

European Commission Adopts Guidance on State Aids to the Financial Sector

Catriona Hatton and Jean-Michel Coumes

Hogan & Hartson, Brussels

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Following a flurry of rescue measures put in place by many European Union Member States in recent weeks to support the banking sector, the European Commission (the Commission) issued, on October 13, a Communication to clarify the types of measures which it considers will be compatible with state aid rules—although any state aid provided to the banks will still require Commission approval. The Communication focuses on guarantee schemes, recapitalisation schemes and complementary forms of liquidity support.

The Commission specifies that, in view of the seriousness of the situation, Member States may ground the provision of state aid to financial institutions on art.87(3)(b) of the EC Treaty, which allows “aid to remedy a serious disturbance in the economy of a Member State”. The Commission has put in place a fast track procedure for state aids which comply with the guidance set out in the Communication and aims to approve such measures within 24 hours of receipt of a notification of such measures.

The Commission Communication is inspired by previous guidelines adopted for rescue and restructuring aids (“R&R guidelines”). However, the Communication has a broader scope and applies more flexible criteria. The Communication acknowledges that Member States may adopt general measures aimed at remedying the problems of the whole financial sector, as opposed to limiting themselves to individual aid for certain institutions, which was the focus of the previous R&R guidelines.

As regards duration, in contrast with the R&R guidelines, the Commission is prepared to authorise certain rescue measures; for example, some guarantee schemes for up to two years (as opposed to six months under the R&R guidelines)—and longer if necessary.

However, state aid schemes adopted by the Member States in application of the Communication must meet the same criteria as those previously applied by the Commission in enforcement of EC state aid rules. In particular, guarantee and recapitalisation schemes:

- must be temporary and, as such, subject to regular review and report by the relevant Member State authorities (at least every six months);
- must be proportionate, i.e. limited in time and scope to what is strictly necessary to achieve its legitimate purpose. For example, the Commission considers that guarantee schemes for retail deposits and for certain types of wholesale deposits—and even short-and-medium term debt instruments—may be necessary, but extension of a guarantee scheme to other types of debt would require close scrutiny. Further, guarantee schemes must ensure a significant contribution from the beneficiary and/or the sector (e.g. through an association of private banks). This contribution may be in the form of fees paid for the provision of the guarantee, or claw-back/better fortunes clauses allowing the Member State to receive compensation for the guarantee at a later date or to recoup amounts paid out under the scheme. In the case of recapitalisation schemes, the Commission considers that the Member State, in principle, should receive shares in the institution whose value corresponds to the contribution to recapitalisation, or should provide for claw-back provisions;
- must be non-discriminatory (for example, guarantee schemes must be available to all institutions incorporated in the Member State concerned with significant activities in that Member State, including subsidiaries of banks from other Member States); and
- must be followed by restructuring plans either in the form of general adjustment measures for the sector as a whole or individual restructuring plans where, for example, an individual bank has drawn on the guarantee or has benefited from recapitalisation. These individual restructuring plans will be investigated by the Commission to ensure compliance with state aid rules. The Commission specifies that restructuring plans for institutions that are in difficulty because of their particular business model or practice will undergo increased scrutiny, in comparison to otherwise “sound” establishments which are affected by the general market conditions that have severely restricted access to liquidity.

This Communication confirms the Commission’s intention to continue to apply EC state aid rules to any state aid measure to banks. However, with regard to general

schemes in favour of the sector as a whole, the Commission indicates that it will take a flexible approach, while setting some parameters to avoid discrimination and undue distortions of competition. Further, the Commission makes it clear that it will have a continuing role in overseeing these schemes on a regular basis and that it will expect Member States to put in place further measures to ensure that the sector is on a more sound footing and to avoid continued reliance on state support. Finally, individual institutions which have to

draw on the general state guarantee, which receive an injection of capital from the state, or are otherwise supported by state aids, will need to undergo restructuring. The Commission can be expected to scrutinise closely such restructuring plans that Member States will need to notify for Commission approval, in particular where the Commission considers that the individual institution required rescue because of the way it conducted its business, rather than because of the current difficulties with access to liquidity.