MEMO/09/350

Brussels, 23rd July 2009

State aid: Commission presents guidelines on restructuring aid to banks - frequently asked questions

(see also IP/09/1180)

Why does the Commission not simply apply the existing state aid rules for restructuring firms in difficulty?

The underlying principles of the Community Guidelines on rescue and restructuring aid to companies in financial difficulties (see MEMO/04/172) will continue to apply. These principles are restoration of long-term viability, adequate burden-sharing and measures to limit distortions of competition. However, the new specific bank restructuring guidelines explain in detail how the Commission will apply these principles to the specific, temporary circumstances created by the current financial crisis, taking into account the systemic role of the banking sector for the whole economy and the possible systemic effects arising from the need for a number of European banks to restructure at the same time.

In these circumstances, state intervention in banks' rescue and restructuring takes place against the background of the vital need to ensure financial stability and restore market confidence. These concerns have also been central to the Commission's evaluation of rescue aid to the banking sector since the beginning of the financial crisis. However, safeguarding financial stability in the short-term must not result in longer-term damage to the level playing field for banks and to competitive financial markets (in other words, the restructuring aid must not give rise to disproportionate, unfair competitive advantages for recipient banks).

Building on the immediate requirements of safeguarding financial stability and market confidence, the present Communication provides a balanced framework for assessing restructuring aid with a view to restoring the viability of the beneficiary banks without continued state support and returning to a competitive market functioning.

This Communication thus complements the previously issued guidance on state aid rules applicable to rescue aid to banks in the present crisis (see IP/08/1495), to recapitalisation of banks (see IP/08/1901) and to impaired assets (see IP/09/322).

As the Communication addresses the specific circumstances of the present crisis, it applies only to the financial sector and only until 31 December 2010.

In what way will the Commission adjust its previous practice for bank restructuring cases in the present crisis?

The Communication adjusts the Commission's practice in particular as regards the following aspects:

- The type of information that will be required to determine whether the proposed restructuring measures are apt to restore a bank's long-term viability. The restructuring plan will need to include a thorough diagnosis of the bank's problems, including a stress test and, where applicable, details on treatment of impaired assets. This information is necessary to devise sustainable strategies for a return to viability.
- Given the overriding goal of financial stability and the prevailing difficult economic outlook throughout the EU, special attention will be given to ensuring a sufficiently flexible and realistic timing of the necessary restructuring measures. The implementation of the restructuring plan could last up to five years, compared to the usual practice of two to three years. This would allow in particular more time for finalising certain structural measures, notably to avoid depressing the markets through precipitated asset sales.
- The bank's own contribution to the costs of restructuring could, on a case-by-case assessment, be lower than the 50% threshold fixed in the rescue and restructuring guidelines. This would allow taking into account difficulties to access private capital in the current context. Where significant burden sharing was not immediately possible due to the market circumstances at the time of the rescue, this would need however to be addressed at a later stage of the implementation of the restructuring plan, for example through claw-back clauses.
- Measures aimed at limiting distortions of competition should be designed so as to support the primary objective of restoring the long-term viability of the banking sector, while limiting any disadvantage for other banks. Where the immediate implementation of structural measures was not possible due to market circumstances (for example where finding buyers for divested assets is objectively difficult), the Commission could extend the time period for the implementation of these measures. Intermediate behavioural safeguards would need to be put in place where necessary.
- The Commission would not necessarily apply the "one time last time" rule to restructuring aid to banks in times of crisis, reflecting *inter alia* the uncertainty about the recovery outlook.

Which banks need to present a restructuring plan?

The previous Commission Communications on rescue aid to the banking sector set out in detail when a bank needs to present a restructuring plan. The present Communication does not change this scope.

In particular, a Member State must notify a restructuring plan to the Commission where it has recapitalised a distressed bank or when a bank, in connection with the crisis, has received aid (except for participation in a guarantee scheme) exceeding 2% of the total bank's risk weighted assets.

For banks that are not distressed and have received a limited amount of aid, no restructuring plan would be required. However, Member States would have to submit a viability review enabling the Commission to assess viability of these banks and the Communication explains what type of information the Commission would expect to receive in these cases.

Why does the Commission dictate when and how banks should restructure?

In the current climate, banks will adjust and restructure according to market imperatives. The Commission would only enter into this market-driven process when banks benefitted from state aid. Such aid gives the beneficiary banks a competitive advantage that can only be accepted if they take the necessary measures to restore their viability and demonstrate that they are able to stay on the market without continued state support.

Even in these cases, the Commission would never dictate to banks *how* to restructure. The Communication only describes what information the Commission would need for assessing whether a bank was viable.

Would the Commission require divestments that would lead to a retrenchment to national markets, with a negative impact on the Single Market?

No. The Commission would not require banks to withdraw from foreign markets and become national in focus. On the contrary, the Communication clearly states that "the integrity of the internal market and the development of banks throughout the Community must be a key consideration […] and fragmentation and market portioning should be avoided". This principle governs all aspects of the Commission's assessment of restructuring measures under the state aid rules.

Depending on the particular problems of individual banks, restructuring their operations to become viable in the long-term could imply focusing on core business. However, this is not to say that core business is defined along national borders! Core business is defined by the viability needs of each individual bank.

The Communication emphasises that state aid may result in shifting an unfair share of the burden of structural adjustment to other Member States, creating entry barriers and undermining incentives for cross-border activities. This is one of the reasons why restructuring needs to be accompanied by effective and proportionate measures which limit such competition distortions.

The Commission would view positively structural measures that were taken without discrimination between businesses in different Member States and thus contributed to the preservation of a Single Market in financial services. In this context, the Commission pledges to view positively particularly measures that contribute to national markets remaining open and contestable.

If Member States wished to condition support to banks with certain lending targets, the Commission would view positively such targets extending beyond the territory of the Member State granting the support.

Does the Communication introduce limitations on remuneration of equity and bond holders?

The Communication takes the position that banks which need state subsidies should not use it to pay remuneration to stakeholders. This would not be compatible with the objective of burden-sharing, according to which the bank and its capital holders must contribute to the restructuring as much as possible and thus bear adequate responsibility for the bank's past behaviour that lead to its difficulties.

However, the Communication also recognises that such limitation would not prevent banks from making coupon payments on subordinated debt when they were under a binding legal obligation to do so. It also recognises that, depending on the concrete circumstances of a case, this limitation may need to be balanced with ensuring that the bank is capable of refinancing itself on the market, especially as this also contributes to an earlier exit of the state aid. In that respect, the Commission may also view favourably coupon payments on newly issued hybrid capital instruments with a greater seniority than existing subordinated debt.

How will the Commission ensure that aided banks do not use state aid to finance expansion or trading practices that are detrimental to their competitors?

Member States need to submit six-monthly reports on all banks that have benefited from state support, even if they are not required to notify a restructuring plan. This Communication also requires Member States to provide detailed regular reports on the implementation of the restructuring plans. The use of state aid is one of the important aspects that the Commission will examine in this monitoring exercise.

Furthermore, the Communication prescribes a number of behavioural constraints so as to prevent the use of state aid to fund anti-competitive behaviour. In particular, state aid could not be used to offer business terms that could not be matched by competitors without state support. Also, banks should in principle not use state aid for the acquisition of competing businesses for at least three years, except in exceptional circumstances and with prior authorisation from the Commission. Where appropriate, limitations could be imposed on the pricing behaviour of the aided bank. Finally, banks may not invoke state aid as a competitive advantage when marketing their products.

Should the priority not be to rid banks of impaired assets before thinking of restructuring?

Ridding banks of impaired assets constitutes restructuring. For some it will be sufficient, while others will need to scrutinise their business models more profoundly. In any case, cleaning up impaired assets is part of the process that many banks will have to undertake to re-gain market confidence. Dealing with impaired assets and restructuring are not mutually exclusive processes; they often complement each other and logically are implemented at the same time.

However, the Commission does not decide on when this process should start or how it should be conducted. It only says that, when and where states intervene in this process through state aid, some common rules will need to be applied to this state intervention. As an increasing number of such cases have been brought before the Commission, it was opportune to issue objective guidance on how these will be assessed.

Why is it necessary to address competition distortions in times of systemic crisis?

State-financed bail-outs have various negative effects. State interference:

- goes against the principle of competition on merits
- reinforces the market power of the aid recipient
- reduces dynamic incentives of non-aided competitors
- encourages moral hazard and excessive risk-taking and
- undermines the Single Market.

All these effects are still present in times of crisis. Moreover, there are additional reasons why the competition rules are more important than ever during a systemic crisis.

First, if on the one hand, for reasons of financial stability, a more limited contribution of the bank and its shareholders to the cost of the restructuring has to be accepted, on the other hand, it is vital to pave the way for a rapid return to normal market conditions. This requires that moral hazard is properly tackled to avoid repeating the mistakes of the past.

Second, banks and Member States across Europe have been hit by the crisis by very different degrees. In a situation of financial, economic and budgetary crisis, differences between Member States in terms of resources available for state intervention become even more pronounced. And those banks which today need huge subsidies may have in recent years engaged in expansionary strategies to the detriment of their competitors.

Finally, national interventions in the current economic crisis are by their nature bound to promote a focus on national markets. Even where there is no explicit requirement of lending to the domestic economy, there is a risk of promoting retrenchment into national boundaries. This would hinder the functioning of the Single Market for financial services, create entry barriers and reduce incentives for cross-border activities to the detriment of European businesses and consumers.