activities are, to a very large extent, cross border. On average, the 30 largest European banks conduct half of their business abroad. Despite the increase of cross border banking activities, no supranational regulators were created. In The de Larosière Report, which analyzed the causes of the financial crisis, the lack of supranational regulators were mentioned as one of the causes of the crisis. As the financial crisis was mainly spread through banks with cross-border activities, supranational regulators would have been better prepared to deal with the financial crisis than national regulators. The manner in which banks were regulated and supervised were part of the cause of the financial crisis, in particular, the fragmented financial regulation and supervision, which protected domestic markets.<sup>288</sup>

The need for supranational governance has become especially important during times of crisis. In order to handle cross-border externalities, it is important to create supranational governance arrangements.<sup>289</sup> Due to the lack of supranational regulation, EU authorities did not have the capability to establish a coordinated response to the crisis. This is because the banking and financial sector remained regulated on a national level.<sup>290</sup> The crisis showed that the EU was lacking a clear and predictable legal framework to deal with distressed financial institutions.<sup>291</sup>

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<sup>288</sup> Schoenmaker, *Governance of International Banking: The Financial Trilemma*, (OUP 2013) 138

<sup>289</sup> Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma*, (OUP 2013) 138

<sup>290</sup> Leila Simona Talani (ed), *The Global crash: Towards a New Global Financial Regime?*, (Palgrave Macmillan 2010) 183

<sup>291</sup> Alexander Kern, 'Bank Resolution and recovery in the EU, enhancing banking union?' (2013) 14 ERA Forum

<<https://www.uzh.ch/cmsssl/rwi/lehreforschung/alphabetisch/alexander/person/publikationen/KABRAREU.pdf>> accessed 12 April 2015, 81, 82

As a result, in the De Larosière Report it was suggested to form a European Systemic Risk Council (ESRC) and a European System of financial supervisors composed of three European supervisory authorities:

- a European Banking Authority;
- a European Securities and Markets Authority;
- a European Insurance and Occupational Pensions Authority.<sup>292</sup>

‘An enhanced supervision framework would contribute to minimize the likelihood of a crisis in the future, while the new bank regulation would contribute to minimizing the cost of such a crisis by more appropriately sharing its cost between the public and private sectors, thereby also addressing moral hazard issues.’<sup>293</sup>

A European Banking Union could be a solution to avoid the problems, which occurred during the financial crisis in Europe. It can be argued, ‘A single market in banking asks for unified supervision and resolution’.<sup>294</sup> The European Banking Union can also be a solution ‘to the discrepancy between the national focus of financial market supervision and the cross-border dimension of the banking industry’.<sup>295</sup>

According to the IMF, solutions for finding a better balance between short-term (financial stability) and long-term objectives (competition policy), would be to designate ‘responsibility for competition policy in the financial sector to a stability oriented EU body’. Another suggestion would be to increase cooperation between the Commission’s DG competition and the financial stability authorities, by establishing a specific framework and coordination mechanism.<sup>296</sup>

## **8.2 The first steps towards the creation of a Banking Union**

By the end of 2010 the Commission noted that for preventing a crisis to happen again and to deal with the challenges related to the financial crisis in the long term, State aid control is not sufficient. State aid control can be beneficial in the short term but there is a need to

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<sup>292</sup> Ilias Kapsis, *Competition Law and policy for the EU banking sector in a period of increased economic uncertainty*, 284, 292 & The de Larosière Group, *Report of the high-level group of financial supervision in the EU*, Report, paras 177, 183, 194 < [http://ec.europa.eu/finance/general-policy/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/finance/general-policy/docs/de_larosiere_report_en.pdf)> accessed 29 March 2015

<sup>293</sup> European Commission, ‘The effects of temporary State aid rules adopted in the context of the financial and economic crisis’ (Commission Staff Working Paper) (2011), 108

<sup>294</sup> Mathias Dewatripont, ‘European Banking: Bailout, bail-in and state aid control’ (2014) *International Journal of Industrial Organization* 37, 41

<sup>295</sup> Franziska Bremus and Claudia Lambert, ‘Banking Union and Bank Regulation: Banking Sector Stability in Europe’, (2014) 9 *DIW Economic Bulletin* (2014) 29, 29

<sup>296</sup> Wim Fonteyne and others, ‘Crisis Management and Resolution for a European Banking System’ IMF Working Paper WP/10/70, (2010) <http://www.imf.org/external/pubs/ft/wp/2010/wp1070.pdf> accessed 28 March 2015, 52

implement new and improved rules for bank regulation, supervision and resolution to solve the long-term problems.<sup>297</sup>

In the 2013 Banking Communication, the creation of a Banking Union was mentioned.<sup>298</sup> A Banking Union is created when the banks are placed under the supervision of a European authority, where the responsibility would belong to a federal government.<sup>299</sup> In June 2012, the Commission noted that deeper economic integration, through the creation of Banking Union, could be a way to exit the crisis.<sup>300</sup>

The Commission had 'legislative proposals to create a Single Supervisory Mechanism (SSM) 'to prevent banking risks and cross-border contagion from emerging' and for the ECB 'to carry out supervision directly' by 'using national supervisors in regular supervisory tasks as much as possible.'<sup>301</sup>

The European Council decided to explore a single supervisory mechanism with the ECB as a supervisor'. This means that the ECB would act as a supervisor and lender of last resort at the European level. The ECB would be the major institution in the supranational framework for supervision of large European banks.<sup>302</sup>

Following the institutional and regulatory changes taken by the Union during the financial crisis, in order to improve the prevention of the banking crisis, the European Council had agreed to create a Banking Union, which would start with a Single Supervisory System (SSM) and a Single Resolution Mechanism for credit institutions. In addition, 'Member States had agreed to set up a stability mechanism by which financial resources could be provided to members and their banks in case of need'.<sup>303</sup>

### **8.3 Structure of the Banking Union**

In December 2012, the Commission published the communication 'A Roadmap towards a Banking Union'. This communication contains legislative proposals for the setting up of a Single Supervisory Mechanism by:

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<sup>297</sup> European Commission, 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis' (Commission Staff Working Paper) (2011), 108

<sup>298</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 12

<sup>299</sup> Jean Pisari-Ferry, *The Euro-Crisis and Its Aftermath*, (OUP 2014) 149

<sup>300</sup> European Commission, 'Competition Policy and Economic Recovery: Tackling the Financial Crisis', <[http://ec.europa.eu/competition/recovery/financial\\_sector.html](http://ec.europa.eu/competition/recovery/financial_sector.html)> accessed 29 March 2015

<sup>301</sup> Alexander Kern, 'Bank Resolution and recovery in the EU, enhancing banking union?' (2013) 14 ERA Forum <<https://www.uzh.ch/cmsssl/rwi/lehreforschung/alphabetisch/alexander/person/publikationen/KABRAREU.pdf>> accessed 12 April 2015, 81, 83-84

<sup>302</sup> Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma*, (OUP 2013) 139

<sup>303</sup> Communication from the Commission - of 1 August 2013 of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') [2013] OJ C 216/1, para 12

- conferring specific supervisory tasks in relation to credit institutions on to the ECB and;
- adaptations to the Regulation setting up the European Banking Authority (EBA).<sup>304</sup>

The Van Rompuy paper called for an integrated EU financial framework that should consist of three pillars: 'single European banking supervision, a common deposit insurance and resolution framework.'<sup>305</sup>

The Banking Union had to be based on:

- a single rule book;
- a single framework on banking supervision;
- a common deposit guarantee scheme;
- a single framework for the managed resolution of banks and financial institutions;
- and a common backstop for temporary financial support.<sup>306</sup>

In the establishment of the Banking Union, the European Commission focused on regulation and supervision, which meant the development of the Single Rule Book and the supervisory powers of the ECB.<sup>307</sup>

The ECB would have an important role to play in terms of supervision of credit institutions. According to the Commission 'it is critical that the EBA plays fully its role to build a common legal framework and supervisory culture across the whole Union', by using the existing instruments and powers.<sup>308</sup> Furthermore, in this new structure, there should be access to financial resources, in case of need. This also includes tax resources in the last instance.<sup>309</sup>

Overall, this new structure would constitute a major shift of powers and further centralization of banking supervision and resolution powers from the national to the EU level.<sup>310</sup>

### 8.3.1 The single rule book

The Commission noted that the creation of the Banking Union must not have a negative impact on the unity and integrity of the single market. This has been done by the

<sup>304</sup> European Commission, 'A Roadmap towards a Banking Union' Communication (COM (2012) 510 final, 4

<sup>305</sup> Alexander Kern, 'Bank Resolution and recovery in the EU, enhancing banking union?' (2013) 14 ERA Forum <<https://www.uzh.ch/cmsssl/rwi/lehreforschung/alphabetisch/alexander/person/publikationen/KABRAREU.pdf>> accessed 12 April 2015, 81, 82-83

<sup>306</sup> David Howarth and Lucia Quaglia, 'Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and 'Completing' Economic and Monetary Union' (2013) 51, Journal of Common Market Studies, 103, 103-104

<sup>307</sup> Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma*, (OUP 2013), 139, 140

<sup>308</sup> European Commission, 'A Roadmap towards a Banking Union' Communication (COM (2012) 510 final, 4

<sup>309</sup> Jean Pisari-Ferry, *The Euro-Crisis and Its Aftermath*, (OUP 2014) 150

<sup>310</sup> David Howarth and Lucia Quaglia, 'Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe's Banks and 'Completing' Economic and Monetary Union' 51 (2013) 103, 103-104.

establishment of a single rule book, which ‘provides a common foundation which allows a move to the Banking Union without any risk of fragmenting the single market’.<sup>311</sup>

‘The single rulebook is the foundation of the Banking Union. It consists of a set of legislative texts that all financial institutions (including approximately 8300 banks) in the EU must comply with. These rules, among other things, lay down capital requirements for banks, ensure better protection for depositors, and regulate the prevention and management of bank failures.’<sup>312</sup>

In summary, a single rule book is ‘a set of fully harmonized EU rules applied consistently across the Member States.’<sup>313</sup>

### **8.3.2 Single supervision: Supervisory powers to the ECB**

The supervisory powers of the ECB are outlined in EU regulation No 1022/2013 of the European Parliament and of the Council. According to this regulation, a single supervisory mechanism is the first stage in the formation of a European Banking Union.<sup>314</sup>

As of November 2014, the largest banks are directly supervised by the European Central Bank. The remaining banks are still being supervised by the national supervisors. The ECB and the national supervisors will be working together, to check that banks comply with the EU banking rules as well as to find solutions to problems at an early stage.<sup>315</sup>

As already noted in the “Roadmap towards a Banking Union, the EU regulation on supervisory powers of the ECB”, the functioning of the internal market for Financial services should not be hindered by the creation of the Banking Union. The European Supervisory Authority (European Banking Authority (EBA), should continue to work on the consistent application of the single rulebook in all Member States and to strengthen the concentration of supervisory practices in the EU.<sup>316</sup>

Besides the single rule book, there is a need for a European supervisory handbook on the supervision of financial institutions, which identifies best practices across the Union,

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<sup>311</sup> European Commission, ‘A Roadmap towards a Banking Union’ Communication (COM (2012) 510 final, 5

<sup>312</sup> European Commission, ‘Banking and Finance: Banking Union’, <[http://ec.europa.eu/finance/general-policy/banking-union/index\\_en.htm](http://ec.europa.eu/finance/general-policy/banking-union/index_en.htm)>, accessed 23 November 2014

<sup>313</sup> David Howarth and Lucia Quaglia, Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe’s Banks and ‘Completing’ Economic and Monetary Union’ 51 (2013) 103, 107

<sup>314</sup> Regulation (EU) of the European Parliament and of the Council 1022/2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, [2013] OJ L287/5, para 2

<sup>315</sup> European Commission, ‘Banking and Finance: Banking Union’, <[http://ec.europa.eu/finance/general-policy/banking-union/index\\_en.htm](http://ec.europa.eu/finance/general-policy/banking-union/index_en.htm)>, accessed 23 November 2014

<sup>316</sup> Regulation (EU) of the European Parliament and of the Council 1022/2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, [2013] OJ L287/5, para 4

regarding supervisory methodologies and processes to comply with international and Union principles.<sup>317</sup>

### 8.3.3 Single resolution mechanism

A Single Resolution Mechanism has been established aimed at securing that failing banks are settled in an orderly manner with minimal costs for taxpayers and to the real economy. This Single Resolution Mechanism (SRM) will be applicable to the banks which are covered by the SSM. The failure of banks will be managed in an effective manner through a Single Resolution Board and a Single Resolution Fund, financed by the banking sector.<sup>318</sup>

The Single Resolution Board (SRB), has been in operation as an independent EU Agency since January 2015. The SRM, plays a significant role in case a bank is risking failure or fails. Its main purpose is to establish an orderly resolution of failing banks, while minimizing the costs. The SRM is responsible for the preparation of resolution plans in cooperation with the national resolution authorities of the Member States.<sup>319</sup>

The Single Resolution Fund, which is a pool of money financed by the banking sector, needs to ensure that funding is available for a medium-term period, while a credit institution is being restructured. The SRB will be responsible for this Single Resolution Fund.<sup>320</sup>

## 8.4 Challenges in the formation of a Banking Union

The creation of these supranational bodies or governance arrangements is not without any problems. 'National banks have national government paper on their balance sheet; and national governments provide the fiscal backstop for national banks. Lifting banking supervision and resolution to the European level would mitigate this bank-sovereign link. But the long-term rationale for European governance is the intensity of cross-border externalities'.<sup>321</sup> In addition, the creation of a Banking Union can possibly lead to a separation in the EU internal market between participating and non-participating Member States.<sup>322</sup>

Furthermore, the formation of a Banking Union is challenging, as 'the level of governance in charge of addressing crises should be the same as that is in charge of preventing them'. In

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<sup>317</sup> Regulation (EU) of the European Parliament and of the Council 1022/2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013, [2013] OJ L287/5, para 7

<sup>318</sup> European Commission, 'Banking and Finance: Banking Union', <[http://ec.europa.eu/finance/general-policy/banking-union/index\\_en.htm](http://ec.europa.eu/finance/general-policy/banking-union/index_en.htm)> accessed 11 April 2015

<sup>319</sup> European Commission 'Single Resolution Board', <<http://srb.europa.eu/>> accessed 3 February 2015

<sup>320</sup> European Commission, 'Single Resolution Board', <<http://srb.europa.eu/>> accessed 3 February 2015

<sup>321</sup> Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma*, (OUP 2013), 138

<sup>322</sup> Alexander Kern, 'Bank Resolution and recovery in the EU, enhancing banking union?' (2013) 14 ERA Forum <<https://www.uzh.ch/cmsssl/rwi/lehreforschung/alphabetisch/alexander/person/publikationen/KABRAREU.pdf>> accessed 12 April 2015, 81, 81

other words, 'only a comprehensive Banking Union can address the fragility of the Euro area.'<sup>323</sup>

Prior to the establishment of the Banking Union, there were different preferences on its structure. The European institutions and other Member States, including France, were in favor of a supranational body with the power to wind-down or recapitalize ailing banks. In contrast, Germany preferred establishing a network of national authorities that would coordinate separately.<sup>324</sup>

One way of explaining these differences in the preferences in banking supervision, is by looking at the degree of foreign ownership and domestic bank internationalization of a Member State. Countries with a low level of foreign ownership and high levels of internationalization of domestic banks prefer more banking supervision harmonization at the European level. In contrast, countries with a high foreign ownership and a low domestic bank internationalization prefer keeping more autonomy for their national financial institutions.<sup>325</sup>

## 8.5 Other solutions

Apart from the European Banking Union, the Financial Stability Board (FSB) was set up in 2009, with the purpose of identifying potential threats to global Financial market stability. To accomplish this task, the FSB works together with the International Monetary Fund. International exchange between regulatory authorities is promoted.<sup>326</sup>

## 8.6 Conclusion

Based on the analysis of The de Larosière Report, which mentioned the manner in which banks were regulated protecting the domestic market and the lack of a supranational regulatory body as one of the causes of the financial crisis, I think that the EU would have responded much better to the crisis by having a supranational regulatory body in place prior to the financial crisis. This can be supported by the argument that the banking sector was regulated on a national level which meant that it was difficult for EU authorities to respond to the crisis in a coordinated manner.

I agree with the Commission that there needs to be improved rules for bank regulation, supervision and resolution to solve the long-term problems. Even though the new legal framework provided a good and detailed guidance in assessing the restructuring and

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<sup>323</sup> Jean Pisari-Ferry, *The Euro-Crisis and Its Aftermath*, (OUP 2014) 150

<sup>324</sup> Jean Pisari-Ferry, *The Euro-Crisis and Its Aftermath*, (OUP 2014) 151-152

<sup>325</sup> Aneta B. Spendzharova, 'Banking Union under construction: The impact of foreign ownership and domestic bank internationalization on European Union member-states' regulatory preferences in banking supervision' *Review of International Political Economy*, 21 2014, 949, 973

<sup>326</sup> Franziska Bremus and Claudia Lambert, 'Banking Union and Bank Regulation: Banking Sector Stability in Europe', (2014) 9 DIW Economic Bulletin (2014) 29, 29

recapitalisation measures to be taken by financial institutions with a long-term perspective, this was not enough to create long-term and equal recovery across the EU.

Based on the foregoing, the creation of a Banking Union with a single supervisory and resolution mechanism could be a possible solution to handle similar problems in the future. Especially due to the relatively large proportion of cross border activities of banks, it is important to have a supranational body governing European Banking. With a supranational body in place, such as a European Banking Union, it will be possible to act in a coordinated manner in response to crises situations.

Assessing the structure of the European Banking Union it can be concluded that this involves a major shift in power in regulating the financial sector from the Member States to a supranational body. Not all Member States were favoring a supranational institution. However, I think that having a supranational regulatory body with the necessary tools to solve the problems in the long-term is more important than maintaining regulatory power at the national level.

## **9 Conclusion**

Based on the previous chapters the question on how the Commission approached the question regarding the approval of State aid to banks during the financial crisis in Europe is answered. The question on how the Commission balanced the interests of economic, financial and social advantages with market oriented disadvantages will also be answered. The balancing between short-term and long-term consequences will be addressed as well. The question on to what extent State aid led to distortions of competition will also be looked at. Finally possible solutions for handling similar problems in the future and future lessons we can learn from this crisis will be presented.

### **9.1 Commission response to the financial crisis: a new legal framework**

The Commission responded to the financial crisis by developing a new legal framework with Article 107 (3) (b) as its legal basis, consisting of the 2008 Banking Communication, the 2013 Banking Communication, the Recapitalization Communication, the Impaired Assets Communication and the Restructuring Communication. The main aim of the 2008 and 2013 Banking Communications was to restore financial stability while keeping distortions of competition to the minimum.

### **9.2 Balance of the interests of economic and financial stability and social benefits in the EU with market oriented disadvantages**

State aid in the financial sector has economic and social advantages as well as market oriented disadvantages. The following economic advantages of State aid in the financial sector can be identified: the preservation of the integrity of the internal market; ensuring financial stability; avoiding a total collapse of the financial system; decreasing the chance of a continuation and deepening of the financial crisis and protecting the national economy as a whole. The Commission also used State aid measures with the aim of protecting a competitive market and to increase competition in the market. One of the social benefits of State aid is the protection of employment.

Negative consequences of State aid in the financial sector are possible distortions of competition and moral hazard. Moral hazard can arise as a result of State aid because if companies know other companies receive aid they might think they will be granted State aid as well, and as a result might engage in risky behavior. The Commission used compensatory measures to limit possible distortions of competition and to avoid the creation of moral hazard.

In its legal framework the Commission balanced between the restoration of financial stability and possible undue distortions of competition and fragmentation of the internal market. With

the aim of limiting distortions of competition, the Commission kept the aid to the minimum amount necessary and of temporary nature. The principles of proportionality and burden sharing were used to maintain or increase competition in the banking sector. The principle of proportionality was also used to assess the minimum burden sharing and the appropriate own contribution. By putting restrictions on the banks' behavior the risk of State aid measures having distortive effects on competition was reduced.

In the beginning of the crisis the Commission distinguished between 'sound' and 'unsound' banks in its measures to limit distortions of competition. Less-performing banks needed less restructuring than well-performing banks. In the first prolongation of the Restructuring Communication, the distinction between fundamentally 'sound' and 'unsound' banks was taken away. It can be concluded that by abandoning this distinction, the Commission became stricter with their requirements for restructuring by requiring more restructuring for fundamentally 'sound' banks.

With the Commission's legal framework in place, I think the Commission was able to provide guidance on the measures necessary to limit distortions of competition while at the same time aiming for more financial stability.

In the beginning of the crisis, when decisions were still taken under the Rescue and Restructuring Guidelines and under Article 107 (3) (b), State aid was used by the Commission for social objectives such as protection of employment. In later Cases, which were decided under Article 107 (3) (c), the Commission justified State aid more often by economic objectives such as protection of financial stability and economic stability in the wider economy.

In the State aid Cases the Commission used the principle of proportionality to address possible distortions of competition. By deciding about the appropriate measures to limit distortions of competition, the Commission looked at the relative amount of aid and its form. In highly concentrated markets, the Commission used the method of creating a new entity and divestments with the result of a reduction in market shares, as a means to increase competition and to avoid undue distortions of competition.

Both the Legal Framework and the Case law stressed the importance of limiting distortions of competition. The compensatory measures, aimed at limiting distortions of competition, developed in the Legal Framework were applied in the Case Law. There was a development towards stricter and tougher requirements for restructuring during the financial crisis, aimed at limiting distortions of competition. This can be demonstrated by the abandoning of the distinction between 'sound' and 'unsound' banks.

### **9.3 Balance between short-term and long-term consequences of State aid**

The Commission balanced the short-term and long-term consequences of State aid in its assessment and approval of State aid. Assessing the Commission's legal framework the following long-term objectives can be identified: restoring long-term viability of the company, restoring financial stability, a return to normal market conditions, limitations of undue distortions of competition and avoiding fragmentation of the internal market and measures aimed at limiting moral hazard.

The Commission also had a number of short-term objectives in its legal framework which were: restoring trust in the financial sector and thereby decreasing the likelihood of a total collapse of the financial system and avoiding moral hazard.

It can be concluded that in its legal framework, the Commission paid special attention to the restoration of long term viability of the banks. I think the new legal framework provided a good and detailed guidance in assessing the amount of State aid and appropriate measures to be taken to solve the problems in the long-term. Restructuring and recapitalisation measures were taken with a long-term perspective. The avoidance of moral hazard, which is both a short-term as well as a long-term objective, was also included in the legal framework.

I think the Commission established a legal framework which was suitable to solve the problems in the short-term by improving the short-term financial situation. The 2008 Banking Communication allowed for ad-hoc emergency interventions which were aimed at restoring financial stability in the short-term.

In its legal framework, at the beginning of the crisis the Commission focused a bit more on the short-term consequences of the aid compared to the end of the crisis. This can possibly be explained by the evolution and severity of the crisis. When the crisis started in 2008 there was more need to intervene with short term objectives as it was important to avoid a complete collapse of the financial system. As the situation gradually stabilized and when the effects of the aid became clear, it became more important to look at the long-term objectives. The avoidance of moral hazard remained a short-term as well as a long-term objective during the crisis. In my opinion the correction of moral hazard is also a short-term objective because correcting companies from moral hazard decreases risky behaviour. This will lead to more financial stability in the short-term and a faster return to 'healthy' market conditions in the short run.

In my opinion, the Commission should have focused more on the long-term consequences when developing its legal framework at the beginning of the crisis. This could have been done by being stricter with their assessment of restructuring plans starting with the 2008 Banking Communication. In addition, the Commission should have raised the minimum requirements for burden sharing from the beginning because it could be expected that the Member States would not go beyond minimum requirements for burden sharing.

During and towards the end of the crisis, the Commission improved its legal framework by focusing more on the long-term objectives. A more in depth-investigation of the restructuring plans were included in the 2009 Restructuring Communication. In addition, with the first prolongation of the Restructuring Communication the removal of the distinction between 'sound' and 'unsound' banks, a higher degree of restructuring was required by the 'sound' banks. This pointed towards stricter requirements for restructuring for all banks. A more in-depth assessment will increase the chances of long-term financial stability. Furthermore, in the 2013 Banking Communication it was mentioned that the levels of burden sharing should be raised.

In the Case law, both short-term and long-term objectives of the aid were taken into consideration when approving the State aid and the conditions under which the aid was approved. State aid was approved as an emergency measure with the short-term objective of restoring confidence in the financial market and avoiding the risk of a disturbance of the national economy, with possible negative spill-overs to the whole EU economy. Short-term consequences were one of the objectives of these emergency measures as these measures were specifically targeted at a fast return to financial stability.

The Commission applied the compensatory measures as developed in the legal framework in the Case law. Limiting the aid to the minimum necessary and an appropriate own contribution (burden sharing) to the costs were the main means through which the Commission aimed at restoring financial stability in the long-term.

The correction of moral hazard in the Case law is both a long-term as well as a short-term objective. I would like to argue that avoiding moral hazard through compensatory measures can prevent banks from risky behaviour in the short-term. Without the correction of moral hazard the assumption might be created that certain banks are politically and economically too important to collapse. This can lead to banks engaging in risky behavior in the long-term. Therefore, I would like to suggest that the correction of moral hazard in the Case law was also a means to prevent risky behavior by the banks which would eventually lead to more

financial stability in the long-term. Measures aimed at correcting moral hazard can also have short-term objectives because banks might engage in risky behavior because if other banks receive State aid, they expect to receive State aid as well. By correcting moral hazard through compensatory measures banks are more likely not to engage in risky behavior.

The Case law showed that when taking measures with a short term objective, long term consequences were also taken into account. The Case law also showed a gradual shift from focusing on the short-term impact to the long-term impact. The reason might be found in the severity of the financial crisis and the increased expertise and experience in dealing with State aid Cases during the financial crisis. Furthermore, the Commission could learn from its decisions that were taken at the beginning of the crisis in 2008, as some of the effects of these decisions were already visible.

Both the legal framework and the Case law show a shift in focus from short-term objectives to long-term objectives. I think this can be explained by the fact that in the beginning it was more important to return to normal market conditions as soon as possible than financial stability in the long-term.

In conclusion, in the beginning of the financial crisis the legal framework and the Case law focused more on short-term objectives, whereas at a later stage during the crisis, the long-term objectives became more a focal point for the Commission. The objective of avoiding moral hazard remained a short-term as well as a long-term objective throughout the crisis in the legal framework and the Case law.

#### **9.4 Assessment of the effects of the EU State aid to the financial sector**

State aid was successful in maintaining and restoring confidence in the financial sector and thereby avoiding a collapse of this sector. By using effective tools to limit distortions of competition, State aid was also successful in maintaining competition between the banks. One effective way to maintain competition between banks was through structural measures resulting in more and smaller entities on the market. In this way there were fewer chances of distortions of competition.

I share the concern that structural measures imposed by the Commission have an impact on the market structure. Therefore I think these measures should only be used in special circumstances. However, I think the Commission should not refrain from using these measures as they are an effective tool in limiting distortions of competition as a result of State aid.

On the other hand State aid did not lead to an even and enduring recovery everywhere in Europe. This is something that can be improved in any future decisions on State aid in crisis situations in Europe.

State aid helped to restore confidence and stability in the financial sector. State aid also contributed to more financial stability in the EU as a whole. To some degree State aid had an impact on the structure of the market. However, I think it is very difficult to avoid any impact on the market structure with any kind of governmental interference in the banking sector. I also think that by granting State aid there is always a chance of distortive effects on competition. However, with the Commission's legal framework in place which includes compensatory measures, these distortions of competition are to a very large extent reduced. I also think that the Commission has learned from its experience during the crisis. This can be demonstrated by the fact that the Commission became more strict in its compensatory measures towards companies, which reduced the risk of significant distortions of competition on the banking sector in the future.

Based on the Commission's analysis on the effects of State aid on competition it is possible to conclude that there were no significant distortions. However, to a very limited extent State aid has some degree of distortive effects on competition, as aided banks had a shorter recovery period than non-aided banks. Moreover, there is a possibility that State aid had an effect on the market structure. Based on my analysis I would like to conclude that the positive effects of the State aid outweighed the negative effects.

## **9.5 Possible solutions to treat similar problems in the future and lessons to be learned**

A couple of lessons were already learned during the financial crisis. As the financial crisis proceeded, measures for improvement were taken by the Commission. By abandoning the distinction between fundamentally 'sound' and 'unsound' banks the Commission became stricter on the requirements for restructuring by requiring more restructuring for fundamentally 'sound' banks.

In the 2013 Banking Communication, it was mentioned that the previous Banking Communications did not lead to financial stability in the long term, as Member states did not go beyond the minimum requirements for burden sharing. Therefore under the 2013 Banking Communication it was necessary to raise the minimum requirements for burden sharing. This was one of the ways to preserve integrity in the single market, as the previous approach led to different approaches to burden-sharing between the Member States.

I think the new legal Framework provided a good and detailed guidance in assessing the restructuring and recapitalisation measures to be taken by financial institutions with a long-term perspective. However, this was not enough to create long-term and equal recovery across the EU. Therefore, there needs to be improved rules for bank regulation supervision and resolution to solve the long-term problems.

An important lesson which was learned from the financial crisis is that without a supranational body in place, it was difficult to solve the financial problems of the crisis, as banks were and still are increasingly operating cross-border. Due to a lack of a clear and predictable legal framework, the EU could not respond to the financial crisis problems in a coordinated manner. In addition, the financial sector remained regulated on national level, which made it difficult for the EU to respond on EU level.

I think that the EU would have responded much better to the crisis if there would have been a supranational regulatory body in place at the time of the crisis. This can be supported by the analysis of the The de Larosière Report, in which the lack of a supranational body and the regulation of banks which protect domestic markets, was seen as factors causing the financial crisis.

The creation of a Banking Union with a single supervisory and resolution mechanism could be a possible solution to handling similar problems in the future. Due to the relatively large proportion of cross border activities of banks, it is necessary to have a supranational body governing European Banking. With the European Banking Union, it will possibly be easier to act in a better and coordinated manner in response to any future crisis situations in the financial sector in Europe.

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## List of abbreviations

European Commission: Commission

European Banking Authority: EBA

European Union: EU

Gross domestic product: (GDP)

Treaty of the Functioning of the European Union: TFEU