FACULTY OF LAW
Lund University

Mathilde Lecomte Sandebring

State Aid control in the Financial Sector and Systemic Financial Stability: rules applied during the financial crisis and in the Banking Union

JAEM03 Master Thesis
30 higher education credits (30 ECTS)

Supervisor: Marco Claudio Corradi

Master's Programme in European Business Law

Spring Semester 2017

Acknowledgements

My sincere thanks go to my supervisor Marco Claudio Corradi, Senior lecturer at the Department of Law of Lund University, for his useful help and guidance throughout my research.

I would also like to thank Judge Ian Forrester QC, Judge at the General Court of the Court of Justice of the European Union, as well as Aleksandra Melesko and Pascal Berghe, référendaires at the General Court, for their precious comments about State aid and judicial review of Commission decisions, and the knowledge they have shared with me about European Union law in general.

Abstract

State aid is an area of competition law. State aid measures are used to remedy market failures and to help undertakings when they are facing difficulties. State aid control aims at ensuring a level playing field between aided and non-aided firms. During the 2007-2009 financial crisis, several banks have encountered difficulties, and Member States have been forced to help them out through diverse means. The European Commission has been comprehensive and has issued a temporary framework with an expiry date of application to guide Member States and accelerate the aid approval process. Nevertheless, a balance had to be found between protection of the financial stability and maintaining a level playing field. The financial crisis made the European Union realise that it lacked a harmonised set of rules concerning supervision and regulation of credit institutions at Union level. The creation of the Banking Union appears as drawn from a lesson learnt during the crisis.

Key words: State aid, Financial crisis, Banking Union, Systemic Financial Stability

Sammanfattning

Statligt stöd är ett område för konkurrenslagstiftning. Statsstödsåtgärder används för att avhjälpa marknadsmisslyckanden och hjälpa företag när de står inför svårigheter. Statsstödskontroll syftar till att skapa lika villkor för stödda och icke-stödda företag. Under finanskrisen 2007–2009 har flera banker stött på svårigheter, och medlemsstaterna har tvingats hjälpa dem på olika sätt. Europeiska kommissionen har varit omfattande och har utfärdat ett tillfälligt ramverk med utgångsdatum för ansökan för att styra medlemsstaterna och påskynda godkännandet av statligt stöd. Ändå fick Kommissionen hitta en balans mellan skydd av finansiell stabilitet och upprätthållande av konkurrensen i Europeiska unionen. Finanskrisen gjorde att Europeiska unionen inser att det saknades en harmoniserad uppsättning regler för tillsyn och reglering av kreditinstitut på unionsnivå. Skapandet av bankunionen framträder som dragits av en läxa som man har lärt sig under krisen.

Nyckelord: Statligt stöd, Finanskris, Bankunionen, Systemisk Finansiell Stabilitet

Abbreviations

AG	Advocate General
BRRD	Bank Recovery and Resolution Directive
CJEU	Court of Justice of the European Union
CRR	Capital Requirements Regulation
CRD IV	Capital Requirements Directive
DGSG	Deposit Guarantee Scheme Directive
EBA	European Banking Authority
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EEC	European Economic Community
ELA	Emergency Liquidity Assistance
ECSC	European Coal and Steel Community
EU	European Union
GATT	General Agreement on Tariffs and Trade
OJ	Official Journal
R&R	Rescue and Restructuring
SAAP	State Aid Action Plan
SAM	State Aid Modernisation
SRB	Single Resolution Board
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union

Table of contents

1. **Introduction**

1.1. Purpose

Subsidies granted to undertakings by Member States are controlled at European level. State aid consists of '*an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities*'.[1] State aid is thus a form of public intervention in the economy. The rules governing State aid can be found in the Lisbon Treaty.[2] State aid may be incompatible with the internal market, as provided by Art 107(1) of the Treaty on the Functioning of the European Union ('TFEU') '*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.*'

The control of the compatibility of State aid with the internal market by the European Commission ('Commission') is thus part of the competition framework and meets a specific set of rules. The principle underlying the concept of State aid control is that Member States should not favour certain undertakings over others, to protect free competition within the internal market. Competition is indeed essential to build a robust economy. However, in certain circumstances, State aid is required to safeguard undertakings and can thus be justified by reasons of general economic interest.

During the financial crisis of 2008, massive State intervention occurred in the European Union. The financial crisis affected all sectors of the economy and challenged regulations especially in the banking sector. In 2008, the amount of aid granted to financial institutions reached €212 billion, more than three times the amount of aid given to undertakings operating in other sectors of the economy.[3] The banking sector is a fragile one, and its failure would have a negative impact on all the other sectors of the economy. Certain banks were thus considered 'too big to fail.' A systemic meltdown of the financial sector was feared after the Lehman Brothers

---

[1] Doris Hildebrand, *The Role of Economic Analysis in EU Competition Law (*Kluwer Law International, 2016), p. 486.

[2] Articles 107 and 108 of the Treaty on the Functioning of the European Union, 2012/C 326/01.

[3] Common Market Law Review 47 :313-318, Kluwer Law International [2010] p. 314.

collapse in September 2008. Swift interventions by the governments of the Member States helped stabilize the financial sector. That is the reason why Member States granted large supports to their credit institutions. Different instruments have been applied to restore the soundness of the financial market and ensure its proper functioning.[4] Banks were saved because the impact of their failure on consumer confidence and the viability of other banks would be too high for the government to allow it.[5] In other words, Member States feared the systemic effects of the crisis on the financial sector. However, balance was needed between the necessity to safeguard the financial stability and the obligation to preserve competition within the Union.

Many economists consider that the 2008 financial crisis was the worst recession since the Great Depression of the 1930s. Banks failed in waves during the 1929 crisis in the United States and caused adverse effects on all industries of the real economy. Milton Friedman and Anna Schwartz pointed out that difficulties of banks, aggravated by a loss of confidence in the banking industry, led to a rapid fall in the supply of liquidity.[6] The banking industry was structurally weak in 1929: when one bank failed, the assets of others were frozen; one failure led to another, spreading with a domino effect.[7]

In response to the 2008 financial crisis and the urgent need of support to the banking system, the Commission had to rethink the apprehension of State aid control and re-establish a comprehensive set of rules. The political mandate is now for 'less and better targeted' State aid.[8] The question is, therefore, to know to what extent have the rules governing State aid in the financial sector been modified during the banking crisis, and what kind of measures have been taken to prevent the collapse of the banking system.

---

[4] Common Market Law Review 47 :313-318, Kluwer Law International [2010] p. 313.

[5] Philip Lowe 'State aid policy in the context of the financial crisis' Competition policy newsletter n°2, 2009, p.4, available at http://ec.europa.eu/competition/publications/cpn/2009_2_1.pdf

[6] Ben S. Bernanke 'Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression' in The American Economic Review, Vol. 73, No. 3 (Jun., 1983), p. 257.

[7] John Kenneth Galbraith, *The Great Crash 1929* (Houghton Mifflin Harcourt Publishing Company, 1955), p. 179.

[8] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Contro : An Economic Framework* (ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, p. 625.

1.2. Research Questions

How did the Commission apply State aid rules during the crisis? Is the creation of the Banking Union, with the European Central Bank as supranational supervisor, enough to prevent future recourse to State aid, through tools such as bail-in mechanisms instead of bailing out the banks, the Resolution Fund, and deposit guarantee schemes?

1.3. Method and Material

To provide an answer to these questions, I will start with a succinct overview of State aid history in the European Union and present the general rules applying to State aid control, as well as the standard approach of the Commission to State aid in the banking sector before the 2008 financial crisis.

Second, I will analyse the measures taken by the Commission during the crisis and the effect of the rescue plans of banks on competition and the Member States' sovereign debts.

Finally, I will examine the reform undertaken by the Union regarding rescue and restructuring of credit institutions post-crisis under the creation of the Banking Union.

1.4. Delimitation

The thesis focuses on State aid granted to credit institutions in the European Union as defined in EU law, and will thus not examine the effects of subsidies provided to any other kind of undertakings by the Member States.

2. Brief history of the concept of State Aid in EU Law

2.1. GATT, ECSC and EEC rules

(1) GATT

An important antecedent of EU State aid law started is represented by the 1947 GATT, which provided for an obligation to notify subsidies and a prohibition of export subsidies for non-primary products.[9] The idea was that the liberalization of trade through the reduction of tariff customs could be balanced by domestic support; States could resort to subsidies while other trade barriers, easier to control, were abolished.[10] It was therefore deemed necessary to control subsidies, to maintain the benefits of the reduction of tariffs customs on trade between the European States.

(2) ECSC Treaty

In 1951, Article 4(c) of the Treaty of Paris (Treaty establishing the ECSC)[11] introduced the principle of prohibition of subsidies, which were considered incompatible with the common coal and steel market. Subsidies were strictly and without conditions banned. The article did not contain any criterion; there was no requirement of distortion of competition, selectivity test, or *de minimis* rule.[12] Since 1965, general decisions by the Commission regarding aid were based on Article 95 ECSC Treaty, authorising under certain conditions the granting of aid by the Member States to the coal industry. This article allowed the provision of national aid considered compatible with the objectives of the Treaty.

(3) EEC Treaty

Rules regarding State aid in the EEC Treaty[13] were no longer restricted to the coal and steel market. The Treaty provides that national aids are incompatible with the internal market when they distort competition and are liable to affect trade between Member States. Exceptions to the ban on State aid can be made, as the Treaty recognized that aid can be socially beneficial. The Treaty does not provide for Community aid.

---

[9] Piernas Lòpez, *The concept of State aid under EU Law* (OUP, 2015), p. 35.
[10] *Ibid*., p. 32.
[11] Treaty constituting the European Coal and Steel Community, 1951, Article 4(c).
[12] Piernas Lòpez, *The concept of State aid under EU Law* (OUP, 2015), p. 34.
[13] Treaty establishing the European Economic Community, signed on 25 March 1957.

2.2. Evolution of the approach to State aid in the EU

(1) Spaak report

The Spaak report was drafted in 1956 by the Spaak Committee. The report stated that it is necessary to impose competition rules on undertakings to avoid agreements and practices that could have effects on barriers to trade.[14] The report also suggested the reformer to prevent Member States from granting aids having as their object and effect the distortion of competition. The general rule emanating from the report was thus that State aid which distorts competition is incompatible with the single market. The report stated that the notion of aid must be broad so as to cover any support given from the Member States.[15] The report gave the task to the Commission of discerning between compatible and non-compatible aid. The Member States had to pre-notify to the Commission any intended measure; yet, the Commission could act ex officio.

The report created an important distinction between Member States measures: the drafters considered aids as artificial advantages granted by the States. Other benefits, i.e., regulatory measures or legislative disparities, which could also *de facto* create distortions, could not be assessed by the Commission through an ex-ante analysis, but only ex-post.

(2) The *Travaux préparatoires* in Val Duchesse

The Rome Treaties (EEC and Euratom Treaties) were negotiated at the Intergovernmental Conference on the Common Market and Euratom in Brussels, in 1956.

The competition principle is very present in the EEC Treaty: The Treaty provides for competition rules having the purpose of preventing any distortion of competition, should they come from public authorities, cartels or monopolies.

EEC Treaty Article 92 prohibits State aids that threaten to distort competition, as means to give a guarantee to private operators that competition in the free market would not be distorted by

[14] Piernas Lòpez, *The concept of State aid under EU Law* (OUP, 2015), p. 36

[15] The Brussels report on the General Common Market ('Spaak report'), 21 April 1956, p. 57, Section 2 'La règle générale est que sont incompatibles avec le marché commun les aides, sous quelque forme qu'elles soient accordées, qui faussent la concurrence et la répartition des activités en favorisant certaines entreprises ou certaines productions'.

State aid measures. The article contains the notion 'or though State resources', widening the scope of application for the notion of aid.[16]

These two events resulted in a broad definition of the notion of State aid; as aid was seen mostly as a mean to distort competition by a Member State, an expanded definition was necessary to encompass subsidies.[17]

Effective competition is the rationale behind a European State aid control. It is clear that the compatibility of State measures with the common market must be decided at EU level, the decision cannot be left to the Member States, if one wants a level playing field and fair competition to be maintained across the EU. State aid control is about controlling the behaviour of the national governments and to some degree the one of the recipient undertakings, by reducing moral hazard. The Commission is thus the only entity that is entrusted with the task of assessing State aid, even though it could be argued that national supervisory authorities would be better informed of the economic situation and market failures of their respective countries. That is the reason why excellent communication between the Member States and the European administration is necessary, by transmitting all relevant information needed to decide on the measure.

In 2005, the Commission adopted the State Aid Action Plan and launched a reform of the State aid policy for the period 2005-2009. The idea was to bring a more economic-based test approach, to rethink the balance between State intervention and economic stability.[18] The modernisation plan also includes an extension of the use of guidelines, to render the procedural State aid rules more transparent.[19]

On 8 May 2012, the Commission launched a new State Aid Modernisation ('SAM') initiative, with the aim to consolidate the existing guidelines, including State aid guidelines on Rescue

---

[16] Article 92(1) EEC Treaty 'Save as otherwise provided in this Treaty, 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 common market.'

[17] Piernas Lòpez, *The concept of State aid under EU Law* (OUP, 2015), p. 42.

[18] Doris Hildebrand, *The Role of Economic Analysis in EU Competition Law (*Kluwer Law International, 2016) p. 487.

[19] Speech/05/440 by Neelie Kroes, Former European Commissioner for Competition, 'The State Aid Action Plan – Delivering Less and Better Targeted Aid', London, 14th of July 2005, available at http://europa.eu/rapid/press-release_SPEECH-05-440_en.htm?locale=en

and Restructuring aid.[20] The Commission develops the notion of 'burden-sharing' with the SAM: the undertaking benefiting from restructuring aid should contribute to the restructuring with its own resources.[21]

3. Standard Approach to State Aid Control: General Rules

3.1. Some basics on the notion of State Aid

Article 107(1) TFEU is the point of departure of State aid policy: this provision states that State aid is, in principle, incompatible with the internal market. Under Article 107(2) and (3), a measure can be declared compatible if one of the conditions stated is fulfilled. State aid should be granted to address market failures.

Article 108 TFEU endows the Commission with the task of controlling the compatibility of State aid measures with the competition rules. The Commission assesses first if the measure at stake falls under its jurisdiction or not, and second, whether the measure is compatible with the internal market. The provision is designed so as to allow a margin of discretion to the administration, which leaves room for political decisions, such as authorizing the grant of exceptional amounts of aid during the crisis.

The Treaties allows for several policy objectives for which State aid can be declared compatible with the internal market under control of the Commission. The discretionary powers of the Commission regarding State aid control is outlined in the soft law adopted by the Commission, such as Guidelines and Communications, on the legal basis of Article 107(3)(c).[22] The guidelines have the purpose of making the proceedings more transparent and predictable. The guidelines also outline the policies of the Commission to reach EU objectives such as protection of the environment: i.e., the Guidelines on State aid for environmental protection and energy.[23]

---

[20] Communication from the Commission – Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (OJ 2014 C 249/1).
[21] Doris Hildebrand, *The Role of Economic Analysis in EU Competition Law (*Kluwer Law International, 2016) p. 494.
[22] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (*ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, P.627.
[23] Guidelines on State aid for environmental protection and energy 2014-2020, 2014/C 200/0.

Four criteria as developed by the case law must be fulfilled for a measure to be qualified as State aid, in the meaning of Article 107(1) TFEU. The notion of State aid has been clarified by the Commission through the SAM.[24]

(1) First, the aid must be granted by a State or through State resources to an undertaking.[25] The notion of State encompasses the State *per se*, as well as its administrations and organs.
(2) Second, the aid must constitute an advantage for the recipient entity.[26] This advantage can reside in a money transfer, but also in a tax exemption, for instance.
(3) Third, the aid must affect trade between the Member States.[27]
(4) Fourth, the measure must distort competition. The Commission should assess the effects of the measure on competition when analysing its compatibility with the internal market.[28]

The two last criteria are considered fulfilled if the aid is selective. The measure must favour an undertaking or a group of undertakings, i.e., it cannot be a general measure.[29] To affect competition and trade, the measure at issue must be likely to affect the balance between the recipient undertaking and its competitors.

The notion of selectivity is composed of a geographical and a material variable: as for the geographical component, a measure is deemed selective if it treats differently undertakings in a particular part of the entire territory of a Member State, that is, more favourably than in the rest of this area. As for the material component, a measure is considered selective for all other forms of unequal treatment of undertakings by the intervention of a Member State.

---

[24] Doris Hildebrand, *The Role of Economic Analysis in EU Competition Law (*Kluwer Law International, 2016) p. 501.
[25] See, inter alia, case C-102/87, *France v Commission of the European Communities* [1988] ECR I-4067; case T-47/15, *Germany* v *Commission* [2016] EU:T:2016:281.
[26] See for instance Opinion of AG Jacobs, para 60, in case C-39/94, *SFEI* [1995] I-03547.
[27] See for instance case T-288/97, *Regione autonoma Friuli-Venezia Giulia v Commission* [2001] ECR II-01169, para 41.
[28] See for instance case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten* [2001] ECR I-8365.
[29] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (*ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, p. 628.

When assessing a given measure, the Commission operates an economic analysis: the prudent private investor test, or market economy investor principle ('MEIP'). The Commission examines the repayment terms of the aid; the investment or credit approved is only considered to be State aid if the monetary terms are lower than what a private investor would have agreed on. The action undertaken by the State in these cases is compared to the behaviour of a private investor.[30]

3.2. State Aid rules of procedure

3.2.1. Notification and assessment of the measure

The Member State that intends to grant aid to an undertaking or a credit institution shall notify the measure to the Commission, according to Article 108(3) TFEU.[31] The Commission has two months to take a decision: the Commission can either decide that the aid does not constitute State aid, that it constitutes State aid and is compatible or not with the internal market, or that the measure raises serious doubts and needs to be further investigated.

During the preliminary phase, the Commission examines the measure at stake and decides whether it constitutes State aid or not. If the Commission finds that the measure does not constitute State aid, the measure may be implemented. Only measures that constitute State aid within the meaning of Article 107(1) TFEU are subject to EU State aid control.[32] If the Commission finds that it is State aid, it assesses then its compatibility with the internal market. Measures falling under the scope of Article 107(2) TFEU are automatically exempted, and the Commission may clear the measure under Article 107(3) TFEU, benefiting from a certain discretion.

---

[30] See for instance case T-103/14, *Frucona Košice* v *Commission* [2016] EU:T:2016:152, para 268, in which the General Court ruled that it was for the Commission to apply the private investor test and to determine whether the recipient undertaking would have or not manifestly obtained comparable facilities from a private investor.

[31] Article 108(3) TFEU 'The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plan to grant or alter aid (…).'

[32] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (*ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, p. 627.

If the measure raises serious doubts during this first phase, the Commission shall open the formal procedure and pursue an in-depth investigation.[33] This decision is an obligation and can be challenged before the CJEU. In the case the Commission decides that the measure is not compatible, the Member State is not authorised to put the aid in application, in accordance with Article 108(3) TFEU (the standstill clause).[34] The Commission may use injunctions against the Member State concerned to enforce its refusal decision or order the recovery of the aid if it has already been paid out.

The recipient bank or undertaking does not play a direct role in the procedure, the decision of the Commission is directly addressed to the Member State. But the entity may send information and observations to the Commission during the process.

The content of the decision should reflect the economic assessment of the efficiency of the measure made by the Commission and whether it appropriately addresses the failure. The Commission should balance the costs to taxpayers with the benefits to consumers. The Commission is under the obligation to state reason, within the meaning of Article 296 TFEU.[35] Recourse to State aid should have the incentive effect of changing the firm's behaviour to have a beneficial effect on consumers. The decision should also contain a safeguard against windfalls profits for the recipient bank; the amount of the aid should be proportionate to the desired result.

3.2.2. Exceptions to the notification

As stated in the paragraph above, the principle regarding aid is that it must be notified *ex ante* by the Member State to the Commission.

However, there are some exceptions to this general rule: some categories of aids do not need to be notified.

(1) *De minimis* approach: Small amounts of aid, up to 200.000 euros granted over a period of three fiscal years are presumed to have an insignificant impact on competition and

[33] Article 182 TFEU; Article 6 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 248, 24.9.2015).

[34] Article 108(2) TFEU 'If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the internal market having regard to Article 107, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

[35] Franz Jürgen Säcker, Frank Montag, *European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 273.

on trade between Member States and thus fall outside the jurisdiction of the Commission and do not need to be authorized.[36]

(2) Block exemption regulations: Some categories of aid benefit from block exemption regulations and are presumed compatible with the internal market.[37] For instance, employment aid falls out of the jurisdiction of EU control. Block exemption regulations encourage 'good' aid that fosters economic growth and reduce the administrative burden for the Member States and the Commission, while allowing the latter to focus on more distortive kind of aid.[38]

(3) Aid previously authorised: Aid linked to a scheme already authorised does not need to be notified to the Commission, as the scheme has already been deemed compatible with the internal market, provided that it does not constitute new aid.

Amounts of aid falling under the scope of these exceptions only need to be notified to the Commission *ex post*.[39]

3.3. Judicial review of Commission decisions in the field of State aid

The Commission being a European institution,[40] its decisions are subject to judicial review by the CJEU, under Article 263 TFEU.[41] An action for annulment can be brought by any party satisfying the conditions under this Article, namely being directly and individually concerned by the decision of the Commission, within the meaning of the *Plaumann* doctrine.[42] The recipient undertaking, or a competitor to it, may thus have *locus standi* before the Court. As for every action undertaken under Article 263 TFEU, the conditions for admissibility are quite

[36] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid (OJ L 352, 24.12.2013), Article 3(2).
[37] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187/1, 26.6.2014).
[38] Press release from the European Commission 'State aid: Commission exempts more aid measures from prior notification' Brussels, 21 May 2014.
[39] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (*ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, p. 627.
[40] Article 13(1) TEU.
[41] Article 263(1) TFEU 'The Court of Justice of the European Union shall review the legality of legislative acts, of acts of the Council, of the Commission and of the European Central Bank, other than recommendations and opinions, and of acts of the European Parliament and of the European Council intended to produce legal effects vis-à-vis third parties.'
[42] Case 25/62, *Plaumann v Commission*, EU:C:1963:17 [1963].

tough to satisfy; for instance, in its recent judgments *Heitkamp BauHolding* v *Commission* and *GFKL Financial Services* v *Commission*, the General Court found that that an undertaking could not, in principle, bring an action for annulment of a Commission decision prohibiting a sectoral aid scheme if it was concerned by that decision solely by being a potential beneficiary of the scheme.[43]

The General Court will review the facts and the legality of the decision but will leave complex economic assessments largely to the discretion of the Commission.

In 2016, 50 State aid cases were decided by the judges of the General Court, out of a total of 755 cases completed. State aid represents thus around 6.5% of the General Court's activity.[44]

3.4. State Aid rules in the Financial Sector

Prior to the financial crisis, there were no specific State aid rules applicable to the financial sector.[45] The importance of the State aid control in the banking sector has fundamentally changed with the crisis.[46] Before October 2008, State measures granted to banks were dealt under the 2004 Rescue and Restructuring Guidelines,[47] and Article 107(3)(c) TFEU.[48]

Aids in the financial sector are granted to credit institutions and may take various forms. Aids may have adverse effects on the competition and the financial stability of the European Union.

3.4.1. Definition of a credit institution

The definition of a credit institution in current EU law can be found in Article 4(1)(1) of the Capital Requirements Regulation ('CRR'), which states that ''credit institution' means an

[43] Case T-287/11, *Heitkamp BauHolding* v *Commission,* EU:T:2016:60 [2016] and case T-620/11, *GFKL Financial Services* v *Commission,* EU:T:2016:59 [2016].

[44] Annual report of the Court of Justice of the European Union, Judicial Activity 2016, p. 209, available at https://curia.europa.eu/jcms/upload/docs/application/pdf/2017-03/ra_jur_2016_en_web.pdf

[45] Kelyn Bacon QC, *European Union Law of State Aid*, Third Edition (OUP, 2017), p. 364.

[46] Franz Jürgen Säcker, Frank Montag, *European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 1291.

[47] Communication from the Commission - Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004).

[48] Article 107(3)(c) states that 'the following may be considered to be compatible with the internal market: (…) 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.'

undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.'[49] The EBA regularly updates the list of national authorised credit institutions in the EU.

The terms 'deposits' or 'other repayable funds' are not defined in the CRR. Therefore, the interpretation of this definition varies between the Member States, as well as the requirements to obtain a banking license.[50] Certain forms of 'deposits' are excluded from the scheme coverage by Article 5(1) of the Deposit Guarantee Scheme Directive ('DGSD'), for instance, deposits by investment firms.[51] The clients of these entities might face risks if they were to encounter financial difficulties.[52]

The definition of a credit institution is of great importance for a uniform application of EU banking law, as it determines which entities fall under its scope.[53] Some establishments are carrying on bank-like activities, and could potentially present similar risks to the consumers and the financial stability, but are not considered as credit institutions within the meaning of Article 4(1)(1) of the CRR and therefore would not be subject to the prudential requirements. Shadow banking entities perform activities such as fund raising with deposit-like characteristics, performing maturity or liquidity transformation, allowing credit risk transfer, using direct or indirect leverage, without direct access to government backstops like traditional commercial banks.[54] These entities are operating 'in the shadows' by circumventing existing rules and should be targeted by financial stability policies.

Shadow banking refers to the system of credit intermediation that involve entities outside of the regular banking system. Shadow banks may pose a threat to the financial stability, by contagion to the regulated system. The Commission issued a Communication in 2013 addressing shadow

---

[49] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

[50] EBA Report to the European Commission on the perimeter of credit institutions established in the Member States, 27 November 2014, §11.

[51] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014).

[52] EBA Report to the European Commission on the perimeter of credit institutions established in the Member States, 27 November 2014, §52.

[53] *Ibid.*, §12.

[54] Tobias Adrian, Federal Reserve Bank of New York Staff Report No. 664 'Financial Stability Policies for Shadow Banking,' February 2014, p. 1.

banking as a new source of risk in the financial sector.[55] The Commission outlines that risks of a systemic nature could arise from the shadow banking sector's size and interconnectedness with the regulated banking sector. Liquidity creation in the shadow banking sector has effects on the fluctuation of the financial stability.[56] The destabilisation of an important entity of the shadow banking system could have contagion effects on the regular banking system. The Commission's approach, as presented in its Communication, is to apply similar rules to activities showing the same level of risk, although there are economists that are not that concerned.

To that aim, the Commission, following the recommendations of the Financial Stability Board,[57] has adopted measures such as imposing higher requirements on banks in their transactions with the shadow banking system or imposing more transparency in the transactions by collecting information. The Financial Stability Board ('FSB') is an international body established in 2009 in charge of making recommendations about the global financial system. The FSB coordinates supervisory regulations and policies of regulatory authorities. Increasing control over the shadow-banking sector would help to preserve the financial stability within the EU.

3.4.2. Specific reasons for providing aid to a failing bank

As stated in Article 18(4) of the SRM Regulation,[58] a bank is deemed to be failing or likely to fail in one of several circumstances, notably: when the bank is unable to pay its debts or other liabilities when they fall due; when the assets of the entity are less than its liabilities; when extraordinary public financial support is required; or when the entity infringes the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the ECB.

---

[55] Communication COM (2013) 614/3 from the Commission to the Council and the European Parliament 'Shadow Banking – Addressing New Sources of Risk in the Financial Sector'.
[56] Tobias Adrian, Federal Reserve Bank of New York Staff Report No. 664 'Financial Stability Policies for Shadow Banking', February 2014, p. 6.
[57] Recommendations of the Financial Stability Board 'Shadow Banking: Strengthening Oversight and Regulation', 27 October 2011.
[58] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014).

The failure of a bank is likely to cause a serious disturbance in a Member State's economy. To preserve the financial stability of the Union, a Member State can thus decide that the failing credit institution is too important to collapse, as it would have severe consequences on the real economy and the other credit institutions, as they are intertwined. The Member States want to avoid a total collapse of the banking system that could lead to a sovereign default.

State aid in the financial sector aims at correcting the negative spillover effects that the failure of one bank could cause on others, due to the interconnectedness of the banking system. Indeed, banks depend heavily on the ability to lend and borrow money to each other. The failure of one institution is not likely to benefit its competitors, unlike in other sectors of the economy.[59] The collapse of a systemically important financial institution is enough to trigger a financial crisis, by undermining the confidence in the banking system and thus drying up the interbank sector. By preserving the general confidence of clients in the soundness of the banking industry, credit will continue to flow in the real economy and the market will continue to function properly.

Providing aid to a failing bank should have the aim of protecting the interbank network and the depositors, not saving the bank itself. Aid does not have the purpose of maintaining artificially alive banks.

It is, however, important to remember that State aid is not free and that it is financed by taxpayers' money.

3.4.3. Types of aid used to rescue and restructure credit institutions

Ad hoc measures or general schemes were applied to credit institutions during the financial crisis. Rescue aid and restructuring plans were used to organise the exit in a controlled manner of inefficient firms from the market, leaving market shares available for viable banks.

State subsidies in the financial sector can be granted under several forms:

(1) State guarantees provided at preferential rates. Governments can guarantee deposits or other bank liabilities. A guarantee is presumed to constitute State aid when the recipient

[59] State aid Crisis rules for the financial sector and the real economy, Study from the Directorate General for internal policies, June 2011, p. 22, available at http://www.europarl.europa.eu/document/activities/cont/201107/20110714ATT24010/20110714ATT24010EN.pdf

bank cannot find any private actor that would provide the same guarantee at the same rate. In that case, the aid amounts to the difference between the interest rate obtained with State guarantee, and the market interest rate without guarantee.

(2) Recapitalisation measures consist of government capital injections to strengthen the capital base of the credit institution. Recapitalisation creates a capital buffer against future losses.[60] Recapitalising a bank in difficulty will help to maintain financing flows to the real economy, when no private investor would have had this behaviour. The amount of State aid granted is the amount of the recapitalisation.

(3) Impaired asset measures: banks hold a variety of assets, such as financial assets, loans, treasury bills, or intangible assets such as property or plants. An impaired asset is a company's asset whose market price is lower than the value registered in the company's balance sheets. Impaired asset relief measures protect the bank from losses that would occur because of these impaired assets. A transfer of assets above their market price from the balance sheets of the beneficiary bank to that of another entity called a 'bad bank', as provided by an asset relief measure, constitutes State aid. The amount of aid granted is the difference between the market price and the purchase price.[61] Asset relief may also be realised through asset guarantee: the impaired assets remain on the balance sheets of the recipient bank, but the losses occurred are secured by the State.

(4) Liquidity measures may be granted in the form of credit lines, loans or State deposits. The State provides the funding directly, rather than guaranteeing access to credit funds.[62]

Quantifying the amount of aid transferred is not always easy, as the market prices can be distorted during financial turmoil.[63]

3.4.4. Potential adverse effects of State aid granted to credit institutions

State aid may have distortive effects, by granting an advantage to the recipient bank over its competitors. In an integrated financial market, such as the European Union, the intervention of a national government may have adverse impacts on other Member States. Negative cross-

[60] Kelyn Bacon QC, *European Union Law of State Aid*, Third Edition (OUP, 2017), p. 384.
[61] *Ibid.*, p. 371.
[62] *Ibid.*, p. 378.
[63] *Ibid.*, p. 371.

country externalities and international spillovers are justifying a supranational control of State aid.[64]

Distortions of competitions manifest themselves inter alia in bank funding rates being artificially low for weak banks in countries with very high expectations that investors will be bailed out by the State in the end.[65]

State aid measures entail potential distortions of competition by:

(1) supporting inefficient firms: State aid measures may keep unsound banks artificially alive.

(2) distorting dynamic incentives: State aid measures may alter the investment incentives of firms.

(3) increasing market power: State aid measures may create entry barriers for non-domestic competitors, that do not benefit from State support.

(4) affecting location decisions across Member States: State aid measures may alter the location of productive assets in the EU.

Aid schemes tend to be less distortive than ad hoc measures, as they are designed to support a specific firm and can be used to 'pick a winner.'[66]

Potential distortion of competition also depends on the amount of aid granted: larger amounts are more likely to have distortive effects. That is the reason why aid under the *de minimis* threshold is automatically exempted, as it is presumed to have minimal effects on competition. To reduce the distortive effect of the aid measures, the Commission requires that State measures are accompanied by a restructuring plan, including burden sharing, compensatory measures and

---

[64] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (*ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, p. 640.

[65] State aid Crisis rules for the financial sector and the real economy, Study from the Directorate General for internal policies, June 2011, p. 11, available at http://www.europarl.europa.eu/document/activities/cont/201107/20110714ATT24010/20110714ATT24010EN.pdf

[66] Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (* ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008), Chapter 17, p. 654.

the demonstration that the bank can return to long-term viability, by refocusing on its core activities and changing its business model.

State aid measures may also induce moral hazard. Moral hazard arises when a party is protected from adverse effects that could occur because of its behaviour and is thus behaving differently than if that protection did not exist. For instance, State guarantee could give incentives to a bank to take risky investments, if the bank knows that it will eventually be backed up by the State.

3.5. Summary

State aid measures that distort competition or affect trade between Member States are in principle prohibited under Article 107(1) TFEU. State measures may be authorised by the Commission under Article 107(2) or (3) if they are compatible with the internal market. The discretion of the Commission when deciding on State aid cases is limited by its Guidelines adopted under Article 107 TFEU.

In the financial sector, State aid measures are granted to credit institutions subject to supervisory requirements; some financial establishments are excluded from the scope of the prudential requirements legislative framework, a fact that can threaten the financial stability as turbulences in the shadow banking system are likely to spread in the regulated banking sector.

State aid may be granted to banks through different means: funding guarantees, recapitalisation, impaired assets relief measures or liquidity measures. Granting aid to a distressed bank aims at maintaining financial stability and avoiding negative spillover effects on the whole banking system.

State measures must be proportionate to their objective and limited to the amount necessary; State aid may have adverse effects such as distortion of competition or creation of moral hazard. The potential negative effects of State measures can be avoided through the application of compensatory measures, burden sharing or the obligation to demonstrate that the bank is able to return to long-term viability without State support.

4. State Aid Rules applied by the Commission during the Financial Crisis

4.1. Overview of the Financial Crisis and main concerns raised by it in relation to the systemic financial stability

4.1.1. Origins and causes of the Crisis

The 2008 financial crisis is the biggest financial crisis since the Great Depression and has reshaped the banking sector. The primary underlying cause of the crisis is that the abundance of cheap credit led to asset price booms in real estate in the United States. The functioning of wholesale credit markets has been disrupted since mid-2007. The real estate bubble finally exploded, and the country saw a quick decline of the property prices, triggering the so-called subprime crisis. The burst of the North Atlantic housing bubble raised concerns about the soundness of banks, as financial institutions had significant exposure to losses from mortgage defaults. The bankruptcy of the investment bank Bear Stearns in March 2008 was the first symptom of the premises of the crisis. The collapse of Lehman Brothers on 15 September 2008 triggered the financial crisis. The following weeks, the US government injected billions of dollars into the banks.[67] On the other side of the Atlantic, governments were forced to intervene massively through rescue plans and extended bank guarantees. Confidence in banks' balance sheets dropped drastically, liquidity in the financial markets dried up, and prices collapsed for many assets, causing solvency issues for the banks. Indeed, the failure of one of the world's largest investment bank created anxiety about subprime products of uncertain quality. Banks faced the need to replace a source of funding that had become unavailable: an impaired access to money market borrowing and the impossibility to rely on maturing bank bonds during the crisis.[68]

[67] Christian Ahlborn and Daniel Piccinin, *Chapter 7: The Great Recession and other mishaps: The Commission's policy of restructuring aid in a time of crisis,* in Research Handbook on European State Aid Law (edited by Erika Szyszczak, Edward Edgar Publishing, 2011), p. 124.

[68] Speech by Peter Praet, member of the Executive Board of the ECB, at the Committee on Capital Markets Regulation conference on The lender of last resort – an international perspective, 'The ECB and its role as lender of last resort during the crisis' Washington DC, 10 February 2016, available at https://www.ecb.europa.eu/press/key/date/2016/html/sp160210.en.html

The financial crisis has shed light on the fact that financing risky things creates a vicious circle of debts which can eventually lead to the failure of one bank that triggers the collapse of other credit institutions, and have an impact on the real economy. The financial crisis has eventually led to a sovereign debt crisis threatening the Euro zone.

As it regards the EU, Ireland's extension of its bank guarantees to Irish banks raised concerns that those State rescue measures may distort competition and put other Member States at a disadvantage. The Commission had to find a balance between saving a bank which equates under certain conditions to maintaining the financial stability within the EU and preserving fair competition within the EU, which is one of its roles. The Commission's role in controlling State aid is of the utmost importance when it comes to preserving the banking system and the real economy.

4.1.2. Impact of the Financial Crisis on the Financial Stability and the Banking Sector

Systemic risk to the financial stability can be defined as the risk that the provision of necessary financial products and services by the financial system will be impaired to a point where economic growth and welfare might be affected. Systemic risk may occur because of financial imbalances and contagion across the market. Financial stability is reached when the risk is contained.[69] One market-based indicator of systemic risk is the probability of default of two or more banking groups in the euro area.[70]

Financial and price stability are two facets of the same coin. The ECB has the duty to maintain price stability across the EU, by keeping inflation at a level below 2%, and to promote the smooth operation of payment systems.[71] The ECB has actively been supporting the establishment of a robust regulatory framework for financial institutions.

---

[69] Financial Stability Review, document by the ECB, May 2017, p.3, available at https://www.ecb.europa.eu/pub/fsr/html/index.en.html

[70] *Ibid.*, p. 85.

[71] Article 127(1) and (5) TFEU '(5) The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.'

The main impact of the failure of banks on the real economy was the lack of liquidity. If credit institutions are not sound, they are not able to provide safe and stable deposits, payments and credit to the real economy.[72] It was, therefore, essential to recover financial stability and to rebuild a sound banking system that can support the real economy, which is its core function.

The financial crisis has caused severe damages to the banking system. There have been massive losses and fear that many banks might not be able to survive. Some banks have disappeared through bankruptcy or been nationalised.[73] Almost all the Member States have granted State aid to their financial institutions. To prevent the collapse of the financial markets, the decisions authorising the grant of State aid were taken in only a couple of weeks, or even a few days, instead of several months as it is the case under normal circumstances.[74] Cases with such an impact would probably have triggered the formal investigation procedure by the Commission if there was no urgent need to prevent a global collapse of the banking sector and thus to take swift decisions.

The measures deployed have managed to prevent the collapse of the European financial system, but concerns remain about the sovereign debt in Europe and the fragility of the market.

4.2. Phases of State Aid Control: Evolution of the Commission's reaction to the Crisis

The Commission applied in the first place the standard State aid guidelines for 'rescue and restructuring operations' to assess aid measures to entities in difficulty. The second step was to adopt a package of crisis communications; four communications during the period 2008-2009, with two prolongation communications, and one banking communication adopted in 2013 introducing burden-sharing.

[72] Speech by Johannes Laitenberger 'From bail out to bail in: laying foundations for a restructured banking sector in Europe' Banking Union and Competition, Universidade Católica Portuguesa, Lisbon 25 February 2016.
[73] Lehman Brothers in the US, Fortis and Dexia in Belgium and in the Netherlands in September 2008; the Anglo-Irish Bank in the Republic of Ireland in January 2009… In total, more than 400 banks have been bailed out or failed in the period 2008-2010, resulting in significant depositor losses.
[74] Common Market Law Review 47 :313-318, Kluwer Law International [2010] p. 314

4.2.1. Early stage: application of the Rescue and Restructuring Guidelines

When the crisis was triggered in 2008, the Commission recognised the need for urgent action. The Commission had two main objectives: safeguarding the financial stability and bringing liquidity to the real economy. In the absence of other regulatory instruments, State aid control functioned as a *de facto* resolution framework for the financial sector during the crisis.[75] The first step was thus to undertake rescue and restructuring plans. The second phase was to ensure the viability of the banks without State support. The former Commissioner Neelie Kroes noted thus 'In terms of enforcement, the most crucial thing in my inbox is bank restructuring. This is the second stage of 'rescue and restructuring' aid offered in the past year. In plain English – the price of State support is that you must submit a restructured business to us for approval in order to offset the competition distortions of aid.'[76]

4.2.1.1. The content of the 2004 Rescue and Restructuring Guidelines

Rescue and restructuring (R&R) aid measures are typically assessed and approved under Article 107(3)(c) TFEU, as granting aid for the rescue and restructuring of individual undertakings is considered by the Commission as 'facilitating certain economic areas or economic activities'. The 2004 Rescue & Restructuring Guidelines ('R&R Guidelines'), based on Article 107(3)(c) TFEU, were first used at the premises of the financial crisis to deal with the approval of rescue and restructuring aid to credit institutions in difficulty and including restructuring plans, as they apply to firms of all sector. The guidelines set out the Commission's approach to State aid to firms in difficulty. Rescue aid is temporary liquidity aid, granted in the form of loan guarantees or loans not exceeding six months while working out a restructuring plan, with the aim to regain long-term viability.[77] The amount of aid granted must be proportionate to what is needed to maintain the firm afloat.[78] Before the end of the period of six months, the Member State must either approve a restructuring plan or a liquidation plan or ask for reimbursement of the loan.[79]

---

[75] Speech by Gert Jan Koopman, Deputy Director-General, DG Competition, European Commission 'Market based solutions to bank restructuring and the role of State Aid Control: the case of NPLs' ECMI Annual Conference, Brussels, 9 November 2016, p. 1.

[76] Speech by Neelie Kroes 'Antitrust and State Aid Control – The lessons learned', 36th Annual Conference on International Antitrust Law and Policy, Fordham University, New York, 24 September 2009, p. 6.

[77] R&R Guidelines, points 15, 25(a).

[78] *Ibid.*, point 25(d).

[79] *Ibid.*, point 80.

The guidelines operate with a 'one time, last time' principle to avoid repeated use of State aid to non-viable firms and reduce moral hazard.[80]

State aid for rescuing and restructuring institutions in difficulty has substantial distortive effects on competition.[81] Therefore, the conditions under which it may granted are strict, and it must be demonstrated that the failure of the credit institution would lead to a social hardship, i.e., a rise in unemployment, or a market failure.[82] In those cases, R&R aid would contribute to an objective of common interest. The restructuring plan must certify that the undertaking will regain long-term viability.

The restructuring plan must focus on restoring the viability of the bank, and aid should not be used for non-core or non-viable activities.[83] The 2004 R&R Guidelines include as well the principle that in any restructuring operation, the beneficiary bank should be obliged to finance at least a part of its restructuring, by selling non-core assets, and abandon loss-making activities.[84] The Guidelines also specify that the Commission will ask for compensatory measures to limit distortions of competition.[85] Compensatory measures may include divestment of assets, reductions in capacity or market presence, and reduction of entry barriers on the markets concerned.[86] The compensatory measures should be proportionate to the distortive effects created by the grant of State aid, and depend on the size of the firm and its importance on the market.[87] State aid measures to a company of bigger size are more likely to have distortive effects on competition than aid granted to small and medium enterprises.

[80] *Ibid.*, section 3.3.
[81] *Ibid.*, point 4.
[82] Franz Jürgen Säcker, Frank Montag, *European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 47.
[83] R&R Guidelines, point 45.
[84] *Ibid.*, points 35, 43.
[85] *Ibid.*, points 7, 38.
[86] *Ibid.*, point 39.
[87] R&R Guidelines, Point 40.

4.2.1.2. Restructuring cases prior to October 2008

Ad hoc individual assistance measures were first granted to financial institutions in the EU with significant collateralised debt obligations risks.[88] Rescue measures were applied to several banks, based on the R&R Guidelines and of Article 107(3)(c) TFEU.

(1) Northern Rock

Northern Rock was the UK's 5th biggest mortgage bank that suffered severe liquidity difficulties in 2007 because of the on-going financial turbulences.[89] Northern Rock became unable to meet its funding needs and requested ELA from the Bank of England in September 2007. The news of the provision of ELA triggered a bank run, as the depositors feared they would suffer losses, aggravating the bank's difficulties. The UK government decided to guarantee Northern Rock's liabilities on 17 September and on 9 October 2007 and notified the measures to the Commission on 26 November 2007.

The Commission had to assess the compatibility with the internal market of several measures: the provision of ELA by the Bank of England on 14 September 2007, the State guarantee for existing accounts granted from 17 to 20 September 2007, the extension of the ELA programme on 9 October 2007, and the State guarantee on new accounts from 9 October 2007.

The UK claimed that the provision of ELA of 14 September 2007 lies solely on the responsibility of the Bank of England and therefore that it does not constitute State aid. The UK recognised that the other measures were State aid, but that they were consistent with the 2004 R&R Guidelines.

The Commission decided on 5 December 2007 that the measures taken from 17 to 20 September 2007 as well as the measures decided on 9 October 2007 constitute ad hoc State aid within the meaning of Article 107(1) TFEU, which the UK did not notify *ex-ante*. The measures are however compatible with the internal market, as the loans and State guarantees respect the conditions of form and duration set out in point 25 of the R&R Guidelines. The Commission

[88] Franz Jürgen Säcker, Frank Montag, *European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 1308.

[89] Commission Decision of 5 December 2007 on State aid NN 70/2007 (ex CP 269/07) – United Kingdom Rescue aid to Northern Rock, C 14/2008 (OJ C 135/21).

has balanced the negative social effects that the bankruptcy of the bank would cause in the absence of aid (in the form of job losses) and the distortions of competition that the aid could potentially cause. As the aid is restricted to the minimum necessary for the bank to mitigate liquidity shortfalls, the Commission has considered that adverse effects on trade were neutralised.

Regarding the legal basis of the decision, the Commission recalled that an aid benefiting an individual bank or a single sector cannot be considered to remedy a severe disturbance, within the meaning of Article 107(3)(b) TFEU. The Commission decided that there was no sufficient evidence that the bank-run would have caused a systemic crisis. The decision was thus adopted under Article 107(3)(c) TFEU and the R&R Guidelines.

As regards the ELA granted by the Bank of England on 14 September 2007, the Commission notes that the liquidity assistance was provided on the initiative of the central bank, when Northern Rock was solvent, against high-quality collaterals and at a penalty rate interest, to mitigate liquidity issues.[90] This measure does thus not constitute State aid within the meaning of Article 107(1) TFEU.

(2) Sachsen LB

In the case of Sachsen LB of June 2008,[91] the Commission decided to open the formal investigation procedure because the liquidity measure seemed to confer a selective advantage upon the bank, stating that 'it being unlikely that a market economy investor would have granted the credit facility to Sachsen LB on the same conditions as the banking pool.'[92] The German State argued that the liquidity measure would have been provided by a market investor, as the remuneration was above the market standards. In any event, even if the liquidity measures involved State aid elements, it constitutes rescue aid compatible with the R&R Guidelines as it is similar to a loan, not structural, and limited to six months.[93]

[90] *Ibid.*, para 32.
[91] Commission Decision of 4 June 2008 on State aid C 9/08 (ex NN 8/08, CP 244/07) implemented by Germany for Sachsen LB (notified under document number C(2008) 2269), 2009/341/EC (OJ L 104/34).
[92] *Ibid.*, para 47.
[93] *Ibid.*, para 50.

The Commission decided that the liquidity facility and the guarantee granted to Sachsen LB in connection with its sale by the German State constituted State aid within the meaning of Article 107(1) TFEU, as they would not have been provided by a private market investor, and that the measures were compatible with the internal market. As regards the legal basis of the approval decision, the Commission decided that it could not be Article 107(3)(b) TFEU, as the problems encountered by Sachsen LB were peculiar to the company and not of a systemic nature. The Commission stated thus that 'the information provided by the German authorities has not convinced the Commission that the systemic effects that might have resulted from a bankruptcy of Sachsen LB could have reached a size constituting 'a serious disturbance in the economy' of Germany within the meaning of Article 87(3)(b). Therefore, the present case must be regarded as based on individual problems, and thus requires tailor-made remedies, which can be addressed under the rules on firms in difficulty.'[94] Instead, the Commission considered that the legal basis of the decision would be Article 107(3)(c) TFEU.

About the rescue aid provided in the form of liquidity support facility to Sachsen LB, the Commission took the view that it was compliant with point 25 of the R&R Guidelines, as the measure was restricted to the amount needed to maintain the firm in business for a period of six months and does not have negative spill-over effects on other Member States. The 'one time, last time' principle set out in the R&R Guidelines was also respected, as the bank did not receive rescue or restructuring aid in the past.

The Commission also approved the restructuring aid in the form of State guarantee and the restructuring plan submitted by the German State that included asset divestment, compensatory measures and behavioural commitments such as focusing on core activities. The investigation convinced the Commission that the restructuring aid would restore the viability of the bank. The compensatory measures entail a clear reduction of Sachsen LB's activities and the divestment of one of its valuable subsidiaries and were considered sufficient to reduce the distortive effects of the State aid measures. The plan also foresaw that the bank would make a significant contribution of its own, in compliance with the R&R Guidelines, i.e., at least 50% of the restructuring costs.

[94] *Ibid*., para 95.

The Commission did thus not apply Article 107(3)(b) in these cases, considering that the Member States did not present enough evidence that not granting State aid to these banks would cause serious potential disturbance of the economy.[95]

4.2.2. Adoption of the Crisis Framework: need for deep restructuring

4.2.2.1. The common action plan

State measures were at first individual, but systemically important financial institutions were concerned, and the whole banking system was threatened. The Member States started to adopt general aid schemes as of October 2008. During the Ecofin Council of 7 October 2008 in Luxembourg, the Member States agreed on a common action plan.[96] EU authorities decided to coordinate their endeavours to fight against the impact of the financial crisis on the banking sector, as systemically important banks are often cross-border entities and their failure is likely to cause disturbances in several member states. The financial stability of the whole EU was threatened, requiring common action that would be guided by principles such as avoidance of negative spill-over effects, protection of the interests of taxpayers, or burden placed on the shareholders.

Commission reacted to the announcement of massive recapitalisations through the adoption of a comprehensive framework on the consequences of support to the financial sector. The Commission had committed during the Ecofin Council to create a new framework to assess the compatibility of the aid granted during the crisis, to enhance transparency and make it possible to take swift decisions, while preserving legal certainty. The Commission adopted five new communications and two prolongation communications based on Article 107(3)(b) TFEU, in which different issues are addressed. Aid assessed under Article 107(3)(b) is used to remedy a serious disturbance in the economy of a Member State, as the failure of systemically important credit institutions would lead to such a disturbance. The Court has ruled that a serious disturbance in the economy of a Member State entails that the entire economy of that Member

[95] Franz Jürgen Säcker, Frank Montag, *European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 1311.
[96] Council Conclusions - Ecofin Council of 7 October 2008 'Immediate responses to financial turmoil', press release available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/misc/103202.pdf

State is affected, not only a part of it.[97] Until the financial crisis, Article 107(3)(b) had never been used to assess State measures granted to a financial institution.[98]

Article 107(3)(c) TFEU in conjunction with the R&R Guidelines was no longer the appropriate legal basis to assess State aid measures in the context of the crisis. Articles 107(3)(c) and 107(3)(b) TFEU have different objectives: Article 107(3)(c) and the R&R Guidelines concern rescue and restructuring under normal market conditions.[99] As of October 2008, the primary purpose of State aid measures is now to maintain the economies of the Member States afloat, not to rescue individual institutions or foster development in certain areas.

The Crisis Communications reflect the evolution of the crisis and the market conditions. The Commission based its analysis of the compatibility of the State measures on three principles:[100]

(1) The viability of the recipient bank: The Commission wanted to avoid keeping non-viable banks artificially alive. Adjustments of the bank's business model can be necessary to that aim.
(2) Burden sharing: Moral hazard is one factor that explains why banks had risky behaviours, knowing that they were backed up by the States. Placing the burden on the bank ensures that the board directors would act as 'prudent persons,' be less likely to make risky investments and ensure that the aid is not used to finance activities non-linked to the restructuring plan.
(3) Limited distortions to competition: It is the duty of the Commission to establish a level playing field within the EU, and *a fortiori* between aided and non-aided banks. Maintenance of competition can be ensured through various compensatory measures and behavioural commitments from the aided banks.

Under the Crisis Framework, aid to banks in difficulty was thus approved under Article 107(3)(b) as aid to remedy a serious disturbance in the economy. The Commission took advantage of the different legal basis to produce four new bank-specific rescue and restructuring guidelines in seven months, as the two provisions have different objectives.

---

[97] Joined Cases C-57/00 P and C-61/00 P, *Freistaat Sachsen and Others v Commission* [2003] ECR I-09975, para 97.
[98] Franz Jürgen Säcker, Frank Montag*, European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 1311.
[99] *Ibid*., p. 1312.
[100] See 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 financial crisis, O.J 2008, C 270/08, point 31.

4.2.2.2. The 2008 Banking Communication

The 2008 Banking Communication was adopted on 13 October 2008.[101] The Commission invokes for the first time Article 107(3)(b) TFEU to address the systemic crisis.[102]

The Banking Communication provides that both ad hoc measures and general schemes can be used at the same time.[103] Recourse to Article 107(3)(b) TFEU is possible as long as the crisis justifies it.[104] Therefore, the Commission requires that the Member States carry out a review of the general schemes at least every six months.[105] The 2008 Banking Communication makes a distinction between illiquid but fundamentally sound banks and distressed banks.[106]

The Banking Communication provides criteria for the assessment of general support schemes such as guarantees covering the liabilities of financial institutions, recapitalisation of financial institutions, controlled winding-up of financial institutions and provision of other forms of liquidity assistance.

Under the Banking Communication, a general scheme including State guarantee or recapitalisation measures is deemed compatible with the internal market if it respects several conditions:

(1) The eligibility criteria for the scheme must be objective, transparent and non-discriminatory.[107]
(2) The duration and scope of the scheme should be limited to the minimum necessary. If the Member State commits to reviewing the scheme every six months, the aid can be authorised for a period longer than six months, up to two years in principle.[108]

---

[101] 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 financial crisis, O.J 2008, C 270/08 '2008 Banking Communication'.
[102] *Ibid.*, point 9.
[103] *Ibid.*, point 10.
[104] *Ibid.*, point 12.
[105] *Ibid.*, point 13.
[106] *Ibid.*, point 14.
[107] I*bid*., point 18.
[108] *Ibid.*, points 24, 35.

(3) The amount of aid must be limited to the strict minimum. The beneficiaries of the aid or the private financial sector at large must contribute significantly to the costs of the general scheme.[109]

(4) Negative distortive effects on non-beneficiary banks must be avoided. The Member State must include mechanisms to that aim, such as behavioural constraints.[110]

(5) When the scheme is applied to an individual case, the emergency rescue measures must be followed by a restructuring or liquidation plan.[111]

As regards the winding-up of a credit institution, the 2008 Banking Communication states that the liquidation phase should be temporally limited and that the banking license should be withdrawn as soon as possible,[112] and that the protection of the financial stability may imply that State aid measures are used to reimburse creditors of the insolvent bank.[113]

As it relates to the provision of ELA by a national central bank, the Banking Communication considers that it may not amount to State aid, provided that the recipient bank is solvent, that the liquidity facility is secured by collaterals to which haircut is applied, that a penal interest rate is applied, and that the initiative of the central bank is not guaranteed by the State.[114]
The Banking Communication provides that Commission decisions regarding the compatibility of aid schemes may be taken over 24 hours, considering the need for urgent action.

4.2.2.3. The Recapitalisation Communication

The Recapitalisation Communication of 5 December 2008 followed.[115] The Recapitalisation Communication details the compatibility assessment of bank recapitalisation with State aid rules.

[109] *Ibid*., points 25, 35.
[110] *Ibid*., points 27, 35.
[111] *Ibid*., point 30.
[112] *Ibid*., point 47.
[113] *Ibid.*, point 48.
[114] *Ibid*., point 51.
[115] Communication from the Commission – The recapitalization of financial institution in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, O.J. 2009, C 10/2.

The Recapitalisation Communication restates that recapitalisation measures may have distortive effects on competition and that a balance must be found between these effects and the objective to restore the financial stability.[116] To that aim, capital injections should be temporary and remunerated based on market prices, to give the incentive to the bank to repay the aid as soon as possible. The Recapitalisation Communication provides that financially sound banks may be entitled to rates below the market of recapitalisation, based on the recommendations of the ECB.[117] This Communication thus emphasises the distinction between sound and unsound banks, as was made in the 2008 Banking Communication. Recapitalisation of unsound banks is subject to higher requirements.[118]

About the risk profile of the bank, the Recapitalisation Communication develops some indicators such as capital adequacy (evaluation of the bank's exposure to credit or liquidity risks, the quality of its assets, and its business model strategy); size of the recapitalisation; and the current rating of the bank (a rating of A or above by a Rating Agency being an indicator of a low-risk profile).[119]

4.2.2.4. The Impaired Assets Communication

The Impaired Assets Communication was adopted on 25 February 2009 and substantiates the two previous crisis communications.[120] This Communication presents a methodology for Member States who wish to implement asset relief measures. One reason for the lack of liquidity in the banking sector since the beginning of the crisis is the uncertainty about the value of impaired assets and the quality of bank balance sheets.[121]

The Impaired Assets Communication states that an application for an asset relief measure should contain disclosure of the correct valuation of the assets covered by the measure and the potential losses, followed by an assessment of the bank's balance sheet and its viability.[122] Any

[116] *Ibid.*, point 11.
[117] *Ibid.*, points 15, 16.
[118] *Ibid.*, point 43.
[119] *Ibid.*, annex 1.
[120] Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector, O.J. 2009, C 72/1.
[121] *Ibid.*, point 6.
[122] *Ibid.*, point 20.

transfer of assets at a higher price than their market value, achieving the relief effect, will constitute State aid. Impaired asset relief programmes should be limited to six months and should contain appropriate remuneration for the State, through claw-back clauses.[123]

Toxic assets, for instance, US mortgage backed securities, have triggered the financial crisis and are as such eligible for asset relief measures.[124] The Communication provides guidance as to the identification of eligible assets, based on opinions of experts, that can be found in the annexes to the Communication.[125]
The Impaired Assets Communication specifies that long-term viability means that the bank can survive without State support and to redeem any State aid granted.[126] Need for restructuring is presumed if the bank cannot survive without State support. The Communication provides that the Member State shall commit to present a reorganisation plan or a viability review for each recipient bank within three months after the approval of the scheme or individual measure.[127] Finally, the Communication stipulates that in-depth restructuring will be required if the bank has already received State aid (except participation in a guarantee scheme), or if the aid received exceeds 2% of the bank's risk-weighted assets.[128]

4.2.2.5. Financial Restructuring Communication

The Restructuring Communication of 23 July 2009 is the fourth communication of the Crisis Framework.[129] The Communication explains how the Commission examines restructuring plans during the financial crisis, in the light of the systemic role of the banking sector in the real economy. It recalls that when a bank is granted State aid, in whatever form, the Member State should submit a viability review or a restructuring plan for the credit institution.[130]

---

[123] A clawback mechanism is a provision of a contract that requires the beneficiary to redeem the State capital received and any excess profits, in order to avoid sur-compensation.
[124] *Ibid.*, point 32.
[125] *Ibid.*, Annex 3.
[126] *Ibid.*, point 53.
[127] *Ibid.*, Annex 5.
[128] *Ibid.*, point 55.
[129] Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, O.J. 2009, C 195/5.
[130] *Ibid.*, point 4.

A restructuring plan should contain the causes of the bank's difficulties, its business model and show how the bank will overcome them and regain viability without State support. The plan should include comparison with other possibilities. In case return to long-term viability is not an option, the plan should present the way the bank will be wound-up, as non-viable players should not remain on the market.[131]

Viability is reached when a bank is able to cover all its costs and to compete on the market, under normal conditions, and under stress testing. The restructuring plan should not be longer than five years.[132]

As regards the potential distortion of competition, the Commission will assess the amount of State aid in absolute terms and in relation to the weight of risked assets of the recipient bank. The Commission will then analyse the likely effects of the aid on the market. The compensatory measures applied (assets divestment, behavioural constraints, appropriate remuneration of the State) should not hinder the bank from regaining viability.[133]

4.2.2.6. The 2013 Banking Communication

The 2013 Banking Communication was adopted on 30 July 2013 to replace the 2008 Banking Communication and was designed to harmonise burden-sharing for ailing banks across the EU.[134]

As of 2013, the Commission considered that the serious disturbance in the economy of the Member States and the spillover risks stemming from it were still justifying the use of Article 107(3)(b) TFEU as legal basis for State aid approval. The 2013 Banking Communication was thus adopted on this basis. This Communication helps to the transition from the Crisis Framework to the recovery and resolution directive.[135]

---

[131] *Ibid.*, points 9, 10, 11.
[132] *Ibid.,* points 13, 15.
[133] *Ibid.,* points 31, 32.
[134] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (2013/C 216/01).
[135] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU,

The 2013 Banking Communication points out that the Commission will assess whether the difficulties encountered by the banks stem from the sovereign crisis, and not from unreasonable risk-taking behaviour.[136] As it relates to burden-sharing, the previous communications did not set up any threshold, specifying only that the recipient bank should contribute as much as possible to the restructuring costs, and creditors were not involved, as confidence in the banking sector first needed to be restored, to ensure financial stability.[137] The fact that the Crisis Framework did not set up any minimum amount for burden-sharing led to disparities among the Member States, threatening the integrity of the single market in financial services, and the taxpayers have suffered from repeated bail-outs.[138]

The 2013 Banking Communication provides therefore that burden-sharing measures should be applied before granting any restructuring aid, regardless of the solvency of the bank. By 2013, there is less need for rescue aid than in 2008, and the Communication provides that aid in the form of recapitalisation and impaired assets measure will only be granted once a restructuring plan has been adopted in compliance with the Restructuring Communication, as the use of general schemes over *ad hoc* measures have resulted in high bills for taxpayers.[139] The Communication specifies however that an exception can be made to this requirement when the financial stability is threatened; aid measures may be granted if the supervisor of the bank would be forced to withdraw its banking license immediately, in the absence of such measures.[140] In that case, the rescue measures must be notified *ex ante* to the Commission and must comply with the Recapitalisation and Impaired Assets Communications.

Burden sharing entail contribution by hybrid capital holders and subordinated debt holders before any State aid can be granted.[141] The Banking Communication also provides for capital

2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament.

[136] *Ibid.*, point 9.

[137] *Ibid.*, point 17.

[138] *Ibid.*, point 18.

[139] *Ibid.*, point 23.

[140] *Ibid*., point 50.

[141] Shareholders own shares of the stock (equity) of a company. Debt holders hold bonds and receive interest payments as well as the return of the principal. Subordinated debt ranks after other debts in a liquidation. Hybrid capital holders hold hybrid securities that include elements of equity and debt, such as convertible bonds; these bonds can be converted to stock shares at a set price. Write-down is used to reduce the value of an asset in the balance sheet, when the market value of the asset has decreased; write-off is used to eliminate the asset from the balance sheet.

raising measures. If the bank does not meet the minimum capital requirements, subordinated debts must be converted or written down.[142]

In the *Kotnik* case, delivered on 19 July 2016, the Grand Chamber of the Court ruled that the 2013 Banking Communication was binding on the Commission; meaning that if a Member State notifies an intended State aid measure that complies with the Guidelines, the Commission should authorise the aid scheme.[143] Besides, the Court stated that the Banking Communication is not binding on Member States.[144] About the requirement of burden sharing on the shareholders and creditors as a condition for authorising an aid scheme, the Court ruled that this measure is likely to reduce the amount of funding needed. Therefore, the Commission had the competence to adopt such measure, under its mandate to assess the compatibility of State aid with the internal market.[145] Since shareholders are liable for the debts of the bank up to the amount of its capital, the fact that the Banking Communication requires that the shareholders should contribute to the absorption of the losses suffered by the bank cannot be regarded as affecting their right to property in a disproportionate manner.[146]

4.2.3. Application by the Commission of the Crisis Framework in the Case Law

Under the Crisis Framework, 112 banks in the EU have received State aid in the form of individual ad hoc measures.[147]

1) Commission decision under the 2008 Banking Communication: the Fortis Bank case

Belgium, Luxembourg and the Netherlands have granted a package of aid to banks of the group Fortis between 29 September and 5 October 2008, Fortis Bank and Fortis Bank Luxembourg.[148] The Commission has assessed and approved the aid granted by the Member States under the

[142] *Ibid.*, points 41, 44, 50.
[143] Case C-526/14, *Kotnik and Others* [2016] EU:C:2016:570, para 43.
[144] *Ibid.,* para 45.
[145] *Ibid.,* para 59.
[146] *Ibid.*, paras 78-80.
[147] Competition State aid brief, Occasional papers by the Competition Directorate–General of the European Commission 'State aid to European banks: returning to viability', February 2015, available at http://ec.europa.eu/competition/publications/csb/csb2015_001_en.pdf
[148] Press release, 'State aid: Commission clears state aid to rescue and restructure Fortis Bank and Fortis Bank Luxemburg' Brussels, 3rd December 2009.

2008 Banking Communication, on 3 December 2008.[149] The measures were granted in the form of liquidity assistance, capital injections, loans, impaired assets relief measures, partial nationalisation and sale of 75% of Fortis Bank to the group BNP Paribas.

In the decision, the Commission describes Fortis Bank's difficulties as being the result of the subprime crisis, lack of liquidity on the interbank market, loss of confidence in the banking sector and the acquisition by Fortis of ABN AMRO. Fortis Bank found it almost impossible to borrow money. The Commission assessed the various measures first in the meaning of Article 107(1) TFEU and found that the capital injection by Belgium constitutes State aid, as the government did not act as a private investor, the aid was granted through State resources, it distorts the competition by favouring the bank and affects the trade between Member States, as Fortis Bank is active in several Member States.[150] The same conclusion was drawn regarding the loan granted by Luxembourg to Fortis.[151]

Regarding the liquidity assistance provided by the Belgian central bank, the Commission found that it did not respect the conditions set out in the 2008 Banking Communication (notably, that the bank was not solvent) and therefore that it constitutes State aid.[152]

On 5 October 2008, three transactions were concluded, including the sale of 75% of Fortis Bank to BNP Paribas. The Commission took the view that the sale was realised at market price, as no other private investor was interested, and therefore that it does not constitute State aid.[153]

As it relates to the legal basis of the assessment of the compatibility of the aid elements of the measures with the internal market, the Commission considers, based on the size of Fortis Bank and on the exceptional market circumstances, that the aid seeks to prevent the failure of the bank, which would cause a serious disturbance in the economy of Belgium and Luxembourg. To that extent, the appropriate legal basis for the analysis is Article 107(3)(b) TFEU.[154]

---

[149] Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands, Commission Decision C(2008) 8085, Restructuring aid to Fortis Bank and Fortis Bank Luxembourg.
[150] *Ibid.*, point 37.
[151] *Ibid.*, point 41.
[152] *Ibid.*, points 43 to 47.
[153] *Ibid.*, points 59, 61.
[154] *Ibid*., points 73, 76.

Lastly, the Commission assessed the compatibility of the aid measures under the 2008 Banking Communication. The Commission decided that the measures were well-targeted to restore Fortis' long-term viability, especially the sale to BNP Paribas which is financially sound.[155] The capital injections by Belgium and Luxembourg were also considered essential to stop the liquidity problems aggravated by the bank run encountered.[156] With regard to the contribution of the bank, the Commission notes that Fortis had attempted to resolve its problems through assets and subsidiaries divestment.[157] As regards distortions of competition, the Commission considers that the sale of its subsidiary made Fortis Bank significantly smaller, limiting thus the effects of the aid on competition, and that the sale of a part of the bank to a competitor is a form of compensatory measure.[158] The aid measures granted were thus considered compatible with the internal market by the Commission, as the conditions set out in the 2008 Banking Communication were fulfilled.

2) Commission decision under the 2008 Banking Communication, the Impaired Asset Communication, and the Restructuring Communication: the ING case

On 18 November 2009, the Commission approved a restructuring plan for the ING bank including an illiquid asset back-up facility granted by the Dutch State.[159] The Commission had previously authorised recapitalisation, liabilities guarantee, and impaired assets measures for the ING bank for a period of 6 months.

The Dutch authorities have then submitted a restructuring plan of five years to the Commission on 12 May 2009, subsequently amended and complemented.

ING has benefited from three aid measures from the Dutch State: capital injection, impaired assets relief, and State guarantees over liabilities. The first measure allowed the bank to increase its Core Tier 1 capital by 10 billion euros.[160] In the restructuring plan, the Netherlands have amended the repayment terms resulting in an additional advantage for ING; the State justified it by the fact that the repayment conditions are now aligned on those of other capital

[155] *Ibid.*, point 83 to 85.
[156] *Ibid.*, point 86.
[157] *Ibid.*, point 90.
[158] *Ibid.*, points 93, 95.
[159] Commission Decision of 18 November 2009 on State aid C 10/09 (ex N 138/09) implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan (OJ L 274, 19.10.2010).
[160] *Ibid.*, point 32.

injections.[161]

The impaired assets measure includes a claw back mechanism.[162] The guarantee measures are part of the restructuring plan but will be notified separately to the Commission.[163]

As regards the restructuring plan, ING commits to make a number of divestments and to simplify the group, in order to reduce the costs, as well as to reduce risk-taking investments and adhere to an acquisition ban. ING has submitted a base and a stress scenario showing its ability to return to long-term viability.

The Commission chose to open the formal investigation procedure, as it had doubts regarding the compatibility of the impaired assets measure with the Impaired Assets Communication, with regard to valuation and burden sharing.[164]

The Commission has found previously that the capital injection constitutes aid within the meaning of Article 107(1) TFEU, amounting to the sum of the recapitalisation, which is 10 billion euros. The impaired assets measure constitutes aid as well; the aid amount results from the difference between the purchase price and the market price. The Dutch guarantee scheme from which ING benefits is also State aid, as the guarantees were granted at a time where funding was hard to raise, and a private investor would not have granted such guarantees.[165]

The Commission applied Article 107(3)(b) TFEU when assessing the compatibility of the measures, accepting that ING is a systemically important bank and that its failure would have severe repercussion on the economy of the Netherlands and of other Member States.[166] As regards the compatibility of the impaired assets measure, the terms relating to valuation of the assets and to burden sharing having been modified, the Commission found it to be compatible with the Impaired Assets Communication and thus with the internal market.[167]

As it relates to the compatibility of the restructuring aid, the Commission assessed it under the Restructuring Communication to make sure that the bank is able to regain long-term viability without State support. Long-term viability entails that aid is redeemed over time or adequately

[161] *Ibid*., point 34.
[162] *Ibid.*, point 43.
[163] *Ibid*., point 47.
[164] *Ibid.,* point 93.
[165] *Ibid*., point 104.
[166] *Ibid*., point 107.
[167] *Ibid*., points 109 to 116.

remunerated.[168] The Commission considers in the present case that the restructuring plan demonstrates that ING would be viable even under stress test. The plan further illustrates that ING has learnt lessons from the crisis, by getting away from risky activities and cutting on its remuneration policy. Furthermore, the Commission notes that the plan contains an adequate burden-sharing: ING will pay an appropriate remuneration for the capital injections, and capital raising amongst shareholders.[169] The Commission notes that the amount of aid granted to ING is significant, which means that the plan should entail consisting compensatory measures.[170] The plan indeed involves behaviour measures to address distortions of competition, such as reduction of the balance sheet, and several divestments that will reduce the presence of the bank on the market.

The Commission thus concludes that the impaired assets measure and the restructuring aid are compatible with the internal market, pursuant to Article 107(3)(b) TFEU.

4.2.4. Analysis

The Communications of the Crisis Framework were all adopted on the basis of Article 107(3)(b) TFEU, showing that the Commission recognised the severity of the crisis in comparison to cases dealt under the R&R Guidelines prior to October 2008.
The four first communications distinguish between 'fundamentally sound' and 'distressed' credit institutions. The Commission highlights that fundamentally sound banks suffer only from liquidity issues stemming from the financial crisis, whereas distressed banks are non-viable and unable to regain long-term viability, because of risky business strategies or inefficient business model.[171] The 2008 Banking Communication provides for different requirements for State aid approval depending on the viability of the ban; fundamentally sound bank have easier access to aid, presenting a lower risk profile.

The five communications point out that the criteria for granting State aid should be transparent and non-discriminatory. They emphasise the fact that aid must be limited to the amount

[168] *Ibid.*, point 121.
[169] *Ibid.*, points 133, 136.
[170] *Ibid.*, point 142.
[171] Franz Jürgen Säcker, Frank Montag, *European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016), p. 1309.

necessary to safeguard financial stability and bring liquidity to the real economy while minimising costs to taxpayers. They also always point out to the fact that State aid is competition distortive by nature and lead to moral hazard. Against that background, the Crisis Framework contains requirements for compensatory measures. The importance of the compensatory measures depends on the size of the potential distortion effects that the aid could have; in general, the size of the institution, its capital shortfalls and the amount of aid granted are the criteria used to assess the potential negative effects that an aid measure could have. The compensatory measures take different forms, such as behavioural constraints (prohibition of aggressive commercial practices, reduction of the bank's balance sheets, focus on core assets, assets divestment) and ensuring adequate State remuneration of the aid. The behavioural constraints have the effect of restricting competition among banks on the market by limiting the bank's ability to lend.

As regards burden-sharing, the four first communications preconize adequate own contribution 'the bank should contribute as much as possible,' but do not contain any fixed input as it was the case in the R&R Guidelines, which provides that the contribution should amount to 50% of the restructuring costs. The four first communications do not contain any obligation for the creditors to participate to the costs, as was then provided for in the 2013 Banking Communication; the objective at the beginning of the crisis was to restore confidence in the banking sector, so lending funding to the real economy would continue. Bailing-in deposits at the start of the crisis would probably have undermined even more confidence in the banking system. The 2013 Banking Communication points out that application of burden-sharing decreases the need for compensatory measures, as burden-sharing diminishes moral hazard.

The 2008 Banking Communication and the Restructuring Communication state that a restructuring or liquidation plan must be presented for distressed banks as the counterpart of government support, to make sure no banks are artificially kept alive. The measures or general scheme should be reviewed every six months at least, to ensure that application of Article 107(3)(b) TFEU is still necessary to remedy a serious disturbance in the economy. The 2013 Banking Communication obliges the State to present a restructuring plan or viability review of the bank before any grant of State aid in the form of recapitalisation or impaired assets measures, regardless of the solvency state of the bank, except if the aid measures are absolutely necessary to safeguard the financial stability.

The Communications were designed so as to ensure transparency of the criteria and allow for swift action to be taken; their annexes contain a methodology for the Member States to follow for when they notify a scheme or individual measure to the Commission, notably in the Restructuring Communication. The Member States know precisely with which criteria the aid should comply, and that allowed the Commission to approve the State measures presented in very limited periods of time.

The coordinated approach to State aid during the crisis had the aim to limit spillover effects stemming from the failure of cross-border banks, as well as ensuring consistency to protect the single market in financial services. The Crisis Framework was only applied to financial institutions, to remedy the exceptional circumstances on the market during the crisis. The 2013 Banking Communication was adopted in the course of the transition from the Crisis Framework to the creation of the Banking Union.

4.3. Summary

The 2008 financial crisis has reshaped the banking sector, that was forced to adapt to the lack of liquidity caused by a loss of confidence in the system and the reluctance of banks to lend.
Member States were compelled to take actions, to grant restructuring aid to distressed banks, but also to provide liquidity to fundamentally sound banks.
State aid measures are taken at national level but coordinated at EU level. The Commission has been quite flexible when enacting the Crisis Framework and assessing the State measures by, i.e., not providing for any contribution threshold, or not requiring that a Member State should present a restructuring or viability plan before granting restructuring aid; the aim was at first to preserve the immediate financial stability rather the long-term sustainability of the banks. The 2013 Banking Communication strengthens and coordinates burden-sharing across the EU and states that before granting aid in the form of recapitalisation or impaired assets measures (measures that have large distortion potential effects), the Member State shall present a restructuring plan for the recipient bank.

The main phases of State aid control in the Banking Sector during the Financial Crisis have thus been:
-the period prior October 2008, when all the cases were dealt with under Article 107(3)(c) TFEU and the R&R Guidelines;

-the period from October 2008 to February 2009, when the Commission recognised the risk of serious disturbance that could arise from the failure of a systemically important and applied Article 107(3)(b) TFEU to approve ad hoc individual measures and general schemes;
-the period from February 2009 to July 2009 in which the Commission started to assess restructuring plans for a significant number of aid recipient banks and to place importance on the long-term viability of the banks;
-the period from July 2009 to December 2009, when the Commission started to apply its new Financial Crisis Restructuring Communication, which increased the restructuring obligations on aid recipient banks;
-the application as of 2013 of the new Banking Communication, as a transition to the new State aid rules of the Banking Union, and the emphasis on burden-sharing by shareholders and subordinated creditors.

5. The effects of State aid control applied during the financial crisis

5.1. The effects of the crisis on sovereign debt

Between October 2008 and 31 December 2012, Member States have granted 591.9 billion euros of capital support (recapitalisation and asset relief measures) to the financial sector.[172] The measures reached a peak in 2009, before decreasing progressively. 22 Member States have provided aid to their financial sector.[173] The State aid used to rescue the banking sector amounted to 10% of EU GDP.[174] The crisis has had a significant impact on gross public debt in the EU. The average increase in gross debt for the EU has been 23 % of GDP in the period 2008- 2010. Public debt resulted from State interventions.[175] Greece and Ireland have granted

[172] Press release ‘State aid: Commission's new on-line state aid benchmarking tool shows less aid to banks’ Brussels, 20 December 2013.
[173] Competition State aid brief, Occasional papers by the Competition Directorate–General of the European Commission ’State aid to European banks: returning to viability’, February 2015, available at http://ec.europa.eu/competition/publications/csb/csb2015_001_en.pdf
[174] Commission Staff Working Paper ‘The effects of temporary State aid rules adopted in the context of the financial and economic crisis’, October 2011, p. 6.
[175] Common Market Law Review 47 :313-318, Kluwer Law International [2010] p. 318.

the equivalent of more than 8% of the total assets of their national credit institutions in aid.[176] By the end of 2008, some countries were already in recession. The EU GDP growth dropped to -5% in 2009.[177] The financial crisis led to a sovereign debt crisis affecting Greece, Ireland, Portugal, and Cyprus.

5.2. The effects of the Crisis Framework

The crisis has been contained to some extent by massive government action. Measures taken by the authorities have allowed the banking sector to return to its regular activity in 2010 and avoided a systemic collapse of the system. Granting liquidity measures in a controlled manner prevented bank runs, and at the same time, financial stability was preserved from the risk of credit crunch.

The risk of default of systemically important financial institutions has been circumvented, and lending to the real economy has resumed. State aid control has been used as a de facto resolution authority, in the absence of a common resolution authority. The legal framework put in place by the Commission allowed it to clear emergency State aid measures in a consistent way and accelerated the decision-making process while ensuring legal certainty. Consequently, in most cases, the Commission did not raise objections. The Commission adopted a negative decision in one single case and ordered recovery of the aid.[178] Commission's swift action to create the Crisis Framework allowed for the State aid rules enshrined in the Treaties to be applied. As of 2010, the Commission started to strengthen the conditions to grant aid, as the market conditions improved. The Crisis Communications as applied in the case law ensured that aid was not granted for free, as the aid schemes or individual measures had to entail adequate remuneration of the State or redemption of the capital by clawback mechanism, and that negative effects on competition were limited, by imposing compensatory measures. Moral hazard was fought by imposing measures regarding governance of the credit institutions, i.e., measures concerning the remuneration or change of the management.

[176] Commission Staff Working Paper 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis', October 2011, p. 11.
[177] *Ibid.*, p. 19.
[178] Case C33/2009, Restructuring of Banco Privado Português (OJ L 159, 17.6.2011).

In most Member States, the aid measures were concentrated only on a few institutions, the 'too big to fail' ones, which are more likely to create negative spillover effects but also to have a negative impact on competition. State aid control could not suffice to eradicate distortions of competition totally.[179] The most efficient tool to minimise them was the imposition of high requirements for restructuring plans. Non-aided banks even seem to have performed better during 2008-2010 than aided banks, in terms of profitability and asset growth.[180] Commission reports show nonetheless that the restructuring plans approved by the Commission have helped to save many banks.[181] A bank was deemed viable was it was able to redeem the aid received.

As a reaction to the crisis, the EU has launched a reform of the supervision and regulation mechanisms in the banking sector, giving rise to the Banking Union.

6. Preservation of the systemic financial stability post-crisis

6.1. Main issues to address

The management of the crisis was hampered by an incomplete institutional euro area and by the lack of an integrated banking system. The crisis has led to a fragmentation of the financial sector. The Banking Union was necessary to complete the European Monetary Union. The Banking Union encompasses automatically the interdependent Euro area countries sharing a common currency, but is open to other nations of the EU willing to participate.

The objective of the Banking Union is to break the vicious circle between bank debts and sovereign debts, through the shift from bail-out to bail-in. Burden-sharing in a bank failure aims at preventing moral hazard. The Banking Union aims at restoring consumer confidence in the banking sector and protecting taxpayers. The rules led down must be rigorously implemented

[179] *Ibid.*, p. 12.
[180] *Ibid.*, p. 14.
[181] Competition State aid brief, Occasional papers by the Competition Directorate–General of the European Commission 'State aid to European banks: returning to viability', February 2015, available at http://ec.europa.eu/competition/publications/csb/csb2015_001_en.pdf

to keep the balance.[182] Banks must adjust to more demanding regulatory and supervisory standards, with increased capital and liquidity requirements.[183]

The previous banking legislation was based on Directives, leaving some autonomy to the Member States as for how to implement them. This left autonomy has led to disparities between the national banking systems, for instance as it regards the resolution of failing credit institutions. The divergence between the national resolution procedures was a source of conflict when it came to resolution of transnational entities. Cross-border banks cannot be resolved properly if there is no harmonised legislation governing their liquidation.

6.2. Creation of the Banking Union: from bail-out to bail-in

6.2.1. The new framework

The Banking Union is based on a single rulebook for all financial actors in the EU, with the aim to foster the integration of the Euro area banking system. The Banking Union consists of three pillars: The Single Supervisory Mechanism (SSM'), the Single Resolution Mechanism ('SRM') and the common European Deposit Insurance Scheme ('EDIS').
The framework aims at preventing financial crisis in the first place, and organise the orderly winding-up of credit institutions in difficulty in the second place, without having to rely on taxpayers' money and ensuring that depositors are protected.

6.2.1.1. The Single Rulebook

The purpose of the Single Rulebook is to ensure a consistent application of the banking legislation throughout the Euro zone. The legislative framework comprises the Capital

[182] Speech by Johannes Laitenberger 'From bail out to bail in: laying foundations for a restructured banking sector in Europe' Banking Union and Competition, Universidade Católica Portuguesa, Lisbon, 25 February 2016.
[183] Speech by Gert Jan Koopman, Deputy Director-General, DG Competition, European Commission 'Market based solutions to bank restructuring and the role of State Aid Control: the case of non-performing loans (NPLs)', ECMI Annual Conference, Brussels, 9 November 2016, p. 2.

Requirements Directive 'CRD IV',[184] read in conjunction with the Capital Requirements Regulation 'CRR',[185] the Bank Recovery and Resolution Directive 'BRRD'[186], and the Deposit Guarantee Schemes Directive 'DGSD.'[187]

(1) The CRD IV/CRR package sets in place prudential requirements to which credit institutions are subject, such as the obligation to have a buffer capital for all credit institutions of the Euro area.[188]
(2) The BRRD organises the resolution of distressed credit institutions, based on the bail-in principle and early interventions.[189] Before the adoption of the BRRD, there were no specific harmonised resolution rules at EU level for credit institutions; failure of banks was dealt under national insolvency procedures, as applied to other insolvent undertakings.[190] Normal insolvency proceedings are not always the most appropriate manner to deal with a bank failure, as they do not operate swiftly, and may not ensure the continuation of the bank's critical function nor preserve the financial stability of the EU. The BRRD should apply to credit institutions subject to the prudential requirements laid down in the CRD IV/CRR.[191] The BRRD specifies that a resolution scheme should be proportionate to the systemic importance of the credit institution.[192]
(3) The DGSD harmonises the laws of the Member States regarding the rules on deposit guarantee schemes ('DGSs') to which the credit institutions are subject, increasing the stability of the banking system and the protection of depositors.[193] The Member States shall ensure that at least one DGS is introduced on their territory.[194] A credit institution

[184] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.
[185] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.
[186] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament.
[187] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.
[188] CRD IV, Recital (43).
[189] BRRD, Recitals (31), (40) and (45).
[190] *Ibid.*, Recital (4).
[191] *Ibid.*, Recital (11).
[192] *Ibid.*, Recitals (25), (80) and Article 130.
[193] DGSD, Recital (3).
[194] *Ibid.*, Article 4(1).

shall not take deposits if it is not a member of a DGS.[195] The DGSD provides for a uniform level deposit safeguard of up to 100.000 euros per depositor, should the bail-in tool be applied to a failing credit institution.[196] The DGSs are financed through *ex ante* funding from banks amounting to 0,8% of their covered deposits.[197]

6.2.1.2. The Single Supervisory Mechanism

The Single Supervisory Mechanism was created by the SSM Regulation, adopted on the basis of Article 127(6) TFEU.[198] The ECB is now supervising all the banks of the Eurozone as well as banks in other participating countries, together with the national competent authorities of the Euro zone. The ECB will directly supervise credit institutions of significant importance, being banks having assets of more than 30 billion euros, or constituting at least 20% of their country's GDP.[199] The national competent authorities will supervise less significant institutions, but the ECB can decide at any time to place of one these institutions under its direct supervision.[200]

Supervisory tasks include for instance the grant or withdrawal of authorisation to the credit institutions and ensuring that credit institutions have in place robust governance arrangements.[201] The SSM Regulation points out that the ECB should carry out its tasks in compliance with Commission decisions in the area of State aid.[202]

An assessment of the Eurozone banks' balance sheets has been carried out to ensure that the institutions entering the SSM are viable.[203]

[195] *Ibid.*, Article 4(3).
[196] *Ibid.*, Article 6(1).
[197] *Ibid.*, Article 10(2).
[198] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013).
[199] SSM Regulation, Article 6(4).
[200] *Ibid.*, Article 6(4) 'The ECB may also, on its own initiative, consider an institution to be of significant relevance (…)'.
[201] *Ibid.*, Article 14; Article 4(1)(e).
[202] *Ibid.*, Recital (32).
[203] *Ibid.*, Article 33(4); SRM regulation, Recital (13).

6.2.1.3. The Single Resolution Mechanism and the Single Resolution Fund

The Single Resolution Mechanism is based on the SRM Regulation, adopted on the basis of Article 114 TFEU.[204] The SRM Regulation lays down the principle that effective resolution mechanisms are necessary tools to avoid damages to the public interest and the financial stability that have occurred because of failures of banks in the past.[205] The SRM Regulation covers all banks participating in the SSM.[206]

A new agency, the Single Resolution Board ('SRB') has been created, whose role is to resolve failing banks in an orderly manner by an early intervention. The SRB and the national resolution authorities are thus entrusted with a central power of resolution. The SRM Regulation now provides for clear rules regarding the resolution of cross-border entities, essential for the completion of the internal market for financial services. Ensuring effective and uniform resolution rules is essential to prevent negative systemic impacts of bank crisis on the financial stability of the EU.[207] When making decisions, the SRB is to take into consideration possible adverse effects on participating and non-participating Member States, such as threats to the financial stability.[208]

The decision-making process and the adoption of resolution schemes involve the ECB, the Commission and the Council, as regards the discretionary aspects of the scheme, and is designed to permit swift action compared to regular insolvency proceedings, as the scheme can be adopted by the SRB within 24 hours if it does not raise any concern from the part of the Commission.[209] The decision to put an entity under resolution should be taken before it is balance sheet insolvent, after it has been determined that the entity is failing or likely to fail and that no private sector measure would be able to prevent the failure.[210] An entity is deemed to be failing or likely to fail notably when it is unable to pay its debts when they fall due, or when

---

[204] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014)

[205] *Ibid.*, Recital (8).

[206] *Ibid.*, Recital (15).

[207] SRM Regulation, Recital (12).

[208] *Ibid.*, Recital (55).

[209] *Ibid.*, Recitals (24) and (26); Article 18(7).

[210] *Ibid.*, Recital (57).

the entity requires recourse to exceptional public financial support, except in some circumstances. Exceptional public financial support means State aid within the meaning of Article 107(1).[211] The need for ELA is not *per se* a demonstration that the entity is failing. If the ELA provided by a national central bank is guaranteed by a State, its provision is subject to State aid rules, but does not necessarily trigger the resolution of the recipient bank, if certain conditions are met. ELA is used in the event of a systemic liquidity shortage, to preserve the financial stability; it should be limited in time, it should be approved under State aid rules and should not be part of a larger aid package. The Member State should also ensure that the guarantee is sufficiently remunerated by the recipient credit institution.

The winding-up of a credit institution should be considered under normal liquidation proceedings before applying resolution tools to it.[212] The choice between the two procedures depends on their effects on creditors and the financial stability; the shareholders should not suffer greater losses under a resolution scheme than what they would have suffered under normal liquidation proceedings (the 'no creditor worse off' principle).[213] An ex-post comparison is possible.[214] The objectives of the resolution procedure are to ensure continuity of essential financial services, to maintain the financial stability and to protect the depositors.[215]

A resolution scheme should ensure that shareholders and subordinated creditors bear a proportionate bear of losses, to reduce moral hazard by giving the incentive to the board to manage the credit institution in a sound and reasonable way in order to avoid exit strategies from the shareholders, knowing that they will no longer be bailed-out by the State. The SRM Regulation provides thus for use of the bail-in tool, provided that it abides by the right to property enshrined in Article 17 of the Charter of Fundamental Rights, in compliance with its Article 52.[216] Bail-in tool means the mechanism for effecting the exercise of the write-down and conversion powers in relation to liabilities of an institution under resolution.[217] Deposits under 100,000 euros are covered and should not be used in a bail-in mechanism. The Court, in

[211] *Ibid.*, Article 3(1)(29).
[212] *Ibid.*, Recital (59).
[213] 2013 Banking Communication, point 46.
[214] SRM Regulation, Recital (63).
[215] *Ibid.*, Recital (58).
[216] Charter of Fundamental Rights of the European Union (2000/C 364/01), Articles 17 and 52.
[217] SRM Regulation, Article 3(1)(33), Articles 21 and 27.

its case *Kotnik*, has ruled that the bail-in tool does not constitute an intolerable interference to the right to property.[218]

The Single Resolution Fund ('SRF') is financed by contributions of all banks in the EU. Contributions to the Fund should take account of the degree of risk presented by the institution. Its purpose is to break the link between bank debt and sovereign debt.[219] The Fund should only be used after the resources from shareholders and creditors are exhausted.[220]

6.2.1.4. The European Deposit Insurance Scheme

The European Deposit Insurance Scheme is the third pillar of the Banking Union and is based on a proposal of the Commission of 24 November 2015. The proposed regulation will establish a common EDIS, which would as of 2024 fully insure national DGSs. The DGSD harmonised the rules governing the national DGSs, but did not create a DGS at EU level. The EDIS will progressively ensure that national DGSs do no longer rely on Member State financial support.

There's a difference of scope between the EDIS and the SSM/SRM. The EDIS will cover a wider scope, mirroring the scope of the DGSD; the EDIS proposal applies to all entities affiliated to a DGS. Certain entities covered by the DGSs are not supervised or regulated by the SSM or SRM.[221]

The aim of having a wider scope could be to protect all depositors against negative consequences of insolvency proceedings, not only depositors of credit institutions regulated by the SSM/SRM.

[218] Case C-526/14, *Kotnik and Others* [2016] EU:C:2016:570, paras 78-80.
[219] SRM Regulation, Recital (19).
[220] *Ibid.*, Recital (101).
[221] DSGD, Recital 10 'This Directive should not prevent Member States from including within its scope credit institutions as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council which fall outside the scope of Directive 2013/36/EU of the European Parliament and of the Council pursuant to Article 2(5) of that Directive (…).'

6.2.2. The Banking Union and State aid control

State aid control remains a central element of the Banking Union, as the State aid rules continue to apply during resolution proceedings, to ensure a level playing field.

Article 19(1) of the SRM Regulation states that when a resolution scheme involves the use of State aid, the Commission must first assess its compatibility with the internal market, instead of simply endorsing the resolution scheme by not objecting to it within 24 hours as provided for in Article 18(7) of the SRM Regulation.[222] If the resolution scheme entails a State aid measure, the Board should invite the Member State concerned to notify the scheme to the Commission under Article 108(3) TFEU. In the same way, if the resolution scheme includes use of the SRF, the Board shall notify it to the Commission.[223] The Commission will assess whether use of the Fund distorts competition or not. The involvement of the Commission in the resolution process means that the SRB and the Commission should work closely together and exchange all information necessary.

Under the BRRD, any State aid support implies that an institution is failing or likely to fail.[224] When State aid is provided, it should lead to resolution of the bank. It is the responsibility of the supervising body or resolution authority to ensure that a resolution scheme is applied to the recipient bank, not of the Commission. The Commission only assesses whether the intended measure complies with the State aid rules.

There are three exceptions to the principle that provision of State aid to a credit institution should trigger its resolution, according to Article 18(4)(d):
(1) State guarantee to ELA;
(2) State guarantee of newly issued liabilities;
(3) Precautionary recapitalisation, which can only be used to cover capital shortfalls arising under a scenario of stress test.
In these cases, only State aid rules apply, and the entity will not automatically be considered as failing or likely to fail.

---

[222] BRRD, Article 37(10)(b).
[223] SRM Regulation, Article 19(3).
[224] BRRD, Article 32(4)(d).

As regards DGSs, Article 7(3)(e) of the SRM Regulation provides that compensation payments to creditors are not State aid; but contribution to resolution by a DGS as provided for in Article 11(3) of the DGSD must be assessed under the State aid framework, according to Article 19 SRM.[225]

State aid control is a key element for successfully achieving the change from bail-out to bail-in in the Banking Union. Any kind of public financial support to credit institutions, including the use of deposit guarantee schemes or funds of the SRF, is subject to State aid control.[226]

6.3. Summary

The Banking Union completes the European Monetary Union and the single market in financial services. The Banking Union is comprised of a Single Supervisory Mechanism, a Single Resolution Mechanism, and a European Deposit Insurance Scheme, the latter being progressively introduced.

In the Banking Union, supervisory and resolution rules are now harmonised and enforced at EU level. Credit institutions are now supervised by the European Central Bank and the European System of Central Banks, while a new body has been designed to adopt resolution schemes, the Single Resolution Board. State aid rules remain applicable during the resolution process; any use of State aid or resolution funds should only be granted after shareholders and subordinated creditors have contributed to the losses through the bail-in tool. The aim of the bail-in tool is to reduce moral hazard; mathematically, when a bank is failing someone has to cover the losses, and if the bail-out mechanism is no longer an option, the board will be less likely to adopt risky behaviours and risk-taking business models. The switch from bail-out to bail-in has the purpose to break the vicious circle between bank debt and sovereign debt. As a consequence, the credibility of a bank will no longer depend on its location, but on its risk profile.[227] The Banking Union also provides for harmonised deposit coverage; deposits under 100.000 euros shall be guaranteed by a deposit guarantee scheme, currently set up at national level, but soon covered by a common deposit insurance scheme.

---

[225] See also 2013 Banking Communication, point 63.

[226] Speech by Johannes Laitenberger, Director-General of DG Competition 'From bail out to bail in: laying foundations for a restructured banking sector in Europe' Banking Union and Competition, Universidade Católica Portuguesa, Lisbon 25 February 2016.

[227] *Ibid.*

7. Conclusion

All sectors of the economy have been hit by the financial and economic crisis, but the financial sector has been harmed in a particular way. In other fields of the economy, the failure of an economic actor is likely to favour competition, by liberating market shares for its competitors. In the banking sector, the failure of one bank, especially an important one, is a negative externality for others and can trigger a negative collapse spiral if its failure is not controlled.

That is why the Member States invested so much aid in their banking systems during the crisis; the aim was not only to save one bank, and to protect the employees and depositors (which would have been done under Article 107(3)(c) TFEU), but to save the system. The banks saved were considered 'too big to fail,' because of their systemic importance and their interconnectedness. Against that background, Article 107(3)(b) TFEU was used to remedy to the serious disturbance their failure would cause in the economy of the EU.

State aid was also used to inject liquidity into the market, as banks became reluctant to lend to each other.

The State aid principles as enshrined in the Treaties were respected during the whole time of the crisis. State aid should not overly distort competition nor have an impact on trade between Member States. If such effects were likely to arise, because of the volume of aid granted or the size of the bank, aid was only provided at the price of compensatory measures. The Crisis Framework was enacted in respect of these principles. Only the scope has been extended: the restructuring plans were approved for five years instead of two or three, and restructuring aid was granted for more than six months, in some cases, at the condition that the Member State would provide reports to the Commission.

State aid control is thus a handy tool to preserve the financial stability of the EU and at the same time maintaining a level playing field amongst aided and non-aided banks. The Commission managed to produce a temporary framework in a very short lap of time. At first, the Commission relaxed some requirements, such as the threshold for own contribution to the costs of the bank, but starting from the Restructuring Communication burden sharing was enforced.

As the financial crisis and the forced bail-out of several non-viable banks have been costly for EU's taxpayers, the EU institutions have decided to foster the Economic and Monetary Union integration by creating the Banking Union. As the Banking Union creates a new body in charge of resolving failing banks, the resolution will now be applied in consistently. If the Banking Union had been in place at the times of the crisis, the cost on taxpayers would maybe have been lowered thanks to the bail-in tool. But there is a chance that the bail-in tool would have damaged confidence in the banking sector, with the depositors fearing to lose their deposits. The bail-in tool was established as the rampart against moral hazard, but not all banks that needed State aid were necessarily having risk-taking behaviours or risky business models.

In conclusion, we can note that the Commission did what it could to control State aid with the tools available during the crisis, and made sure that in all cases compensatory measures were applied, as well as an appropriate remuneration for the aid. The Commission made sure no banks were artificially kept on the market, by asking for viability review when aid was granted without restructuring plan. Decisions were adopted within a concise period, which did not prevent the Commission from presenting detailed economic based assessments of the measures and their effects on competition. This necessity for swift action is emphasised in the SRM Regulation, which provides that decisions of the SRB to put a bank into resolution should be adopted within 24 hours. State aid control has been a useful tool, but the crisis has shown that an effective permanent banking sector regulation was needed, establishing a temporary crisis framework during each financial crisis is not a valid option. A regulatory framework and State aid control are interconnected, as an efficient supervisory mechanism, as well as early intervention measures, should usually allow detecting problems at a sufficiently early stage to prevent future recourse to taxpayers' money.

As it relates to the next challenges, the future Brexit, and its unpredictable outcome could be one of them, with the uncertainty regarding resolution of cross-border UK banks and State aid regulation, even if the UK is not a member of the Eurozone and chose not to opt into the SSM.

Bibliography

Legislation

Primary Law

Treaty constituting the European Coal and Steel Community, 1951.

Treaty establishing the European Economic Community, 1957.

Treaty on the European Union (2012/C 326/01).

Treaty on the Functioning of the European Union (2012/C 326/01).

Protocol (No 4) on the Statute of the European System of Central Banks and of the European Central Bank (C 326/230, 26.10.2012).

Charter of Fundamental Rights of the European Union (2000/C 364/01).

Regulations

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013).

Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid (OJ L 352, 24.12.2013), Article 3(2).

Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187/1, 26.6.2014).

Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014).

Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 248, 24.9.2015).

Directives

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014).

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

European Commission Guidelines

Communication from the Commission - Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004).

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 financial crisis, O.J 2008, C 270/08.

Communication from the Commission – The recapitalization of financial institution in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, O.J. 2009, C 10/2.

Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector, O.J. 2009, C 72/1.

Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, O.J. 2009, C 195/5.

Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') (2013/C 216/01).

Communication COM (2013) 614/3 from the Commission to the Council and the European Parliament 'Shadow Banking – Addressing New Sources of Risk in the Financial Sector'.

Communication from the Commission – Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (OJ 2014 C 249/1).

Guidelines on State aid for environmental protection and energy 2014-2020, 2014/C 200/0.

Books

Christian Ahlborn and Daniel Piccinin, *Chapter 7: The Great Recession and other mishaps: The Commission's policy of restructuring aid in a time of crisis,* in Research Handbook on European State Aid Law (edited by Erika Szyszczak, Edward Edgar Publishing, 2011).

Kelyn Bacon QC, *European Union Law of State Aid*, Third Edition (OUP, 2017).

Hans W. Friederiszick, Lars-Hendrik Röller, and Vincent Verouden, *European State Aid Control: An Economic Framework (*ed. Handbook of Antitrust Economics. Cambridge, MA, USA: MIT Press, 2008)

John Kenneth Galbraith, The Great Crash 1929 (Houghton Mifflin Harcourt Publishing Company, 1955).

Doris Hildebrand, *The Role of Economic Analysis in EU Competition Law (*Kluwer Law International, 2016).

Piernas Lòpez, *The concept of State aid under EU Law* (OUP, 2015).

Franz Jürgen Säcker, Frank Montag*, European State Aid Law: a Commentary* (C.H.Beck-Hart-Nomos, 2016).

Articles and publications

The Brussels report on the General Common Market ('Spaak report'), 21 April 1956

Ben S. Bernanke 'Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression' in The American Economic Review, Vol. 73, No. 3 (Jun., 1983).

Rossella Delfino 'Credit Institutions and State Aids in EC Law', 2004.

Speech/05/440 by Neelie Kroes, European Commissionner for Competition, 'The State Aid Action Plan – Delivering Less and Better Targeted Aid', London, 14th of July 2005, available at http://europa.eu/rapid/press-release_SPEECH-05-440_en.htm?locale=en

Council Conclusions - Ecofin Council of 7 October 2008 'Immediate responses to financial turmoil', press release available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/misc/103202.pdf

Speech by Neelie Kroes, 'Antitrust and State Aid Control – The lessons learned', 36th Annual Conference on International Antitrust Law and Policy, Fordham University, New York, 24 September 2009.

Philip Lowe 'State aid policy in the context of the financial crisis' Competition policy newsletter n°2, 2009, available at
http://ec.europa.eu/competition/publications/cpn/2009_2_1.pdf

Press release 'State aid: Commission clears state aid to rescue and restructure Fortis Bank and Fortis Bank Luxemburg' Brussels, 3rd December 2009.

Common Market Law Review 47 :313-318, Kluwer Law International [2010].

Anu Arora, 'The 2007-2009 Banking Crisis and the EU's regulatory response', 2010.

State aid Crisis rules for the financial sector and the real economy, Study from the Directorate General for internal policies, June 2011, available at
http://www.europarl.europa.eu/document/activities/cont/201107/20110714ATT24010/20110714ATT24010EN.pdf

Recommendations of the Financial Stability Board 'Shadow Banking: Strengthening Oversight and Regulation', 27 October 2011.

Commission Staff Working Paper 'The effects of temporary State aid rules adopted in the context of the financial and economic crisis', October 2011,.

Press release 'State aid: Commission's new on-line state aid benchmarking tool shows less aid to banks' Brussels, 20 December 2013.

Tobias Adrian, Federal Reserve Bank of New York Staff Report No. 664 'Financial Stability Policies for Shadow Banking', February 2014.

Press release from the European Commission 'State aid: Commission exempts more aid measures from prior notification' Brussels, 21 May 2014.

EBA Report to the European Commission on the perimeter of credit institutions established in the Member States, 27 November 2014.

Competition State aid brief, Occasional papers by the Competition Directorate–General of the European Commission 'State aid to European banks: returning to viability', February 2015, available at http://ec.europa.eu/competition/publications/csb/csb2015_001_en.pdf

Speech by Peter Praet, member of the Executive Board of the ECB, at the Committee on Capital Markets Regulation conference on The lender of last resort – an international perspective, 'The ECB and its role as lender of last resort during the crisis' Washington DC, 10 February 2016, available at https://www.ecb.europa.eu/press/key/date/2016/html/sp160210.en.html

Speech by Johannes Laitenberger, Director-General of DG Competition 'From bail out to bail in: laying foundations for a restructured banking sector in Europe' Banking Union and Competition, Universidade Católica Portuguesa, Lisbon 25 February 2016.

Speech by Gert Jan Koopman, Deputy Director-General, DG Competition, European Commission 'Market based solutions to bank restructuring and the role of State Aid Control: the case of non-performing loans (NPLs)', ECMI Annual Conference, Brussels, 9 November 2016, available at http://ec.europa.eu/competition/speeches/text/sp2016_09_en.pdf

European Commission Memo/12/1018 'State aid: Overview of decisions and on-going in-depth investigations of Financial Institutions in Difficulty' Brussels, 31 December 2016.
Annual report of the Court of Justice of the European Union, Judicial Activity 2016, available at https://curia.europa.eu/jcms/upload/docs/application/pdf/2017-03/ra_jur_2016_en_web.pdf

Financial Stability Review, document by the ECB, May 2017, available at
https://www.ecb.europa.eu/pub/fsr/html/index.en.html

Table of Cases

Court of Justice

Case 25/62, *Plaumann v Commission* [1963] EU:C:1963:17

Case C-102/87, *France v Commission of the European Communities* [1988] ECR I-4067

Opinion of AG Jacobs in case C-39/94, *SFEI* [1995] ECR I-03547

Case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten* [2001] ECR I-8365

Joined Cases C-57/00 P and C-61/00 P, *Freistaat Sachsen and Others v Commission* [2003] ECR I-09975

Case C-526/14, *Kotnik and Others* [2016] EU:C:2016:570

General Court

Case T-288/97, *Regione autonoma Friuli-Venezia Giulia v Commission* [2001] ECR II-01169

Case T-287/11, *Heitkamp BauHolding* v *Commission* [2016] EU:T:2016:60

Case T-620/11, *GFKL Financial Services* v *Commission* [2016] EU:T:2016:59

Case T-103/14, *Frucona Košice* v *Commission* [2016] EU:T:2016:152

Case T-47/15, *Germany* v *Commission* [2016] EU:T:2016:281

Commission

Commission Decision of 5 December 2007 on State aid NN 70/2007 (ex CP 269/07) – United Kingdom Rescue aid to Northern Rock, C 14/2008 (OJ C 135/21).

Commission Decision of 4 June 2008 on State aid C 9/08 (ex NN 8/08, CP 244/07) implemented by Germany for Sachsen LB (notified under document number C(2008) 2269), 2009/341/EC (OJ L 104/34).

Case NN42/2008 - Belgium, NN46/2008 - Luxembourg, NN/A/2008 – Netherlands, Commission Decision C(2008) 8085, Restructuring aid to Fortis Bank and Fortis Bank Luxembourg.

Commission Decision of 18 November 2009 on State Aid C 10/09 (ex N 138/09) implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan (OJ L 274, 19.10.2010).

Case C33/2009, Restructuring of Banco Privado Português (OJ L 159, 17.6.2011).