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STATE AID CONTROL IN THE FINANCIAL CRISIS

From rescue to restructuring and to resolution

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Jacques Derenne, member of the Brussels and Paris bars

Partner, *Head of EU Competition & Regulatory*

Professor, *University of Liège & Brussels School of Competition*

Outline

- Basics of EU State aid control
  - Notion of "State aid"
  - Compatibility assessment & procedure
    - Commission & national courts
- Before the crisis
- Pending the crisis – Evolution
  - rescue, restructuring, sovereign debt, towards resolution tools
- New set of legislative rules since 2013
  - Single Resolution Mechanism

Notion of State aid (Article 107 (1) TFEU)

- Advantage ("*in any form whatsoever" - "favouring*")
- Selective ("*certain*")
- Transfer of State resources <u>and</u> imputability to the State ("*granted by a Member State or through State resources*")

- Risk of distortion of competition
- (likely to) Affect trade between Member States

Competition between Member States: need for a supranational, independent arbitrator (European Commission)

Compatibility assessment (Article 107 (3) TFEU) Procedure (Article 108 TFEU)

- Unlawful aid ("illegal")
  - aid not notified
  - aid notified but implemented before Commission decision
  - misuse of existing aid
- National courts
  - obligation to protect subjective rights of third parties
  - ensure that Commission can carry out its compatibility assessment
  - no stay of proceedings
  - enforce Commission negative decisions
- Incompatible aid
  - lawful or unlawful aid
  - aid not exempted
    - various types of exemptions
- Exclusive powers of Commission
  - Compatibility assessment
  - prohibition to implement incompatible aid
  - obligation to order recovery if unlawful

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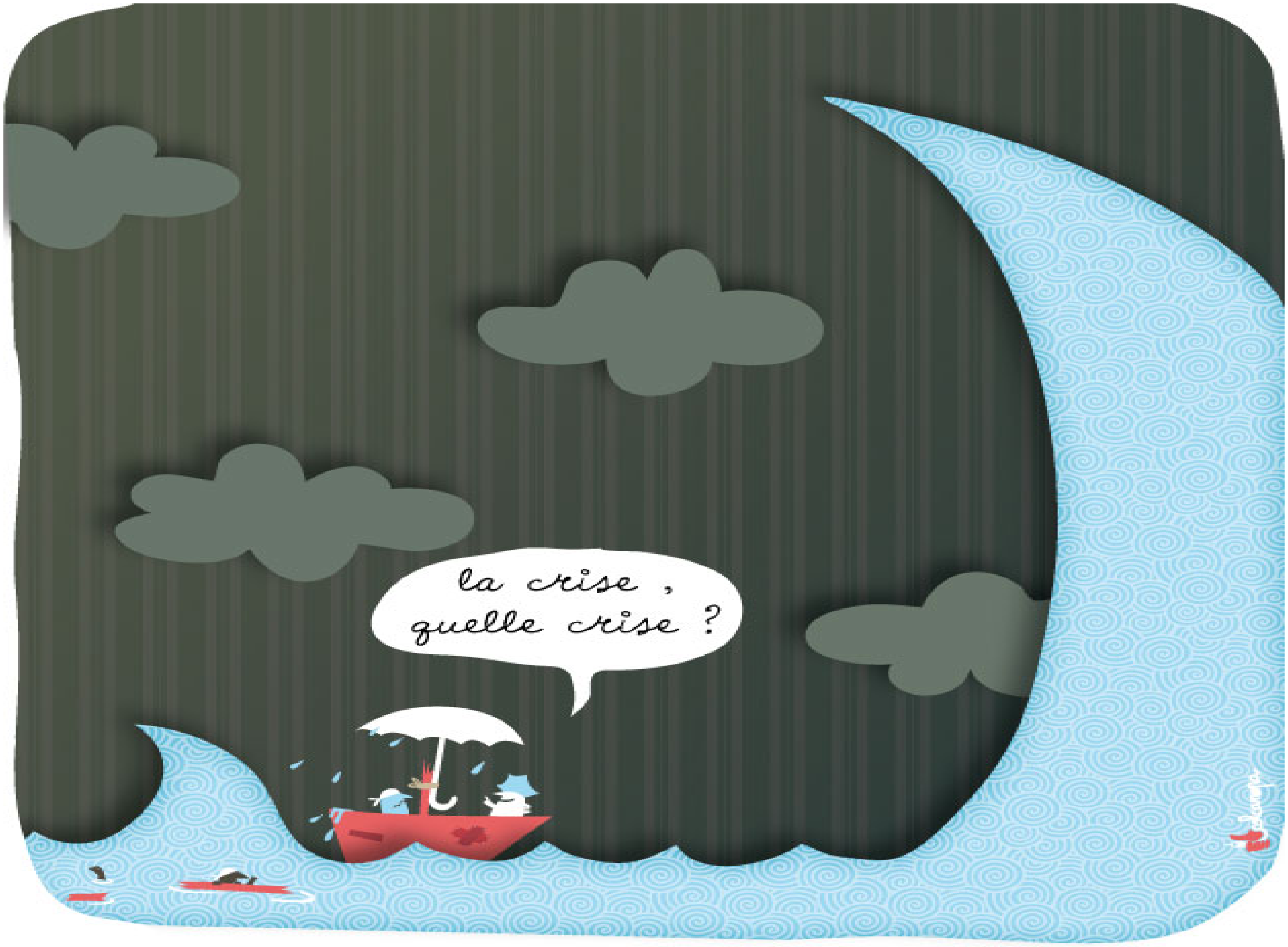
Before the crisis: traditional approach



Financial crisis - outbreak

- Liquidity or solvency problems
- Affecting fundamentally sound banks
- Systemic effect
  - Stability of the entire financial system in jeopardy
  - Potential impact on the whole economy
- Member States intervened on an unprecedented scale by granting State aid in order to
  - Prevent collapsing of further banks
  - Restore the provision of credit

Traditional approach outside the crisis

- Banking sector subject to State aid control
- Rescue & Restructuring 2004 Guidelines (107(3) c) TFEU)
  - rescue aid
    - > temporary (six months)
    - > non structural measure (reversible)
  - restructuring aid
    - > restructuring plan
    - > long term viability
  - own contribution
    - > aid limited to the minimum necessary
  - compensatory measures
    - > avoid undue distorsions of competition

Pending the crisis: evolution of the Commission's approach

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October 2008 – March/April 2009

- October 2008: on the edge...
  - "*State aid rules are part of the solution not of the problem*"
- Urgency
  - need for guidelines and legal certainty
  - flexibility
- Avoid the systemic crisis
  - "sound" and "unsound" / distressed banks
  - beyond 6 months
  - structural rescue measures
  - but consistency with the principles
    - > limited in scale and time
    - > prevent undue distortions of competition
    - > own contribution (remuneration)
- A co-ordinated approach
  - aid regimes

- Κρίσις, κρίσεως
- Κρίνω
- Κρασις

New legal basis: Article 107(3) **b)** TFEU

- "*aid to remedy a serious disturbance in the economy of a Member State*"
- Three precedents
  - 1975 (V Report, § 133); 1987 (OJ L 76/18); 1991 (XXI Report, § 251)
- Rejections
  - CL (OJ 1995 L 308/92); GAN (OJ 1997 L 78/1); NR (NN 70/07); WestLB (NN 25/08); Sachsen LB (C9/08)
- CJEU: "*regional disturbance is insufficient*"
  - T-132/92 & T-143/96, *Freistaat Sachsen*
  - C-301/96, *Germany v Commission*
- Since 2008: over 300 aid schemes and individual decisions
  - +€4.5 tn (around +25% of EU GDP)

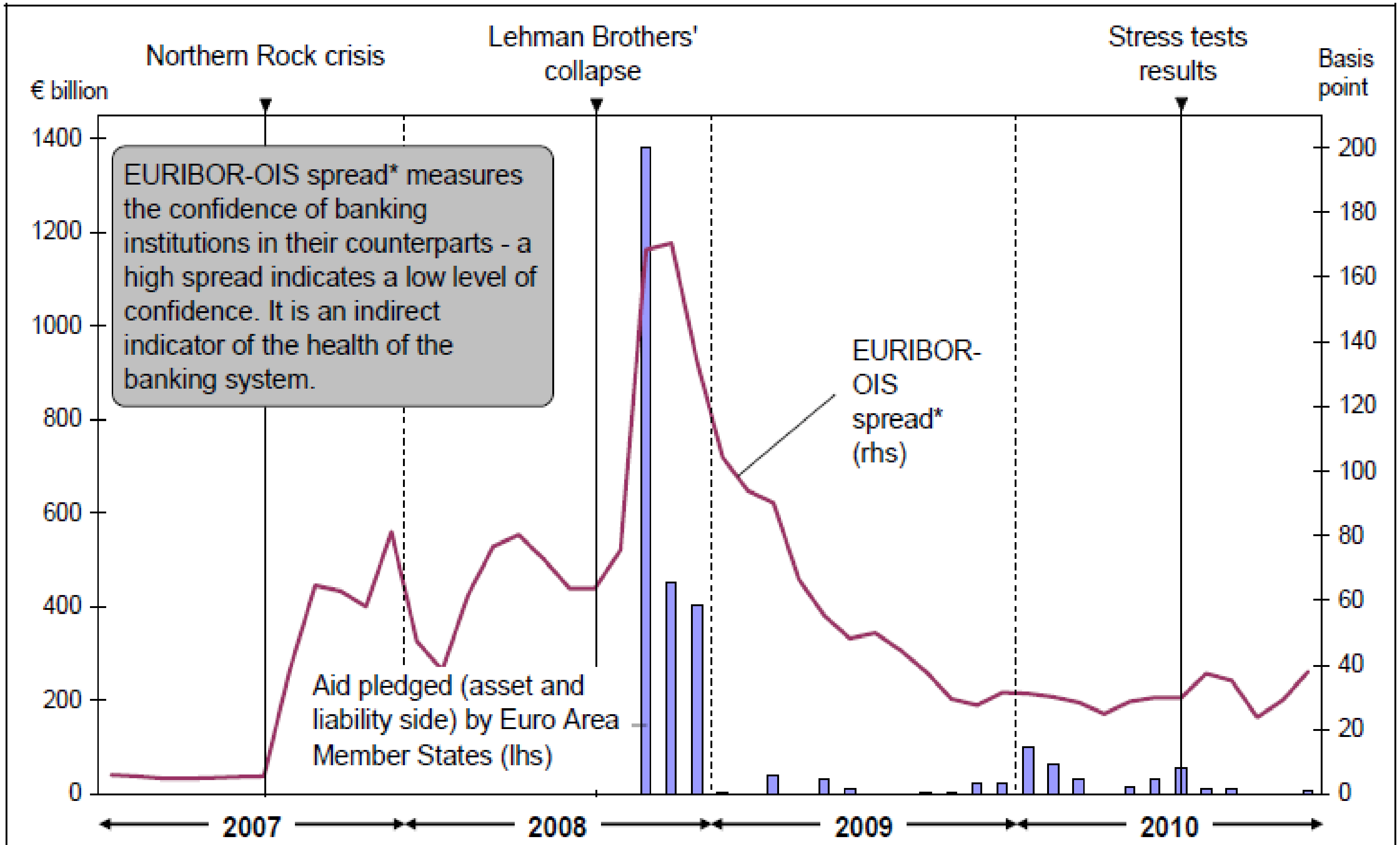
Financial crisis – main principles

- Proportionate aid measures
  - aid limited to the minimum
  - contribution by the beneficiary
- Return to long term viability
  - well targeted aid
  - stress tests
  - restructuring plan if needed
- Avoiding undue distortions of competition
  - structural and behavioural remedies

Financial Crisis – [2008-2010]

Source: Commission Staff Working Paper, October 2011

Figure 5.1: Evolution of EURIBOR-OIS spread and of State aid support to the financial sector pledged by Euro Area Member States[130]



Source: Ecowin; Commission services

* Spread between EURIBOR (interbank market rate) and OIS (overnight rate swap index)

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Compatibility assessment of aid to banks since October 2008

Summary of developments

- **13 October 2008 – 31 July 2013**
  - Communications (Banking, Recapitalisation, Impaired Assets, Restructuring, Prolongation)
  - Focus on rescue aid, then restructuring
- **1 August 2013 – 31 December 2014**
  - New Banking Communication
    - > More effective restructuring process
    - > Strengthened burden-sharing requirements (shareholders, subordinated debtholders)
    - > Assets quality reviews, stress tests
- **1 January 2015 – 31 December 2015**
  - Bank Resolution and Recovery Directive (BRRD)
    - > default option is insolvency if not "resolved" in the public interest
    - > exception: "precautionary recapitalisation"
- **1 January 2016**
  - Bail-in requirement
    - > at least 8% of liabilities, senior debt, uncovered deposits

New legislation beyond State aid rules (1) Crisis prevention

- Stronger prudential requirements
  - Capital Requirements Directive IV
    - > Directive 2013/36/EU
    - > Sufficient level of capital
      - Quantity
      - Quality
  - Single Supervisory Mechanism (SSM)
    - > Regulation No 1024/2013
    - > ECB empowered for the supervision over banks in the euro area

New legislation beyond State aid rules (2)
Tools to deal with unsound or failing banks

1. Directive 2014/59/EU (BRRD) (1.1.2015 - bail-in 1.1.2016)

- Each institution to prepare a full recovery plan setting measures
  - dismissing management and appointing temporary administrator
  - convening a meeting of shareholders to adopt urgent reforms
  - prohibiting the distribution of dividends or bonuses, etc.

- Resolution authority in each Member State
  - resolution plan for each individual firm, “failing or likely to fail”
  - most appropriate resolution tools in each scenario
  - effect private sector acquisitions
  - transfer business to temporary structure
  - asset separation (“good bank/ bad bank”)
  - investors and creditors to be bailed-in before public funds can be used.

New legislation beyond State aid rules (3)
Tools to deal with unsound or failing banks

2. Regulation No 806/2014 (SRM) (1.1.2016)

- Single Resolution Mechanism (SRM)
  - to ensure that the complicated resolutions (e.g. in case of cross border resolutions) can be managed more efficiently with binding effect for all Member States.
- SRM built around
  - Single Resolution Board (SRB)
  - Single Resolution Fund (SRF).

3. Directive 2014/49/EU Deposit Guarantee Scheme (DGS) (31.5.2016)

- Strengthens the protection of tax payers' deposits in case of bank failures (deposits to be guaranteed up to €100 000 per depositor).

Current rules applying to the Commission's assessment

- Two-fold assessment in case of resolution:
  - compatibility under the 2013 Banking Communication
  - compliance with BRRD provisions.
- Recent examples
  - Italy
    - > Banca Romagna, 2/07/2015, case SA.41924
    - > 4 banks, 22/11/2015, cases SA.39543, SA.41134, SA.41925, SA.43547
  - Hungary
    - > Magyar Kereskedelmi Bank (MKB), 16/12/2015, case SA.40441
  - Portugal
    - > Banco Internacional do Funchal, 21/12/2015, case SA.43977
  - Croatia
    - > Resolution scheme for small banks, 5/10/2016, case SA.46066

Unpacking Complexity
Unfolding Opportunity

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Thank you for your attention!

Jacques Derenne
Partner, Head of EU Competition & Regulatory
Tel: 32 2 290 7905
jderenne@sheppardmullin.com

SheppardMullin

Sheppard, Mullin, Richter & Hampton LLP

Brussels
IT Tower
Avenue Louise 480
1050 Brussels
Belgium

T: +32 (0)2 290 7900