

State aid to Banks during the Financial Crisis: Procedure, Substantive Issues, Litigation and the Passage to the Banking Union

Leo FLYNN¹

Pre-notification phase of informal contacts

As a general background to pre-notification contacts, see the Code of Best Practice for the conduct of State aid control procedures, OJ C 136, 16.6.2009, p. 13, points 10 to 17

For an example of pre-notification contacts, see recital 1 of Commission Decision C(2009)9165 final of 20 November 2009, State aid N 349/2009 – Ireland, Credit Institutions Eligible Liabilities Guarantee Scheme

- (1) *Following several preliminary exchanges, on 12 June 2009, Ireland submitted a notification on a revised guarantee scheme, the Credit Institutions Eligible Liabilities Guarantee (the "ELS Scheme"). The proposed scheme amends the existing guarantee scheme (the "CIFS Scheme") which was approved on 13 October 2008. Following contacts with the Irish authorities, the Commission asked for further information on 3 August 2009, to which Ireland replied on 28 September, 20 October and 10 November 2009.*

Pre-notification is strongly encouraged in the 2013 Banking Communication, point 32, second sentence, as regards capital support measures

On the pitfalls of not engaging in pre-notification contacts, see recitals 1 to 3 of Commission Decision C(2008)6059 final of 13 October 2008, State aid NN 48/2008 – Ireland, Guarantee scheme for banks in Ireland, OJ C 312, 06.12.2008.

- (1) *On the 30th September 2008, the Irish Minister for Finance announced a government decision to guarantee all deposits and debts of six Irish banks and their subsidiaries located abroad.*
- (2) *The same day, the Commission sent a letter to the Irish authorities asking further information about this measure, followed on the 1st October by a list of questions concerning the precise features of the guarantee.*

¹ Legal Adviser, Legal Service, European Commission. All views expressed are personal and do not represent the position of the Commission.

(3) *The Irish authorities replied to the Commission on the 2nd October. On the 3rd October they formally notified the scheme. Further information on the precise features of the guarantee was sent to the Commission between the 8th and 12th October.*

The fact that pre-notification contacts have taken place cannot be used by interested parties as a basis on which to claim that the Commission should have opened a formal investigation procedure: see Case C-287/12 P *Ryanair v Commission* EU:C:2013:395, paragraph 71.

Preparation and drafting of individual measures and schemes

Recapitalisation of individual financial institutions for restructuring

- Addressing capital shortfall – 2013 Banking Communication, points 32 to 34
- Remuneration arrangements depend on the form in which capital is injected
 - Ordinary equity

Starting point is current market rates (point 21 of the Recapitalisation Communication)
A compatible pricing methodology is set out at points 26-30 of the Recapitalisation Communication.

The 2011 Prolongation Communication deals with the pricing of shares, and requires the Member State to take account of the theoretical ex-rights price ("TERP") and any absence of voting rights (points 7 to 12).

- Hybrid instruments

Note the role of Basel III and the CRD IV

Need for an alternative coupon satisfaction mechanism ("ACSM") (point 13 of the 2011 Prolongation Communication). Prior to the requirement being introduced, the hybrid instruments subscribed by several Member States gave them very limited ability to ensure a return on the capital injected (see *KBC recap*; *ING recap*).

Impaired asset relief measures

They are governed by the Impaired Assets Communication. It deals with matters concerning:

- eligible assets – points 32 to 36 and Annex III
- valuation of assets – points 37 to 43 and Annex IV
- management of assets – points 44 to 46

Those considerations apply both for guarantee (e.g. *HSH Nordbank*) and purchase models (e.g. *NAMA*).

Liquidity measures

Terms and conditions – 2013 Banking Communication, point 59

Remuneration must be in line with the 2011 Prolongation Communication

EIB-related measures – 2013 Banking Communication, point 61

- Commission Decision of 27 June 2013, State aid SA.36180 (2013/N) – Portugal, Guarantee Scheme on EIB Lending, OJ C 220, 1.8.2013, p. 3
- Commission Decision of 7 October 2013, State aid SA.37417 (2013/N) – Portugal, Amendment of the Portuguese Guarantee Scheme on EIB Lending, OJ C 251, 1.8.2014, p. 4

Status of Central Bank interventions – 2013 Banking Communication, point 62

- Certain measures taken by Central Banks are aid (e.g. BNB in *Dexia I*; BoE in *RBS Restructuring*)

Liquidation aid

2013 Banking Communication, points 65 to 82.

Contrast the approach between winding-down of small and large banks:

- Commission Decision of 6 June 2011, State aid SA.31945 (2011/NN) – Denmark, Aid for the liquidation of Eik Banki P/F and Eik Bank Denmark A/S, OJ C 274, 17.9.2011, p. 3
The Commission examines (potential) aid to the purchaser; aid to economic activities sold; and aid to the remaining business
On limitation of distortion of competition in relation to the sold businesses, see recitals 44 to 47.
- Commission Decision 2012/269/EU of 29 June 2011 on the State aid No SA.32504 (2011/N) and C 11/10 (ex N 667/09) implemented by Ireland for Anglo Irish Bank and Irish Nationwide Building Society, OJ L 139, 26.5.2012, p. 18.

Schemes

Under the 2013 Banking Communication, there is far less scope for schemes than previously.

They remain possible for:

- liquidity support (point 60);

- recapitalisation of small institutions (points 54 and 55 – six-month period; beneficiaries with balance-sheet total of less than EUR 100 million; sum of beneficiaries' balance-sheets less than 1.5% of total assets held by banks in the Member State's domestic market);
- orderly liquidation schemes (points 83 to 86 – based on Danish experience, beneficiaries must have total assets of less than EUR 3 billion).

Formal notification

Issues around formal notification are covered by the general State aid procedural regime are dealt with in Articles 2 and 3 of Commission Regulation (EC) No 794/2004, OJ L 140, 30.4.2004, p. 1.

Notification Form (Annex I to the Implementing Regulation)

State Aid Notification Interactive (SANI)

Language waiver

Standstill obligation

See recitals 1 to 3 of Commission Decision C(2008)6059 final of 13 October 2008, State aid NN 48/2008 – Ireland, Guarantee scheme for banks in Ireland, OJ C 312, 06.12.2008.

Remedies/Commitments

On the role of commitments, see Case C-537/08 P *Kahla Thüringen Porzellan* EU:C:2010:769, paragraph 45.

Commitments are not the same as conditions, see Case C-287/12 P *Ryanair v Commission* EU:C:2013:395, paragraphs 67, 70 and 71.

The possibility for a temporary approval

Capital support

The scope for temporary approval is greatly reduced under the 2013 Banking Communication, points 28, 29, 34, 50 to 53.

Guarantees and liquidity support

Such support is still possible under the 2013 Banking Communication, point 56

For an example, see Commission Decision C(2013)5814 final of 6 September 2013, SA. 37315 – Slovenia, Rescue aid in favour of Factor Banka d. d. (http://europa.eu/rapid/press-release_IP-13-822_en.htm?locale=en)

Commission preliminary and in-depth investigation procedure

General rules laid down in Regulation (EU) No 2015/1589 ("the Procedural Regulation").

The preliminary examination is governed by Article 4(1) of Regulation 2015/1589. The preliminary examination must end with a decision, which can only be one of the following: finding no aid (Article 4(2)), raising no objection (Article 4(3)) or opening a formal investigation procedure (Article 4(4)).

The preliminary examination is subject to a time limit of two months from when the notification is complete (Article 4(5)).

Under Article 4(4) of Regulation 2015/1589, an opening decision is mandatory where the Commission has serious doubts about the compatibility of a measure with the internal market. The existence of serious doubts is an objective notion.

Currently open formal investigation procedures are:

- Commission Decision C(2015) 8651 final of 4 December 2015, State aid SA.34720 (2015/C) (ex 2013/N) – Denmark – Aid for the restructuring of Vestjysk Bank
- Commission Decision C(2013) 3908 final of 21 June 2013, State aid SA.29338 (2013/C-30) (ex 2013/N-504) – Germany – Increase of the second-loss guarantee for HSH Nordbank AG

Closed cases on bank restructuring or resolution in which an opening decision had been taken include:

- Restructuring of Caixa Géal de Depósitos
- Banco Privado Português
- Amendment of the ING Restructuring
- Restructuring of ABN AMRO Group
- ING Restructuring and illiquid asset backup facility
- Additional aid to Latvian Mortgage and Land Bank
- Resolution of Anglo Irish Bank and Irish Nationwide Building Society
- Restructuring aid to BayernLB
- Approval of the split-up of WestLB
- Restructuring of HSH Nordbank
- Restructuring aid for Hypo Real Estate
- Restructuring plan and impaired assets relief measure for LBBW
- Aid for the restructuring of WestLB
- Restructuring aid to IKB
- Restructuring aid to SachsenLB
- Asset relief and restructuring for KBC
- Resolution plan for Dexia and restructuring plan for Belfius
- Restructuring plan for Dexia
- Liquidation of Hypo Group Alpe Adria
- Restructuring of Österreichische Volksbanken
- Belgian guarantee scheme for shares of individual members in financial cooperatives
- Transfer of property-related assets from FIH to the FSC
- Restructuring of NLB
- Restructuring aid to Proton Bank
- HFSF recapitalisation commitment to Alpha Bank
- HFSF recapitalisation commitment to National Bank of Greece
- HFSF recapitalisation commitment to Eurobank
- HFSF recapitalisation commitment to Piraeus Bank
- HSH Nordbank

The formal investigation procedure is governed by Article 6 of Regulation 2015/1589. Unless the procedure becomes moot, a formal investigation procedure must end with a decision:

- finding that there is no aid (Article 9(2));
- finding the measure compatible with the internal market (Article 9(3));
- laying down conditions on which the measure is compatible (Article 9(4)); or
- finding that the measure is not compatible with the internal market (Article 9(5)).

There have been few negative decisions on aid to banks during the crisis:

Commission Decision 2011/346/EU of 20 July 2010 relative to State aid C 3309 (ex NN 57/09, CP 191/09) implemented by Portugal in the form of a State guarantee in favour of BPP, OJ L 159, 17.6.2011, p. 95.

Commission Decision of 23 December 2015 on the State aid SA.39451 (2015/C) (ex 2015/NN) implemented by Italy for Banca Tercas, IP/15/6395.

Conditional decisions adopted to date include:

- *ABNO AMRO*
- *Dexia I*
- *HSH Nordbank*

Assessment of aid: Commission discretion and applied practices

Any capital or structural support requires restructuring if the beneficiary bank is to remain on the market on a stand-alone basis. That approach has been in place since 1 January 2011, on the basis of the 2010 Prolongation Communication. Prior to that, the Commission operated a distinction between fundamentally sound and non-fundamentally sound banks, which is now only of historical interest.

The extent of restructuring can be limited if the capital injection is covered by point 14 of 2011 Prolongation Communication.

Liquidity support above a dual threshold of a total amount of EUR 500 million and 5% of the beneficiary's total liabilities has, since the 2010 Prolongation Communication, triggered the need to submit a viability plan. Since the 2013 Banking Communication, if a bank exceeds that dual threshold, it must submit a restructuring plan within two months (point 59).

A restructuring plan must address viability issues, burden-sharing and competition measures.

Viability issues include business model, corporate governance, capital adequacy during the restructuring period, funding sources and sufficient profitability at the end of the restructuring period. For retail banks, the loan-to-deposit ratio should not be excessive (e.g., recital 184 of *BoI Restructuring I* sets out a final LDR of 125% while recital 127 of *BoI Restructuring II* sets out LDRs of 122.5% and 116% as triggers for supplementary divestments at fixed points under the restructuring process).

The planned restructuring has to be examined under both a base case and a stress test scenario.

As part of viability efforts, a beneficiary will be expected to divest loss-making businesses and those which cannot be made adequately profitable within a reasonable period.

The State aid should ultimately be redeemed or remunerated at market terms.

The restructuring period can be up to five years from the date of the restructuring decision.

The "one time, last time" principle does not apply (*WestLB Liquidation; Dexia Resolution Plan; Bank of Ireland II*).

Separate issues arise where viability is ensured through sale of a bank.

Burden-sharing issues include the adequacy of the remuneration paid by the beneficiary for the State aid; the degree to which providers of capital contribute to the costs of restructuring (see points 40 to 46 of the 2013 Banking Communication); closing any capital gap by divestments, liability management exercises, limiting executive remuneration etc.; acquisition bans ("need to have, not nice to have"); dividend and coupon bans.

Where adequate burden-sharing is ensured through appropriate remuneration of the public assistance, claw-back or better fortunes clauses can be used on their own or in combination with further-reaching restructuring.

Competition measures include divestments; reduction of business activities; acquisition bans; advertising ban; behavioural constraints (price leadership bans; minimum margins on certain forms of business).

They may include market-opening measures by the Member State where cumulative effects of multiple Commission decisions make behavioural measures from the beneficiary unsuitable.

See recitals 257 to 277 in Commission Decision C(2010)4963 final of 15 July 2010, State aid N 546/2009 – Restructuring of Bank of Ireland, OJ C 40, 09.02.2011, p 9.

Crisis-related litigation on State aid to banks

Case T-457/09 R *Westfälisch-Lippischer Sparkassen- und Giroverband v Commission* EU:T:2011:96

Case T-457/09 *Westfälisch-Lippischer Sparkassen- und Giroverband v Commission* EU:T:2014:683

Joined Cases T-29/10 and T-33/10 *Netherlands and ING Groep v Commission* EU:T:2012:98

Case T-22/11 R *Westfälisch-Lippischer Sparkassen- und Giroverband v Commission* EU:T:2011:64

Case T-27/11 R *Rheinischer Sparkassen- und Giroverband v Commission* EU:T:2011:65

Case T-319/11 *ABN Amro Group v Commission* EU:T:2014:186

Case T-487/11 *Banco Privado Português and Massa Insolvente do Banco Privado Português v Commission* EU:T:2014:1077

Case C-224/12 P *Commission v Netherlands and ING Groep* EU:C:2014:213

Case T-427/12 *Austria v Commission* EU:T:2016:41

Case T-499/12 *HSH Investment Holdings Coinvest-C and HSH Investment Holdings FSO v Commission* EU:T:2015:840

Case T-120/13 *Codacons v Commission* EU:T:2013:287

Case T-313/13 *Codacons v Commission* EU:T:2013:355

Case T-321/13 *Adorisio and others v Commission* EU:T:2014:175

Case C-667/13 *Banco Privado Português and Massa Insolvente do Banco Privado Português*
EU:C:2015:151

Joined Cases C-352/14 and 353/14 *Iglesias Gutiérrez and Rion Bea* EU:C:2015:691

Case T-386/14 *Fih Holding and Fih Erhvervsbank v Commission*, hearing 25 February 2016

Case C-526/14 *Kotnik and others*, Opinion of AG Wahl, EU:C:2016:102

Case T-664/14 *Belgium v Commission*

Case T-711/14 *Arcofin and others v Commission*

Case T-812/14 R *BPC Lux 2 and others v Commission* EU:T:2015:119

Case T-812/14 *BPC Lux 2 and others v Commission*

Case T-814/14 *Banco Espírito Santo v Commission* EU:T:2015:936

Case C-41/15 *Dowling and others*, hearing 19 April 2016

Case C-76/15 *Vervloet and others*, hearing 6 April 2016

Case C-93/15 P *Banco Privado Português and Massa Insolvente do Banco Privado Português*
v Commission EU:C:2015:703

Passage to the Banking Union

Directive 2014/59/EU on recovery and resolution of credit institutions and investment firms ("BRRD"), OJ L 173, 12.6.2014, p. 190 (NB Article 32(4)(d) BRRD on the connection between extraordinary public support and the concept of "failing or likely to fail").

Directive 2014/49/EU on deposit guarantee schemes ("DGS Directive"), OJ L 173, 12.6.2014, p. 149 (NB recital 18 and Article 11(3) DGS Directive).

Regulation (EU) No 806/14 establishing a Single Resolution Mechanism and a Single Resolution Fund ("SRM Regulation"), OJ L 225. 30.7.2014, p. 1, (NB Article 19 SRM Regulation establishing a control procedure for "Fund aid").

Further Materials

State aid to banks FAQ (http://europa.eu/rapid/press-release_MEMO-13-886_en.htm)

State aid: Overview of decisions and on-going in-depth investigations of financial institutions in difficulty (http://europa.eu/rapid/press-release_MEMO-16-282_en.htm) [gives situation as of 10 February 2016]

Go to: http://ec.europa.eu/competition/state_aid/legislation/temporary.html for the crisis regime guidelines for banks. The relevant ones are:

- Recapitalisation Communication
- Impaired Assets Communication
- Restructuring Communication
- 2010 Prolongation Communication
- 2011 Prolongation Communication
- 2013 Banking Communication