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State Aid: Commission State Aid Guidelines on National Measures for Banks in Crisis

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Following the 12th October Eurogroup declaration, the European Commission ("Commission") published on 13th October a new Communication on the application of state aid rules to measures by EU Member States in relation to financial institutions in the context of the current global financial crisis ("Guidelines").

General Rescue Schemes vs. Individual Rescue Measures

The Guidelines particularly address two specific instruments: state guarantees and recapitalization schemes. While the Commission in previous state aid decisions (e.g. Northern Rock, SachsenLB) analyzed and cleared guarantees and recapitalization measures for individual banks in difficulty under the Article 87 (3) (c) EC Treaty and its so-called Rescue and Restructuring Guidelines, the new Guidelines solely concern national programs for the entire banking sector adopted to address the crisis under a specific provision of the EC Treaty which allows aid granted to address **"a serious disturbance of the economy of a Member State"** (Article 87 (3)(b) EC Treaty). The first of such national schemes inter alia encompassing a guarantee for inter-bank lending, was notified to the Commission by Denmark on 8th October and approved by the Commission on 10th October.

Substantive Requirements

According to the Guidelines, national programs to be adopted have to fulfill the following criteria:

- *non-discriminatory access*: Access to the national schemes for financial institutions is to be based on **objective criteria and to be granted on a non-discriminatory basis**. The programs should be open to all institutions incorporated in the Member State concerned, including subsidiaries, and with significant activities in that Member State. For recapitalization schemes, the selection of individual banks and the level of capitalization is to be based on objective criteria with respect to the solvency requirements.

- *state commitments to be limited in time, review required every six months*: The Commission points out that the justification of the schemes under Article 87 (3)(b) EC Treaty is not open on an open-end basis but **only as long as the current turmoil justifies its application**. Therefore, Member States have to carry out a review of their programs at least every six months and to report back to the Commission. The duration of the schemes should in principle not exceed two years. Moreover, in regard to recapitalization schemes, also individual measures taken for banks have to be reported within six months from the date of the intervention. All schemes have to be terminated as soon as the economic situation of the Member State in question so permits.

- *state support to be clearly defined and limited in scope to what is necessary to address the acute crisis*: The measures taken have to be **well-targeted to the specific source of difficulties** and proportionate to the challenge faced, not going beyond what is required to attain this effect.

- *appropriate contribution of the private sector*: In application of the general state aid principles, Member States have to ensure an appropriate contribution of the private sector by way of an **adequate remuneration for the guarantees** by the beneficiaries, which may also include pricing mechanisms reflecting the varying degree of risks and the beneficiaries' different credit profiles and needs. In case of recapitalization schemes, Member States should in principle receive rights, whose value corresponds to their capital contribution.

- *sufficient behavioral rules that prevent an abuse of state support*: The national systems should include **mechanisms to minimize distortions of competition** the potential abuse of the preferential situations of beneficiaries brought by a state guarantee. Especially for recapitalization schemes, the Commission requests to include safeguards to ensure that the capital injection does not allow the beneficiary to engage in aggressive commercial strategies or other purposes that would imply undue distortions of competition.

- *appropriate follow-up by structural adjustment measures – restructuring/liquidation of insolvent institutions*: The Commission considers the planned general schemes only as temporary emergency measures to address the acute symptoms of the current financial crisis and requires that the guarantee/recapitalization schemes need to be accompanied by necessary adjustment measures for the sector as a whole and/or by the restructuring or liquidation of individual beneficiaries.

Notification and Clearance Procedure

The Commission pledges to review and approve Member State schemes complying with the issued guidance very quickly (usually within 24 hours) to meet the challenge of the current crisis, but also emphasizes that these measures have to be notified to the Commission prior to their implementation under the state aid rules of the EC Treaty. Once the particular scheme is authorized, any support granted to individual banks under the national program (e.g. guarantee, capital injection) does not require any further state aid approval. However, in case **the aid granted under the general scheme keeps an insolvent institution afloat**, the Commission requires that the aid is followed up by adequate steps leading to a restructuring or liquidation of the bank as soon as the situation of the financial markets so permits. In that case, Member States are required to notify a **restructuring or liquidation plan**, which will be separately assessed by the Commission for its state aid compliance under the strict Rescue and Restructuring Guidelines.

Conclusion

The new guidance contributes significantly to provide more clarity and legal certainty for rescue measures to be adopted by Member States while also emphasizing that the current crisis does not render state aid provisions inapplicable and that aid to otherwise insolvent banks is subject to follow-up restructuring measures once the current crisis subsides.

If you have any questions or require specific advice on any matter discussed in this publication, please contact one of the lawyers listed below.

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