Juridical and financial considerations on the public re capitalisation and rescue of financial institutions during periods of financial crises (Part I)

Ojo, Marianne and Rodríguez-Miguez, Jose

Center for European Law and Politics, University of Bremen, Oxford Brookes University, King's College London

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ABSTRACT

As well as a consideration of why the lender of last resort facility should be used for emergency situations and systemically relevant institutions in particular, an interesting point which will be considered in this publication is the comparison between the European Central Bank (ECB) Recommendation and its application by the Commission in the Re capitalisation Communication, specifically with its Annex, where the Commission explains how it determines the price of equity or own funds (ordinary or common shares) - balancing the "real value" with the "market value" within a crisis context. This publication will also consider how to transform the Crisis into an opportunity in order to minimise tax burdens to taxpayers – as well as making financial markets more efficient.

Furthermore, whether the Commission and Member States have applied the methodology (the determination of the price of equity – as stated in the Annex to the Recapitalisation Communication on Financial Institutions) in determining the price of equity with respect to the capital of banks acquired by Member States, will be addressed. Such consideration could provide a vital key to determining the real value of State Aid and the best possible price for which capital could be sold.

Given the scale of government intervention and State rescues which occurred during the recent crisis – as well as the prominence accorded to measures aimed at preventing and limiting distortions of competition, calls have been made for competition authorities to take on more formidable roles in designing and implementing exit strategies. In order to foster competition as much as possible, it is proposed that "governments should provide financial institutions with incentives to prevent them from depending on government support once the economy begins to recover."

Key Words: Financial Crisis, state aid, recapitalisation, equity, own funds, tier capital, MEIP, guarantees, Troubled Asset Relief Program (TARP), fundamentally sound institutions, rescue and restructuring aid, recovery.

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Juridical and Financial Considerations on the Public Recapitalisation and Rescue of Financial Institutions During Periods of Financial Crises (Part I)

Jose Rodríguez-Miguez[1] and Marianne Ojo[2]

1. Introduction: The Crisis as a Context of Reference

The recent Financial Crisis, which started in 2007 – culminating in 2008, is still generating a considerable number of related and published articles. According to most of these sources, the "sub prime" crisis is considered to be the "root" cause of all present and future challenges. However, this is just part of the story.[3] There were, and still are, specific and deep rooted problems in the financial system itself - problems such as those related to the supervision of central banks (how supervision should be carried out)[4]; the role of rating agencies (what role should be assumed by rating agencies); the management of risk by individual entities, and so on.

Even though it is evident that the Crisis began in the US, its rapid dissemination has been attributed to many other different factors – most of them linked to the globalisation of the financial system. However, it is evident that the degree of variation and intensity of the Crisis, from one country to another, is dependent on individual circumstances. Apparently, it constitutes more than just a simple case of the so called "domino effect" –more like a "tsunami"[5] effect for the international financial system – as observed and noted by many headlines.

From an economic point of view, the best and clearest reference point to such a crisis would be the Big Crash of 1929. The credibility of audited financial statements – both at domestic and global levels, was the most significant victim of that particular Crisis. It is easy to forget

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[1]Dr José Antonio Rodríguez-Miguez, Associate of the IDIUS (Instituto de Derecho Industrial de la Universidad de Santiago de Compostela. Spain). Part of this article was written whilst working as a Visiting Scholar at King's College School of Law, University of London jarmiguez@gmail.com My contributions to this work were realized during the frame of the Project of Research of the National Plan of I+D+I DER2008-04791/JURI - New instruments of protection of the competition and of the consumers, financed by the Department of Science and Innovation and the European Fund of Regional Development (EFRD).

[2] Marianne Ojo (LLM, PhD) Center for European Law and Politics (ZERP) University of Bremen, Oxford Brookes University, Oxford marianneojo@hotmail.com and Legal Scholarship Network

[3] In other words, this partial diagnosis constitutes just a fraction of the antidote – and not the entire prescription.

[4]On the 21st of July 2010, President Obama signed the US Financial Reform into Law which, precisely, re – shaped the system of financial supervision in the US. The recent conclusions and announcements of the Group of Governors and Heads of Supervision on higher global minimum capital standards, of 12 September 2010, of the Bank for International Settlement (BIS), widely referred to as "Basel III", should also be taken into account. See the Press releases at http://www.bis.org/press/p100912.htm

[5] Even with the prevailing and grave conditions of many financial institutions, many of these have managed to survive, on the short term. However it's possible that such an event will occur in the medium-long term, when the restructuring plans are examined, in the case of the European Union, by the European Commission.

that the sustenance and growth of financial markets is dependent on such credibility.[6] The typical image and perception of a banker – like the image perceived of a British gentleman (with the classical bowler hat) or that of the serious Wall Street broker or financier, as transmitted across screens to the general public, was really deceptive.[7]

This being the case, because the classic perception was being transformed dramatically. Moreover the images perceived from the 1929 Crisis have remained in the sub conscious minds of many and such perceptions have constituted lasting and dramatic reminders of the 1929 Crisis.

Moreover, the key question is how to transform the Crisis into an opportunity in order to minimise tax burdens to taxpayers – as well as making financial markets more efficient-.

This is the primary reason why this publication focuses on the public re capitalisations of financial institutions. It approaches this objective through a consideration of how (they existed); a consideration of the conditions under which they existed; as well as through a comparative analysis of these data with the Swedish experiences at the start of the nineties – when the Swedish Government assumed control of several private banks and subsequently, following an intense restructuring process, privatised these banks – hence generating income for the Treasury. (Comparative analyses with the Swedish experiences will be considered in the second part to this publication[8]).

However, we should not forget that during that period of the Crisis, Sweden was not yet a member of the European Union[9], hence it was not subject to European State Aid control.[10] It is clear that the State Aid received in form of equity participations (ordinary capital and other types of shares), provides the Government with means of transforming the management of firms in difficulties as well as the facilities to make sound decisions in relation to the future of such firms.

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[6] Even though the original quote that "The first casualty when war comes is the truth", is usually attributed to the US Senator, Hiram W Johnson, it could be regarded as a credible statement within the context of a financial crisis. For this reason it's interesting. However, and perhaps a bit later, the Member States realized the Stress Test for a considerable number of European Banks institutions. For full official information about this Stress test, see the website of the CEBS (Committee of European Banking Supervisors "2010 EU Wide Stress Testing" in http://www.c-ebs.org/EuWideStressTesting.aspx

[7] It was, obviously, almost at first, an important communication failure, because many felt that the huge amount of grants coming from member states and flowing into the banking sector was just a gift to rich people and not a desperate means of controlling the Financial Crisis itself (a crisis that would generate devastating consequences for the entire economy – as well as for the welfare of citizens). However, important questions persist – which need to be addressed: Were all the State Aids granted to financial institutions really necessary? Were all financial efforts of those member States (which were involved) really efficient - from an economic and long-term point of view?

[8] In relation to the second part of this article, it is clear that it will be neccesary to wait to find out how the different restructuring plans will come into effect – as well as their results. The Swedish crisis is particularly clear on this point: See DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS.: "The Swedish model for resolving the banking crisis of 1991-93. Seven reason why it was succesfull", en *European Economy*, Economics Paper, nº 360, February, 2009 [http://ec.europa.eu/economy_finance/publications/publication14098_en.pdf]; BERGSTRÖM, C./ENGLUND, P./THORELL, P.: "Securum and the Way out of the Swedish Banking Crisis", en Summary of a report commissioned by SNS – Center for Business and Policy Studies, P.O., May 2003. Este trabajo puede consultarse en http://www.sns.se/document/securum_eng.pdf; ASLUND, A.: "Lessons for the US from the Swedish Bank Crisis", in Peterson Institute for International Economics, February 24th, 2009 [http://www.iie.com/realtime/?p=504].

[9] Sweden has been a member of the EU since 1995.

[10] Nevertheless, Sweden was a member of the European Free Trade Association (EFTA), which has equivalent rules to that of the European State Aid control, under the control of the Surveillance Authority.

In response to the recent Financial Crisis - after it had been widely accepted that "a serious disturbance in the economy of Member States" had occurred, and that several measures were required to remedy this disturbance, various Commission communications were adopted. However, it is to be observed that these Communications were inspired by the "Guidelines" that the Commission introduced, in an exceptional way, in the Crédit Lyonnais case in 1995 - which elaborated on a considerable part of the text which constitutes these Communications[11]. The Communications include: The first Communication which (initially), was the only one that the Commission adopted intentionally: the *Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*[12] (hereinafter "the Banking Communication"). However, faced with the pressure to issue more guidelines (such pressure being exerted by Member States), the Commission adopted three further Communications: the *Communication on the re capitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*[13] (hereinafter "the Recapitalisation Communication"); the Communication "*On the treatment of impaired assets in the Community banking sector*" [14] (hereinafter, "the Toxic Assets Comunication*")*[15] and finally, the *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*[16] (hereinafter "the Restructuring Communication")." The Banking and Re capitalisation Communications will constitute the focus of this study.

Purpose of the Banking Communication

The purpose of the Commission's Communication on the "the application of State aid rules to measures taken in relation to financial institutions within the context of the current global financial crisis" (hereinafter referred to as the Banking Communication),[17] is namely, "the provision of guidance on the criteria relevant for the compatibility with the Treaty of general schemes, as well as individual cases of application of such schemes and ad hoc cases of systemic relevance."[18]

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[11] For further information on the Crédit Lyonnais case and this guideline, see J. A. Rodríguez-Miguez, "Rescue of Financial Institutions: An Overview of European Commission Frameworks and Practice on State Aids to Financial Sector in the Current Global Crisis" in SSRN, May 25, 2010, pp. ** [http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1615324].

[12]OJ C 270, de 25.10.2008, p. 8. For general comments on this communication, see, J. A. Rodríguez Miguez, "The General Príncipes of the Banking Communications on Financial Institutions in dificultéis" (only available in Spanish version, "Los Principios generales de la Comunicación de la Comisión sobre las ayudas estatales a instituciones inancieras en dificultades"), in *Revista Mensual de Competencia y Sectores Regulados*, Despacho CMS Albiñana & Suárez de Lezo, nº 66, December, pp. 12 to 15 and C. Hatton and J. M. Coumes, "The Comisión Adopts Guidelines on State Aids ti the Finantial Sector", in *European Competition Law Review*, nº 2, 2009, pp. 51 and 52.

[13]OJ C 10, 15.1.2009, p. 2.

[14] OJ C 72, de 26.03.2009, p.1.

[15] The use of the expression "Toxic Assets", is commonly used in the media.

[16]OJ C 195, de 19.8.2009, p. 9.

[17] European Commission, "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" (2008/C 270/02)

[18] See section 1 paragraph 5;ibid

The adoption of appropriate measures to safeguard the stability of the financial system was considered necessary, as well as vital, by the Commission – owing to:[19]

- the scale of the Financial Crisis (such that the viability of fundamentally sound banks was also being placed at risk
- the high degree of integration and interdependence of European financial markets and
- the drastic repercussions of the potential failure of a systemically relevant financial institution – which could contribute to further aggravation of the Crisis.

Such peculiar nature of the recent Financial Crisis, as illustrated above, and with particular reference to systemic repercussions, has also promulgated the realisation that an extension of measures beyond those necessary to safeguard the stability of the financial system, to include general schemes, may be required.[20]

A number of factors considered to have triggered the recent Financial Crisis include:[21]

i) Macro economic issues such as low interest rates in the United States which helped create widespread housing bubbles whose developments were fuelled by insufficiently regulated mortgage lending and securitisation financing techniques
ii) Poor risk management by issuers of structured financial products
iii) Underestimation by credit rating agencies of the credit default risks of instruments collateralised by sub prime mortgages
iv) Corporate governance failures in financial firms – where the complex nature of financial products was not adequately understood
v) Regulatory, supervisory and crisis management failures.

In classifying the above mentioned factors into two, reference is made to the observations in the Communication[22] where the impact of general market conditions not only contributed to the difficulties experienced by even fundamentally sound financial institutions, but also severely restricted their access to liquidity. Further factors which contributed to liquidity problems included "the pervasive uncertainty about the credit risk of individual financial institutions – which not only facilitated the process of exhausting sources and facilities for inter bank lending, but also consequentially, resulted in the restriction of access to liquidity for such financial institutions.[23] Such exogenous factors attributed to the impact of general market conditions constitute one of the classes into which the above mentioned factors will be classified and (i) provides the best illustration of these.

"Financial institutions with problems that are a result of their particular business model or business practices whose weaknesses are exposed and exacerbated by the crisis in the financial markets,"[24] constitute the other half of the classification and (ii)-(v) could be considered to fall under this category. Such management inefficiency induced problems are considered to require greater "far reaching" restructuring arrangements than the other

[19] See section 1 paragraph 4; ibid
[20] ibid
[21] A Petrovic and R Tutsch, „National Rescue Measures in Response to the Current Financial Crisis" ECB Legal Working Paper Series No 8/ July 2009 at page 6 http://www.ecb.europa.eu and http://ssrn.com/abstract_id=1430489
[22] European Commission, "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" (2008/C 270/02);paragraph 2
[23] see ibid; paragraph 1
[24] ibid;paragraph 2

category. As highlighted in a recent publication,[25] signals should be sent to management of firms considered to be "too big to fail" that their importance (in terms of the threats posed to systemic stability – where they are permitted to fail) does not provide an excuse for management of such firms to act recklessly – reckless behaviour being attributed to the knowledge that in any case, government bail outs would be provided in the event of a likelihood that financial failure may occur. Intensive restructuring, to the extent that the entire management of a rescued firm, whose failure is attributed to management inefficiencies, is replaced in the event of an institutional failure, provides an illustration of such a warning.

An example of the devastating effects of interconnectedness between financial markets is illustrated by the consequences of the problems triggered within the US financial sector in 2008 which affected financial institutions in Europe, as well as other parts of the world.

The insolvency of Lehman Brothers in 2008 resulted in a crisis of confidence which consequently resulted in the reluctance of banks to engage in inter lending activities.[26] In October 2008, even fundamentally sound financial institutions were facing serious difficulties in accessing liquidity and this resulted in a situation whereby national governments were compelled to intervene at an unprecedented level.[27]

As well as the systemic related nature of the Financial Crisis (which constituted a vital reason for the adoption of measures aimed at restoring confidence to the financial sector), devastating consequences of liquidity risk related issues contributed to the ECOFIN Council's decision to adopt "Conclusions committing to take all necessary measures to enhance the soundness and stability of the banking system in order to restore confidence and the proper functioning of the financial sector."[28]

2. State Aids[29] as Tools for Addressing the Financial Crisis

General Overview: Public Intervention and State Aid.

Public ownership of enterprises is not a new phenomenon at European level. It has existed throughout the course of European Economic History. Almost all European countries have used this mode of public intervention at different periods in time. Notwithstanding, it is clear that the size of the so called "public sector" was changing with time, and from one country to another.[30]

[25] "See M Ojo, "Liquidity Assistance and the Provision of State Aids to Financial Institutions" 2010 Munich RePec and SSRN Working Papers.

[26] A Petrovic and R Tutsch, „National Rescue Measures in Response to the Current Financial Crisis" ECB Legal Working Paper Series No 8/ July 2009 at page 6 http://www.ecb.europa.eu and http://ssrn.com/abstract_id=1430489

[27] see ibid and also paragraph 2 of section 1 of European Commission, "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" (2008/C 270/02)

[28] see paragraph 3 of section 1;ibid

[29]For further information on rescues of financial institutions and State aids, see also J. A. Rodríguez-Miguez, "Rescue of Financial Institutions: An Overview of European Commission Frameworks and Practice on State Aids to Financial Sector in the current Global Crisis" SSRN Working Paper http://ssrn.com/author=1482639.

[30] As emphasised by Buendia, the Founding Member States had different attitudes in relation to State economic intervention and this constitutes one of the merits of the integration process and the founding treaties (J. L.

The public sector is expanding or decreasing for many different reasons, namely: the development of new technologies or activities where the private sector did not have prior interest or activities it was unable to support - like in the railway industry during the 19th century, or the aviation sector in the 20th century. However, there are many other reasons, even ideological reasons or more circumstantial reasons, such as sectoral or individual crises, that are considered to pose dangerous threats to the national social-economy stability. This has been the case for many financial institutions in the past two years[31]. But apparently, the financial sector is very peculiar because its failure would generate consequences for "system stability". Is this really the truth? Is it true in all cases? Our academic research will include a focus on these questions.

European Law always remained obscure on this issue of public intervention. As a result, Article 345 TFEU (ex Article 295 EC) clearly provides and stipulates that "*The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership.*"[32]

At the same time, Article 106.1 TFEU (ex Article 86.1 EC) provides for equal treatment between public and private enterprises in Member States where it declares that "*1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.*"

Since the beginning of the European integration process, both principles have served as parameters for understanding the relationship between public and private economic activities in the European Union.

One of the most significant characteristics of the European system of control on State Aids is attributed to the fact that neither the Treaty establishing the European Coal and Steel Community (ECSC)[33], nor the Treaty establishing the European Economy Community[34] included a definition of "State Aid".

While the first of these limits itself to an outright prohibition, the second one, described by Roberti[35] as a "complex hypothesis," comprises of a series of requirements under which a State Aid can, initially, be declared as incompatible.

Buendía Sierra, ""An analysis of Article 86(2) EC", in SANCHEZ-RYDELSKI, M. (ed.), The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade, Cameron May, London, 2006, pp. 541 to 574, in particular, p. 541.

[31] It's clear that this wasn't the first time...

[32] The text relating to this article is exactly the same as that of the Treaty of the Economic European Community (1956), where it existed as Article 222.

[33] Paris, 1951. It was establishing in the Article 4 ECSC that "The following are recognized as incompatible with the common market for coal and steel and shall accordingly be abolished and prohibited within the Community, as provided in this Treaty:

[...]

(c) subsidies or aid granted by States, or special charges imposed by States, in any form whatsoever; [...]".European Coal and Steel Community Treaty (ECSC) expired on 23 July 2002.

[34]Rome, 1957. Name of the Treaty thereafter was the Treaty establishing the European Community (TEC). On 1 December 2009, the Treaty of Lisbon entered into force and TEC changed to Treaty on the Functioning of the European Union (TFEU)

[35] Vid. ROBERTI, G. M. (1993): "Le contrôle de la Commission des Communautés Européennes sur les aides nationales", en *L'Actualité Juridique-Droit Administratif*, nº 6, 20, juin, París, pp. 397 a 411, .p. 399

Article 107.1 TFEU (ex Article 87 TEC) provides thus : "*1. 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.*"

It was the European Jurisprudence which, once again, provided a definition for State Aid, identifying it with the idea of "economic free advantage"[36]. This concept is confirmed in the Judgment of the Court, 24 July 2003[37], Altmark Trans and Regierungspräsidium Magdeburg and Nahverkehrsgesellschaft Altmark GmbH (widely known as the Altmark case), where it is stipulated that the 107.1 TFEU: "[...] lays down the following conditions. First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition."

The expression "*in any form*", enabled the Commission to develop a notion of State Aid which was extensive in its scope, including for example public injections of capital, which, initially, were not considered to be State Aid[38]. It wasn't until the eighties when the Commission presided in the first cases[39]. The European Court of Justice immediately recognized that State Aid could exist under public injections of capital[40], even if this is still a very controversial form of State Aid - since Member States usually do not notify them.

We must remember that even if a measure is declared a State Aid, within the context of EC Treaty (now TFEU), it can be considered legal if any of the exceptions of Articles 107(2) and (3) TFEU are fulfilled. And, in the cases of the so called "Services of General Economic Interest" (SGEI), the exception of Article 106(2) TFEU [ex Article 86(2) EC][41].

A decisive and problematic moment in the relations between Member States and the public sector occurred, undoubtedly, when the Commission adopted the Commission Directive

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[36] In the Judgment of the Court of 15 March 1994. Banco de Crédito Industrial SA, now Banco Exterior de España SA v Ayuntamiento de Valencia. Case C-387/92. ECR 1994 Page I-00877

[37] Case C-280/00, ECR 2003 p. I-7747.

[38] The first reference being the Commission Decision 2320/81/ECSC, of August, 7, 1981, establishing Community rules for aids to the steel industry (OJ L 228, 13.6.1981p. 14) and the Council Directiva 81/363/EEC, of 28 April 1981 on aid to shipbuilding (OJ L 137, 23.5.1981, p. 39. Meanwhile, the first Commission's document about equity infusions and MEIP was The Commission's position: Application of Articles 92 and 93 (now 87 and 88) of the EEC Treaty to public authorities' holdings, Bulletin EC 9-1984. This was the topic of our Thesis, *The participation in the capital of enterprises as a form of State Aid* (available only in the Spanish version), March, 8, 2002. This thesis was published as a monograph, J.A. Rodríguez Miguez, *The participation in the capital of enterprises as a form of State Aid* (available only in the Spanish version), EGAP, Santiago de Compostela, 2003.

[39] See Decisions in the cases Balamundi1 (OJ L 138, 19.5.1982, p. 18).), Intermills1 (OJ L L 280, 2.10.1982, p. 30) and Leeuwarder (OJ L 277, de 29.9.1982, p. 15).

[40] The ECJ recognized this possibility for the first time in its Judgment of November, 14, 1984, SA Intermills *et alii* v. European Commission, case 323/82, ECR.. 1984, p. 4295. Nevertheless, as we quoted in our thesis, it was the Attorney General, Sir Gordon Slynn, who first made this proposal - in his opinions in the case 84/822, Federal Republic of Germany v. European Commission, ECR.. 1984-3, p. 1451; even these questions were not reflected in the judgment of the Court.

[41] For more information on State Aids and SGEI, see, J. L. Buendía Sierra, "An analysis of Article 86(2) EC", in M. Sanchez-Rydelski (ed.), *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade*, Cameron May, London, 2006, pp. 541 to 574; and, of the same author, "Finding the right balance: State Aid and Services of General Economic Interest", in *EC State Aid Law. Le droit des Aides d'Etat dans la CE. Liber Amicorum Francisco Santaolalla Gadea*, Wolters KluwerHolanda, 2008, pp. 191 to 222.

80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings[42], the so called “Transparency Directive”.

This Directive compelled Member States to demonstrate their financial links with the public sector.[43]

As a means of protesting against such a rule, some Member States went to the European Court of Justice claiming its legality – however this was rejected by the Court in its Judgment of 6 July 1982.[44]

However, we must recognise that, neither State aids, nor mergers, which were used in some cases in the capacity of rescue instruments of firms in difficulties constitute the “magic formula” for solving all financial problems, especially if State Members use them for their own particular interests. Rescue aid, as we shall see, are merely short term solutions[45], because, as the former Competition Commisioner Nelie Kroes declared, State aids are only “part of the solution”[46].

I. What Constitutes a State Aid?

Firstly, a clarification on what constitutes a State aid is required from the perspective of the European legal system, because it is not an intuitive notion (as many State measures are not really, and formally State aids).

a) Bases for Assessment

Article 107(1) TFEU [ex Article 87(1) EC] establishes that “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

[42] OJ L 195, 29.7.1980, p. 35.

[43] Nevertheless, even the 1985 reform of this directive, the Commission Directive 85/413/EEC of 24 July 1985 amending Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings by the Commission Directive 85/413/EEC of 24 July 1985 (OJ L 229, 28.8.1985, p. 20), that established that This Directive shall not apply to financial relations between the public authorities and:

(a) public undertakings, as regard services the supply of which is not liable to affect trade between Member States to an appreciable extent;

(b) central banks and the Institut Monétaire Luxembourgeois;

(c) public credit institutions, as regards deposits of public funds placed with them by public authorities on normal commercial terms;

(d) public undertakings whose total turnover before tax over the period of the two financial years preceding that in which the funds referred to in Article 1 are made available or used has been less than 40 million ECU. However, for public credit institutions the corresponding threshold shall be a balance sheet total of 800 million ECU.'

OJ L 229, 28.8.1985, p. 20

[44] French Republic, Italian Republic and United Kingdom of Great Britain and Northern Ireland v Commission of the European Communities. Joint cases 188 to 190/80. European Court Reports 1982 Page 02545.

[45] The difference between short, medium and long term measures is clarified in Antonio Sáins de Vicuña’s foreword in Ana Petrovic and Ralf Tutsch’s legal working paper, *National Rescue Measures in Response to The Current Financial Crisis*, ECB Legal Working Series, nº 8, july, 2008, p. 4.

[46] KROES, N. (European Commissioner for Competition Policy): “EU state aid rules – part of the solution”, *EStAL* conference, Luxembourg, 5th December 2008, Reference: SPEECH/08/679 Date: 05/12/2008 [http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/679&format=HTML&aged=0&language=EN&guiLanguage=en]

undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

According to this provision, "State aid" is any aid granted by a Member State or (ii) through state resources[47] in any form whatsoever and which iii) distorts or threatens to distort competition by favouring certain undertakings as far as it affects trade between Member States." [48]

For the purposes of this study, we must take into account one fundamental distinction between "aid scheme" and "Ad hoc". In accordance with the Council Regulation (EC) No 659/1999 of 22 March 1999 setting down detailed rules for the application of Article 93 of the EC Treaty [now, article 108 TFEU][49], Article 1 ("Definitions"):

- "(d) 'aid scheme` shall mean any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount;"

And

- "(e) 'individual aid` shall mean aid that is not awarded on the basis of an aid scheme and notifiable awards of aid on the basis of an aid scheme;" (also known as "Ad hoc Aid",).

As can be seen, the first State Aid measures were "ad hoc" aid, because member states regarded the crisis as a crisis of individual institutions, but later, aid schemes were adopted - particularly after Lehman Brothers' bankruptcy (where the danger of a systemic crisis was evident).

b) Individual Undertakings in Difficulty

State aid to individual undertakings in difficulties is usually assessed under Article 87 (3)(c) of the EC Treaty [Article 107 (3)(c) TFEU] and the Community Guidelines on State aid for rescuing and restructuring firms in difficulty.[50] As well as the grant of the Commission's consent for state aids to be utilised as remedies in situations which involve serious threats of instability to the economy of member states - pursuant to Article 87(3)(b), a restrictive interpretation of what can be considered to be "a serious disturbance of a member state's economy" is also required under Article 87(3)(b) EC [now, Article 107(3)(b) TFEU].[51]

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[47] In SCJEC of March, 17, 1993, Firma Sloman Neptun Schiffahrts AG c. Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG (joints cases C-72/91 y C-73/91, ECR. 1993, p. I-0887), both conditions are considered equivalent. For a wide view of the notion of State Aid, see the classical article, M. M. Slotboom, "State Aid in Communty Law: A Broad or Narrow Definition?", in ELR, vol. 20, nº 3, June 1995, pp. 289 a 301.

[48] For a general and complete overview on European State Aid Law, see. QUIGLEY, C.: *European State Aid Law and Policy*, Second Edition, Hart Publishing, Portland, 2009 y BACON, K.: *European Community Law of State Aid*, Oxford University Press, Oxford, 2009.

[49] OJ L 83, 27.3.1999, p. 1.

[50] OJ C 244, 1.10.2004, p.2 (hereinafter R and R guidelines). Such guidelines "articulate the Commission's understanding of Article 87(3) (c) of the Treaty for this type of aid." See ibid; paragraph 6

[51] see ibid at paragraphs 7 - 8

The guidelines define the notion of "firm in difficulties[52]. As a result, even the Commission recognises that no Community definition exists in relation to what constitutes «a firm in difficulty». However, and for the purposes of these Guidelines, the Commission regards a firm as being in difficulty "where it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term.

The Commission provides further clarity by adding that:

"10. In particular, a firm is, in principle and irrespective of its size, regarded as being in difficulty for the purposes of these Guidelines in the following circumstances:

(a) in the case of a limited liability company(4), where more than half of its registered capital has disappeared(5) and more than one quarter of that capital has been lost over the preceding 12 months;

(b) in the case of a company where at least some members have unlimited liability for the debt of the company(6), where more than half of its capital as shown in the company accounts has disappeared and more than one quarter of that capital has been lost over the preceding 12 months;

(c) whatever the type of company concerned, where it fulfils the criteria under its domestic law for being the subject of collective insolvency proceedings."

In addition, the Commission elaborates on these guidelines:

"14. Rescue aid and restructuring aid are covered by the same set of guidelines, because in both cases the public authorities are faced with a firm in difficulty and the rescue and restructuring are often two parts of a single operation, even if they involve different processes.

15. Rescue aid is by nature temporary and reversible assistance. Its primary objective is to make it possible to keep an ailing firm afloat for the time needed to work out a restructuring or liquidation plan. The general principle is that rescue aid makes it possible temporarily to support a company confronted with an important deterioration of its financial situation reflected by an acute liquidity crisis or technical insolvency. Such temporary support should allow time to analyse the circumstances which gave rise to the difficulties and to develop an appropriate plan to remedy those difficulties. Moreover, the rescue aid must be limited to the minimum necessary. In other words, rescue aid offers a short respite, not exceeding six months, to a firm in difficulty. The aid must consist of reversible liquidity support in the form of loan guarantees or loans, with an interest rate at least comparable to those observed for loans to healthy firms and in particular the reference rates adopted by the Commission. Structural measures which do not require immediate action, such as, the irremediable and automatic participation of the State in the own funds of the firm, cannot be financed through rescue aid."

This Guideline included in its footnote 15[a] special rules for banking sector. In this footnote, Commission stated:

[52] Points 9 and 10.

"(15) An exception may be made in the case of rescue aid in the banking sector, in order to enable the credit institution in question to continue temporarily carrying on its banking business in accordance with the prudential legislation in force (Directive 2000/12/EC of the European Parliament and of the Council, OJ L 126, 26.5.2000, p. 1). At any rate, aid granted in a form other than loan guarantees or loans fulfilling the conditions set out in point (a), should fulfil the general principles of rescue aid and cannot consist in structural financial measures related to the bank's own funds. Any aid granted in a form other than loan guarantees or loans fulfilling the conditions set out in point(a), will be taken into account when any compensatory measures under a restructuring plan are examined in accordance with points 38 to 42."

These were the general rules used by the Commission in the preliminary cases of the recent financial crisis.[53] Cases such as the British Northern Rock[54], the German IKB[55] or Sachsen LB[56]. Obviously, the reason being that the Commission considered these preliminary cases to be individual crises of non large entities so, therefore it applied the normal rules of rescue and restructuring firm in difficulties, with special rules for banking sector, established under the general guidelines.

As can be seen, following the adoption of the 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[57] (hereinafter "the Restructuring Communicaton"), this Communication confers special rules for the restructuring plans of financial institutions.[58]

c) Impact of the Recent Crisis

In addition, under Article 87(3)(b) of the Treaty (Article 107 (3)(b) TFEU), the Commission may allow State aid 'to remedy a serious disturbance in the economy of a Member State'.[59] This is a more exceptional legal basis for the grant of State aids, because it had only been used once by the Commission. Precisely in the financial sector[60].

In the light of the level of seriousness of the current crisis in the financial markets and its possible impact on the overall economy of Member States, the Commission considers that Article 87(3)(b) is, in the present circumstances, available as a legal basis for aid measures undertaken to address this systemic crisis.[61]

[53] See RODRÍGUEZ-MIGUEZ; J.A.: „Rescue..., op. cit., p. 19
[54] Aid C14/2008. Decision 28.10.2009. See. Resume of the case in http://ec.europa.eu/competition/elojade/isef/index.cfm?fuseaction=dsp_result
[55] Case C10/2008, Restructuring aid to IKB (Decision 21.10.2008).
[56] Case C9/2008, Restructuring aid to Sachsen LB (decision 4.6.2008).
[57] OJ C 195, de 19.8.2009, p. 9.
[58] This idea is clarified in Christian Ahlborn and Daniel Piccinin [AHLBORN, Ch./PICCININ, D.: "The Application of the Principles of Restructuring Aid to Banks during the Financial Crisis", in *ESTAL*, 1|2010, pp. 47 to 64; in particulart, pp. 54 and 56], which stipulate that these (still) new and specific guidelines, the restructuring aid in the banking sector be analyzed under the general rules of the R & R Guidelines. This new communuication from the Commission confers specific rules for specific crisis situations.
[59]See Paragraph 7 of the Banking Communication.
[60]Greece was granted State aid on this basis (Article 87.3.b EC, now 107(3)(b) within a context of a grave national economic crisis. *Cfr*. RODRIGUEZ CURIEL, J. W., *Ayudas de Estado a empresas públicas: las aportaciones de capital y otras medidas de financiación de empresas públicas o con participación pública, como ayudas de Estado según el Tratado de la CEE*, Ministerio de Industria y Energía, Secretaría General Técnica, Madrid, 1990, p. 147 (anexo 11.11. Greek law on organization for the financial recovery of the companies).
[61]Paragraph 9 of the Banking Communication

II. State Aids: Rescue and Restructuring Measures

a) Rescue Aid, Guarantees, Controlled Winding Down of Financial Institutions and Provision of Other Forms of Liquidity Assistance.

The Commission has proceeded with "the swiftness that is necessary to ensure legal certainty and to restore confidence in financial markets' in applying criteria relevant for the compatibility with the Treaty, as well as individual and ad hoc cases of systemic relevance pursuant to paragraph 5 of section 1 of the Banking Communication.

The Commission's desire to facilitate swiftness is demonstrated through its flexible approach to procedures as illustrated through its decision and willingness to extend proceedings and to temporarily find compatible with the Common Market several capital injections[62] Even though such flexibility can be criticised as not facilitating a very high degree of legal certainty, a rigid and very restrictive approach to the application of procedures would have impeded the swiftness in facilitating a restoration of confidence to the financial markers.

The impact of the recent crisis on the choice of legislation reflects the Commission's eagerness to facilitate a speedy restoration of confidence to financial markets. Initially, the rescue decision had concluded that it was not considered necessary to assess whether Article 107(3) (b) TFEU would apply since the rescue measures had been found compatible on the basis of Article 87(3)(c) EC (Article 107 (3)(c) TFEU) and in particular, the Rescue and Restructuring Guidelines.[63]

Against the background of the recent global financial crisis (whereby it was widely accepted that "a serious disturbance in the economy of Member States had occurred and that measures supporting banks are appropriate to remedy this disturbance")[64] and taking into account the objective of the proposed aid measures, namely, the facilitation of Rumpco's wind-down, it was held that the legal basis for the assessment of these measures should be Article 107(3)(b) TFEU. Whereas State aid to individual undertakings in difficulties is usually assessed under Article 87 (3)(c) of the EC Treaty and the Community Guidelines on State aid for rescuing and restructuring firms in difficulty, the systemic relevance of a financial institution and the impact of such an institution's failure on the economy, was reflected by the preference for Article 87(3)(b) EC Treaty (Article 107(3)(b) TFEU).[65] - which was available as a legal basis for aid measures undertaken to address the systemic crisis. Ultimately, the Commission published specific guidelines in the Communication "return to viability and the assessment of

[62]See European Commission, „State aids n° C 15/2009 (ex N 196/2009), N 333/2009 & N 557/2009 - Germany Hypo Real Estate – Extension of formal investigation procedure, and temporary find capital injections compatible"

[63] See European Commission, "State aid N 194/2009 –United Kingdom: Liquidation Aid to Bradford and Bingley Plc section 4 paragraph 44

[64] "This having been confirmed in various Commission communications such as the *Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis(hereinafter "the Banking Communication"), its Communication on the re capitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (hereinafter "the Recapitalisation Communication"), and its 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 (hereinafter "the Restructuring Communication")."*

[65] Under which the Commission may allow State aid 'to remedy a serious disturbance in the economy of a Member State.'

restructuring measures in the financial sector in the current crisis under the State aid rules (The "Restructuring Communication"[66].

The legal certainty demonstrated in applying Articles 107 (1) TFEU (ex Article 87(1) EC) and Article 87(1) EC, in determining what constituting State aid will be illustrated by cases relating to Bradford and Bingley[67] and Hypo Real Estate.

b) Guarantees Covering the Liabilities of Financial Institutions

The general principles underlying the State aid rules of the Treaty, which require that the aid granted does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimized as far as possible, and taking due account of the current circumstances, as well as the observance of these stated criteria [68] translate into the following considerations as regards guarantee schemes protecting liabilities established by way of a declaration, legislation or contractual regime, it being understood that these considerations are of a general nature and need to be adapted to the particular circumstances of every individual case.[69]

Emergency guarantees[70] constitute the first identified systemic measure in response to the recent financial crisis whilst the re capitalisation[71] of financial institutions constitute the "second systemic measure in response to the recent financial crisis to be used to support financial institutions that are fundamentally sound but which may experience distress because of extreme conditions in financial markets."[72] Other measures which may serve as supplements to rescue aids include the controlled winding up[73] of financial institutions and the provision of other forms of liquidity assistance.[74]

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[66] OJ C 195, de 19.8.2009, p. 9.

[67] Decision not to raise objections IP/08/1437.

[68] Stated criteria in paragraph 15 of the Banking Communication (in compliance with the State aid rules and the fundamental freedoms enshrined in the Treaty, including the principle of non-discrimination)

[69] See Section 3 Paragraph (17) of the Banking Communication

[70] Guarantees Covering the Liabilities of Financial Institutions granted either under a national scheme or on an *ad hoc basis*, with the requirements of Article 107 (3) (b) TFEU; see section 3 paragraph 17;ibid

[71] see section 4 paragraph 34;ibid. The recapitalisation of financial institutions is also considered comprehensively in the Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (2009/C 10/03)

[72]See Banking Communication Section 4 paragraph 34 of the "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" (2008/C 270/02) at page 5

[73]"Such a controlled liquidation, possibly carried out in conjunction with a contribution of public funds, may be applied in individual cases, either as a second step, after rescue aid to an individual financial institution when it becomes clear that the latter cannot be restructured successfully, or in one single action. Controlled winding-up may also constitute an element of a general guarantee scheme, e.g. where a Member State undertakes to initiate liquidation of the financial institutions for which the guarantee needs to be activated."

See section 5; paragraph 43 of "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" (2008/C 270/02).

[74] "Complementary forms of liquidity support - with the provision of public funds (including funds from the central bank)", may be implemented by Member States as accompaniments to guarantees or recapitalisation schemes, in addressing very serious liquidity problems encountered by financial institutions. See paragraph 51;ibid.

It should be highlighted that financial institutions must respect the solvency ratio for financial activities[75] and these measures stipulate this clear objective.

Government guarantees, along with the monetary actions of central banks which are aimed at lowering interest rates as well as providing banks with exceptional amounts of liquidity, have served as means of addressing general liquidity needs of banks.[76]

The Law on the implementation of a "package of measures to stabilise the financial market"[77] – which came into effect on the 18 October 2008, and the Order implementing the Law on the financial market stabilisation fund,[78] constitute the basis of the German scheme. Measures included within the scheme comprise guarantees, re capitalisation , the acquisition of risk positions, and nationalisation.[79]

Eligible institutions which fall within the scope of the scheme comprise solvent financial sector entities which have their registered office in Germany, namely: (i) institutions established under the Law on banking; (ii) insurance corporations and pension funds established under the Law on insurance supervision; (iii) asset management companies pursuant to the Law on investment; and (iv) operators of stock exchanges and derivatives exchanges.[80]

III. Hypo Real Estate[81]

On the 2nd of October 2008[82], a rescue aid package was granted by the Commission to Hypo Real Estate (hereinafter referred to as HRE).[83] Formal investigation procedures were instigated by the Commission – in relation to HRE on the 7th May 2009.[84] Further measures were also communicated by the German authorities on the 26th October 2009[85] and these included SOFFin guarantees of 8 billion Euros for HRE and SOFFin guarantees of 10 billion

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75 See Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on thecapital adequacy of investment firms and credit institutions (recast) [OJ L 177, 30.6.2006, p. 201].

76 See DG Competition Staff Working Document, „The Application of State Aid Rules to Government Guarantee Schemes Covering Bank Debt to be issued after 30 June 2010" April2010 at page 2

77 Gesetz zur Umsetzung eines Maßnahmenpakets zur Stabilisierung des Finanzmarktes, (2008) Bundesgesetzblatt I, p. 1982. Article 1 of the law is the Law on the Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfondsgesetz). ; see A Petrovic and R Tutsch, „National Rescue Measures in Response to the Current Financial Crisis" ECB Legal Working Paper Series No 8/ July 2009 at page 35 http://www.ecb.europa.eu and http://ssrn.com/abstract_id=1430489

78 *Verordnung zur Durchführung des Finanzmarktstabilisierungsfondsgesetzes*, (2008), eBAnz. AT123 V1;which came into force a day after; see ibid

79 "The German rescue package was approved by the Commission in its Decision of 27 October 2008 in Case No N 512/08 *Support measures for financial institutions in Germany* (OJ C 293, 15.11.2008, p. 2)."; ibid

80 see A Petrovic and R Tutsch, „National Rescue Measures in Response to the Current Financial Crisis" ECB Legal Working Paper Series No 8/ July 2009 at page 35

81 See European Commission, „"State aid NN 44/2008 – Germany Rescue Aid for Hypo Real Estate" at page 2 of 9 <http://ec.europa.eu/competition/state_aid/register/ii/doc/NN-44-2008-WLWL-en-02.10.2008.pdf>
We should not forget that this entity failed in the recent stress test.

82 Commission decision of 2.10.2008, OJ C 293, 15.11.2008, p. 1

83 European Commission, "European Commission State aid n° N 694/2009 – Germany Emergency guarantees for Hypo Real Estate" paragraph 1 at page 1

84 See Commission decision of 7 May 2009, replaced by decision of 24 July 2009 in case C 15/2009 (ex N 196/2009), OJ C 240, 7.10.2009, p. 11) and ibid paragraph 2

85 Case number: N 557/2009

Euros for HRE.[86] On the 13th November 2009, the formal investigation procedures of 7th May were extended by the Commission (with the inclusion of the stated guarantees of 8 and 10 billion Euros) – along with the temporary grant of several capital injections.[87]

(a) Rescue Aid : Facts of the Case

The events culminating in the grant of rescue aid to Hypo Real Estate (hereinafter referred to as HRA) can be summed up as follows: HRA acquired Depta (Deutsch Pfandbrief bank AG) in 2007. Depfa's business which was characterised by low risk premiums resulted in principally long term credits being refinanced using short or medium term credit lines – a process known as "term transformation."[88] The rescue measure was triggered as a result of the expiration period of a large par t of Depfa's short term refinancing measures – which was fast approaching and which was in need of renewal.[89] Depfa's inability to obtain refinancing at short notice because of the collapse of the interbank's market – such collapse being attributed to the year long financial crisis (particularly events which occurred in the aftermath of September 2008 – including the collapse of Lehman Brothers) meant that HRE had to secure financing for Depta's short term liquidity needs.[90]

b) Consequences of Hypo Real Estate's Insolvency

Three consequences emanating in the event of HRE's insolvency, as identified are as follows:[91]

- Firstly, it would lead to very serious disturbances in the money markets in Germany and in the European Union.

- Secondly, there is a danger of serious distortions of payment transactions, for example in the case of transactions involving foreign exchange, securities or derivatives.

- Thirdly, it would damage the covered bond market, which plays an important role in refinancing the banks, particularly at this time of crisis. "[92]

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86 European Commission, "European Commission State aid n° N 694/2009 – Germany Emergency guarantees for Hypo Real Estate" paragraph 3

87 see ibid paragraph 4 and Decision C(2009) 8967 final)

88 see ibid paragraph 5 of section 2.2

89 paragraph 6; ibid

90 ibid; However, the amount of the credit line to be repaid on 30 September was too large for HRE.

"From 26 to 29 September intensive consultations took place at the Federal Financial Supervisory Authority (hereinafter "BaFin") between representatives of HRE, private banks, the Federal Bank and BaFin. The aim of these discussions was to find a solution for HRE's liquidity problems which had arisen at short notice. The starting point was that a credit line of €35 billion is necessary in order to ensure HRE's liquidity in the medium term. A liquidity forecast was used to justify this to the Commission. In the night from 28 to 29 September, the German Federal Bank and BaFin announced that the German financial sector and the Federal Bank would grant HRE a credit line of €35 billion. The Federal Bank and BaFin assume that HRE's commercial viability is ensured. Thus, the systemic reduction of HRE´s risk positions should be enabled and damage to the German and European financial markets should be avoided." See paragraphs 7-8;ibid.

91 See paragraph 18 at page 5 of 9; ibid

92 "At around €900 billion, the German covered bond market is the second largest in the world. HRE represents around one fifth of this market. Covered bonds are a popular form of investment abroad, including in the USA, and confidence in them is high. Germany considers that the consequences of an uncontrolled collapse would be inestimable for the many creditors of HRE, with many banks being involved. Germany also states that pension schemes, professional associations, *Bundesländer* and municipalities had, in some cases, invested hundreds of millions in the Munich-based institute." ibid

c) SOFFin Guarantees

What Constitutes State Aid? (Article 107 (1) TFEU): Evaluation of 8 and 10 billion Euros worth of SOFFin Guarantees.

In assessing what constitutes the existence of State aid under Article 107(1) TFEU, the Commission arrived at the preliminary conclusion that "all measures granted till May 2009 were to constitute State aid within the meaning of Article 107(1) TFEU."[93] Further, the Commission considered the 8 and 10 billion worth of SOFFin guarantees to HRE to be State aid – in accordance with the conclusion in respect of guarantees addressed in the opening decision and the preliminary decision of the extension decision.[94] It regarded the guarantees as State aid since HRE would not have received them in the private market under the present conditions.[95]

Furthermore, the Commission justified its decision to consider the guarantees as State aid since:[96]

i) It considered it evident that the guarantees were from State resources
ii) They had been offered to one bank only; and that
iii) Because HRE is active in the banking sector (which is characterised by competition across member states), these measures distort competition and affect inter State trade.

(d) Compatibility of aid with the Internal market: The requirement of a Condition aimed at remedying "a serious disturbance in the economy of a member state."(Article 107(3)(b) TFEU.

In line with the general principles which constitute the basis of State aid rules of the Treaty, which require that the aid granted "does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimized as far as possible, and taking due account of the current circumstances, all general support measures are require to be":[97]

- well targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy;
- proportionate to the challenge faced, not going beyond what is required to attain this effect; and
- designed in such a way as to minimize negative spill over effects on competitors, other sectors and other member states."

Article 107 (3) (b) TFEU allows the Commission to find aid compatible with the internal market if it serves " to remedy a serious disturbance in the economy of a Member State".[98]

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[93] European Commission, "European Commission State aid n° N 694/2009 – Germany Emergency guarantees for Hypo Real Estate" at page 3 (section 4.1 paragraph 18)
[94] ibid at paragraph 19
[95] ibid
[96] ibid
[97] See section 3 paragraph 15 of the Banking Communication
[98] European Commission, "European Commission State aid n° N 694/2009 – Germany Emergency guarantees for Hypo Real Estate" at page 4 section 4.2.1 paragraph 21

The Commission justified its assessment of State aid measures in the banking sectors at the time, in view of the current fragile state of the financial markets and with regards to the fact that the collapse and failure of a systemically relevant bank can directly affect the financial markets and indirectly the entire economy of a Member State.[99] Furthermore, the supervisory authority, BaFin, indicated that "a collapse of HRE group would have considerable negative effects on the national and international financial markets, with the potential to cause major disruptions and to eliminate the trust that has recently resurged."[100] The Commission, on these bases, assessed the State aid measures for HRE under Article 107(3)(b) TFEU.

(e) Are Guarantees Appropriate, Necessary and Proportional?

In arriving at the conclusion that the guarantees were appropriate, necessary and proportional at the time, and in considering their compatibility with the Internal Market on the basis of Article 107(3)(b)TFEU on a temporary basis, the Commission based its decision on the following considerations:[101]

i) That from the information provided by Germany, it was evident that HRE was still experiencing serious difficulties in covering its refinancing needs without continued State support, and therefore State guarantees on its funding operations are an appropriate means and necessary to ensure that it can maintain its operations.

ii) In cases where financial stability is at stake and urgent remedial action is needed to keep the ailing bank afloat - as in the present case -, it can be accepted that it is necessary to temporarily grant emergency aid prior to the final assessment of the revised restructuring plan.

iii) The guarantee amounting to EUR 8 billion is proportionate as it is limited in amount and time.

iv) The guarantee amounting to EUR 10 billion is proportionate as it is limited in time and amount.

(f) Decision in Respect of Guarantees and Rescue Aid

The Commission decided to temporarily find compatible with the internal market the SoFFin guarantee of EUR 8 billion in favour of HRE.[102] In respect of the 10 billion Euros, the Commission also decided to temporarily find compatible with the internal market the granting of a SoFFin guarantee of EUR 10 billion in favour of HRE granted before 21 June 2010.[103]

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[99] ibid

[100] ibid at paragraph 22

[101] see ibid at paragraphs 24-27

[102] "while the conditions of the guarantee might be reviewed in the Commission's final decision on the restructuring plan." See ibid section 5

[103] "But for a duration which will in any case be one year at maximum, while the conditions of the guarantee might be reviewed in the Commission's final decision on the restructuring plan." ibid

The Commission's decision to regard the rescue aid measure for HRE as State aid within the meaning of Article 87(1) of the EC Treaty was based on the following considerations:[104]

i) The fact the provision by the consortium and the Federal Bank of the liquidity lines guaranteed through the Federal Government's default guarantee constitutes state resources benefiting HRE, and thus distorting or threatening to distort competition, and affecting trade between Member States in which HRE takes part as an international bank.
ii) HRE derives a selective advantage from the measure. The Commission would recall that any intervention financed using public resources that gives a company an advantage constitutes state aid under Article 87(1) of the EC Treaty, unless an investor acting under normal market conditions would have also taken such a measure. The Federal Government's decision to provide the default guarantee in question must therefore satisfy the principle of the market-economy investor in order to exclude state aid elements.
iii) Without the Federal Government's above-average involvement, no private participation at all would have been possible. For this reason, the Commission concludes that an investor acting under normal market conditions would at least not have granted HRE such a high liquidity line or default guarantee. The measure in question therefore constitutes state aid, despite the participation of private parties. Moreover, the Commission notes that Germany notified the measure as state aid, and therefore does not call the classification as such into question.
iv) The granting of the emergency liquidity line amounting to […] by the German Federal Bank is an aid measure too because, according to the Commission's decision-making practice, it does not satisfy the criteria for central bank liquidity lines not constituting aid, as the liquidity line could be granted without eligible securities and thus only on the basis of the Federal Government's default guarantee.[105]

In sum, as well as arriving at the decision that: i) Pursuant to Article 87(1) of the EC Treaty, that the measure was to be regarded as a state aid; (ii) That the component of the aid measure which was implemented in violation of Article 88(3) of the EC Treaty (Article 108(3) TFEU) was to be regarded as non-notified state aid; the Commission also concluded that since such a measure was compatible with the common market – pursuant to Article 87(3)(c), ii) no objections were to be raised against it.[106]

In January 2009, the German government had promulgated necessary procedures aimed at facilitating the adoption of legislation which would enable it acquire a majority stake holding

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[104] See European Commission, „"State aid NN 44/2008 – Germany Rescue Aid for Hypo Real Estate" paragraphs 20 –22 at page 6 of 9 <http://ec.europa.eu/competition/state_aid/register/ii/doc/NN-44-2008-WLWL-en-02.10.2008.pdf>

[105] It had to be first be established that the consortium's private participation in the liquidity line for HRE did not disqualify the measures from the outset from being state aid. The Federal Government was much more exposed than the consortium's banks since it is taking a far greater risk than the institutes belonging to the consortium, since it, in contrast to the institutes, is providing and guaranteeing liquidity over and above the mark-to-market amount of the collateral. It seems, however, that the entire amount is needed in order to overcome HRE's present difficulties.

See ibid; paragraph 23 at page 7 of 9

[106] See ibid at page 8 of 9.

in Hypo.[107] The squeeze-out of minority shareholders - this being approved by a court in Munich in October 2009, paved way for the German government's rescue fund SoFFin to get 100 percent of the real estate lender.[108]

“Evidence shows that the use of guarantees has considerably declined since the peak in the first half of 2009 in terms of both numbers of issues of guaranteed bank debt and volume of issuances.[109] The data collected further demonstrates that the number of banks resorting to government guarantees is shrinking and that this group is now essentially made up of banks that are: [110]

- either already undergoing restructuring following a Commission decision or where a restructuring commitment has been made pending a final decision on its exact form or shape; or
- that are under no such obligation, but have a relatively low rating of A or below or no rating.

IV) Rescue Aid Case: The Bradford and Bingley Case

a) Rescue aid to Bradford & Bingley

The rescue aid package for which authorisation was sought by the UK authorities was to comprise of i) The working capital facility and ii) Guarantee arrangements for wholesale depositors.[111] Bradford and Bingley[112], in the UK authorities’ view, was regarded as having satisfied the requirements for the grant of State aid based on paragraphs 9-11 of the Community Guidelines[113] – since it was considered to be a firm in difficulty, and also because it satisfied the “one time last time” principle.[114] Furthermore, the measures were regarding as being compatible with the common market for the purposes remedying “a serious disturbance in the economy of the United Kingdom”- pursuant to Article 87(3)(b) of the EC Treaty [Article 107(3)(b) TFEU].[115]

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107 See Reuters, “Hypo Real Estate’s path to Nationalisation” <http://www.reuters.com/article/idUSTRE5381WB20090409 >

108 See Reuters, “Hypo Real Estate is Nationalised with Squeeze Out” <http://www.reuters.com/article/idUSLD67573320091013>. “The Financial Market Stabilisation Authority purchased 47.31 % of Hypo Real Estate shares. This was to ensure that at the General Meeting, which would take place on 2 June 2009, the Financial Market Stabilisation Authority would have the simple majority of votes and thus be able to put through a capital increase. After the capital increase of EUR 3 billion, the Financial Market Stabilisation Authority was to subscribe to all new shares, which would give it 90 % of the voting rights. This would enable it to take over all shares by means of a squeeze-out. The planned acquisition by the Government was granted merger clearance by the Commission on 15 May 2009.”;see Petrovic and R Tutsch, „National Rescue Measures in Response to the Current Financial Crisis” ECB Legal Working Paper Series No 8/ July 2009 at page 41

109 DG Competition Staff Working Document, „The Application of State Aid Rules to Government Guarantee Schemes Covering Bank Debt to be issued after 30 June 2010” April2010 at page 2

110 see ibid at pages 2 and 3

111 “The UK authorities accept that the guarantee arrangements and the working capital facility contain State aid elements. However, the transfer package being not an aided undertaking for which the transferee paid the best price, the UK authorities considers that it does not contain State aid elements.” See European Commission, “State aid NN 41/2008 – United Kingdom Rescue Aid to Bradford & Bingley” paragraphs 22 and 26.

112 State aid NN 41/2008 – United Kingdom Rescue Aid to Bradford & Bingley”.

113 On State aid for Rescuing and Restructuring firms in difficulty – referred to as „the Rescue and Restructuring Guidelines”; ibid

114 “As it had not received any aid in the past 10 years “; ibid

115 ibid at paragraph 27

However, in contrast to the situation with Northern Rock, the effects of the credit crunch were considered to be far from restricted to individual banks in the UK.[116] Given these circumstances and owing to the fact that B&B was (at the time) the third significant mortgage lender to be in severe financial difficulties, a "real systemic risk" was considered to be in need of redress, and not merely individual difficulties.[117]

b) Do the Measures Constitute State Aid: Assessment under Article 87(1) EC [Article 107(1) TFEU]?

As with Hypo Real Estate, the Commission first assessed whether the measures were to be regarded as State aid pursuant to Article 87(1) EC – under which "state aid is any aid granted by a Member State or (ii) through state resources in any form whatsoever and which iii) distorts or threatens to distort competition by favouring certain undertakings as far as it affects trade between Member States."

Pursuant to Article 87(1) of the EC Treaty [Article 107(1) TFEU], the guarantee arrangements and the working capital facility were held, by the Commission, to constitute state aid.

In accordance with point 25 (b) of the Rescue and Restructuring Guidelines, the aims of the measures are as follows: [118]

- The prevention of serious social difficulties. Furthermore such measures have no unduly adverse spill-over effects on other Member States.
- The protection of the jobs of some of the workers of B&B - who in the case of an ordinary liquidation may have lost their jobs. The protection of depositors hence preventing a situation whereby the savings of UK citizens could be endangered.
- Maintaining confidence in the UK financial system – this being considered to be the most important of all the aims.

In its decision, the Commission held that pursuant to Article 87 (1) EC Treaty, the working liquidity facility and guarantee arrangements were to be treated as State aids. Furthermore, it held that aids associated with the Transfer Order (even though these were structural by nature) could be considered to be urgent rescue aids. Even though it was held that a breach had occurred and that aid measures constituted non notified State aid, no objections were raised by the Commission against these measures since they were also held to be compatible with the Common Market as rescue aid.[119]

[116] ibid
[117] ibid
[118] ibid at paragraph 47 and page 9 of 11; "The Commission did not consider it necessary to assess whether Article 87(3)(b) EC, which allows aid to remedy a serious disturbance in the economy of a Member State would apply at that stage in time - given that the Commission considers that the measure is compatible on the basis of Article 87(3)(c) EC." See ibid at paragraph 52
[119]See ibid at paragraphs 54 -56

3. RECAPITALISATION OF FINANCIAL INSTITUTIONS

1. Capitalisation and re-capitalisation: The specificity of Financial Institutions

It's not only a common sense rule, but also an economic and financial one too, that all firms must be equipped with adequate capital – as a means of achieving corporate goals. The first source of capitalisation is, obviously, capital granted by shareholders, but there are other sources, such as bank loans.

From a financial perspective the key term is "own funds" [120], - which includes not only "share capital", but all capital that assumes the risks of the firms activities.

Where capital, from this financial perspective, is not adequate for the execution of business activities, the firm must be recapitalised.

In the special case of financial institutions, regulatory institutions establish a specific level of capital, the "solvency ratio"[121], specially the so called Tier I (one) capital[122], that is the minimum that these kind of firms require to carry out their activities[123].

The recapitalisation of financial institutions is a very common form of State Aid, even if its classification as a State Aid is not particularly convincing. The so called Market Economy Investor Principle (MEIP) which is based on the comparison between State injections (capital

[120] For the purposes of this article, the notion „own funds" is provided by the Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [OJ L 177 of 30.6.2006, p. 1]

[121] Capital ratios are a measurement of a bank's capital strength – as implemented by regulatory agencies. Tier one (core) capital, the more important of the two, consists largely of shareholders' equity.

This is the amount paid to originally purchase the shares of the bank and retained profits (minus losses). Put simply, if the original stockholders paid £100 to buy their stock and the bank has made £10 in profits each year since, paid out no dividends and made no losses, after 10 years the bank's tier one capital would be £200.

National regulators now permit several other instruments other than common shares to be included as tier one capital, which are commonly referred to as upper tier one capital.

Tier two capital is also known as supplementary capital. Under the Basel I Accord, it is categorised as undisclosed reserves, revaluation reserves, general provisions, hybrid instruments and subordinated term debt (Source: Business glossary. Capital ratios - tier one and tier two. guardian.co.uk, Thursday 9 October 2008 15.13 BST

[122] As stipulated in the International Convergence of Capital Measurement and Capital Standards (July 1988, Updated to April 1998), Basle Capital Accord, under point nº 14: " 14. The Committee has therefore concluded that capital, for supervisory purposes, should be defined in two tiers in a way which will have the effect of requiring at least 50% of a bank's capital base to consist of a core element comprised of equity capital and published reserves from post-tax retained earnings (tier 1). Other elements of capital (supplementary capital) will be admitted into tier 2 up to an amount equal to that of the core capital. These supplementary capital elements and the particular conditions attaching to their inclusion in the capital base are set out below and in more detail in Annex 1. Each of these elements may be included or not included by national authorities at their discretion in the light of their national accounting and supervisory regulations.".

[123] Within this context, see Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) [OJ L 177 of 30.6.2006, p. 1].

and private injections), appears in this context. Only if both are equivalent can we exclude the presence of an element of State Aid[124].

Recapitalisation is also an instrument whose purpose serves to provide solvency to financial institutions to enable them recover the legal solvency ratio. However, at the same time, it sometimes gives to public authorities, control over the firm in question, and in this way, the possibility to change the financial institutional strategy.

The notion of recapitalisation is, as previously highlighted, more economic than strictly juridical, because it is not only linked to ordinary capital, but also to numerous risk instruments (sometimes hybrids), through which the State takes on risks of investing in the firm that received the public funds[125].

I. Recapitalisation Schemes and "Ad Hoc" State Aids

Guarantee schemes could be distinguished from recapitalisation schemes in that re capitalisation schemes are generally used in collaboration with financial institutions that are "fundamentally sound but which may experience distress because of extreme conditions in financial markets."[126] However, the Recapitalisation Communication also makes provision for banks which are not so fundamentally sound.[127]

The objective being the provision of public funds in order to "consolidate the capital base of the financial institutions directly or to facilitate the injection of private capital by other means, so as to prevent negative systemic spill- overs."[128]

Under section 2 paragraph 14 of the Banking Communication, distortions of competition resulting from schemes supporting the viability of institutions which are illiquid but otherwise fundamentally sound, will normally be more limited and require less substantial restructuring than those financial institutions which are particularly affected by losses stemming for instance from inefficiencies, poor asset-liability management or risky strategies. In the publication preceding this,[129] the justification for the grant of State aid to institutions whose

[124] For further information on the MEIP, see, J. A. Rodríguez Miguez, *The participation in the capital of enterprises as a form of State Aid* (available only in Spanish version), EGAP, Santiago de Compostela, 2003, Chapter V; P. Anestis and S. Mavroghenis, "The Market Investor Test", in SANCHEZ-RYDELSKI, M. (ed.), *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade*, Cameron May, London, 2006, pp. 109 to 127; N. Khan and K. D. Borchardt, "The Private Market Investor Principe: Reality Check or Distorting Mirror" in *EC State Aid Law. Le droit des Aides d'Etat dans la CE. Liber Amicorum Francisco Santaolalla Gadea*, Wolters KluwerNetherland, 2008, pp. 109 to 123.

[125] For further information on this wide interpretation of participation in capital (capital injection) see, J. A. Rodríguez Miguez, *The participation in the capital…op. cit.*.

[126] Recapitalisation schemes constitute a "second systemic measure in response to the recent financial crisis to be used to support financial institutions that are fundamentally sound but which may experience distress because of extreme conditions in financial markets." See Banking Communication Section 4 paragraph 34 of the "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" (2008/C 270/02) at page 5

[127] See Section 2.3 paragraph 43 of the Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition - which states that the recapitalisation of banks which are not fundamentally sound should be subject to stricter requirements. Furthermore, paragraph 44 states that

> "As far as remuneration is concerned, it should in principle reflect the risk profile of the beneficiary and be higher than for fundamentally sound banks. This is without prejudice to the possibility for supervisory authorities to take urgent action where necessary in cases of restructuring."

[128] See section 4 paragraph 34 of the Banking Communication

[129] M Ojo, "Liquidity Assistance and the Provision of State Aid to Financial Institutions" (2010) Munich RePEc and SSRN Working Papers

losses result from inefficiencies, poor asset-liability management or risky strategies was considered. Furthermore, the grant of State aid to such institutions was justified on the basis that systemic relevant institutions within this category[130], whose failure pose such disastrous consequences for financial stability, should not be allowed to fail.

With respect to purposes which the re capitalisation of banks could serve, three common objectives are listed in the Commission's Communication [131] and these are as follows:

i) Contribution to the restoration of financial stability as well as the restoration of the confidence needed for the recovery of inter-bank lending. Further, additional capital serves as a cushion during periods of recession by absorbing losses and reducing the likelihood and risk of banks becoming insolvent.[132]

ii) Facilitating lending to the real economy[133]

iii) State re capitalisation could also serve to address and rectify insolvency problems faced by financial institutions – such problems having arisen as a result of such institutions' particular business model or investment strategy.[134]

In respect of this third objective (for which the re capitalisation of banks could serve), it is interesting to note that Paragraph 6 of the Re capitalisation Communication, provides for "problems of financial institutions facing insolvency as a result of their particular business model or investment strategy" - given the fact that paragraphs 4 and 5 explicitly provide for fundamentally sound financial institutions. Whilst paragraph 4 *interalia* states that „additional capital provides a cushion during periods of recession, to absorb losses and limits the risk of banks becoming insolvent", paragraph 5 recognises that fundamentally sound banks may prefer to restrict lending in order to avoid risk and maintain higher capital ratios.

According to paragraph 6 of the Re capitalisation Communication, „a capital injection from public sources providing emergency support to an individual bank may also help to avoid short term systemic effects of its possible insolvency. In the longer term, re capitalisation could support efforts to prepare the return of the bank in question to long term viability or its orderly winding-up." Against the back drop of this exceptional provision, a case relating to the grant of capital injections for a non fundamentally sound financial institution will be considered.

[130] Category of institutions whose losses result from inefficiencies, poor asset-liability management or risky strategies.

[131] See paragraph 4 of the Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition

[132] ibid

[133] "Fundamentally sound banks may prefer to restrict lending in order to avoid risk and maintain higher capital ratios. State capital injection may prevent credit supply restrictions and limit the pass-on of the financial markets' difficulties to other businesses." see ibid at paragraph 5. Further, according to paragraph 39 of the Re capitalisation Communication, "When Member States use recapitalisation with the objective of financing the real economy, they have to ensure that the aid effectively contributes to this. To that end, in accordance with national regulation, they should attach effective and enforceable national safeguards to recapitalisation which ensure that the injected capital is used to sustain lending to the real economy."

[134] Furthermore recapitalisation may also respectively serve to address short term and long term systemic effects through capital injections from public sources providing emergency support to an individual bank and "supporting efforts to prepare the return of the bank in question to long term viability or its orderly winding-up." see ibid at paragraph 6

II. Hypo Real Estate (HRE) – Capital Injections

„In April 2010, the German Financial Markets Stabilisation Fund (SoFFin) approved the next re capitalisation tranches of up to €1.85 billion for Hypo Real Estate Holding AG (HRE), within the framework of the existing capital plan. It is planned that this capital be paid into HRE's capital reserve in at least two tranches as necessary. In particular, the re capitalisation is necessary in order for DEPFA BANK plc to maintain its minimum regulatory capital ratios in the near future. The capital measure is subject to approval by the European Commission. Including the support measure at hand, SoFFin has to date, provided total re capitalisation support of around € 7.85 billion to the HRE Group.“[135]

Having regards to i) Article 87(3)(b) EC Treaty which enables the Commission to declare aid compatible with the Common Market if it is "to remedy a serious disturbance in the economy of a Member State"; the fact that ii) Germany considered HRE to be a bank with systemic relevance for the financial market, iii) BaFin confirmed that the own capital of the bank would fall short of the regulatory requirements if the bank did not receive further capital and iv) that bank supervisory procedures would be initiated if the bank did not receive further capital, the Commission assessed the State aid measures for HRE under Article 87(3)(b) of the EC Treaty.[136]

„The Commission decided to assess the temporary compatibility of capital measures until a decision on the restructuring plan was taken - since Germany had asked for temporary approval of the capital measures. If the measures were held to be compatible the Commission decided it would not consider whether the measures were already compatible under the German rescue aid scheme.“[137]

Even though HRE was in the process of restructuring at the time, and Germany had already provided a restructuring plan which was subsequently updated and was being assessed by the Commission at the time, the need to temporarily grant emergency aid prior to the final assessment of the revised restructuring plan was acknowledged since financial stability was at stake in the prevailing case and urgent remedial action was required to keep the ailing bank afloat – this also being confirmed by the national financial supervisory authority.[138]

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[135]See „SoFFin passes resolution on € 1.85 billion recapitalisation for HRE“ 30 April 2010 <http://www.hyporealestate.com/eng/pdf/1004recaptranch_e.pdf> „In 2007, HRE took over the Dublin-based DEPFA Bank plc and extended its business to public sector and infrastructure finance. HRE currently consists of the following main companies: Hypo Real Estate Holding AG, Deutsche Pfandbriefbank AG and DEPFA Bank plc.“ see European Commission, „State Aids n° C 15/2009 (ex N 196/2009), N 333/2009 & N 557/2009 – Germany Hypo Real Estate – Extension of Formal Investigation Procedure, and Temporary Find Capital Injections Compatible“ at paragraphs 12 and 13

[136]See European Commission, „State Aids n° C 15/2009 (ex N 196/2009), N 333/2009 & N 557/2009 – Germany Hypo Real Estate – Extension of Formal Investigation Procedure, and Temporary Find Capital Injections Compatible“ paragraphs 41 and 42, at pages 6 and 7; „The Commission re iterated is doubts on the viability of HRE in its decision (Decision C(2009) 5888 final) of 24 July 2009 and the present case, taking into account the more detailed figures in the updated restructuring plan and questioning whether the intended restructuring was sufficient to allow restoration of long-term viability on the basis of the State aid received and planned.

The Commission also identified three problematic aspects that could affect the long-term sustainability of HRE's business model – which it intended to investigate further. The three problematic aspects included :i) Funding, ii)Short- and long-term profitability and (iii)the fact that HRE indicated in its revised business plan that it wanted to remain active in two fields: Commercial Real Estate and Public Finance. Nevertheless, the Commission observed at the time that the intended margin in the area of public finance was very low and that market pressure could further reduce achievable margins.“ See paragraphs 58 -61;ibid

[137]See ibid at paragraph 44

[138]Ibid at paragraph 48

The Commission temporarily found compatible with the Common Market, the capital injection amounting to EUR 60 million carried out in March 2009[139], the capital injection amounting to EUR 2 959 632 240 carried out in June 2009, and the capital injection amounting to EUR 3.0 billion to be carried out in November 2009 in favour of HRE until the Commission has taken a final decision on the restructuring plan.[140] Furthermore the Commission concluded that the capital injections „are appropriate, necessary and proportional, and can be considered compatible with the Common Market on a temporary basis until a final decision was taken on the restructuring plan of HRE.“[141]

Such a decision to accord priority to financial stability will be contrasted to other scenarios which give more preference to the need to minimise and avoid distortions of competition in the next section.

III. Minimising and Avoiding Distortions of Competition

i) Safeguards Against Possible Distortions of Competition in Recapitalisation Schemes.[142]

As well as highlighting the Banking Communication's emphasis on the need for safeguards aimed at preventing and limiting possible distortions of competition in re capitalisation schemes,[143] paragraph 35 of the Re capitalisation Communication also makes mention of the Banking Communication's requirement[144] that capital injections be limited to the minimum necessary and not to allow the beneficiary to engage in aggressive commercial strategies which would be incompatible with the underlying objectives of re capitalisation. Where higher remuneration is required by the State, there will (as a general principle) be less need for safeguards - since the level of price, in the Commission's view, will limit distortions of competition.[145]

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[139]„With regard to its silent participation of EUR 1 billion, SoFFin was to receive a profit-related coupon of 10 %. This level of remuneration was considered to be in line with paragraph 44 of the Recapitalisation Communication, which stipulates that where the price cannot be set to levels that correspond to the risk profile of the bank, it would nevertheless need to be close to that required for a similar bank under normal market conditions. Moreover, the Commission highlighted the fact that HRE would not get capital at an economically justifiable remuneration level on the market in the current circumstances but that given the fact that HRE was in difficulty, it should pay at least a reasonable price - that 10 % was considered to be an acceptable level.“ (See Commission decision of 12 May 2009 in case N 615/2008, *BayernLB);* see paragraph 52; ibid.

[140]See ibid; section 5 at page 11; „The capital injection of EUR 60 million had only limited scope, resulting in a 8.65% share of HRE's equity capital which did not give Germany a major influence on the bank“; see paragraph 49

[141]Ibid at paragraph 54

[142]In the Commission's view, „Safeguards may be necessary to prevent aggressive commercial expansion financed by State aid. In principle, mergers and acquisitions can constitute a valuable contribution to the consolidation of the banking industry with a view to achieving the objectives of stabilising financial markets and ensuring a steady flow of credit to the real economy. In order not to privilege those institutions with public support to the detriment of competitors without such support, mergers and acquisitions should generally be organised on the basis of a competitive tendering process." see paragraph 37 of the Recapitalisation Communication.

[143]Paragraph 35 of the Banking Communication

[144]Paragraph 38 of the Banking Communication

[145]„Banks receiving State recapitalisation should also avoid advertising it for commercial purposes." See paragraph 36 of the Recapitalisation Communication. (Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition)

However this can be contrasted with the case involving Hypo Real Estate where in respect of the capital injections carried out by acquiring share capital and the injection into the reserves, the German authorities highlighted that SoFFin as 100% HRE owner, was entitled to a shareholder's usual remuneration. Furthermore, it was stated that „for a distressed bank, no market-conform remuneration can be expected, at least in the short-term, for such provision of capital and that in line with the Re capitalisation Communication, such a situation required a thorough and far-reaching restructuring."[146]

Safeguards which have been proposed as means of preventing distortions of competition with guarantee schemes include restrictions on commercial conducts through for example market share ceilings, limitations to the size of the balance-sheet of the beneficiary institutions or other behavioural constraints that may be needed to achieve the purpose of the guarantee.[147] Issues which are also considered to arise with these safeguards include:[148]

- How they can be properly monitored and enforced since financial services are typically not regarded as standardized products.
- The likelihood that some restrictions such as those on the growth of undertaking may themselves generate anticompetitive effects in terms of collusive agreements.
- Of paramount importance is the concern related to the remuneration of the guarantee scheme or any other form of intervention such as the re capitalization schemes. [149]

ii) Prevention and Limitation of Undue Distortions of Competition

Three levels of possible distortions of competition are highlighted in the Commission Communication[150] on the Re capitalisation of Financial Institutions and these are as follows:[151]

- First, re capitalisation by one Member State of its own banks should not give those banks an undue competitive advantage over banks in other Member States. Access to capital at considerably lower rates than competitors from other Member States, in the

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[146]See paragraph 53 of European Commission, „State Aids n° C 15/2009 (ex N 196/2009), N 333/2009 & N 557/2009 – Germany Hypo Real Estate – Extension of Formal Investigation Procedure, and Temporary Find Capital Injections Compatible"

[147]Organisation for Economic Cooperation and Development, "Competition and the Financial Crisis" Organisation for Economic Cooperation and Development Publications February 2009 at page 15.*Paper served as the basis for a discussion on the financial crisis in the OECD Competition Committee on 17-18 February 2009 and is published under the responsibility of the Secretary General of the OECD.* <http://www.oecd.org/dataoecd/52/24/42538399.pdf>

[148]ibid

[149]„In principle, the remuneration of any type of support such as the issuance of new shares or asset swaps should be determined on the basis of a market-oriented valuation and be as close as possible to the market rate. However, at the current moment, the pricing mechanism in the markets seems to have stopped working properly. In such a situation, an important question is how to explicitly calculate an appropriate remuneration for the public supports in a time when markets are so highly illiquid and volatile that market prices may no longer be tied to the value of fundamentals. This issue resembles the current de"bate in the application of mark-to-market accounting standards when markets do not work properly." ibid

[150] See paragraphs 7-10 of the Communication from the Commission – „The recapitalisation of Financial Institutions in the Current Financial Crisis: Limitation of aid to the Minimum Necessary and Safeguards Against Undue Distortions of Competition

[151]See paragraphs 8 -10; ibid

absence of an appropriate risk-based justification, may have a substantial impact on the competitive position of a bank in the wider single European market.[152]

- Secondly, re capitalisation schemes which are open to all banks within a Member State without an appropriate degree of differentiation between beneficiary banks according to their risk profiles may give an undue advantage to distressed or less-performing banks compared to banks which are fundamentally sound and better-performing.[153]

- Thirdly, public re capitalisation, in particular its remuneration, should not have the effect of putting banks that do not have recourse to public funding, but seek additional capital on the market, in a significantly less competitive position.[154]

In considering whether State aid (and in particular emergency guarantees) was to be granted to Hypo Real Estate, the Commission in attempting to ensure that distortions of competition were minimised (as far as possible), considered the Requirement that aid granted "does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimized as far as possible" - in line with the general principles which constitute the basis of State aid rules of the Treaty, which require that the aid granted "does not exceed what is strictly necessary to achieve its legitimate purpose and that distortions of competition are avoided or minimized as far as possible."[155]

iii) Exit Strategies to Address Distortions to Competition Instituted by Crisis Responses

According to the Recapitalisation Communication, "recapitalisation measures need to contain appropriate incentives for State capital to be redeemed when the market so allows. The simplest way to provide an incentive for banks to look for alternative capital is for Member States to require an adequately high remuneration for the State re capitalisation."[156]

Furthermore, the Communication states that „if a Member State prefers not to increase the nominal rate of remuneration, it may consider increasing the global remuneration through call options or other redemption clauses, or mechanisms that encourage private capital raising, for instance by linking the payment of dividends to an obligatory remuneration of the State which increases over time."[157]

In facilitating exit strategies, „member States may also consider using a restrictive dividend policy to ensure the temporary character of State intervention."[158]

[152]„ Excessive aid in one Member State could also prompt a subsidy race among Member States and create difficulties for the economies of Member States which have not introduced recapitalisation schemes. A coherent and coordinated approach to the remuneration of public capital injections, and to the other conditions attached to re capitalisation, is indispensable to the preservation of a level playing field. Unilateral and uncoordinated action in this area may also undermine efforts to restore financial stability ('Ensuring fair competition between Member States')."

[153]„ This will distort competition on the market, distort incentives, increase moral hazard and weaken the overall competitiveness of European banks ('Ensuring fair competition between banks')."

[154]"A public scheme which crowds out market-based operations will frustrate the return to normal market functioning ('Ensuring a return to normal market functioning')."

[155]European Commission, "European Commission State aid n° N 694/2009 – Germany Emergency guarantees for Hypo Real Estate"

[156]See paragraph 31 of the Recapitalisation Communication.

[157]See paragraph 32 of the Recapitalisation Communication.

[158]See ibid

The OECD's proposal is founded on the distinction between the types of aid provided for i) financial firms for systemic reasons and ii) for non-financial firms with structural problems. As pre requisite for the grant of aid to non financial firms, the requirement that " structural reforms to a sustainable industry structure" exist, was put forward.[159]

Furthermore, "the need to ensure that structural reforms promote the long-term viability of these firms" is considered to constitute part of an exit strategy.[160] Other forms of aid considered include:[161]
• nationalization of financial institutions or non-financial firms;
• state-sponsored capital injections[162]
• extended liquidity facilities;
• inter bank lending guarantees; and
• state acquisition of so-called "toxic assets".

According to Schäfer and Zimmermann, five ways through which ailing banks could efficiently be relieved of their assets – through their conversion , by the government, to „bad banks" include:[163]

- Troubled assets should be valued based on current market prices prior to their takeover by the bad bank. Troubled assets for which there is no market should be transferred to the bad bank at a „zero price" and therefore at zero cost for the government as the bad bank's sponsor. [164]
- The government should re capitalise the rescued component of the bank through the acquisition of a shareholder stake; in extreme cases, the rescued component should be taken over by the government. [165]
- The „bad bank" should be funded by the government. External experts should be entrusted with the management and future sale of the troubled assets at the government's expense. If a profit remains after the proceeds from holding the troubled assets until expiration date or selling those assets to the market have materialised and

[159]See Organisation for Economic Co operation Development, "Competition and the Financial Crisis" at page 22
[160]ibid
[161]ibid
[162]„In the European Union, relevant competition decisions have included Commission Decision of 13 October 2008 in Case N 507/08 *Financial Support Measures to the banking Industry in the UK* (OJ C 290, 13.11.2008, p. 4), Commission Decision of 27 October 2008 in Case N 512/08 *Support measures for financial institutions in Germany* (OJ C 293, 15.11.2008, p. 2) and Commission Decision of 19 November 2008 in Case N 560/08 *Support measures for the credit institutions in Greece*, Commission Decision of 12 November 2008 in Case N 528/08 the Netherlands, *Aid to ING Groep N.V.*, Commission Decision of 25 November 2008 in Case NN 68/08 on *Latvian State support to JSC Parex Banka*. Commission Communication of 13 October on The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (OJ C 270, 25.10.2008, p.8) and European Commission principles are outlined in Commission Communication of 5 December on The recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortion of competition (OJ C 10, 15.1.2009 p.2)." see OECD, "Competition and the Financial Crisis" at page 22
[163]D Schäfer and KF Zimmermann „Bad Bank(s) and Recapitalization of the Banking Sector" (2009) Discussion Paper 897 of DIW Berlin <http://www.voxeu.org/index.php?q=node/3656>
[164]Such a move, in their opinion, would „ create transparency, avoid the high expense of pricing distressed assets, and insure that shareholders are the first ones to bear the cost of failure. The risk of moral hazard would also be effectively limited."
[165]They also argue that "with the value of their toxic assets written down to zero, a number of banks would no longer meet the legislated core capital requirement. The government should take a stake in these banks in order to recapitalise them if they are unable to acquire sufficient private funds within a predetermined period of time."

operating costs have been deducted, these profits should be distributed to the former shareholders.

- The government should announce its commitment to the future re-privatisation of its stake in the rescued bank. When establishing a bad bank, the government should make a binding commitment to how long it has to sell its shares in the good bank following the closure of the bad bank.
- All "systemically relevant" banks should be identified and required to participate in the plan."

In evaluating the above proposals, several considerations should be taken into account, namely:

i) The need to prevent and limit undue distortions of competition
ii) The need to facilitate exit strategies – by providing incentives for banks to look for alternative sources of capital.

The logic of the valuation of assets at a "zero-price" - assets for which no market is available – hence at zero cost for the government[166] should serve to prevent a situation whereby taxpayers burdens are minimised as far as possible. In their opinion, the German government's use of government bonds to compensate the bank for the transfer of the toxic assets to the bad bank burdens and encumbers taxpayers' with future debt owned by the participating bank.[167]

However, a balance needs to be struck between the desire to prevent future debt being accrued by the participating bank (such future debt being transferred to tax payers) and the need to ensure the prevention and limitation of undue distortions of competition. Furthermore, in respect of the rescued component of the bank, there is need to provide incentives to banks to look for alternative capital by requiring a sufficiently high level of remuneration for State re capitalisation - such that these incentives enable State capital to be redeemed when the market provides for such redemption.[168]

iv) **Recapitalisation Schemes in Respect of Non Fundamentally Sound Institutions and the Grant of State Capital: The Objective of Fostering Competition Overriding the Need to Promote Financial Stability?**

Why should financial institutions whose problems are attributable to inefficiencies, poor asset liability management or risky strategies not be accorded the same treatment as those whose viability problems are exogenously induced (and also related to extreme conditions which prevail in the financial market) as far as such "non fundamentally sound" institutions are considered to be systemically relevant?

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[166]Schäfer and Zimmerman argue that troubled assets should be valued based on current market prices prior to their take over and that troubled assets, for which there is no market, should be valued at "zero price".

[167]Other challenges which a public "bad bank" should be prepared to address, in their opinion include: "The transparent removal of troubled assets – which is considered necessary to ensure that the rescued bank has real prospects for a fresh start. Second, minimisation of the costs of the bailout for the taxpayer. Third, the establishment of measures aimed at preventing future materialisation of incentives or new opportunities for opportunistic behaviour." A means of achieving this, in their view, would be through the implementation of bad bank model which should limit the potential for "hold-up" problems whilst making it clear to shareholders and executives that entrepreneurial failure is a real possibility."

[168] See paragraph 31 of the Recapitalisation Communication

Section 2.3 paragraphs 43 and 44 of the Re capitalisation Communication highlights safeguards which are available where the grant of State capital to non fundamentally sound institutions are approved. Banks which would require more far reaching restructuring and which are considered not to be fundamentally sound are subject to more stringent requirements than fundamentally sound financial institutions (which would require less restructuring). Such stringent requirements include:

- The requirement that remuneration should "in principle reflect the risk profile of the beneficiary and be higher (for non fundamentally sound banks) than for fundamentally sound banks - without prejudice to the possibility for supervisory authorities to take urgent action where necessary in cases of restructuring."[169]

- The acceptability and approval of use of State capital for non fundamentally sound banks being dependent on the condition of either a bank's winding-up or a thorough and far-reaching restructuring, including a change in management and corporate governance where appropriate. [170]

The Commission in its Communication explicitly states that „Notwithstanding the need to ensure financial stability, the use of State capital for these banks (non fundamentally sound financial institutions) can only be accepted on the condition of either a bank's winding-up or a thorough and far-reaching restructuring, including a change in management and corporate governance where appropriate."[171]

Does this infer that the Commission is prepared to override the paramount objective of financial stability – by according greater prominence to the goal of fostering competition? This might initially appear to be the case. As highlighted in the second section of its predecessor publication,[172] financial institutions whose problems are attributed to "inefficiencies, poor asset-liability management or risky strategies" and which are considered to be systemically relevant, should benefit from state aid where restructuring of such institutions occur – to the extent that senior management (or indeed the entire management) of those institutions are replaced.

Such intentional safeguard by the Commission whilst ensuring that competition is not unduly distorted, also serves as a warning to "too big to fail firms" that guaranteed government or central bank intervention in the case of impending financial difficulties does not serve as an excuse for complacency or reckless risk taking behaviour. Such a move by the Commission is therefore aimed at deterring moral hazard whilst fostering competition.

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[169]See paragraph 44 which furthermore adds that "Where the price cannot be set to levels that correspond to the risk profile of the bank, it would nevertheless need to be close to that required for a similar bank under normal market conditions. "

[170]"As a result, either a comprehensive restructuring plan or a liquidation plan will have to be presented for these banks within six months of recapitalisation. As indicated in the Banking Communication, such a plan will be assessed according to the principles of the rescue and restructuring guidelines for firms in difficulties, and will have to include compensatory measures."

[171]See paragraph 44 of the Recapitalisation Communication. (Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition)

[172]See M Ojo, "Liquidity Assistance and the Provision of State Aid to Financial Institutions" (2010) Munich RePEc and SSRN Working Papers

IV. **Comparison between the ECB Recommendation and its application by the Commission in the Re capitalisation Communication (specifically with Annex to Communication) where Commission explains how it determined the price of equity – balancing the "real value" with the "market value" in a crisis context.**

According to paragraph 18 of the Re capitalisation Communication, the Commission while acknowledging that the current exceptional market rates do not constitute a reasonable benchmark for determining the correct level of remuneration of capital, is also of the view that re capitalisation measures by Member States should take into account the underestimation of risk in the pre-crisis period. Without this, public remuneration rates could give undue competitive advantages to beneficiaries and eventually lead to the crowding out of private re capitalisation.

Recommendations of the Governing Council of the European Central Bank (ECB)[173]

The Recommendations of the European Central Bank[174] included a proposal for "a methodology for benchmarking the pricing of State re capitalisation measures for fundamentally sound institutions in the Euro area". Whilst focus in the Recommendations is specifically directed at the importance of effective re capitalisation - for purposes aimed consolidating financial stability and facilitating unimpeded flow of credit within the real economy, emphasis is also placed on the need to sustain "a level playing field between competing banks" as well as pricing which is market oriented .[175]

The ECB Governing Council proposed seven recommendations aimed at clarifying essential aspects on pricing public recapitalisation of financial institutions in the particular context of the current financial crisis.

The first recommendation focuses on those factors that the Government should take into consideration in defining conditions for recapitalising and stipulating the price of instruments to provide Tier 1 capital to financial institutions [176].

The second recommendation focuses on different financial instruments that Member States intend to serve as sources of Tier 1 capital (core capital). As observed by the ECB, capital injections would be made for the greater part, through the acquisition of "preferred shares" and other "hybrid instruments[177]" which fulfil the conditions for reinforce the Tier 1 capital[178], even some Member States had considered the provision of capital through the acquisition of ordinary shares.

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[173] http://www.ecb.europa.eu/pub/pdf/other/recommendations_on_pricing_for_recapitalisationsen.pdf

[174] "The Recommendations of its Governing Council of 20 November 2008" See Communication from the Commission — The recapitalisation of financial institutions (1) in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, paragraph 16

[175] ibid

[176] As declared by the ECB, this recomendations serves " in order to support the implementation of the Paris declaration of 12 October 2008".

[177] For further information on Hybrid instruments, see the document *Implementation Guidelines for Hybrid Capital Instruments*, CEBS, 10 December 2009.

[178] Under footnote (2), it was added that "For purpose of regulatory capital, the Capital Requirements Directive (Art. 66) covers only fixed-term cumulative preferred shares by setting a ceiling of 50% for their recognition in Tier 1. The CRD is under review with the aim also to address the capital treatment of hybrid instruments in general. The advice given by the CEBS in this respect in March 2008 s that hybrid capital instruments should only be eligible as Tier 1 capital if they meet all the following requirements: (i) they must be issued and fully paid up, (ii) be publicly disclosed and easily understandable; (iii) be permanent, (iv) can absorb losses in liquidation and on a going concern basis and allow the cancellation of payments; (v) in stress situations, the instrument should help prevent the bank's insolvency and make the recapitalisation of the issuer more likely.

Obviously the variety of financial instruments would have different conditions such as the required rate of return and redemption and repurchase terms, across Member States and would also depend on the situation of the individual beneficiary financial institution.

For this reason, the ECB recommended that the required rate of return by the government on the recapitalisation instruments could be determined on the basis of a "price corridor" defined by several criteria.

The third recommendation provided an idea of those components that would be used to determine the rate of return on subordinated debt, in order to obtain an average rate of return of 6%, comprising 3.27% average euro area government bond yield, 0.73% median of all A CDS subordinated debt spreads, and an add-on fee of 2.00%. In such a way, the ECB provided a clear and direct reference.

The required rate of return on ordinary shares is the object of the fourth recommendation, considering that it would be determined as the sum of several components that were specified, as understood in a open renumeration. The ECB fixed an average rate of return g to euro area banks of 9.3%, comprising a 3.27% average euro area government bond yield, an equity risk premium of 5.00%, and an add-on fee of 1.00%.

The required rate of return on preferred shares and other hybrid were analyzed in the fifth recommendation. Obviously, the variety of financial instruments imply that the determined in relation to the specific features of the instruments concerned. The ECB offered different criteria for each specific case.

The sixth of the ECB's recommendations established the revision of the pricing of recapitalisation instruments after a period of 6 months to reflect changes in market conditions. As can be noted, this six month period is the same as that of the Commissions's communications in banking crisis fixed for other purposes, like, a. g, the fixed period to the State Members reviewed and reported all general schemes set up on the Banking Communication in the form of a guarantee or recapitalization[179].

The last recommendation, the seventh, denotes the temporary nature of the recapitalisation - that would be ensured by providing financial institutions with incentives to redeem such instruments as early as possible after a certain period of time, e.g. through step-up or payback clauses. Once again it is clear that the exit strategy is vital in all recapitalisations plans which are applicable to this financial crisis.

The Commission's appreciation of the Recommendations are reflected under paragraph 17 of the Recapitalisation Communication – however, this fundamental difference, it draws attention to the need for guidelines and conditions aimed at providing direction in respect of banks which are not fundamentally sound. Whilst the ECB Recommendations focussed on fundamentally sound financial institutions, the Recapitalisation Communication "extends guidance to conditions other than remuneration rates and to the terms under which banks which are not fundamentally sound may have access to public capital."

The Recapitalisation Communication achieves this aim through section 2.3 paragraphs 43- 45 which specifically provide for rescue recapitalisations of non fundamentally sound financial

[179]The underlined one of this one and previous texts is ours,

institutions. Before proceeding with a more detailed discussion of this section, elements which should be considered when determining the remuneration of fundamentally sound financial institutions will be analysed.

Such elements are set out under paragraph 23 of the Re capitalisation Communication. For fundamentally sound financial institutions, the determination of overall remuneration, as provided by paragraph 23, requires a consideration of the following elements:

(a) current risk profile of each beneficiary ;
(b) characteristics of the instrument chosen, including its level of subordination; risk and all modalities
of payment ;
(c) built-in incentives for exit (such as step-up and redemption clauses);
(d) appropriate benchmark risk-free rate of interest.

In respect of State re capitalisations, paragraph 24 stipulates that remuneration is not expected to be as high as prevailing market levels since such levels would not provide an adequate indication of what could be regarded as "normal market conditions."- in this sense, the Commission is giving consideration to the conditions induced by the recent Financial Crisis – within a crisis context. As a result, the Commission highlighted its willingness to accept the price for re capitalisations of fundamentally sound banks at rates which exist below the prevailing market rates.[180] Such a move, according to the Commission, was aimed at facilitating access to such instruments – as well as restoring financial stability and ensuring lending to the real economy.

Whilst recognising the need for remuneration rates to operate at rates which are below the prevailing market rates, the Commission also acknowledges the need for parity between the total expected return on re capitalisation to the State and current market prices. In the Commission's view, minimisation of excessive discrepancies between the total expected return on re capitalisation to the State and current market prices since the total expected return on re capitalisation should:[181]

- Avoid the pre-crisis under-pricing of risk
- reflect the uncertainty about the timing and level of a new price equilibrium
- provide incentives for exiting the scheme and
- minimise the risk of competition distortions between Member States, as well as between those banks which raise capital on the market today without any State aid."

Further a remuneration rate which is not too remote from prevailing current market rates would help prevent "crowding out re capitalisation through the private sector – as well as help in restoring such rates to the usual market conditions.[182]

In contrast with the remuneration conditions for fundamentally sound financial institutions – as set out above, section 2.3 paragraph 44, in accordance with paragraph 43 of the same section,[183] provides that "remuneration should in principle, reflect the risk profile of the beneficiary and be higher than for fundamentally sound banks."

[180] see ibid at paragraph 24
[181] ibid at paragraph 25
[182] ibid
[183] Which provides that „the recapitalisation of banks which are not fundamentally sound should be subject to stricter requirements."

The Commission appeared to relax its stipulation in respect of non fundamentally sound banks - regarding the need for more stringent requirements of such institutions where it provided for situations whereby price cannot be set at levels which correspond to the risk profile of the bank.[184]

However, it re-iterates its more restrictive stance in the grant of re- capitalisation to such banks where it indicates its willingness to override its preference for the need to promote financial stability by stating that " the use of State capital for these banks can only be accepted on the condition of either a bank's winding-up or a thorough and far-reaching restructuring, including a change in management and corporate governance where appropriate." [185]

Other safeguards aimed at preventing undue distortions of competition, which are provided by the Commission under paragraph 45, in respect of non fundamentally sound banks, include "a restrictive policy on dividends (including a ban on dividends at least during the restructuring period), limitation of executive remuneration or the distribution of bonuses, an obligation to restore and maintain an increased level of the solvency ratio compatible with the objective of financial stability, and a timetable for redemption of State participation."[186]

Remuneration rules applied in HRE

Non fundamentally sound financial institutions acquired through nationalisation.

1) Share holder's usual remuneration - since it was highlighted that SoFFin was 100% HRE

2) As HRE was a "distressed bank", no market conform remuneration expected – at least in the short term for provision of capital.

Facilitating Exit

According to paragraph 31 of the Re capitalisation Communication, "Re capitalisation measures need to contain appropriate incentives for State capital to be redeemed when the market so allows: The simplest way to provide an incentive for banks to look for alternative capital is for Member States to require an adequately high remuneration for the State re capitalisation. For that reason, the Commission considers it useful that an add-on be generally added to the entry price determined to incentivise exit. A pricing structure including increase over time and step-up clauses will reinforce this mechanism to incentivise exit."

HRE is also exceptional in the sense that the State has already acquired the undertaking. If the undertaking had been seeking to acquire State capital, there would be greater reasons to

[184] See ibid which provides that "Where the price cannot be set to levels that correspond to the risk profile of the bank, it would nevertheless need to be close to that required for a similar bank under normal market conditions."

[185] Consequently, it adds, "either a comprehensive restructuring plan or a liquidation plan will have to be presented for these banks within six months of recapitalisation." ibid

[186] "Until redemption of the State, behavioural safeguards for distressed banks in the rescue and restructuring phases should, in principle, include: a restrictive policy on dividends (including a ban on dividends at least during the restructuring period), limitation of executive remuneration or the distribution of bonuses, an obligation to restore and maintain an increased level of the solvency ratio compatible with the objective of financial stability, and a timetable for redemption of State participation."

encourage an exit from the continued dependence on State capital – via higher remuneration (which is not the case with HRE).

According to paragraph 6 of the Re capitalisation Communication, „a capital injection from public sources providing emergency support to an individual bank may also help to avoid short term systemic effects of its possible insolvency. In the longer term, re capitalisation could support efforts to prepare the return of the bank in question to long term viability or its orderly winding-up.“ With HRE, the Commission held that „for a distressed bank, no market-conform remuneration can be expected, at least in the short-term, for such provision of capital and that in line with the Re capitalisation Communication, such a situation required a thorough and far-reaching restructuring.”[187]

Source: Annex to the Communication from the Commission — The Re capitalisation of Financial Institutions in the Current Financial Crisis: Limitation of Aid to the Minimum Necessary and Safeguards Against Undue Distortions of Competition.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:010:0002:0010:EN:PDF

Pricing of equity

Equity (ordinary shares, common shares) is the best known form of core Tier 1 capital. Ordinary shares are remunerated by uncertain future dividend payments and the increase of the share price (capital gain/loss), both of which ultimately depend on the expectations of future cash flows/profits. In the current situation, a forecast of future cash flows is even more difficult than under normal conditions. The most noticeable factor, therefore, is the quoted market price of ordinary shares. For non-quoted banks, as there is no quoted share price, Member States should come to an appropriate market-based approach, such as full valuation.

If assistance is given in the issuance of ordinary shares (underwriting), any shares not taken up by existing or new investors will be taken up by the Member State as underwriter at the lowest possible price compared to the share price immediately prior to the announcement of placing an open offer. An adequate underwriting fee should also be payable by the issuing institution ([1]). The Commission will take into account the influence that previously received State aid may have on the share price of the beneficiary.

[187] See European Commission, „State Aids n° C 15/2009 (ex N 196/2009), N 333/2009 & N 557/2009 – Germany Hypo Real Estate – Extension of Formal Investigation Procedure, and Temporary Find Capital Injections Compatible“ at paragraph 53.

Table 1

Types of capital

Debt	**Tier 2**
	Fixed term debt instruments
	Perpetual Subordinated Debt instruments
Greater return required	Cumulative preference shares or other similar instruments
↓	**Tier 1**
Greater loss absorbency	Non-cumulative preference shares or other similar instruments
	Other high quality hybrids
Equity	Reserves/Retained earnings
	Ordinary shares

V. Re capitalisation and Current Impediments faced in the United States.

An essential reference is the case of United States, where public recapitalisation served as a general means of confronting the financial crisis. Nevertheless, we must note, in a preliminary and substantive observation, that competition (Antitrust) considerations haven't been taken into account. As we have seen, European State Aids control serves as an essential component of European Competition Law.

a) Measures Aimed at Rescuing Ailing U.S Markets

On October 14 2008, the following „watershed" measures aimed at rescuing the ailing U.S. Markets were announced by the U.S. Treasury, Federal Reserve and FDIC:[188]

- the Capital Purchase Program programme"
- the FDIC Temporary Liquidity Guarantee Program
- the Federal Reserve's Commercial Paper Funding Facility

[188] See „TARPOONED: The Recapitalization of the US Financial Industry „October 16, 2008 Dewey and Le Boeuf Publications <http://www.dl.com> page 1 of 18 and also "Joint Statement by Treasury, Federal Reserve and FDIC" – October 14, 2008 <http://www.ustreas.gov/press/releases/hp1207.htm>

„In respect of the Capital Purchase Program, the Treasury[189] announced it would channel $250 billion of its $700 billion reserves under The Emergency Economic Stabilization Act of 2008 ("EESA") to purchase $125 billion of senior preferred shares in nine major financial institutions, with the remaining $125 billion available for equity injections into qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities that elect to participate before 5:00 pm (EDT) on November 14, 2008.“[190]

"In respect of the FDIC Temporary Liquidity Guarantee Program**, *t***he FDIC announced[191] it would temporarily guarantee, for a fee, all newly issued senior unsecured debt of banks, thrifts and certain holding companies, and provide full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount.“[192]

„The Federal Reserve released[193] additional details about its Commercial Paper Funding Facility, including the fact that it would begin funding purchases of commercial paper on October 27. This facility complements the Federal Reserve's existing credit facilities to help provide a liquidity backstop to U.S. issuers of commercial paper.“[194]

Further series of initiatives implemented by the Treasury Department, as part of its Financial Stability Plan which alongside the American Recovery and Reinvestment Act provide the foundations for economic recovery include:[195]

- Efforts to Improve Affordability for Responsible Homeowners
- Consumer and Business Lending Initiative to Unlock Frozen Credit Markets
- The Launch of the Capital Assistance Program

b). Addressing the Challenges Posed by Legacy Assets

One major reason why (despite these efforts)hurdles still need to be overcome by the financial system in order to achieve economic recovery relates to the problem of "legacy assets" – „both real estate loans held directly on the books of banks ("legacy loans") and securities backed by loan portfolios ("legacy securities"). These assets create uncertainty around the balance sheets of these financial institutions, compromising their ability to raise capital and their willingness to increase lending.“[196]

According to the Treasury, „the challenge posed by these legacy assets began with an initial shock due to the bursting of the housing bubble in 2007, which generated losses for investors

[189] See "Treasury Announces TARP Capital Purchase Program Description." – October 14, 2008. http://www.ustreas.gov/press/releases/hp1207.htm

[190]ibid

[191] See ibid and " FDIC Announces Plan to Free Up Bank Liquidity: Creates New Program to Guarantee Bank Debt and Fully Insure Non-Interest Bearing Deposit Transaction Accounts." – October 14, 2008. http://www.fdic.gov/news/news/press/2008/pr08100.html

[192]See „TARPOONED: The Recapitalization of the US Financial Industry „October 16, 2008 Dewey and LeBoeuf Publications <http://www.dl.com> pages 1 and 2 of 18

[193] See ibid and *Federal Reserve Press Release*, October 14, 2008: http://www.federalreserve.gov/newsevents/press/monetary/20081014b.htm

[194]ibid

[195]US Department of the Treasury, „„„Public Private Investment Program“ <http://www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf> and „Treasury Department Releases Details on Public Private Partnership Investment Program“ <http://www.ustreas.gov/press/releases/tg65.htm>

[196]ibid

and banks. Losses were compounded by the lax underwriting standards that had been used by some lenders and by the proliferation of complex securitisation products, some of whose risks were not fully understood. The resulting need by investors and banks to reduce risk triggered a wide-scale de leveraging in these markets and led to fire sales. As prices declined, many traditional investors exited these markets, causing declines in market liquidity.“[197]

In March 2009, the "public/private partnership investment programme" was announced by the Treasury – under which “the government is to provide basically all funds – as well as bearing nearly all risks involved. The use of the private sector to price the assets is compensated by a process whereby private investors would obtain rewards based on their performance, through equity participation, alongside the Treasury. The public/private investment programme had the potential of generating $500 billion in purchasing power to buy legacy assets - with the potential to expand to $1 trillion over time through an injection of $75 – 100 billion of Tarp capital as well as capital from private investors.”[198]

c. The Public-Private Investment Program for Legacy Assets

To address the challenge of legacy assets, Treasury – in conjunction with the Federal Deposit Insurance Corporation and the Federal Reserve revealed the Public-Private Investment Program as part of its efforts „to repair balance sheets throughout the financial system and ensure that credit is available to the households and businesses, large and small, that will help towards the goal of achieving recovery.“[199]

“Three Basic Principles define the Public-Private Investment Program:[200]

- ***Maximizing the Impact of Each Taxpayer Dollar:*** First, by using government financing in partnership with the FDIC and Federal Reserve and co-investment with private sector investors, substantial purchasing power will be created, making the most of taxpayer resources.

- ***Shared Risk and Profits With Private Sector Participants:*** Second, the Public-Private Investment Program ensures that private sector participants invest alongside the taxpayer, with the private sector investors standing to lose their entire investment in a downside scenario and the taxpayer sharing in profitable returns.

- ***Private Sector Price Discovery:*** Third, to reduce the likelihood that the government will overpay for these assets, private sector investors competing with one another will establish the price of the loans and securities purchased under the program.”

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[197] „As a result, a negative economic cycle has developed where declining asset prices have triggered further de leveraging, which has in turn led to further price declines. The excessive discounts embedded in some legacy asset prices are now straining the capital of U.S. financial institutions, limiting their ability to lend and increasing the cost of credit throughout the financial system. The lack of clarity about the value of these legacy assets has also made it difficult for some financial institutions to raise new private capital on their own.“ see ibid.

[198] US Department of the Treasury, „„Public Private Investment Program“ <http://www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf>

[199] “Using $75 to $100 billion in TARP capital and capital from private investors, the Public-Private Investment Program will generate $500 billion in purchasing power to buy legacy assets –with the potential to expand to $1 trillion over time.” US Department of the Treasury, “Public Private Investment Program: The Public-Private Investment Program for Legacy Assets“ <http://www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf>

[200] ibid

The Merits of This Approach as highlighted by the Treasury derive from the fact that "it is superior to the alternatives of either hoping for banks to gradually work these assets off their books or of the government purchasing the assets directly. Simply hoping for banks to work legacy assets off over time risks prolonging a financial crisis, as in the case of the Japanese experience. But if the government acts alone in directly purchasing legacy assets, taxpayers will take on all the risk of such purchases – along with the additional risk that taxpayers will overpay if government employees are setting the price for those assets."

d. The Troubled Assets Relief Programme (TARP)

The increased hostility to the financial sector within the United States, as illustrated by Wolf, was revealed through Congress' 2009 discussion of penal retrospective taxation of bonuses for all recipients of government money under the troubled assets relief programme (Tarp).[201]

Wolf is of the opinion that even though there are doubts as to whether this scheme would end the „chronic under-capitalisation of US finance" that it might make clearer how much further the assets held on longer-term banking books need to be written down.

He also puts forward two reasons why this scheme could get in the way of the necessary re capitalisation: First, that Congress may decide the scheme made re capitalisation less important; second and more important, that the scheme is likely to make re capitalisation by government even more unpopular.

Furthermore, he draws attention to the danger that the scheme would, at best, achieve something not particularly important - making past loans more liquid - at the cost of making harder something that is essential – re capitalising banks.

This in his view is significant since „the government had ruled out the only way of restructuring the banks' finances that would not cost any extra government money: debt for equity swaps, or a true bankruptcy. „ He argues that the one way out could be through a means whereby (if possible) the greater transparency offered by the new funds allowed the big banks to raise enough capital from private markets . A successful outcome, moreover, would still imply the need for investors to provide „ vast sums required by huge and complex financial institutions, with a proven record of mismanagement" - which in his view, would only be possible after many years (after which trust in confidence in such financial institutions had been restored) .

„The problems for the U.S. financial system started with increased defaults of sub prime and other non traditional mortgage loans as the housing boom came to an end. During the housing boom of the 2000s, risky mortgage loans were securitised, structured into various types of financial products, and distributed to investors all around the world. However, the risk diversification was far from complete and many financial institutions increased their ownership of real estate related assets. As the underlying mortgages become non-performing, the values of their derivative securities declined, and the financial institutions that held the securities started to suffer losses. Given the leverage in the financial system these losses were significant relative to the equity of these firms (Greenlaw et al., 2008). By early 2008, the losses started to jeopardize the viability of large financial institutions. In March 2008, the Bear Stearns nearly failed and was rescued by JP Morgan with financial assistance from the Federal Reserve System."[202]

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[201] M Wolf, „Why a Successful US bank Rescue is Still So Far Away" Financial Times 24 March 2009

Treasury's Shift in Focus from Buying Troubled/Toxic Assets to Buying bank shares to increase the bank capital Injecting Equity Capital

"In view of the need to rescue numerous vitally economically important financial institutions through ad hoc measures, it became apparent that a massive, comprehensive and coordinated government rescue effort was urgently needed. On September 19, Treasury Secretary Henry Paulson unveiled his proposal (the "Paulson Proposal") to use $700 billion in taxpayer money to purchase toxic mortgage-related assets that were weighing heavily on the balance sheets of financial institutions."[203]

The Treasury's interest in purchasing non-performing assets from major financial institutions was formalized as the Troubled Asset Relief Program (TARP) which was included in the bill for the Emergency Economic Stabilization Act (EESA).[204]

„Section 101 of EESA establishes the now well-known Troubled Asset Relief Program (''TARP'') and authorizes the Treasury to purchase, and to make and fund commitments to purchase, troubled assets from financial institutions up to an amount not exceeding $700 billion outstanding at any one time, as adjusted for the operation of the companion guarantee program."[205]

e. Adopting the Emergency Economic Stabilization Legislation

„On October 3, the U.S. House of Representatives voted 263-171 to pass the EESA bill. Within hours, President Bush signed the bill and EESA was part of the law of the land. In a calculated political response, on October 1, the Senate voted 74-25 to approve an "amendment" to the EESA bill that spliced onto a largely unchanged House version of the EESA bill a raft of stalled tax bills, namely the Energy Improvement and Extension Act of 2008 and Tax Extenders and Alternative Minimum Tax Relief Act of 2008. The Senate's move added up to $150 billion in additional costs and several hundred pages to make the EESA bill about 450 pages long. The only substantive change made to the EESA bill that failed in the House was to add a provision that increased until December 31, 2009 the amount of deposit insurance provided by the FDIC from $100,000 to $250,000. This amended version of the EESA bill was sent back to the House, which approved it 263-171 on October 3."[206]

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[202] T Hoshi and A K Kashyap, "Will the U.S. Bank Recapitalization Succeed? Eight Lessons from Japan" NBER Working Paper No. 14401 August 2009 at page 5

[203] „The rationale, as vigorously advocated by Treasury and the Federal Reserve, was that once freed from the enormous burden of these illiquid assets, financial institutions would be able to gradually resume the flow of credit and breathe life back into the frozen financial markets."

See „TARPOONED: The Recapitalization of the US Financial Industry „October 16, 2008 Dewey and LeBoeuf Publications <http://www.dl.com> pages 5 of 18

[204] T Hoshi and A K Kashyap, "Will the U.S. Bank Recapitalization Succeed? Eight Lessons from Japan" NBER Working Paper No. 14401 August 2009at page 6

[205] See „TARPOONED: The Recapitalization of the US Financial Industry „October 16, 2008 Dewey and LeBoeuf Publications <http://www.dl.com> pages 2 and 3 of 18

[206] "The keystone of the bailout legislation has from the start been the Troubled Asset Relief Program or "TARP." Less than a week after the introduction of the original Paulson Proposal, on September 23, both Secretary Paulson and Chairman Bernanke testified before the Senate Banking Committee with respect to the continuing financial crisis and the rescue measures proposed by the Treasury." ibid at page 5 of 18

„The Treasury started to shift the focus from the original idea of buying troubled assets to buying bank shares to increase the bank capital. After the Republicans lost the election, the Treasury announced that the original TARP plan of buying troubled assets would be postponed indefinitely. On November 25, the Federal Reserve announced the creation of its Term Asset-Backed Securities Lending Facility (TALF). The TALF allowed holders of AAA-rated asset-backed securities, backed by recently originated consumer and small business loans, to qualify for a non recourse loan from the Federal Reserve Bank of New York.“[207]

„As the change in administrations was approaching in January 2009, press reports indicated that the Obama administration was set to announce the creation of an "aggregator bank" that would buy bad assets so that they could be removed from the balance sheets of banks. When the first plans of the administration were announced, the aggregator bank idea was dropped, in part reportedly because the funding requirements would have been huge.“[208]

f. Lessons on Re capitalisation

At least three of eight lessons from the Japanese history which appear to have been ignored or have to be relearned – as identified by Hoshi and Kashyap, include:[209]

- i) The hesitation of the banks to admit publicly their need for government assistance (some of the original TARP institutions were adamant in their insistence that they did not need public support).

- ii) The performance of initial TARP capital purchases without the observation of rigorous audit and inspection requirements

- iii) The third area where the Japanese history appears to have been ignored regards the willingness to nationalize an institution and wind it down. A major constraint on the government throughout the crisis, in their opinion, has been the lack of a resolution procedure that could work for a complex financial holding company.“[210]

[207]T Hoshi and A K Kashyap, "Will the U.S. Bank Recapitalization Succeed? Eight Lessons from Japan“ NBER Working Paper No. 14401 August 2009 at page 7; „By December, the proposed merger between Merrill Lynch and Bank of America seemed to have encountered an impasse and Bank of America was privately telling the government that it was hesitant to proceed. The merger was ultimately consummated on January 1st, but by the time it was completed the government had agreed to provide additional assistance. On January 16, the Treasury, FDIC, and the Federal Reserve announced a package of guarantees, liquidity access and capital for Bank of America. During December 2008, TARP funds were also offered to non-financial firms for the first time.“

[208]ibid

[209]T Hoshi and A K Kashyap, "Will the U.S. Bank Recapitalization Succeed? Eight Lessons from Japan“ NBER Working Paper No. 14401 August 2009at pages 32-33

[210]It is argued that „in contrast, in Japan, a major piece of the legislation was enacted during the crisis precisely to make it possible to fail major financial institutions. The Japanese government also used this authority in at least two very visible cases. Federal Reserve and Treasury officials have repeatedly asked Congress to pass a bill creating the authority to resolve a large, complex financial institution; ibid at page 33. Furthermore, two of the major lessons from Japan involved the use and design of asset management companies. The U.S. record in this regard is mixed. The U.S. has avoided the Japanese mistake of trying to do small asset purchases to solve a serious capital shortage problem. See ibid at page 35.

VI) CONTROLLED WINDING-UP OF FINANCIAL INSTITUTIONS

Pursuant to Section 5, paragraph 43 of the Banking Communication, controlled liquidation (which is possible in collaboration with the contribution of public funds), may be undertaken:

- Either as a second step – after rescue aid to an individual financial institution has been granted (when it becomes clear that the latter cannot be restructured successfully) or;

- In one single action

"Controlled winding-up may also constitute an element of a general guarantee scheme."[211] The need to minimise moral hazard (through the exclusion of shareholders and particular classes of creditors from the receipt of benefit of any aid within the context of the controlled winding up procedure) and the avoidance of undue distortions of competition are amongst several considerations which are of vital importance.[212]

a) Liquidation Aid to Bradford and Bingley Plc

With the financial turmoil in September 2008 and its impact on the liquidity position of Bradford and Bingley, the UK authorities decided to pursue a wind-down procedure whereby the retail deposit book was to be sold while an orderly wind-down of the remainder of the business was to be undertaken for the purposes of maximising recoveries – as well as minimising the burden on taxpayers.[213]

A package of rescue measures which comprised of the following elements was accepted by the Commission : [214]

a) the working capital facility;
b) the guarantee arrangements to certain wholesale borrowings, derivative transactions and wholesale deposits existing as on 28 September 2008; and
c) the public support resulting from the Transfer Order containing two aid elements: firstly, an aid to B&B through the payment of £612 million for the sale of the transfer package, and secondly, an aid to the transferred economic entity, which corresponds to the ability for this entity to remain in the market.

Furthermore, the aid package including the sale to Abbey was found to be compatible rescue aid under Article 107(3)(c) TFEU, in line with the Community guidelines on State aid for

[211] „ For instance, where a member state undertakes to initiate liquidation of the financial institutions for which the guarantee needs to be activated. The assessment for such a scheme and of individual liquidation measures taken under such a scheme are to be applied along the same lines, mutates mutandis, as set out for guarantee schemes." See Section Five paragraph 43-44 of the Banking Communication.
[212] Furthermore, i) "the liquidation phase should be limited to the period strictly necessary for orderly winding up; ii) The beneficiary financial institution should merely continue with ongoing activities and not pursue any new activities – as long as it continues to operate ; and iii) The banking licence should be withdrawn as quickly as possible." See ibid paragraphs 46 and 47.
[213] See European Commission, "State aid N 194/2009 –United Kingdom: Liquidation Aid to Bradford and Bingley Plc at paragraph 4 page 2.
[214] See Rescue Decision and ibid.

rescuing and restructuring firms in difficulty.[215]

As well as the submission of a liquidation plan which was based on the assumption that an orderly winding down process (for Rumpco) would take place, reasons for undertaking the route of a controlled winding down process – as opposed to uncontrolled insolvency were also provided. An orderly winding down process would not only "maximise the value of the remaining assets and minimize the amount of necessary state aid", but would also facilitate the repayment of the working capital facility as well as the statutory debt. Furthermore, the reasons for the choice of a controlled winding down process necessitated a consideration of the legislation in force when the decision to wind down Bradford and Bingley (now Rumpco) was taken and such reasons include:[216]

- An absence of a "strictly defined time-frame" for large and complex liquidations such as that of B & B.
- The fact that B & B would not have obtained the working capital facility which was required in order to pay Rumpco creditors – had B & B chosen the route of uncontrolled insolvency. An uncontrolled insolvency procedure would also have resulted in liquidation shortfall with respect to debt owed to such creditors.
- A uncontrolled insolvency procedure would have endangered the prospects of the recovery of full value of statutory debt.
- Rumpco's uncontrolled insolvency would have undermined financial stability – as well as market confidence.

In deciding on measures required for the winding down of Rumpco, proposals were made by the UK to convert prevailing prolonged or extended measures (which had been approved initially as rescue measures) into measures required for the liquidation of Rumpco.[217]

b) Legal basis for the compatibility assessment and the choice of Article 107 (3)(b) TFEU

Initially, the rescue decision had concluded that it was not considered necessary to assess whether Article 107(3)(b) TFEU would apply since the rescue measures had been found compatible on the basis of Article 87(3)(c) EC and in particular the Rescue and Restructuring Guidelines.[218]

Against the background of the recent global financial crisis (whereby it was widely accepted that "a serious disturbance in the economy of Member States had occurred and that measures supporting banks are appropriate to remedy this disturbance")[219] and taking into account the objective of the proposed aid measures, namely, the facilitation of Rumpco's wind-down, it

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[215] Hereinafter "the Rescue and Restructuring Guidelines " See European Commission, "State aid N 194/2009 – United Kingdom: Liquidation Aid to Bradford and Bingley Plc at paragraph 6

[216] See ibid at paragraphs 13 and 14

[217] „Those measures were supplemented by a commitment to provide a capital injection if necessary to ensure that Rumpco continued to meet the minimum capital regulatory requirements throughout the regulatory process." Further, it was held that "in line with the rescue decision the measures constitute State aid pursuant to Article 107(1) TFEU. According to this provision State aid is 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 is, insofar as it affects trade between Member States."

[218] See European Commission, "State aid N 194/2009 –United Kingdom: Liquidation Aid to Bradford and Bingley Plc section 4 paragraph 44

was held that the legal basis for the assessment of these measures should be Article 107(3)(b) TFEU.

In addition to an observance of the Banking Communication - which sets out the State aid rules applicable to the liquidation of financial institutions in the current crisis, the following conditions are considered necessary in order for the compatibility of liquidation aids with Article 107(3) (b) TFEU to be established:[220]

- Demonstration that the aid enables the bank to be effectively wound up in an orderly fashion,

- Own Contribution and burden sharing

- Measures aimed at limiting the distortion of competition

As well as arriving at the conclusion that all three conditions had been satisfied, the Commission also decided not to raise any objections to the aid measures (in the form of the working capital facility, the guarantees and the possible capital injection) on the ground that they constitute State aid which is compatible with Article 107(3)(b) TFEU.[221]

VII) PROVISION OF OTHER FORMS OF LIQUIDITY ASSISTANCE

According to section 6 of the Banking Communication[222] which deals with the provision of other forms of liquidity assistance, member states are permitted to implement "complementary forms of liquidity support – along with the provisions of public funds (which includes funds from the central bank)" in situations where "acute" liquidity problems are in need of redress. Furthermore, general measures which are implemented and are "open" to all market players on a comparable and equal basis (for example lending provided on an equal footing) and which do not constitute selective measures (which are in favour of individual banks), are often considered by the Commission as falling outside the boundaries of State rules and as such do not require notification to the Commission.[223]

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[219] "This having been confirmed in various Commission communications such as the *Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*(hereinafter "the Banking Communication"), its *Communication on the re capitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition* (hereinafter "the Recapitalisation Communication"), and its

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 (hereinafter "the Restructuring Communication")."

[220] See European Commission, "State aid N 194/2009 –United Kingdom: Liquidation Aid to Bradford and Bingley Plc section 4 paragraphs 49-56 at pages 10-12

[221] See ibid section 5 paragraph 63

[222]See paragraph 51of the Banking Communication

[223]„The Commission considers for instance that activities of central banks related to monetary policy, such as open market operations and standing facilities, are not caught by the State aid rules. Dedicated support to a specific financial institution may also be found not to constitute aid in specific circumstances. The Commission considers that the provision of central banks' funds to the financial institution in such a case may be found not to constitute aid when a number of conditions are met, such as:

— the financial institution is solvent at the moment of the liquidity provision and the latter is not part of a larger aid package,

— the facility is fully secured by collateral to which haircuts are applied, in function of its quality and market value,

— the central bank charges a penal interest rate to the beneficiary, The Increased Prominence of the Role Assumed by Central Banks – The Impact of the Recent Financial Crisis.

According to recent observations, some aspects of the more prominent role which central banks have assumed since the recent crisis (such a role being partly attributed to circumstances triggered by the recent financial crises), are likely to become more permanent during the aftermath of the Crisis.[224]

Unconventional measures which were introduced by advanced economies in response to the latter stages of 2008 include liquidity provision to banks on extra ordinary terms – particularly for longer periods of maturity, intervention in selected credit markets – a measure aimed at supporting secondary market liquidity and the outright purchase of bonds – such purchase being aimed at improving financing conditions beyond that which can be achieved by policy rate cuts.[225]

A change in supervisory responsibilities and functions of regulators – with more powers being transferred to central banks, is also being witnessed in jurisdictions such as the UK. This response has been prompted by the realisation that the allocation of responsibilities between the tripartite arrangement (consisting of the single financial services regulator – the Financial Services Authority (FSA), the Treasury and the Bank of England) did not function efficiently and timely[226] to avert the crisis generated during the events leading to the collapse of Northern Rock. Greater powers have been transferred to the Bank of England who used to be responsible for bank supervision before this role was transferred to the FSA in 1997.

"The Bank of England's focus on meeting the inflation target" it is contended, "distracted it from monitoring other important variables that affect financial stability."[227] In response to some of the issues brought to light as a result of the recent crisis, the Bank is now to be given responsibility for systemic oversight.[228] As a result, the grant of further supplementary

— the measure is taken at the central bank's own initiative, and in particular is not backed by any counter guarantee of the State." ibid

[224] H Hannoun "The Expanding Role of Central banks Since the crisis: What are the Limits?" June 2010 Bank for International Settlements Publications http://www.bis.org/speeches/sp100622.pdf?noframes=1 at page 1

[225] ibid at page 3

[226] It is also highlighted that a key reason for the failure of the tripartite system of financial oversight during Northern Rock's collapse was a failure by the tripartite body to properly identify and monitor risks to the financial system as whole. See Shearman and Sterling LLP, „UK Government Proposals for Financial Regulatory Reform" Financial Institutions Advisory and Financial Regulatory Group Publications 7 June 2010

[227] ibid; "Under EU legislation currently being discussed in Brussels, there may in the foreseeable future, be a new financial regulatory framework that aims to strengthen prudential supervision across the EU. Macro-prudential supervision would be the responsibility of a new European Systemic Risk Board that would, with the assistance of the European Central Bank, be tasked with giving early warning of any growing systemic risks and, where necessary, recommending action to deal with such risks. Micro-prudential supervision would be carried out by the European System of Financial Supervisors, made up of national supervisors, and by three European Supervisory Authorities for the banking, securities and insurance and occupational pensions sectors. In order for the new EU supervisory framework to work properly, the responsibilities of the Bank of England and the FSA would need to correspond with those of the new EU institutions and their counterparts in other member states."

[228] Ibid; Furthermore, "central banks are increasingly being put in charge of **overseeing systemic risk**. This is because, as "the ultimate provider of liquidity", they are in a unique position to focus on system-wide risks and obtain an integrated view of both the individual financial institutions and the financial system as a whole. Even when financial institutions look strong on an individual basis, systemic risk can emerge as a result of the interconnectedness of financial institutions, markets and infrastructures. The macro prudential approach to supervision has to take account of these externalities.

oversight functions to the Bank of England in relation to the associated subject of prudential regulation, it is further argued, will be desirable.[229] Even though a change in supervisory roles – with respect to present regulator and the central bank is also considered to be a possibility in Germany[230], a radical change such as that which is currently taking place in the UK, is not foreseen. This in partly attributable to the fact that the Deutsche Bundesbank, the central bank, was responsible for numerous vital supervisory functions and was more engaged in bank supervision – in contrast to the position which existed with the Bank of England.

Whilst the need for a greater role for central banks in facilitating financial stability and promoting systemic oversight is a positive and justified development, the growing intervention of central banks in financial markets gives rise to concerns. The recent Financial Crisis witnessed a series of rescues and restructuring of financial institutions – such being facilitated by State aids – hence government intervention. Central bank intervention provides an invaluable source of liquidity funding in terms timeliness (particularly in view of urgent scenarios) when compared to State aids. The promptness of central banks in addressing serious liquidity problems faced by financial institutions has contributed to the realisation that its role in promoting financial stability should be accorded greater prominence. At the same time, it appears to be widely acknowledged that "the role of the lender of last resort facility should not be used to address individual bank insolvencies."[231]

The "classic" view – under which it is held that "central banks should lend freely at a penalty rate as well as against good collateral"[232] is considered to serve as a means of ensuring that :[233]

- The lender of last resort is only used for illiquid banks
- In emergency situations

A restricted application of the lender of last resort facility (as much as possible) is not only justified on the basis that moral hazard could occur – since banks or financial institutions

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Two recent examples of this approach are the creation of the European Systemic Risk Board (ESRB) at the ECB, and the proposed Financial Stability Oversight Council in the United States. The ESRB will be an independent body responsible for conducting macro prudential oversight of the European Union's financial system as a whole. It is thus expected to fill a gap in the ability of financial regulators to detect, assess and contain the build-up of systemic risks. Similarly, the Financial Stability Oversight Council of regulators in the United States is expected to identify systemically significant companies and monitor markets for the development of asset price and credit booms that might threaten financial stability. According to these proposals, the Fed would be responsible for the supervision of systemically important financial institutions." see H Hannoun "The Expanding Role of Central banks Since the crisis: What are the Limits?" June 2010 Bank for International Settlements Publications http://www.bis.org/speeches/sp100622.pdf?noframes=1 at page 6

[229] See Shearman and Sterling LLP, „UK Government Proposals for Financial Regulatory Reform" Financial Institutions Advisory and Financial Regulatory Group Publications 7 June 2010

[230] H Hannoun "The Expanding Role of Central banks Since the crisis: What are the Limits?" June 2010 Bank for International Settlements Publications http://www.bis.org/speeches/sp100622.pdf?noframes=1 at page 6

[231] See Organisation for Economic Cooperation and Development, "Competition and the Financial Crisis" at page 6 of 28

[232] „Another reason why central banks need to unwind their intervention in financial markets is that they are not immune to credit risk. The conventional rule is that central bank lending must be fully collateralised. Unsecured lending is a risky art, requiring discretion, which is incompatible with the principles of transparency and equal treatment in access to central bank credit. Nor is it consistent with the accountability of the central bank." See H Hannoun "The Expanding Role of Central banks Since the crisis: What are the Limits?" June 2010 Bank for International Settlements Publications http://www.bis.org/speeches/sp100622.pdf?noframes=1 at page 9

[233] See Organisation for Economic Cooperation and Development, "Competition and the Financial Crisis" at page 6 of 28

experiencing financial difficulty will almost always expect to be bailed out when such a need arises (and hence will be induced to take greater levels of risks than the case would have been if no such facility had existed). It is also argued that “the sustained bloating of their balance sheets means that central banks still dominate some financial market segments thereby distorting the pricing of some important bonds and loans, discouraging necessary market-making by private individuals and institutions.”[234]

Should lender of last resort arrangements be granted to a wider extent under complementary arrangements which support re capitalisation schemes than those which support guarantee schemes or vice versa?

Lender of last resort arrangements should be granted to illiquid systemically relevant financial institutions in emergency situations. This is partly attributed to the fact that Paragraph 6 of the Re capitalisation Communication, interestingly, provides for “problems of financial institutions facing insolvency as a result of their particular business model or investment strategy.“

Other reasons why the lender of last resort facility should be used for emergency situations and systemically relevant institutions in particular, are attributed to the role played by central banks during the recent crisis – during which the role of central banks “in stepping in to replace disrupted and dislocated funding markets”[235] was highlighted. In drawing attention to such developments, the need to avoid dependency on the central bank – to the extent that it does not become the “lender of first resort” (whenever the markets reveal signs of impeding financial failures), is also emphasised.[236]

Given the scale of government intervention and State rescues which occurred during the recent crisis –as well as the prominence accorded to measures aimed at preventing and limiting distortions of competition, calls have been made for competition authorities to take on more formidable roles in designing and implementing exit strategies. In order to foster competition as much as possible, it is proposed that ”governments should provide financial institutions with incentives to prevent them from depending on government support once the economy begins to recover.”[237] Such incentives, it is further argued, could assume the form of rescue measures having conditions built into them – conditions which would induce financial institutions to opt for private sources of investments (rather than public sources of investment) when economic conditions return to normal.[238]

[234] H Hannoun “The Expanding Role of Central banks Since the crisis: What are the Limits?” June 2010 Bank for International Settlements Publications http://www.bis.org/speeches/sp100622.pdf?noframes=1 at page 7

[235] „During the crisis, central banks had to step in to replace disrupted and dislocated funding markets. Severe tensions in interbank, foreign exchange swap and some segments of securities markets – including, lately, government bond markets – hampered the monetary policy transmission mechanism. The usual relationship between key policy rates and the rates applicable in the real economy was disrupted, and the main tool for influencing financing conditions in the real economy did not work properly.” ibid

[236] ibid at page 9

[237] Organisation for Economic Co operation and Development, „ Competition and the Financial Markets” at page 10

[238] An example is provided where governments could make it un lucrative for beneficiaries to rely on public capital injections any longer than they have to – by imposing restrictions on them (restrictions such as escalating dividends or interest rates). At some point, it is further argued, private sources of equity will become more desirable; see ibid

According to key findings published by the OECD, the design of competition policies in banking within several jurisdictions in Europe has undergone substantial reform at national level – with very unprecedented changes occurring over the last two decades.[239]

The recent crisis has also witnessed unprecedented levels of intervention – in terms of government intervention. The OECD's findings also highlight the fact that competition authorities around the world have also been compelled to participate in these actions for reasons other than those related to intense time pressure for action, - whilst questions relating to the application of competition policy to the financial sector have arisen.[240]

Whilst the findings highlight the controversy generated by some who argue that competition rules should be suspended for the duration of the crisis - thus allowing regulators to focus only on the objective of safeguarding the stability of the financial system, it concludes that whether competition is desirable at all when there is a systemic crisis, is a matter which generally, is in need of clarification.[241]

Conclusions

The successful winding up of financial institutions and the „weaning“ financial institutions from state aid is crucial, not only for the purposes of achieving the desired level of stability, but also to avoid distortions of competition.

Should the Commission and Member States apply the methodology[242] stipulated in the Re capitalisation Commission to safeguard an equitable determination of the acquisition price of capital of banks by Member States, and would such consideration provide a vital key to determining the real value of State aid and the best possible price for which capital should be sold or privatised?

In determining the appropriate level of remuneration of capital, the following considerations should be taken into account:

- the need to minimise burdens to tax payers
- the valuation of troubled assets (and particularly assets for which no market is available) at a "zero price" – since such assets should be realistically valued rather

[239]For example, in Italy since December 2005 competition policy in banking is no longer enforced by the Bank of Italy but rather by the competition authority as in all other sectors. In the Netherlands, the Competition Act of 1998 applies to the banking sector, but only since 2000. See Organisation for Economic Cooperation and Development, "Competition and the Financial Crisis" at page 12

[240]ibid at page 13

[241]"Others have instead emphasised the importance of applying strict competition rules in the current crisis as a means of ensuring a level playing field and a coordinated reaction to the crisis – as well as avoiding a futile race for subsidies between countries to attract depositors and investors. Moreover, the long-term effects of relaxing competition policy can be serious. Mergers that lead to very concentrated markets in particular are almost impossible to reverse."; ibid

[242]„Ordinary shares are remunerated by uncertain future dividend payments and the increase of the share price (capital gain/loss), both of which ultimately depend on the expectations of future cash flows/profits. In the current situation, a forecast of future cash flows is even more difficult than under normal conditions. The most noticeable factor, therefore, is the quoted market price of ordinary shares. For non-quoted banks, as there is no quoted share price, Member States should come to an appropriate market-based approach, such as full valuation.“

than being over valued at an amount which is not only unaffordable for the participating bank (at the time), but which has also has the potential of encumbering future tax burdens.

- The “under estimation of risk in the pre-crisis period”[243] – this being the case even though the Commission acknowledges that “current exceptional market rates do not constitute a reasonable benchmark for determining the correct level of remuneration of capital.” Such a consideration of the under estimation of risk in the pre crisis period, in the Commission’s opinion, would also serve to minimise the occurrence of situations whereby public remuneration rates could give undue competitive advantages to beneficiaries – which could eventually result in the “crowding out” of private re-capitalisation.

- The need to facilitate exit strategies – whereby the remuneration demanded by the State is adequately high enough to provide the participating bank with incentives to look for alternative capital where market conditions allow such redemption of State capital.

It’s still too early to respond to many key questions, and maybe, sooner than later, it will be possible to ascertain whether all public funds were efficiently used. After the Commission has reviewed and evaluated all restructuring plans – as well as funds obtained from tax-payers, it should be possible to analyse if all member state and Commission decisions were appropriate.

At the same time, the combination of failures that generated the recent Crisis, is of such a serious nature that it needs to be rectified - although we should not forget that regulations do not serve as the only solution and that Greed is like, as it has always been, a great engine for just everything, and not always right for everybody.

[243] See paragraph 18 of the Recapitalisation Communication

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Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector, 25 February 2009 (see IP/09/322)
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Communication from the Commission - The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, 23 July 2009 (see IP/09/1180)
State aid cases - situation as of 29 June 2010
Decisions adopted by the Commission in 2008/2009/2010[1]
Austria

Type of measure / Beneficiary	Type of Decision	Date of adoption
N557/2008 - Aid scheme for the Austrian financial sector (guarantees, recapitalisation & other)	Decision not to raise objections IP/08/1933	09 December 2008
N352/2009 - Prolongation	MEX/09/0630	30 June 2009
N663/2009 - Second prolongation	MEX/09/1217	17 December 2009
N241/2010 - Extension	IP/10/839	25 June 2010
N214/2008 - Recapitalisation of Hypo Tirol	Decision not to raise objections IP/09/928	17 June 2009
N 640/2009 - BAWAG - capital injection and asset guarantee	Decision not to raise objections IP/09/1989	22 December 2009
C 16/2009 + N698/2009 – Emergency aid to Hypo Group Alpe Adria	Decision not to raise objections	23 December 2009

[244] See in: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/284&format=HTML&aged=0&language=EN&guiLanguage=en

	IP/09/1998	

Belgium

Belgium/Luxembourg

NN45-49-50/2008 – Guarantee on liabilities of Dexia	Decision not to raise objections IP/08/1745	19 November 2008
Prolongation	IP/09/1662	30 October 2009

Belgium/France/Luxembourg

C9/2009 – Guarantee in favour of Dexia on certain assets in FSA	Decision not to raise objections IP/09/399	13 March 2009

Belgium/Luxembourg/Netherlands

N574/2008 – Measures in favour of Fortis	Decision not to raise objections IP/08/1746	19 November 2008
NN42-46-53A/2008 – Restructuring aid to Fortis Bank and Fortis Bank Luxembourg	Decision not to raise objections IP/08/1884	03 December 2008

Belgium/Luxembourg

N255/2009 and N274/2009 – Additional aid measures in favour of Fortis Bank and Fortis Bank Luxembourg	Decision not to raise objections IP/09/743	12 May 2009

Belgium

N602/2008 – Recapitalisation measure in favour of KBC	Decision not to raise objections IP/08/2033	18 December 2008
NN57/2008 – Capital Injection for Ethias Group	Decision not to raise objections IP/09/254	12 February 2009
C18/2009 – Recapitalisation and asset relief for KBC Group	Decision not to raise objections IP/09/1063	30 June 2009
C18/2009 – Asset relief and restructuring package for KBC	Final conditional decision after formal investigation procedure IP/09/1730	18 November 2009
N 256/2009 – Restructuring aid for Ethias	Decision not to raise objections IP/10/592	20 May 2010

Belgium/France/Luxembourg

C9/2009 – Approval of restructuring plan for Dexia	Final conditional decision after formal investigation procedure IP/10/201	26 February 2010

Cyprus

N511/2009 - Cypriot scheme to support credit institutions (guarantee)	Decision not to raise objections IP/09/1569	22 October 2009

Denmark

NN36/2008 - Rescue aid to Roskilde Bank	Decision not to raise objections (IP/08/1222)	31 July 2008
NN39/2008 - Liquidation aid Roskilde bank	Decision not to raise objections IP/08/1633	5 November 2008
NN51/2008 - Guarantee scheme for banks in	Decision not to raise	10 October 2008

Denmark	objections IP/08/1483	
N31a/2009 – Amendment of the guarantee scheme	Decision not to raise objections IP/09/206	17 August 2009
N20/2010 - Second prolongation	Decision not to raise objections MEX/10/0201	01 February 2010
N257/2010 - Extension	IP/10/854	28 June 2010
N31a/2009 - Recapitalisation scheme (and amendment of the guarantee scheme)	Decision not to raise objections IP/09/206	3 February 2009
NN46/2009 - Prolongation	MEX/09 /0817	17 August 2009
N628/2009 – Second prolongation	MEX/09/1217	17 December 2009
NN23/2009 - Rescue aid for Fionia Bank	Decision not to raise objections IP/09/819	20 May 2009
Finland		
N567/2008 - Finnish guarantee scheme	Decision not to raise objections IP/08/1705	13 November 2008
N44/2009 - Amendment to the guarantee scheme	Decision not to raise objections IP/09/681	5 February 2009
N239/2009 - Prolongation and modification	MEX/09/0430	30 April 2009
N674/2009 – Second prolongation and modification	MEX/09/1217	17 December 2009
NN2/2009 - Guarantee for Kaupthing Bank Finland	Decision not to raise objections IP/09/82	21 January 2009
N329/2009 - Capital injection scheme	Decision not to raise objections IP/09/1303	11 September 2009
N110/2010 – Prolongation	MEX/10/0414	14 April 2010
France		
N548/2008 - Financial support measures to the banking industry in France (Refinancing)	Decision not to raise objections IP/08/1609	30 October 2008
N251/2009 - Extension of the scheme	Decision not to raise objections IP/09/750	12 May 2009
N613/2008 - Financial support measures to the banking industry in France (Recapitalisation)	Decision not to raise objections IP/08/1900	08 December 2008
N29/2009 - Amendment to the Decision	IP/09/158	28 January 2009
N164/2009 - Amendment to the Decision	IP/09/461	23 March 2009
N249/2009 - Capital injection for Caisse d'Epargne and Banque Populaire	Decision not to raise objections	8 May 2009

	IP/09/722	

Germany

C9/2008 - Restructuring aid to Sachsen LB	Conditional decision (after formal investigation procedure IP/08/849	4 June 2008
C10/2008 - Restructuring aid to IKB	Conditional decision (after formal investigation procedure) IP/08/1557	21 October 2008
NN44/2008 - Rescue aid to Hypo Real Estate Holding	Decision not to raise objections IP/08/1453	2 October 2008
N512/2008 - Aid scheme for financial institutions in Germany (guarantees, recapitalisations & other)	Decision not to raise objections IP/08/1589	27 October 2008
N625/2008 - Amendment to the Decision		12 December 2008
N330/2009 – Prolongation	EXME09 / 22.06	22 June 2009
N665/2009 – Second prolongation	MEX/09/1217	17 December 2009
N222/2010 – Extension	IP/10/789	23 June 2010
N615/2008 - Guarantee and recapitalisation for Bayern LB	Decision not to raise objections IP/08/2034	18 December 2008
N655/2008 - Guarantee for NordLB	Decision not to raise objections IP/08/2056	22 December 2008
N412/2009 - Prolongation	MEX/09/0910	10 September 2009
N639/2008 - Guarantee for IKB	Decision not to raise objections IP/08/2055	22 December 2008
N17/2009 - Guarantee for SdB – Sicherungseinrichtungsgesellschaft deutscher Banken mbH	Decision not to raise objections IP/09/114	22 January 2009
N244/2009 - Commerzbank capital injection	Decision not to raise objections IP/09/711	7 May 2009
C43/2008 - Aid for the restructuring of West LB	Conditional decision (after formal investigation procedure) IP/09/741	12 May 2009
N531/2009 - Temporary additional aid to West LB	Decision not to raise objections IP/09/1434	7 October 2009
N264/2009 - Recapitalisation of HSH Nordbank	Decision not to raise objections IP/09/854	29 May 2009
C17/2009 - Recapitalisation and asset relief for LBBW (Landesbank Baden Württemberg)	Decision not to raise objections	30 June 2009

	IP/09/1058	
N314/2009 - German asset relief scheme	Decision not to raise objections IP/09/1216	31 July 2009
N400/2009 - Additional aid (guarantees) for IKB	Decision not to raise objections IP/09/1235	17 August 2009
N 456 /2009 - Scheme to facilitate the refinancing of export credits	Decision not to raise objections IP/09/1319	15 September 2009
N 48/2010 - Prolongation	Decision not to raise objections MEX/10/0309	9 March 2010
C17/2009 - Landesbank Baden Württemberg "LBBW" - restructuring plan and impaired assets relief measure	Conditional decision (after formal investigation procedure IP/09/1927	15 December 2009

N694/2009 – State guarantees for Hypo Real Estate	Decision not to raise objections IP/09/1985	21 December 2009
N555/2009 – Rescue aid for WestLB; in-depth investigation into bad bank	Decision not to raise objections IP/09/1996	22 December 2009
N161/2010 – Recapitalisation of Hypo Real Estate	Decision not to raise objections	19 May 2010

Greece

N560/2008 - Aid scheme to the banking industry in Greece (guarantees, recapitalisation & other)	Decision not to raise objections IP/081742	19 November 2008
Prolongation and modification	MEX/09/0918	18 September 2009
N690/2009 – Prolongation	MEX/10/0125	25 January 2010
N 163/2010 - Amendment		12 May 2010

Hungary

N664/2008 - Financial support measures to Hungarian financial industry in form of recapitalisation and guarantee scheme	Decision not to raise objections IP/09/253	12 February 2009
N355/2009 - Prolongation and modification	MEX09 /0903	3 September 2009
N662/2009 – Second prolongation	MEX/09/1217	17 December 2009
N224/2010 – Prolongation of Hungarian recap scheme	IP/10/789	23 June 2010
N 358/2009 - Hungarian Mortgage Support Scheme	Decision not to raise objections IP/09/1123	13 July 2009
N603/2009 - Prolongation	Decision not to raise	24 November

	objections MEX 09/1124	2009
NN68/2009 – Hungarian liquidity support scheme	Decision not to raise objections IP/10/19	14 January 2010
N225/2010 - Extension	IP/10/854	28 June 2010

Ireland

NN48/2008 - Guarantee scheme for banks in Ireland	Decision not to raise objections IP/08/1497	13 October 2008
N9/2009 - Recapitalisation of Anglo Irish Bank	Decision not to raise objections IP/09/50	14 January 2009
N356/2009 - Recapitalisation of Anglo Irish Bank	Decision not to raise objections IP/09/1045	26 June 2009
N61/2009 - Change of ownership of Anglo Irish Bank	Decision not to raise objections IP/09/271	17 February 2009
N149/2009 - Recapitalisation of Bank of Ireland	Decision not to raise objections IP/09/483	26 March 2009
N241/2009 - Recapitalisation of Allied Irish Bank	Decision not to raise objections IP/09/744	12 May 2009
N349/2009 - revised Irish guarantee scheme for financial institutions	Decision not to raise objections IP/09/1787	20 November 2009
Prolongation	Decision not to raise objections MEX/10/0531	31 May 2010
N254/2010 - Extension	IP/10/854	28 June 2010

N725/2009 - Irish impaired asset relief scheme (National Asset Management Agency (NAMA))	Decision not to raise objections IP/10/198	26 February 2010
NN11/2010 – Temporary approval of Rescue measure in favour of INBS	Decision not to raise objections IP/10/400	30 March 2010
NN12/2010 and C11/2010 – Temporary approval of Second recapitalisation of Anglo Irish Bank and restructuring of Anglo Irish Bank	Decision not to raise objections on recapitalisation, and opening of proceedings on restructuring IP/10/400	31 March 2010
N160/2010 – Temporary approval of recapitalisation of EBS	Decision not to raise objections IP/10/658	2 June 2010

Italy

N520a/2008 - Guarantee scheme for Italian banks	Decision not to raise objections IP/08/1706	14 November 2008
N328/2009 - Prolongation	IP/09/929	16 June 2009

N648/2008 - Recapitalisation scheme	Decision not to raise objections IP/08/2059	23 December 2008
N97/2009 - Amendment		20 February 2009
N 466/2009 - Prolongation	MEX/09/1006	6 October 2009

Latvia

NN68/2008 - Public support measures to Parex Banka	Decision not to raise objections IP/08/1766	24 November 2008
NN3/2009 - Amendment to the Decision		11 February 2009
N189/2009 - Amendment to the Decision	IP/09/732	11 May 2009
N638/2008 - Guarantee scheme for banks	Decision not to raise objections IP/08/2054	22 December 2008
N326/2009 – Prolongation	MEX/09/0630	30 June 2009
N664/2009 – Second prolongation	MEX/09/1217	17 December 2009
N223/2010 – Extension	IP/10/839	24 June 2010
NN60/2009 - Capital injection for Mortgage Bank of Latvia	Decision not to raise objections IP/09/1742	19 November 2009

Luxembourg

N344/2009&N380/2009 - Restructuring aid for Kaupthing Bank Luxembourg	Decision not to raise objections IP/09/1107	9 July 2009

Netherlands

N524/2008 - Guarantee scheme for Dutch financial institutions	Decision not to raise objections IP/08/1610	30 October 2008
N379/2009 - Prolongation and modification	MEX/09/0707	7 July 2009
N669/2009 – Second prolongation	MEX/09/1217	17 December 2009
N528/2008 - Measure in favour of ING	Decision not to raise objections IP/08/1699	13 November 2008

N569/2008 - Measure in favour of Aegon	Decision not to raise objections IP/08/1822	27 November 2008
N611/2008 - SNS REAAL/New capital injection by Dutch authorities	Decision not to raise objections IP/08/1951	10 December 2008
C10/2009 - ING Illiquid asset facility	Decision not to raise objections IP/09/514	31 March 2009
C10/2009 - ING restructuring plan and illiquid asset back-up facility	Final conditional decision after formal investigation procedure IP/09/1729	18 November 2009
N371/2009 – Approval of recapitalisation of SNS REAAL	Decision not to raise objections	28 January 2010

	IP/10/82	
N 19/2010, NN 2/2010, C11/2009 - Temporary approval of additional recapitalisation package in favour of ABN AMRO and Fortis Bank Nederland	Decision not to raise objections IP/10/138	4 February 2010
Poland		
N208/2009 - Polish support scheme for financial institutions (guarantee and liquidity support)	Decision not to raise objections IP/09/1360	25 September 2009
Prolongation	MEX/10/0209	9 February 2010
N302/2009 – Polish bank recapitalisation scheme	Decision not to raise objections IP/09/1979	21 December 2009
Portugal		
NN60/2008 - Guarantee scheme for credit institutions in Portugal	Decision not to raise objections IP/08/1601	29 October 2008
N51/2010 – Prolongation	MEX/10/0222	22 February 2010
NN71/2008 - State guarantee for Banco Privado Português	Decision not to raise objections IP/09/400	13 March 2009
N556/2008 - Bank recapitalisation scheme	Decision not to raise objections IP/09/818	20 May 2009
N 80/2010 – Prolongation	MEX/10/0317	17 March 2010
Slovakia		
N392/2009 - Slovak bank support scheme (guarantees and recapitalisations)	Decision not to raise objections IP/09/1889	8 December 2009
Slovenia		
N531/2008 - Guarantee scheme for credit institutions in Slovenia	Decision not to raise objections IP/08/1964	12 December 2008
N331/2009 - Prolongation	EXME09 / 22.06	22 June 2009
N651/2009 – Second prolongation	MEX/09/1217	17 December 2009
N637/2008 - Liquidity scheme for financial sector	Decision not to raise objections IP/09/452	20 March 2009
N510/2009 – Prolongation	MEX09/1910	19 October 2009
N113/2010 – Second Prolongation	MEX10/0415	15 April 2010
Spain		
NN54a/2008 - Fund for the Acquisition of Financial Assets in Spain	Decision not to raise objections IP/08/1630	4 November 2008
Modification	Decision not to raise objections	8 April 2009
N337/2009 - Prolongation	MEX09/0807	7 August 2009
NN54b/2008 - Spanish guarantee scheme for credit institutions	Decision not to raise objections IP/08/2049	22 December 2008

Prolongation	MEX09 / 0625	25 June 2009
N588/2009 - Second prolongation	MEX/09/1201	1 December 2009
N28/2010 – Spanish recapitalisation scheme for credit institutions (Fondo de Reestructuración Ordenada Bancaria" (FROB))	Decision not to raise objections IP/10/70	28 January 2010
Sweden		
N533/2008 - Support measures for the banking industry in Sweden (guarantees)	Decision not to raise objections IP/08/1600	29 October 2008
N26/2009 - Amendment to the decision	IP/09/186	28 January 2009
N154/2009 - Amendment and prolongation	IP/09/652	28 April 2009
N544/2009 – Prolongation	MEX/09/1026	26 October 2009
N 127/2010 – Second Prolongation	MEX/10/0422	22 April 2010
N 207/2010 - Extension of Swedish guarantee scheme	MEX/10/0615	15 June 2010
NN64/2008 - Emergency rescue measures regarding Carnegie Investment Bank	Decision not to raise objections IP/08/1977	15 December 2008
N69/2009 - Recapitalisation scheme	Decision not to raise objections IP/09/241	11 February 2009
N436/2009 - Prolongation	MEX09 / 0805	5 August 2009
NN 18/2010 – Clearance of restructuring aid for Carnegie Investment Bank	Decision not to raise objections IP/10/558	12 May 2010
United Kingdom		
NN41/2008 - Rescue aid to Bradford and Bingley	Decision not to raise objections IP/08/1437	1st October 2008
N507/2008 - Aid scheme to the banking industry in the UK (guarantees, recapitalisation & other)	Decision not to raise objections IP/08/1496	13 October 2008
N650/2008 - Amendment to the Decision		23 December 2008
N193/2009 - Prolongation	IP/09/586	15 April 2009
N537/2009 – Prolongation	MEX/10/13	13 October 2009
N677/2009 - Prolongation	MEX/09/1217	17 December 2009
N111/2009 - Working capital guarantee scheme	Decision not to raise objections IP/09/471	24 March 2009
UK Asset backed Securities guarantee scheme	Decision not to raise objections IP/09/613	21 April 2009
Prolongation	MEX/09/1027	27 October 2009
C14/2008 - Restructuring package for Northern Rock	Final conditional decision after formal investigation procedure IP/09/1600	28 October 2009
N428/2009 - Restructuring plan of Lloyds Banking Group	Decision not to raise objections IP/09/1728	18 November 2009
N422/2009 and N621/2009 - Royal Bank of	Decision not to raise objections	14 December

Scotland, impaired asset relief measure and restructuring plan	IP/09/1915	2009
N194/2009 – Liquidation aid to Bradford & Bingley	Decision not to raise objections IP/10/47	25 January 2010
NN19/2009 – Restructuring of Dunfermline Building Society	Decision not to raise objections IP/10/48	25 January 2010

Cases currently under formal investigation procedure (in-depth investigation under the EC Treaty's rules on state aid)

Country	Type of measure / Beneficiary	Date of decision regarding the opening of formal investigation	
Germany	C15/2009 - Aid package for Hypo Real Estate (restructuring) Extension and temporary approval of capital injections	7 May 2009 IP/09/712 13 November 2009 IP/09/1708	Case under assessment
Germany, Austria	C16/2009 - Aid package for Bayern LB and its Austrian subsidiary Hypo Group Alpe Adria Extension C 16/2009 – Extension of temporary approval of restructuring aid for Hypo Group Alpe Adria	12 May 2009 IP/09/742 23 December 2009 IP/09/1998 22 June 2010 IP/10/774	Case under assessment
Germany	C29/2009 - Aid package for HSH Nordbank AG	22 October 2009 IP/09/1577	Case under assessment
Germany	C32/2009 - Support measures for German savings bank Sparkasse KölnBonn	5 November 2009 IP/09/1670	Case under assessment
Germany	C43/2009 – WestLB: in-depth investigation into bad bank C43/2009 – Prolongation of temporary approval of aid to WestLB	22 December 2009 IP/09/1996 22 June 2010 IP/10/774	Case under assessment
Ireland	C11/2010 – Temporary approval of Second recapitalisation of Anglo Irish Bank and restructuring of Anglo Irish Bank	31 March 2010 IP/10/400	Case under assessment
Latvia	C26/2009 - Aid package for JSC Parex Banka	29 July 2009 IP/09/1203	Case under assessment
Netherlands	C11/B/2008 - State measures in favour of Fortis Bank Nederland (FBN) and the activities of ABN Amro Extension	8 April 2009 IP/09/565 4 February 2010 IP/10/138	Case under assessment
Portugal	C33/2009 - State guarantee for Banco Privado Português	10 November 2009 IP/09/1691	Case under assessment

Real economy cases falling under the Temporary Framework - situation as of 29 June 2010
Decisions adopted by the Commission in 2008-2010
Austria

Type of measure / Beneficiary	Type of Decision	Date of adoption
N 47/a/2009- Temporary scheme (aid up to € 500 000) N 317/2009 - Amendment	Decision not to raise objections IP/09/454 IP/09/972	20 March 2009 18 June 2009
N 47/d/2009- Temporary scheme (risk capital)	Decision not to raise objections IP/09/484	25 March 2009
N 434/2009 – Temporary scheme (export-credit insurance)	Decision not to raise objections IP/09/1955	17 December 2009
N 118/2010 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/453	19 April 2010

Belgium

N 117/2009- Temporary scheme (subsidised guarantees)	Decision not to raise objections IP/09/447	20 March 2009
N 532/2009 – Temporary scheme (export-credit-insurance)	Decision not to raise objections IP/09/1680	6 November 2009
N 34/2010 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/160	11 February 2010

Bulgaria

N 108/2010 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/454	19 April 2010

Czech Republic

N 237/2009 - Temporary scheme (subsidised interest rates)	Decision not to raise objections IP/09/699	6 May 2009
N 236/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/719	7 May 2009

Denmark

N 198/2009 - Temporary scheme (export-credit insurance) N 554/2009 (amendment)	Decision not to raise objections IP/09/706 IP/09/1630	6 May 2009 29 October 2009

Estonia

N 387/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/1121	13 July 2009

Finland

N 224/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/869	3 June 2009
N 82b/2009 - Temporary scheme (guarantees)	Decision not to raise	9 June 2009

	objections IP/09/919	
N 258/2009 – Temporary scheme (export-credit insurance)	Decision not to raise objections IP/09/979	22 June 2009
N 141/2010 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/604	20 May 2010

France

N 7/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/72	19 January 2009
N 15/2009 - Temporary scheme (reduced interest rates)	Decision not to raise objections IP/09/216	4 February 2009
N 11/2009 - Temporary scheme (reduced interest rates – to producers of green products)	Decision not to raise objections IP/09/205	3 February 2009
N 23/2009 - Temporary scheme (subsidised guarantees)	Decision not to raise objections IP/09/332	27 February 2009
N 119/2009 - modification of French risk capital scheme	Decision not to raise objections IP/09/406	16 March 2009
N 36/2009 - Temporary scheme (risk capital)	Decision not to raise objections IP/09/1094	30 June 2009
N 449/2009 – Temporary scheme (export-credit insurance)	Decision not to raise objections IP/09/1422	5 October 2009
N 609/2009 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/09/1866	2 December 2009

Germany

N 661/2008 – KfW run special program 2009 (interest subsidies)	Decision not to raise objections (IP/08/2063)	30 December 2008
N 668/2008 – Temporary scheme (limited amount of compatible aid) N 299/2009 - Amendment N 411/2009 - Amendment	Decision not to raise objections IP/08/2063 IP/09/877 IP/09/1163	30 December 2008 4 June 2009 17 July 2009
N 39/2009 – Temporary adaptation of risk-capital schemes	Decision not to raise objections IP/09/214	3 February 2009
N 27/2009 - Temporary scheme (guarantees)	Decision not to raise objections IP/09/331	27 February 2009
N 38/2009 - Temporary scheme (reduced	Decision not to raise	19 February 2009

interest rates)	objections IP/09/296	
N 426/2009 – Temporary Scheme (green products)	Decision not to raise objections IP/09/1223	4 August 2009
N 384/2009 – Temporary Scheme (export credit insurance) N 91/2010 - Amendment	Decision not to raise objections IP/09/1222	5 August 2009 31 May 2010
N 597/2009 – Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/09/1805	23 November 2009
Greece		
N 308/2009 - Temporary scheme (guarantees)	Decision not to raise objections IP/09/867	3 June 2009
N 309/2009 - Temporary scheme (subsidised interest rates)	Decision not to raise objections IP/09/868	3 June 2009
N 304/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/1143	15 July 2009
Hungary		
N 77/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/325	24 February 2009
N 78/2009 – Temporary scheme (subsidised interest rates)	Decision not to raise objections IP/09/325	24 February 2009
N 114/2009- Temporary scheme (guarantees)	Decision not to raise objections IP/09/387	10 March 2009
N 203/2009 - Temporary scheme (guarantees)	Decision not to raise objections IP/09/647	24 April 2009
N 341/2009 - Temporary scheme (guarantee methodology) N 56/2010 - Amendment	Decision not to raise objections	1 July 2009 6 May 2010
N 679/2009 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/121	5 January 2010
Ireland		
N 186/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/585	15 April 2009
Italy		
N 279/2009 - Temporary scheme (risk capital)	Decision not to raise objections IP/09/825	20 May 2009

N 266/2009 - Temporary scheme (guarantees)	Decision not to raise objections IP/09/852	28 May 2009
N 248/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/852	28 May 2009
N 268/2009 – Temporary scheme (subsidised interest rates)	Decision not to raise objections IP/09/857	29 May 2009
N 542/2009 – Temporary scheme (aid for green cars)	Decision not to raise objections IP/09/1581	26 October 2009
N 706/2009 – Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/119	1 February 2010

Latvia

N 124/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/442	19 March 2009
N 139/2009 - Temporary scheme (guarantees)	Decision not to raise objections IP/09/626	22 April 2009
N 670/2009 - Temporary scheme (guarantee to JSC Liepājas Metalurgs)	Decision not to raise objections IP/09/1923	15 December 2009
N 84/2010 - Temporary scheme (export-credit insurance)	Decision not to raise objections IP/10/718	10 June 2010

Lithuania

N 272/2009 – Temporary scheme (aid up to € 500 000) N 523/2009 – Amendment N 46/2010 – Amendment	Decision not to raise objections IP/09/890 IP/09/1719	8 June 2009 13 November 2009 10 March 2010
N 659/2009 – Temporary scheme (export-credit insurance)	Decision not to raise objections IP/09/1980	21 December 2009
N 686/2009 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/118	1 February 2010

Luxembourg

N 99/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/334	26 February 2009
N 128/2009 – Temporary scheme (guarantees)	Decision not to raise objections IP/09/392	11 March 2009
N 50/2009 – Temporary scheme (export-credit insurance)	Decision not to raise objections IP/09/603	20 April 2009

Malta

N 118/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/820	18 May 2009

Netherlands

N 156/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/527	1 April 2009
N 409/2009 – Temporary scheme (export-credit insurance) N 14/2010 - Amendment	Decision not to raise objections IP/09/1405 IP/10/131	2 October 2009 5 February 2010

N 611/2009 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/09/1993	22 December 2009

Poland

N 408/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/1483	17 August 2009

Portugal

N 13/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/71	19 January 2009

Romania

N 286/2009 – Temporary scheme (guarantees) N173/2010 - Amendment	Decision not to raise objections IP/09/882	5 June 2009 24 June 2010
N 547/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/1876	3 December 2009
N 478/2009 – State guarantee in favour of Ford Romania	Decision not to raise objections IP/09/1711	13 November 2009

Slovakia

N 222/2009 – Temporary scheme (aid up to € 500 000) N 711/2009 - Amendment	Decision not to raise objections IP/09/680	30 April 2009 2 February 2010
N 707/2009 - Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/234	4 March 2010

Slovenia

NN 34/2009 - Temporary scheme (guarantees) N 105 /2010 - Amendment	Decision not to raise objections IP/09/917	12 June 2009 16 April 2010
N 228/2009 - Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/918	12 June 2009
N 713/2009 - Temporary scheme (export-credit	Decision not to raise	16 March 2010

insurance)	objections IP/10/282	

Spain

N 140/2009 – Temporary scheme (aid for green cars)	Decision not to raise objections IP/09/499	29 March 2009
N 307/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/889	8 June 2009
N 68/2010 – Temporary scheme (guarantees) N 157/2010 - Amendment	Decision not to raise objections	30 March 2010 8 June 2010

Sweden

N 80/2009 - State guarantees in favour of Volvo cars	Decision not to raise objections IP/09/879	5 June 2009
N 605/2009 – Temporary scheme (export-credit insurance)	Decision not to raise objections IP/09/1819	25 November 2009
N 541/2009 – State guarantee in favour of Saab	Decision not to raise objections IP/10/139	8 February 2010

United Kingdom

N 43/2009 – Temporary scheme (aid up to € 500 000)	Decision not to raise objections IP/09/215	4 February 2009
N 71/2009 – Temporary scheme (guarantees)	Decision not to raise objections IP/09/333	27 February 2009
N 72/2009 – Temporary scheme (to businesses producing green products)	Decision not to raise objections IP/09/333	27 February 2009
N 257/2009 – Temporary scheme (subsidised interest rates)	Decision not to raise objections IP/09/793	15 May 2009
N 71/2010 – Temporary scheme (aid up to € 15 000 for the agricultural sector)	Decision not to raise objections IP/10/390	30 March 2010

Cases currently under formal investigation procedure – cases falling under the Temporary framework (in-depth investigation under the EC Treaty's rules on state aid)

Country	Type of measure / Beneficiary	Date of decision regarding the opening of formal investigation	
Romania	C 36/2009 – State guarantee in favour of Oltchim	19 November 2009 IP/09/1748	Case under assessment

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As a general rule, aid schemes are reviewable six months after approval. Some individual decisions are subject to a review and possible restructuring plan.