State aid to financial institutions - the EU and EEA approach

Changes and challenges during the financial crisis

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I. INTRODUCTION

1.1 THE FINANCIAL CRISIS, BANKS AND STATE AID[1]

The bankruptcy of Lehman Brothers, an American investment bank, on 15 September 2008 has detonated a chain reaction that has brought several European banks at the verge of collapse. It did so by arousing a breakdown in investor confidence that quickly transmitted throughout the system. Banks lost access to liquidity as interbank lending and wholesale funding markets dried up. The lack of required liquidity to shore-up reserves and offset mounting losses resulted in several leading European financial institutions, such as Dexia, Fortis and ING, within days tilted on the edge of insolvency[2].

Interlinked with the collapse of Lehman we see that entire countries found themselves in an economic struggle, providing the breeding ground for the financial crisis. Throughout Europe there was a drastic drop in gross domestic product ("GDP") growth, leaving all of the EU and EEA countries with a negative GDP growth for 2009. At the same time the ratios of government debts in many countries were very high, and still growing.

Looking at Iceland, which faced severe financial difficulties in 2008 and 2009, we find that their annual budget deficit increased from 10.3 % of GDP in 2007 to 79.7% in 2010[3], in the same period as their GDP growth of 6.0% in 2007 fell to a dramatic -6.9% in 2009 and ended on -4% in 2010[4]. Greece on the other hand, which is currently in serious economic difficulties, had a negative growth of -13.6 % of GDP in 2009 and -10.6 % in 2010. In the same period their government deficit has increased from a high 115 % of GDP to a sky-high 144.9% in 2010, leaving them incapable of managing their debts without foreign support. Italy is also facing serious financial struggles with a current government deficit of 120 % of

[1] In this paper, banks and financial institutions will be used interchangeably
[2] Doleys, p.1
[3] http://www.state.gov/r/pa/ei/bgn/3396.htm
[4] http://www.statice.is/?PageID=1267&src=/temp_en/Dialog/varval.asp?ma=THJ01702%26ti=Annual+GDP+volume+growth+1980-2010%26path=../Database/thjodhagsreikningar/landsframleidsla_althj/%26lang=1%26units=Percent

GDP; on the borderline of what they can manage alone[5]. If Italy does not fulfill their debts it is likely to have a grave impact on banks around Europe, especially German and French banks which own respectively 48.338 and 44.657 million euro of Italian debts[6].

Despite the efforts of the EU and EEA member States and of international financial institutions, such as the European Central Bank and International Monetary Fund, the financial crisis intensified markedly throughout 2008 and 2009, forcing governments to act quickly and aggressively. Still today the crisis is on-going. The prognoses for the banking sector in 2011 were, in the beginning of the year, better than that of 2010, this has however changed and banks are currently facing financial difficulties in many European countries[7].

The economic situation has threatened and is still threatening the existence of individual financial institutions as their weaknesses, which often are a result of their particular business model or business practices, are exposed and intensified by the crisis in the financial markets. A wide-ranging restructuring of their operations cannot be avoided if these institutions are to be returned to long-term viability[8]. Because of the severity of the crisis, fundamentally sound banks are also being affected as they are facing restricted access to liquidity.

As a result, enormous sums of State aid has been issued in the form of loans, guarantees, recapitalisation and underwriting of toxic assets to banks in both EU and EEA. In the EU alone, an amount equivalent to 36.7% of EU-27 GDP - €4.506.5 billion - has been made available for banks in crisis aid through national schemes and ad hoc interventions between October 2008 and October 2011. "The bulk of the aid was authorized in 2008, when € 3457 billion" were approved, mainly in form of guarantee[9].

This paper will deal with the legal changes adopted, during the financial crisis, on the access to grant such aid to banks and financial institutions. To be able to address the situation with appropriate measures, the European Commission (the "Commission") has temporarily

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[5] Provision of deficit and debt data, 2009 http://ep.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-22042010-BP/EN/2-22042010-BP-EN.PDF and provision of deficit and debt data, 2010 http://ep.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-21102011-AP/EN/2-21102011-AP-EN.PDF
[6] El País *¿Y si cae Italia?,* November 13, 2011 p. 6
[7] For more information see The Economist; "*Banks in central Europe, The ghost of Christmas past"* and *"The euro crisis, The screw tightens"*
[8] Banking Communication p.1
[9] 2011 State Aid Score Board, chapter 3

changed the legal provision to which they authorized aid to banks. The new provision, Article 107(3)(b) of the Treaty on the Functioning of the European Union ("TFEU"), allows the granting of State aid necessary to "remedy a serious disturbance in the economy of a Member State"[10]. Following the Commission's lead, the EFTA Surveillance Authority (the "Authority") also authorized the granting of aids to the banks in Norway, Iceland and Lichtenstein, on the basis of Article 61(3)(b) of the Agreement on the European Economic Area (the "EEA Agreement") which mirrors the formulation of Article 107(3)(b) TFEU.

Article 107(3)(b) TFEU and Article 61(3)(b) of the EEA Agreement have virtually never been used in the past, but all State aid granted to financial institutions after the 13 October 2008, have been authorized by the Commission and the Authority[11] on the basis of the exceptions provided by these provisions[12].

Between 13 October 2008, and 11 December 2011, Article 107(3)(b) TFEU has served as the legal basis for 399 decisions adopted by the Commission. 284 of these decisions have authorized, prolonged or amended schemes[13], 76 have been ad hoc cases[14], and 39 individual case[15]. Financial crisis measures were authorized in 23 of the 27 EU member States. Only Bulgaria, the Czech Republic, Estonia and Malta have not granted aid to their financial institutions.

The Authority has also made a number of decisions under Article 61(3)(b) EEA regard aid schemes and individual aid measures in favour of banks and insurance companies, the vast majority of these decisions have regarded Icelandic banks, where they also have a number of pending decisions.

1.2 AIMS AND PURPOSES

[10] The article applied in September 2008 was in fact Article 87 of the Treaty on the establishing of the European Community "EC", and not Article 107 TFEU. With effect from 1 December 2009, Article 87 of the EC Treaty became Article 107 TFEU; the two sets of provisions are identical in substance. To accommodate the reader, this text will refer only to Article 107 TFEU, also when the correct article would be Article87 EC.
[11] The Authority adopted the equivalent to the Banking Communication on 29 January 2009
[12] Gilliams, p. 7
[13] Acts on basis of which individual aid may be awarded without notifying
[14] Aid not awarded through a scheme
[15] Aid awarded through an approved scheme but has to be notified

The purpose of this thesis is to address the access to grant State aid to banks and financial institutions under Article 107(3)(b) TFEU and the identical Article 61(3)(b) EEA. The aim is to analyse the legal changes made between the fall of 2008 and today, and thereafter to discuss whether the change of legal frame has open up for a wider acceptance for distortion of competition.

This paper is structured as follows; Part 2 will deal with the legal developments, reviewing the temporary change of legal provision for State aid to banks, from Article 107(3)(c) TFEU and Article 107(3)(b) TFEU. Part 3 will mainly focus on competition issues in relation to the application of Article 107(3)(b) TFEU, stating with a discussion on how the criterions for applicability, appropriateness, necessity and proportionality have been applied. We will also look at the balance between State aid and competition and discuss what impact the new provision has had on distortion of competition.

1.3 METHOD AND MATERIAL

This thesis is based on EEA and EU law only, and will not address national law. Pursuant to Article 7 of the EEA Agreement, the EEA Agreement is binding upon the EU Member States and the EFTA States[16]. In accordance with Article 6 of the EEA Agreement and Article 3(2) of the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice ("SCA"), the EU Member States and the EFTA States are committed to place emphasis on the practice of the Court of Justice of the European Union ("ECJ") in their interpretation of the EEA agreement, meaning that judgments from both the EU Courts and the EFTA Court are relevant when interpreting State aid rules in the EEA legal system[17]. The TFEU on the other hand is binding upon the EU Member States only[18], and the ECJ face no obligation to interpret EU law in conformity with the EFTA court.

On account of the large number of decisions it has been necessary to be selective. The thesis is therefore primarily based on a few interesting decisions from the Authority and the Commission. It will also focus on the Commission "crisis communications"; the banking

[16] The term EFTA States in this text refer to Iceland, Liechtenstein and Norway
[17] Alterskjær et.al, p. 23
[18] Cf. Consolidated version of the Treaty on European Union ("TEU") Article 1

communication[19], the recapitalisation communication[20], the impaired assets communication[21] and the bank restructuring communication[22], in addition to the two communications prolonging the timeframe to 2011 and 2012[23] and the equivalent notifications from the Authority[24].

Although guidelines and communications are considered “soft-law”, the EU courts have repeatedly stressed that the Commission is bound by its own guidelines/communications[25]. Since the Commission also decides which aid measures are compatible with Article 107 TFEU, the communications are important when discussion the provision.

The Authority is entrusted with the equivalent powers and similar functions to those of the Commission in the field of State aid. This includes that both material and procedural rules applicable to the Commission apply also to the Authority through the EEA Agreement[26]. As EEA rules on State aid are modeled on those provided in the TFEU, we will focus on the description of EU rules on State aid and point-out the differences *vis-à-vis* the EEA system when appropriate.

1.4 DELIMITATION

The State aid policies include a legal, political and a strong economic aspect. The discussions and analysis of this thesis are legal in nature and will not take in to account whether the choices made by the European Commission and the Authority are politically or financially sound. Even so, State aid is a legal area where politics and economy plays a very important role, which makes it impossible to do a legal analysis without discussing the political and financial motives. Political and economic issues will therefore be considered when relevant.

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[19] OJ C 270, 5.10.2008
[20] OJ C 10, 15.1.2009
[21] OJ C 72, 26.03.2009
[22] OJ C 195/9, 19.08.2009
[23] OJ C 329/7, 7.12.2010 and C(2011) 8744 final, 01.12.2011
[24] The Authority has adopted five Guidelines equivalent to those of the Commission, see Decision 28/09/COL, Decision 191/09/COL, Decision 28/09/COL and Decision 57/11/COL
[25] See T-119/02 *Royal Philips Electronics v Commission* [2003] ECR II-1433, para. 242 and T-91/03 *Tokai Carbon v Commission* [2005] ECR II-10, para. 157
[26] Cf. Protocol 26 to the EEA Agreement.

Furthermore, it is important to realize that during the worldwide economic crisis a number of non-European banks received government aid from jurisdictions, like the US, that does not have rules comparable to the EEA and EU State aid rules. That such aid has been granted outside the EU and EEA has resulted in a significant political pressure for the Commission and the Authority to operate in the same way[27].

Finally, this thesis will only discuss legal issues raised as a consequence of the legal changes made during the financial crisis. Questions regarding State aid measures to banks and financial institutions not related to the financial crisis will not be addressed.

[27] Gilliams, p.4

2 STATE AID TO BANKS AND FINANCIAL INSTITUTIONS

2.1 STATE AID – THE GENERAL RULES

The "constitutional" foundations for EEA and EU State aid policy are set forth in Articles 61 and 62[28] of the EEA Agreement and Articles 107 and 108 TFEU, respectively. Article 61 of the EEA Agreement and 107 TFEU establish the substantive rules while Articles 62 of the EEA Agreement and 108 TFEU set the procedural rules.

2.1.1 ARTICLE 107(1) TFEU

Looking first at the substantive rules, Article 107(1) TFEU establishes that State aid is in principle incompatible with the internal market. In order for a measure to qualify as State aid, four cumulative criteria need to be satisfied, the aid must:

- involve the transfer of State resources;
- provide an economic advantage;
- be selective;
- affect competition and trade between Member States

Transfer of State resources

In order for a measure to be considered as State aid it must imply the transfer of financial resources to the receiver and such resources must be imputable directly or indirectly to the State (including national, regional or local authorities, public banks and foundations, etc.). Furthermore, the aid does not necessarily need to be granted by the State itself. It may also be granted by a private or public intermediate body appointed by the State[29]. The notion of aid is rather broad and includes guarantees, loans as well as other forms of equity interventions, such as accelerated depreciation allowances, capital injections, tax exemptions, provided that represent an economic advantage for the receiver.

[28] Cf Article 1, Protocol 26 to the EEA Agreement
[29] Case C-379/98 *DPAG,* para 63 and C-482/99, *Stardust-case*

Economic Advantage

The aid must constitute an economic advantage that the receiver would not have obtained in the normal course of business.

Selectivity

The measure should be selective, i.e. aimed at favoring only certain undertakings and thus changing the balance between the receivers of the aid and their competitors. This criterion allows distinguishing State aid from so-called "general measures", i.e. measures which apply to all firms in all economic sectors in a certain member State. The assessment of whether or not a measure is selective can be rather complex, however as this analysis has not been problematic in the review of aid granted to the banking sector during the financial crisis, as these "[m]easures are clearly selective as it only concerns the banking sector"[30]. This will thus no longer be discussed in this thesis.

Effect on competition and on trade

The final criteria mentioned in article 107(1) TFEU is that the aid must distort competition and affect trade between member States. In order for this criteria to be satisfied, the Commission is not "required … to establish that the aid has a real effect on trade between Member States and that competition is actually being distorted, but only to examine whether that aid is liable to affect such trade and distort competition"[31].

2.1.2 ARTICLE 107 (2) AND (3) TFEU

As mentioned above, aid measures that satisfy the criteria discussed in section 2.1.1 are in principle incompatible with the internal market. However this does not mean that all State aid is prohibited. Article 107 (2) and (3) provide a list of cases in which State aid can be acceptable ("exceptions"). As far as the banking sector is concerned, aid was traditionally approved on the basis of Article 107 (3)(c) which refers to "aid to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions contrary to the common interest."

[30] *Irish Guarantee scheme* NN 48/2008 Para 47
[31] Case C-372/97, *Italy v. Commission*, [2004] ECR I-3679 para 44, Case C-66/02, *Italy v. Commission,* [2005] ECR-I10901, para 111

As discussed in greater detail below in section 2.3, following the worsening of the financial crisis, aid to banks and financial institutions has been assessed under Article 107(3)(b) TFEU which, among other, allows the granting of aid "to remedy a serious disturbance in the economy of a Member State".

2.1.3 ARTICLE 108 TFEU

Turning now to the procedural rules, pursuant to Article 108 TFEU the supervision of State aid is conducted by the Commission and is based on a system of *ex ante* authorization. Member States are required to inform the Commission of any plan to establish or modify a State aid scheme and are not allowed to put such aid into effect before it has been authorized by the Commission - this is the so-called "standstill-principle"[32]. The Commission is competent to determine whether or not the notified aid measure constitutes State aid pursuant to Article 107 (1) TFEU, and if it does, whether or not it qualifies for exemption under Article 107 (2) or (3) TFEU.

As mentioned above, member States cannot grant State aid that has not been notified and authorized by the Commission. Any aid, which is granted without the Commission's approval, is automatically classified as "unlawful aid" and the Commission is obliged to order the recovery from the beneficiaries of any unlawful aid that is found to be incompatible with the internal market.

When examining a notified aid scheme, the Commission will conduct a preliminary analysis at the end of which it decide (i) not to raise objections, (ii) open a formal investigation or (iii) request additional information. A measure will be cleared if it does not involve State aid, or if the proposed aid is compatible with the internal market. As part of the formal investigation, the Commission will invite comments from the State seeking to implement the measure as well as from other interested parties, such as a proposed aid recipient and its competitors. A formal investigation can end with the approval of the measure, its prohibition or its approval subject to conditions.

[32] TFEU Article 108(3) last sentence and the EEA Agreement Article 1(3) of Part I of Protocol 3,.
However, aid falling under the scope of the Commission's block exemption regulation, cf. [2008] OJ L 214/3, or that is *de minimis,* meaning not exceeding 200.000 € does not need to be notified, cf. [2006] OJ L 379/5 Article 2. The Commission and the Authority increased the *de minimis* between October 2008 and December 2010 from 200.000 € to 500.000 € with notification. This opened up for larger risk of distortion of competition as States could inject more aid in banks without the surveillance of the Commission and the Authority to limit potential distortion.

To enforce the rules, the Authority and the Commission can require the Member States to provide relevant information, to carry out on-site inspections and to order repayment of any aid paid in breach of the rules, together with interest. A Member State (the recipient or their competitors) and the Commission may also obtain the opinion of the Court of Justice as to whether an aid measure is compatible with the Treaty[33].

2.1.4 OTHER RULES APPLICABLE TO STATE AID

The provisions of the TFEU are not the only source of rules applicable to State aids. Over time, the Commission has developed in fact specific approaches to the assessment of State aid which depend on the size of the beneficiary, its location, the industry concerned, the purpose of the aid, etc. The Commission has made public the criteria it uses when deciding whether aid measures notified to it qualify for exemption. These publications have taken various forms, including regulations, "communications", "notices", "frameworks", "guidelines", and letters to member States.

During the financial crisis, the Commission has made extensive use of its ability to adopt communications, i.e. documents that operates as guidelines as to how the Commission will interpret the TFEU, and that are legally binding upon the Commission but not upon the Member States. The Authority, like the Commission, has the power to adopt communications that are legally binding only upon the Authority and that indicate how the Authority will interpret the EEA Agreement. The Authority will follow the Commission's lead and adopt communications that differ from those of the Commission only for some linguistic adjustments. The Authority's communications are then published on its webpage.

2.2 STATE AID AND BANKS – ABANDONING THE TRADITIONAL APPROACH

In July 2007, Kreditanstalt fur Wideraufbau, a German State owned bank, granted a € 26 billion loan to two German banks in financial difficulties, IKB[34] and Sachsen LB[35]. Later the same year, the British bank Northern Rock received emergency liquidity from the Bank of

[33] Cf. Article 218 § 11 TFEU
[34] C 10/2008, *Restructuring Aid to IKB,* [2008] OJ C 76/2008
[35] C 9/2008, *Restructuring aid to Sachsen LB*, [2008] OJ C 71/2008

England[36]. German and UK banks however were not the only ones struggling to survive the financial crisis, the Danish bank Roskilde[37], was bailed-out by the Danish State in the beginning of 2008.

As it can be easily understood from the few examples mention, when Lehman Brothers went bust in September of 2008 the financial crisis was already producing its effects in Europe. However, the bankruptcy of Lehman Brothers accelerated and amplified the effects of the financial crisis. Prior to September 2008 no one had pictured that a bank of such size and importance "could" go bankrupt, its collapse thus resulted in a number of European governments pushing to intervene with bail-outs, guarantees and/or recapitalisation to avoid the collapse of their banking system.

Faced with a crisis of unexpected proportions, the Commission developed a novel approach to State aid in the banking and financial sector, applying for the first time since the institution of the European Economic Community to Article 107(3)(b) TFEU. Prior to the Commission's first "financial crisis communication[38]" adopted on 13 October 2008, all State aid to banks and financial institutions had been approved under Article 107(3)(c) TFEU. This provision allows the granting of "aid to facilitate the development of certain economic activities" provided that "such aid does not adversely affect trading conditions to an extent contrary to the common interest". Article 107(3)(c) TFEU has generally been interpreted as allowing the granting of aid to "firms in difficulty"[39].

Article 107(3)(c) TFEU have traditionally been applied to address "individual problems … [requiring] tailor made remedies which can be addressed under the rules for companies in difficulties"[40] an approach that was ill suited to deal with the complexities of the financial crisis. The test for the assessment of the compatibility of the aid under Article 107(3)(c) TFEU is in fact focused on the individual circumstances of the beneficiary and does not take into account the benefits the measure would have on the economy of the member State granting the aid as a whole.

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[36] C 14/2008, Restructuring aid to Northern Rock [2008] OJ C 135/2008
[37] NN 36/2008 *Roskilde bank* [2008] OJ C 238/2008
[38] Banking communication
[39] http://www.eftasurv.int/media/State-aid-guidelines/Part-III---Aid-for-rescuing-and-restructuring-firms-in-difficulty.pdf
[40] Case NN 25/2008 *West LB, [2008]OJ C 189/03,* para 42

The limits of the individual analysis required by the application of Article 107(3)(c) TFEU became evident when the Irish government, on 30 September 2008, announced a € 400 billion guarantee to Irish banks, which was put into place with immediate effect; i.e. not following the "standstill principle"[41]. The aid scheme was available to 6 banks only due to a criterion that the capital had to be mainly in the hands of Irish investors, non-Irish owned banks active in Ireland could thus not benefit from the aid. Because of the general instability in the market at the time, this guarantee scheme had a severely distortive effect on the Irish banking sector. Irish customers rushed to move their funds to banks covered by the guarantee scheme and fled from banks, mainly based in Ireland and the UK, that were excluded by the guarantee[42]. The guarantee scheme thus had a clear negative effect on banks that were not entitled to the aid as banks los costumers. It also created an unbalance in the market giving Irish-owned banks an unfair competitive advantage. Furthermore, it raised issues of discrimination due to its application based on the nationality of the majority shareholders of the banks[43].

The Irish guarantee scheme was high on the agenda on the Economic and Financial Affairs Council ("ECOFIN") meeting between the European finance ministers of 7 October 2008. The ministers attending the ECOFIN were determined to prevent "individual efforts" to deal with the crisis similar to those put in place by the Irish government with its guarantee scheme. The meeting resulted in a collective approach where the ministers agreed "to take all necessary measures" to restore confidence and proper functioning to the financial sector, and that public interventions where to be appropriately decided on a national level". They also called on the Commission to "act quickly" and to apply the rules "flexibly", emphasising that interventions should be provided within a coordinated framework and on the basis of common principles[44].

While the conclusions of the ECOFIN did not elaborate on the exact meaning of the request for a flexible application of the EU State aid rules by the Commission, one can speculate that the governments of the EU member States expected the Commission to be more obliging of

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[41] Case NN 48/2008 *Guarantee scheme to banks in Ireland, [2008] OJ C 312/2008 para 5*

[42] Doley, p.8

[43] After the notification on September 30, there was intensive contact between the Commission and the Irish authority due to the issues mentioned above. Changes were made to prevent discrimination and limit distortion and negative spill-over. The final scheme was submitted on October 12, 2008, and the Commission made its final approval on October 13, 2008, under Article 107(3)(b) TFEU. See Commission Press release IP/08/1497 and Memo/08/615

[44] *"Immediate responses to the financial turmoil"* ECOFIN Council Conclusions, 7 October 2008, 13930/08 (Presse 284)

State aid than what the rules would normally allow for. This interpretation seems to be confirmed by the Banking Communication, adopted only 6 days later, on 13 October, which indicated Article 107(3)(b) TFEU as the new statutory provision for the assessment of State aid to banks and financial institutions.

The Commission however indicated that the change in legal basis for the assessment of State aid granted to banks and financial institutions was not to be used in all situations. Article 107(3)(b) TFEU in fact can be only be relied on where there is a risk of serious disturbance in the economy as a whole; "invoking this provision is possible only in genuinely exceptional circumstances where the entire functioning of financial markets is jeopardized"[45].

2.3 GRANTING AIR TO REMEDY A SERIOUS DISTURBANCE IN THE ECONOMY

Article 107(3)(b)

In order to analyse the application of Article 107(3)(b) TFEU during the financial crisis, it is necessary to establish the general content of the articles.

Article 107(3)(b) TFEU provides that "aid to remedy a serious disturbance in the economy of a Member State" may be compatible with the internal market. Article 107(3)(b) TFEU does not provide a definition of aid but it is generally understood to refer to aid as defined by Article 107(1) TFEU.

As mentioned above, Article 107(3)(b) TFEU provides that aid to remedy a serious disturbance in the economy may be compatible with the internal market and the use of the term "may" (as opposed to "is") indicates that this exception must be applied on a case-by-case basis and following a concrete and individual evaluation of each case. It is important to point out that in order to benefit from the exception provided in Article 107(3)(b), the aid must be able to remedy the a threat to the entire economy and not only to shield from the effects of such threat its beneficiary or beneficiaries. This was made clear by the Commission

[45] Banking Communication para. 11

in its decision concerning the Danish Guarantee scheme. The Commission relying on the Court of First Instance's case-law indicated that "Article 87(3)(b) EC [now Article107(3)(b) TFEU] needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State"[46]. Furthermore, in the "WestLB" case (which was decided in April 2008) the Commission stressed that "[t]he Commission has consequently decided that a serious economic disruption is not remedied by an aid that "resolve[s] the problems of a single recipient [...], as opposed to the acute problems facing all operators in the industry. "Also in all cases of banks in difficulty, the Commission has to date not relied on this provision [i.e. Article 107(3)(b) TFEU]"[47].

Turning now to what constitutes "a serious disturbance in the economy of a Member State", neither Article 107(3)(b) TFEU nor the Commission's guidance papers offer a definition of this concept. However, in BAWAG P.S.K decision from 2010, the Commission indicated that "the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy this disturbance". In essence, the Commission seems to suggest that a perturbation of the financial markets, such as that caused by the financial crisis constitutes a serious disturbance in the economy. This interpretation has been confirmed in the Banking Communication, the Recapitalisation Communication, the Impaired Asset Communication (IAC) and the Restructuring Communication adopted by the Commission[48]. In the Banking Communication the Commission seems to suggest that there exist a serious disturbance in the economy since also sound banks are struggling financially[49].

In essence, the Commission has considered that in order for the exception provided in Article 107(3)(b) TFEU to apply to healthy banks encountering difficulties in accessing liquidity it is necessary that the shortage of funding must be so severe that it could result in the collapse of the banking sector which in turn due, to the banks' crucial role in modern societies, could have a materially adverse systemic effect on the entire economy.

Since it is the lack of liquidity in the market that has prompted the Commission to rely on Article 107(3)(b) TFEU as legal basis for the granting of State aid to banks and financial

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[46] NN51 /2008 – *Denmark Guarantee scheme for banks in Denmark* [2008] OJ C 273/2008, para 39
[47] NN 25/2008 *WestLB* [2008] OJ C 189/03, para.41
[48] Case NN 261/2010, *BAWAG PSK,* [2010] OJ C250/5 para 58.
[49] Banking Communication para. 2

institutions, it seems unlikely that this provision will be relied on once the financial crisis has come to an end.

Going back to the analysis of Article 107(3)(b) TFEU, the aid must "remedy" a disturbance in the economy. The wording could be interpreted as implying that the aid must correct the disorder that justifies its approval, however this reading is too strict. In order for the aid to be approved, the Commission in fact does not require the aid to remedy a disturbance, but only to be apt to remedy it[50].

Additional criterions

In addition to the criterion in the articles, three specific conditions must be fulfilled for the aid to be compatible with Article 107(3)(b) TFEU, these are: "Appropriateness", "Necessity" and "Proportionality"[51]. The first criteria involve that the aid has to be well targeted to remedy a serious disturbance in the economy. If the disturbance could disappear without the measure or the measure is not appropriate to remedy the disturbance, this condition is not fulfilled.

The next condition, necessity, means that the aid measure must, in amount and form, be necessary to remedy the disturbance in the economy. To achieve this, the aid must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. If the objective could be reached with a smaller amount of aid or with a less distortive measure, the measure in question would not be necessary[52].

Last but not least, the aid must be proportional, meaning there must be a proper balance between the positive effect of the measure and the distortion of competition. This also emerges from Article 3(1)(b) and 119 TFEU which provide that the European Union shall ensure the proper functioning of an internal market with free competition[53]. State aid must therefore be limited to the minimal necessary to achieve its stated objectives, limiting consequential distortion of competition.

[50] NN51 /2008 – *Denmark Guarantee scheme for banks in Denmark* [2008] OJ C 273/1, Para 40
[51] *Ibid.* para. 41
[52] Case C-730/79 *Phillio Morris* [1980] ECR I-2671, para. 17, Case C-390/06 *Nuova Agricast v Ministero delle Attività Produttive*, [2008] OJ C142/07, para. 68, The Court held that "[a]s it is clear from Case 730/79 […] aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC [now 107(3) TFEU] cannot be considered compatible with the common market."
[53] NN51 /2008 – *Denmark Guarantee scheme for banks in Denmark* p.8

Applicability of the article

The threshold for the application of Article 107(3)(b) TFEU has traditionally been very high. Before the "Denmark Guarantee scheme[54]", the last time Article 107(3)(b) TFEU was applied was in the 80s, when the Greek economy faced serious economic imbalance[55], and the Community authorized specific exceptional measures aimed at correcting the situation. As Article 107(3)(b) TFEU has hardly ever been applied before the financial crisis, the limited existing case-law is of limited relevance when assessing the circumstances in which it could be applied.

The wording of Article 107(3)(b) TFEU however indicates that it is aimed, among other, at being applied to the banking sector, the reason for this may be that a serious disturbance in the economy of a member State, is likely to occur in case of a shortage of money in the financial system. In this respect, the Vice President of the Commission and Commissioner for Competition Policy, Commission, Joaquín Almunia has emphasized that the legal framework of Article 107(3)(b), was not meant for situations such as those stemming from the current financial crisis. However, he also indicated but that the Commission, considering the crisis, had to make use of the instruments available and encouraged the Commission to develop regulations suited to address similar situations in the future [56]. That the Commission is currently working on such provisions, seems to confirm that Article 107(3)(b) is not the ideal legal instrument to address the current troubles of the financial sector.

One of the reasons that may have led the Commission to clear the aid granted to banks and financial institutions on the basis of Article 107(3)(b) is probably that, as this Article has hardly ever been applied in the past, there Commission was not bound in its interpretation by past practices. This has allowed the Commission the flexibility needed to adapt the interpretation of this provision so that it could be applied to the evolving financial crisis, and satisfy the request made by the ECOFIM to find a fast and flexible approach to deal with the aid granted to banks and financial institutions.

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[54] Ibid.
[55] 88/167/EEC, concerning Law 1386/1983 by which the Greek Government grants aid to Greek industry, [1988] OJ L 76
[56] http://www.eu-norge.org/PageFiles/439533/Kvartalsrapport3.pdf p.11

The Commission has adopted a number of communications and guidelines to set the rules for the application of Article 107(3)(b). The communications, which have been adopted since October 2008, are specifically directed to the banking sector and are aimed at securing access to loans and liquidity in the market.

2.3.1 GUIDELINES AND COMMUNICATIONS

The Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty

Pursuant to paragraph 6 and 10 of the Banking Communication, the Commission has applied Article 107(3)(b) TFEU consistently with the 2004 Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (the "R&R Guidelines"). The R&R Guidelines clarify the Commission's approach in cases where the public authorities grant financial support to firms in difficulty.

The Commission has indicated that it would not directly apply the R&R Guidelines to banks and financial institutions, but merely rely on their principles in the preparation of its communications laying out the principles that would guide its assessment of aid granted to banks and financial institutions[57]. However, the Commission in its guidelines adopted after October 2008 has diverged from the principles set in the R&R Guidelines in three areas:

- Rescue aid has been authorized for banks that are not classified as "in difficulty"
- The procedural requirements have been simplified
- The "one-time, last-time" rule has been abandoned

(i) Rescue aid has traditionally been granted to "undertakings in difficulty", defined as firms that are unable to stem their losses and that almost certainly set to go out of business in the short or medium term. The R&R Guidelines in fact indicate that States may grant rescue aid to a destitute firm with a view to its temporary survival provided that, within six months after the granting of the rescue aid, the aid is fully reimbursed, a restructuring plan is presented or

[57] See the R&R Guidelines

liquidation plan is notified to the Commission[58]. Rescue aid is therefore a form of State support granted to firms in a situation of acute financial distress[59].

Pursuant to Article 107(3)(b) TFEU, the Commission has authorized rescue or recapitalisation aid in the case of fundamentally sound financial institutions that were experiencing liquidity problems[60]. There are several examples of healthy banks that have received aid. Here we will only mention the case of the KBC group[61]. The Commission found that the losses suffered by KBC were not threatening the solvency of the bank according to the applicable prudential norms but authorized the granting of aid because it found KBC's solvency not to be reassuring in light of the importance of the bank in the Belgium economy.

(ii) Furthermore, the Commission relaxed the procedure for the approval of aid granted to banks and financial institutions. Due to the distortive nature of rescue and restructuring aid the Commission has to follow a complex procedure before it can make a final decision as to whether an aid is compatible with the internal market or not. In this process the Commission must assess the potential effects that the aid may have on the recipients' competitors who have the opportunity of raising their concerns and express their opinion on the potential distortive effects of the aid. Thus, before rescue, restructuring or recapitalisation aid can be approved a wide range of issues must be examined by the Commission in what is usually a lengthy procedure.

After the collapse of Leman Bothers, it was crucial to save the struggling banks and calm the market with swift interventions. Rescue aid was thus approved efficiently and provisionally[62], without too many questions being asked. Procedure to approve aid, which normally took weeks, was cut to 24 hours due to the critical situation in the financial market. To mend this hasty procedure, the Commission examined restructuring plans[63] six months

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[58] R&R Guidelines points 25c and 80
[59] Hancher, Ottervangen and Slot, p. 568
[60] R&R Guidelines point 9 and 15. Gilliams, p. 13
[61] N 602/2008, *KBC*, [2009] OJ C109/4
[62] The Commission approved rescue aid, in many cases, without taking a position on its terms. See C 10/2009 (ex N 138/2009), *ING,* [2009] OJ C158/13; approval of illiquid back-up facility with simultaneous opening of the formal procedure regarding the terms of the measure).
[63] Restructuring plan must ensure the long-term viability of the financial institution. The plan should also ensure sufficient own-contribution by private shareholders. The R&R Guideline require 50 % own-contribution, this has been abandoned; "it is not appropriate to fix thresholds concerning burden-sharing *ex ante* in the context of the current systemic crisis, having regard to the objective of facilitating access to private capital and a return to

after they were provisionally authorized, once the acute fear for a collapse of the financial system had begun to decrease[64].

As a result of this fast-track procedure, competitors did not have the opportunity of providing their opinion on the aid before it was granted, and no thorough evaluation of its effects could be carried out. Even if the Commission subsequently conducted in-depth investigations, this analysis was conducted *ex-post* once that the aid had already been granted and produced its effects on the market (including its distortive effects).

The fast-track procedure has also resulted in a case that is an exception to the already exceptional approach developed by the Commission to deal with the financial crisis. In the rescue of Fortis Bank, the Belgian Government carried out an emergency nationalization of the bank, separating Fortis Netherland from Fortis Bank[65]. The nationalization was immediately followed by the sale of a 75% interest in the bank to BNP Paribas[66], a large and healthy competitor who, the Belgian government, assumed would be able to facilitate, but not guarantee, the long-term viability of Fortis Bank Belgium. The Commission authorized the aid in December 2008 allowing for the recapitalisation of the bank, temporary liquidity support and the creation of an entity resembling a "bad bank". In breach of the provisions of the R&R guidelines and the Banking Communication, a restructuring plan was never notified. As a result, the aid should normally been declared unlawful and reimbursable. The Commission had however made an exception accepting that "Belgium has undertaken to submit to the Commission a restructuring plan for Fortis Bank [only] if at least one of the guarantees granted is called in"[67].

(iii) The last criteria of the Guidelines that has not been applied to banks and financial institutions is the "one-time, last time" rule; i.e. the rule establishing that aid may be granted only once during a period of 10 years[68]. Between 2008 and 2011, various banks have in fact benefitted of two or more restructuring packages. Traditionally the one-time, last time rule has been viewed as a key principle considering the distortive effect of the aid. The

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normal market conditions" see the Authority; Return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules para. 24

[64] Gilliams p. 10

[65] N574/2008, *Fortis Bank Belgium* [2009] OJ C138/1

[66] Ibid para 6

[67] Ibid. para. 19

[68] R&R Guideline, points 72-75

abandonment of this rule during the financial crisis has resulted in a far lenient allocation of aid and the granting of multiple aid packages to the same banks and financial institutions has a multiplied the distortive effect of the aid.

Crisis Communications

Banking communication

In addition to the criteria explained in section 2.3, the ECOFIN Council adopted six additional common principles for State aid[69], which were then implemented by the Commission in its *Banking Communication* of 13 October 2008.

In particular, the Banking Communication indicates that:

- aid measures should be non-discriminatory; this rule is aimed at making sure that eligibility to benefit of the aid is not based on nationality like in the case of the Irish scheme.

- Access to aid should be limited in time, thus guarantee schemes can be authorized only for six months at a time, so that at the periodic review the Commission can request the member State adopting the aid to adjust or terminate it.

- The aid should be clearly defined and limited in scope to what is necessary, without causing unjustified benefits for shareholders at the taxpayers' expense.

- An appropriate own-contribution should be provided to limit moral hazard, where the contribution should reflect the price paid by the beneficiary to the Member State for the aid. This has proven particular difficult with winding-up aid combined with guarantee or other measures, as banks in need of winding-up often has little

[69] Economic and Finance Council ("ECOFIN"). "Immediate responses to the financial turmoil" ECOFIN Council Conclusions, 7 October 2008, 13930/08 (Presse 284);

- Intervention should be timely and the support should in principle be temporary
- Member States will be watchful regarding the interests of taxpayers
- Existing shareholders should bear the due consequences of the intervention
- Member States should be in a position to bring about changes of management
- The management should not retain undue benefits – governments may have inter alia the power to intervene in remuneration
- Legitimate interest of competitors must be protected, in particular through the State aid rules
- Negative spill-over effects should be avoided.

contribution to offer. To mend to this problem winding-up aid cannot be combined with any new activity by the bank.

Furthermore, the Guidelines provide for specific behavioural rules that apply to the beneficiaries of State aid, to prevent abuse of State support, has include ban on advertising State support and aggressive expansion[70].

Recapitalisation Communication

Another significant change to State aid rules was introduced with the Recapitalisation Communication[71] of December 5 2008. Prior to the Recapitalisation Communication only banks facing financial difficulties could qualify for receiving State aid[72] but, because financially sound banks also required liquidity due to the financial crisis, the Commission introduced the possibility of granting aid to banks that were not in financial distress. The communication allows varying levels of remuneration and terms of the aid depending on the risk profile of the bank. The level of remuneration for the aid must be set at a level that incentivizes exit from the aid scheme in case of sound banks. The Communication instead requires n-sound banks to submit to the Commission a restructuring or liquidation plan which must include behavioural safeguards.

Impaired Asset Communication

By the beginning of 2009, the impact of the financial crisis on the economy was escalating requiring the Commission to further clarify and amend State aid rules. The Commission published the *Impaired Assets Communication*[73] on 25 February 2009. One of the main features of the Impaired Assets Communication was that of setting a term, December 31, 2010, for the application of Article 107(3)(b) TFEU to banks and financial institutions. The Commission's decision to limit in time the application of Article 107(3)(b) clearly illustrates the exceptional nature of the policies that the Commission has adopted to face the financial

[70] http://www.ecb.int/events/conferences/shared/pdf/reg_fs/session2_topic2_flynn.pdf?313a6314769a777d08d73b228789f174, slide 10. (last accessed 02.12.2011)

[71] A result of the *European Economic Recovery Plan* to the Council of Europe, on 26 November, where European Union's Heads of States and Government agreed on the need for a coordinated response to the crisis

[72] R&R Guideline

[73] OJ C83, 7.4.2009, p.1.

crisis. The measures and practices put into place are in fact strictly linked to the crisis and would not be justified under different circumstances due to their distortive effect on competition[74]. The limitation in time also indicates that the changes made to the Commission's decisional practice in the application of State aid rules do not represent a general liberalization of State aid, but only a temporary measure to make it possible to address the financial challenges raised by the economic crisis[75].

As to the impaired assets, in its Communication the Commission stressed that assets relief measures must be conditional on full transparency and disclosure on [the amount and nature of] the impaired assets and that Member States must take a coordinated approach to valuing assets and identifying assets eligible for relief. To ensure the return to normal market condition, banks benefitting from the aid must submit to the Commission a restructuring plan within 3 months from accession to the relief program. Final approval of the aid measures is granted only following the assessment of the restructuring plan.

Restructuring Communication

The *Restructuring Communication* was adopted on 14 August 2009, and is aimed at facilitating the restructuring of banks to ensure their long-term viability and financial stability. The restructuring should allow banks to cover all costs and provide adequate return to equity. Where restructuring is not an option, banks should windup or be separated into a "good bank" and "bad-bank" (the latter would contain all of the banks "toxic assets"). Restructuring plans should cover a time frame of 5 years, 2 to 3 years more than what it typical under the "normal rules".

The Communication also provides that the viability of banks should be ensured through stress tests. To limit distortion and moral hazard, restructuring should primarily be done through own and private investors' resources.

Post crisis measures

[74] Campo, p.2

[75] http://www.regjeringen.no/upload/FAD/Vedlegg/Konkurransepolitikk/Offentlig%20stotte/Offentlig_stotte_veildere_2011.pdf

2011

To facilitate the transition to normal market conditions, the Commission extended the applicability of Article 107(3)(b) TFEU until 31 December 2011 through a new communication[76]. In parallel, new and permanent State aid rules based on Article 107(3)(c) TFEU and relating to the rescue and restructuring of banks in normal market conditions are being drafted and should, market conditions permitting, enter into force as of 1 January 2012"[77].

Although the applicability of Article 107(3)(b) TFEU with its guidelines have been prolonged, their application is subject to tighter conditions. First, all recapitalisation aid or impaired asset measure granted after 1 January 2011, will require a restructuring plan which should be presented without delay. Thus, the distinction between sound and un-sound banks has been removed in this area.

2012

On December 1, 2011, the Commission published a new Communication that extended the application of Article 107(3)(b) TFEU (and of its guidelines) without providing for a revised expiration date. The Authority will adopt an equivalent guideline before New Year.

3. THE AIM TO COUNTER DISTORTION OF COMPETITION

3.1 COMPETITION, STATE AID AND BANKS

The main goal of the EU and EEA competition policy on State aid is to protect competition in the internal market. Under normal conditions inefficient banks would in the long period exit the market as part of a self-correcting mechanism that would promote the most efficient financial institutions. The natural competition in the market in fact penalises banks that make inefficient choices about how they organise themselves, what risks they take, etc. State aid to financial institutions in difficulty hinders this natural market adjustment mechanism and

[76] OJ C 329/7, 7.12.2010
[77] The Authority; Financial crisis guideline 2011, para 8. The market condition has not allowed this transition, and Article 107(3)(b) TFEU is applicable for 2012 as well.

produces a distortive unbalance. Thus, aid measures should only be allowed subject to fulfilling of strict conditions[78].

Due to the close economic relationship between the EU and EFTA States, State aid can have an effect that can go beyond the national borders and there are three ways State aid can adversely affect the internal market. The first way is through a distortion of competition between member States. If aids are not coordinated and unilaterally decided, (like the different levels of protection of bank accounts decided during October 2008, or the Irish bank scheme which was discussed above) differences in State decisions can introduce distortions in the market or provoke a subsidy race among Member States.

Second, State aid creates a competitive unbalance between institutions that will receive State aid and those seeking capital at market conditions: the latter can be, and often are, penalized by the advantageous financing conditions granted to the former.

Third, State aid can cause a distortion of competition among financial institutions benefitting of the aid. If no differentiation is made in the conditions at which the aid is granted, financial institutions that have a high risk profile, due to their business model, will receive an advantage compared to other institutions that are also receiving aid but that are fundamentally sound and whose financial difficulties arise from the exceptional circumstances of the financial crisis. As this is the aspect which most relates to competition law in the traditional sense, Section 3 of the thesis will mainly discuss cases on this last type of distortion.

3.2 BALANCING COMPETITION AND STATE AID

To ensure a well-functioning market where market participants are treated fairly, State aid policy must find a good balance between the benefits and distortions created by State aid.

The State Aid Action Plan ("SAAP")[79], introduced by Commissioner Neelie Kroes in 2005, constitutes the blueprint for reform in the area of State aid and represents the foundation of the State aid regulations applied today. One of the main contents of the SAAP is the so-called

[78] Alterskjær et.al, p. 222, Didžiokaitė p.1
[79] State Aid Action Plan: Less and better targeted State aid: a roadmap for State aid reform 2005-2009, COM(2005) 107 final.

balancing-test. This test is based on economic principles and allows a meaningful assessment of the positive and negative implications of government aid[80]. Although the action plan is not legally binding, it is nevertheless applied by the Commission and provides a good indication of how the Commission tries to strike the right balance between positive and distortive effects of State aid.

The analytic framework of the SAAP test is based on three questions aimed at assessing whether the criteria mentioned in section 2.3 above - “appropriateness”, “necessity” and “proportionality” - are satisfied:

- Is the aid measure aimed at a well-defined objective of common interest?
- Is the State aid measure an appropriate policy instrument - i.e. does the aid have an incentive effect and is the amount of the aid proportional?
- Is the distortion of competition generated by the aid and its effect on trade limited, so that the aid’s overall balance is positive?

In the remainder of this thesis we will focus on the analysis of some of the main [Commission/EFTA] decisions dealing with State aid granted to banks and financial institutions and discuss how the criteria mentioned above have been assessed. Measures taken to limit distortion of competition and create a positive balance between the effect of State aid will be discussed in section 3.2.1 and 3.2.2.

<u>Appropriateness: is the aid measure aimed at achieving a well-defined objective of common interest?</u>

The first question the SAAP test raises is whether the aid is directed to remedy a market failure or another objective of common interest. During the financial crisis Article 107(3)(b) TFEU has been used to remedy two different kinds of market failures:

– First, aid has been aimed to prevent the failure of the financial market because of a lack of liquidity.

[80] Röller, p. 13-14 / p.299-300

– Second, to limit the possible negative effect that the failure of a financial institution would have on other financial institutions.

This approach raises additional questions: is *ad hoc* aid really targeted to prevent disturbance in the economy? Are all banks of such importance or size that, if they fail, they can cause a failure in the financial market, or impose a negative effect on other banks? Is recapitalisation aid to sound banks, not facing severe financial issues, really aimed at preventing the collapse of the financial markets? These questions will be discussed below.

Ad hoc aid – targeted to remedy a disturbance in the economy?

The Commission has authorized the granting of State aid to banks and financial institutions on the basis of Article 107(3)(b) both when it was granted through an *ad-hoc* decision or a broader aid scheme, even though this provision is not aimed at covering *ad hoc* measures. In this respect, the Banking Communication states that "ad hoc interventions by Member States are not excluded in circumstances fulfilling the criteria"[81] of Article 107(3)(b)". This suggests that while *ad hoc* interventions are not the Commission's preferred approach, they can nevertheless be put into place when necessary. Almost all of the 76 decisions adopted by the Commission approving *ad hoc* aid have dealt with large and important banks the failure of which could have caused a serious disturbance in the economy. In essence, State intervention through ad hoc measures was appropriate and necessary where suitable broad aid schemes where not possible.

What then with small, less important banks? In the case regarding the granting of rescue and restructuring aid to a small Spanish bank, Caja Castilla-La Mancha ("CCM")[82], the Spanish government stated that the disorderly bankruptcy of CCM would have a severe effect which could undermine the confidence of depositors in other "cajas de ahorros" (saving banks), as well as affect the regional market where the bank is present. The Spanish government further

[81] Banking Communication para. 10

[82] NN 61, *Monitoring of Caja Castilla-La Mancha* [2009] "The bank received a State guarantee of €3 billion in March 2009 followed by a capital injection of €1.3 billion by the Deposit Guarantee Fund for Saving Banks, a liquidity contribution of €350 million and an impaired asset measure consisting in a guarantee of approximately €2.5 billion. The significant amount of aid compared to its size - in June 2009 it had a total balance sheet of €27 billion - required in-depth restructuring to restore its viability and to address the distortion of competition." Cf. IP/10/855

argued that the bankruptcy of CCM could have created significant difficulties for other saving banks and could also have a domino effect on the financial market.

In its decision, the Commission does not discuss the size of the bank, the opinion of the Spanish government or the banks potential to affect the economy[83]. The Commission only acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy such a disturbance. Furthermore, the Commission indicates that the approvals granted to the various measures adopted by the Spanish authorities confirm its aptness to combat the financial crisis[84]. The approach of the Commission suggests that it relied to a large extent on the evaluations of the Spanish government, rather than on its own analysis. However, this is not how Commission would normally operate, but such an approach has been adopted by necessity as it allows to approve State aid in the short timeframe that the financial crisis allows. One can conclude that the Commission in its approach does not make a noticeable distinction between *ad hoc* interventions and schemes.

Even with hindsight, it is difficult to determine whether the bankruptcy of a small bank actually could have caused a disturbance in the market. However, as the relevant criteria to approve the aid under art 107(3)(b) TFEU is that the aid only needs *to be apt* to remedy a disturbance, the application of this provision to small banks seems justified by the general instability in the financial market even when granted with an *ad hoc* measure.

Can small banks create a disturbance in the economy?

In its decision regarding the Danish Max Bank AS[85] ("Max Bank"), the Commission stated that "the financial crisis has created exceptional circumstances in which the bankruptcy of one bank, [even a bank of small size, such as Max Bank], may undermine trust in the financial system. […] It is particularly so in the case of a small economy such as Denmark where counterparts may tend not to distinguish between individual banks, thus extending the lack of confidence generated by the failure of one bank to the whole sector"[86].

[83] CCM's operations are limited only to the Spanish market where it holds slightly above 1% of market share in deposits (1.18%) and loans (1.05%)
[84] NN 61 *Monitoring of Caja Castilla-La Mancha* [2009] para 140
[85] SA33639(11/N), *Rescue aid for Max bank,* [2011] OJ C 343/13
[86] *Ibid.* para 59

In its Max Bank decision, the Commission does not look closely on the actual potential of a bankruptcy of Max Bank to disturb the economy, but concludes that a small bank may cause market failure in a small economy like the Danish one. The Commission thus approved the aid on the grounds that the bankruptcy of a bank might create a general distrust in the banking system; "[g]iven the great uncertainty due to the financial crisis and the necessity of external funding for the Danish banking sector, a lack of confidence in the Danish financial system could severely affect the whole Danish economy"[87]. Considering the distortive effect rescue aid impose on competition, one may question if the Commission goes a bit too far in this case. Especially since Article 107(3)(b) TFEU should be applied restrictively and must tackle a disturbance in the entire economy of a Member State[88].

Furthermore; if the approval of aid granted to a small bank is based on its potential to distort the economy in a small market, one can wonder on what ground the Commission approved on November 22, 2011 the aid of EUR 1 billion granted to the small Spanish Banco the Valencia[89]. In fact, Spain has a significantly bigger financial market than Denmark, and the argument supporting the Commission's decision in the Max Bank case therefor do not apply here. Thus, if one can question if the Commission went too far in the decision regarding Max Bank, the question may certainly be raised in this case. The Spanish market is under strong financial distress and it is therefore thinkable that the Commission applied the provision extra flexible in this case to prevent extended distrust in the Spanish market which has been generally accepted as a legitimate reason.

The collapse of a small bank is not likely to create a big risk for the market as a whole, but due to the instability in the financial market generated by the financial crisis it has been considered in the common interest to restore confidence in the stability of the baking system which would be disrupted in case of failure of a bank. Furthermore, aid to banks of minor importance generally causes a limited distortive effect in the market, especially considering the high price the banks must pay for the aid and the restrictions on its commercial behavior that it must accept.

[87] *Ibid.* para 59

[88] Cf. See, in principle, Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Followed in Commission decision C 47/1996, Crédit Lyonnais, [1998] OJ L 221/28

[89] Press release IP/11/1388. The decision will be made available under case number SA.33917.

Is recapitalisation of sound banks apt to prevent disturbance in the economy?

The NOK 50 billion Norwegian scheme for temporary recapitalisation of fundamentally sound banks in Norway was found to be compatible with Article 61(3)(b) EEA in May 2009[90]. Almost all banks in Norway at the time had a core capital ratio of 7 % or more[91]. The scheme was applicable for banks having a core capital in excess of 6 % and was aimed at strengthening it to 10 - 12 % depending on the bank's risk profile.

The Norwegian banks that benefitted from the aid were not in financial difficulties, yet they had restricted lending thus creating financial difficulties to the Norwegian economy. The Norwegian aid scheme was implemented, in accordance with the Recapitalisation Guidelines[92], to encourage banks to increase their lending. The scheme was thus aimed to remedy a market failure and to remedy a serious disturbance in the Norwegian economy. One may wonder whether the Norwegian scheme was necessary, this will be discussed below in the section on the "necessity" criteria.

<u>Necessity; is there an incentive effect and is the aid amounted proportional?</u>

The second question the SAAP test raises is if the aid measure is necessary[93]. For the measure to be necessary it must represent an appropriate instrument to remedy a disturbance in the economy and better instruments must not be available. This criterion also requires the aid to have an incentive effect so that the same change in behaviour could not be obtained without the aid.

The Norwegian bank scheme

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[90] 205/09/COL, *Norwegian bank scheme* [2009] OJ L 29/36

[91] All European banks should by 2012 have a capital ratio of minimum 9%.

[92] Recapitalisation Communication, para 39

[93] Emergency guarantees were the first systemic measure in response to the financial crisis whilst the recapitalisation of financial institutions constitutes the second. Other measures to supplement rescue aids have include the controlled winding up of financial institutions and the provision of other forms of liquidity assistance like "value" pricing of illiquid assets and recapitalisation to cover remaining impaired assets in balance sheets, and put back more equity capital to cover loans.

As the Norwegian banks were in a strong financial situation and had a relatively high core capital when the aid scheme was introduced, a guarantee scheme might have been sufficient to bring Norwegian banks to increase their lending activity. One could also wonder whether the Norwegian aid scheme was too extensive; the current EU requirement is for all European banks to have a core capital of at least 9% by 2012. Was it then necessary (and compatible with the internal market) to introduce a recapitalisation scheme that aims at bringing the core capital of Norwegian banks to 10-12 %?

The Commission in the Danish guarantee scheme decision indicated that aid is not necessary "if a lesser amount of aid or a measure in a less distortive form (e.g. a guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy." Pursuant to this approach, one wonders whether it would have been less distortive to introduce an aid scheme to bring the core capital to a figure lower than 10-12 % (supplemented by a guarantee scheme, if necessary) rather than an extensive recapitalisation aid.

The decision to approve the Norwegian aid scheme was based on the evaluation made by the financial supervisory authority of Norway on the amount of capital necessary to bring banks to lend. Several recapitalisation schemes[94], including the Danish recapitalisation scheme which was adopted only days after the Norwegian scheme, have been implemented to increase the core capital up to 10-12 % depending on the risk profile of the bank. This suggests that the various recapitalization schemes are the result of a coordinated effort by the various national authorities.

It is important to point out that the core capital requirement of 9 % was introduced after the Norwegian scheme was approved, thus this requirement could not be used as a point of reference for the decision. The Commission has adopted schemes after the introduction of the 9% core capital requirement in which it indicated that it may be necessary to strengthen the banks' core capital beyond the minimum required.

Rescue aid when it is unlikely the rescue attempt will succeed

[94] N 553/2010 – Second emergency recapitalisation in favour of Allied Irish Banks plc, N356/2009 € - $ - Recapitalisation of Anglo Irish, the latter accepted aid to strengthen the core capital to 12,4 %

One may also question if rescue aid is necessary and justified when it is likely that the rescue attempt will not succeed, or when other measures such as a winding-down[95] or some form of liquidity assistance[96] could be introduced[97].

Looking at Commission decisions regarding aid granted to Dexia, Anglo Irish Bank and Hypo Real Estate it seems that the fact that the State aid is directed at "remedying a serious disturbance in the economy of a Member State" is more important than the possibility of actually rescuing the banks.

All three banks mentioned above have received rescue / recapitalisation aid and then were nationalized and now have been wound up or are in the process of being wound up. The granting of aid to banks and financial institutions has been justified on the basis of their key role in the economy and the very serious disturbance they would cause if they were to fail. These arguments appear all the more true having regard of the nationalization of Dexia, Anglo Irish Bank and Hypo Real Estate which suggests that the Belgian, UK and German governments recognized the systemic importance of the banks.

Pursuant to Article 107(3)(b) TFEU aid can be authorized in order to prevent a deterioration of the stability of the economy[98]. In the decisions it has also been highlighted that the recipient of rescue and recapitalisation aid should be encouraged and stimulated to become independent from the Government granting the aid in order to reduce the likeliness of distortions of competition.

When an institution is of such importance that it qualifies for State aid, then that institution should be given the opportunity to be rescued. When it is clear that a rescue is not possible supplementary assistance, such as a controlled winding down, should be introduced. A hasty process where important banks were directly wound up in a non-controlled manner would not

[95] Winding-down is "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." Cf. Banking Communication para. 43

[96] "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. *Ibid* para 51

[97] Ojo, 2 p. 11

[98] Ojo 2 p. 12

only "trigger an immediate loss of jobs, but also serious disturbances and repercussions which could further jeopardize the stability of the economy"[99].

As we have seen, the aid measures approved pursuant to Article 107(3)(b) TFEU raise a number of issues. However, all aid measures to banks and financial institutions since 2008, with one exception, have been approved. In three decisions the aid has been approved subject to conditions. Overall in 398 out of 399[100] cases the Commission has approved the aid[101]. One wonders whether the Commission has actually assessed the effects of the aid in each case, or acted so quickly that aid has been approved irrespective of its effect on competition.

3.2.1 LIMITING THE DISTORTION OF COMPETITION

Through its "crisis communications", the Commission has introduced several safeguard measures and conditions to limit the distortion of competition in the internal market that could result from aid granted to banks and financial institutions. In the case of guarantee schemes, the Commission introduced a number of restrictions that apply to the beneficiary of the aid, including on their commercial conduct through market share ceilings, to the size of the balance-sheet and other behavioural constraints that may be needed to achieve the purpose of the guarantee.

As regards recapitalisation schemes, safeguard measures include the limiting of capital injection to the minimum necessary and prohibiting the beneficiary from engage in aggressive commercial strategies that would be incompatible with the underlying objectives of the recapitalisation[102]. The Commission introduced a number of conditions common to all the guidelines, namely all measures should be temporary, objective, necessary, non-discriminatory and proportionate.

[99] For further details see Ojo 2
[100] Number of commission State aid decisions 09.12.2011
[101] These numbers do not take into account potential adjustments to the applications, made in collaboration between the Commission and applicant, prior notifying the aid
[102] Recapitalisation communication Para. 35 cf. Banking Communication para. 38, Ojo, p. 520

The safeguard measures however are not problem-free and raise a number of issues, such as that of finding appropriate monitoring systems. Furthermore, certain restrictions, such as those relating to the growth of undertakings, may facilitate anticompetitive conduct.

During the financial crisis market has been highly illiquid, resulting in a situation where market prices can no longer be tied to the value of fundamentals[103]. Since there is no standard procedure for market-to-market accounting when markets do not work properly, this creates and uncertainty as to the possibility of preventing a distortion of competition.

Proportionality – is the overall balance positive?

The communications discussed in section 2.3.1 all provide for different financial and behavioural measures to minimise or avoid distortion of competition in order to obtain a positive balance between the benefits and distortion of competition arising from the aid.

To achieve the necessary balance between benefits generated by aid measures and the distortion of competition they cause, the Commission and the Authority have distinguished between "good aid" and "bad aid." Aid that meets the proportionality test and that addresses financial markets breakdown or crisis of confidence is generally just sufficient to return structurally sound banks to viability and is considered to be "good aid". Aid in excess of good aid has been needed, not due to the failure of the financial markets, but because of excessively risky investments made by banks. This latter type of aid is labelled as "bad aid" as it usually cannot be justified because of the distortion of competition that it entails.

In the Recapitalisation Communication the Commission applies the good aid/bad aid approach to distinguish between banks, allowing recapitalisation schemes under different conditions based on the risk-profile of the bank. The principle applied is that fundamentally sound banks whose problems are mainly due to the financial crisis should pay less revenue than banks with a high risk profiles[104]. The aim of this measure is to prevent the granting of an undue competitive advantage to distressed or underperforming banks.

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[103] Ojo1 p. 520 - 521
[104] Recapitalisation Communication para 13

A systematic approach to distinguish good aid and bad aid based on the risk-profile of the bank consists in distinguishing between three types of situations[105].

- Banks and financial institutions whose failure would pose a systemic risk threatening the stability of the financial sector as a whole.
- Banks and financial institutions which are in danger, merely as victims of the collapse of other banks
- And finally, financial institutions who are in trouble because they took reckless risk or where poorly managed

In most decisions we find that banks have fallen within more than one of these categories. State aid granted to banks in the first group is clearly within the scope of measures adopted to “remedy disturbance in the economy”. Aid to banks in the second group may or may not fall within the scope of measures adopted to “remedy disturbance in the economy” depending on its size and importance. Since the difficulties of the banks falling in the second group are not caused by mismanagement, but the lack of liquidity, a rescuing of these banks are in principle lawful as they under normal condition would not exit the market. Actual distortive features must be determined on a case-to-case basis.

Dexia bank[106]

Dexia bank offers a good example of a bank falling within the two first situations. Dexia, which is also mentioned above[107], is a financial group who received its first State guarantee in November 2008. Because of its size, the Commission recognised that its failure would have created a systemic risk for the Belgian banking sector, thus the aid granted to this banks is highly necessary because if the external effects that their failure might entail[108], and therefore it can be granted to “remedy a serious disturbance in the economy”.

The aid was likely to have a highly distortive effect on competition, but was granted following a balancing of the benefits and disadvantages of the aid. Measures were taken, like

[105] Jenny, p.5
[106] C9/*2009Dexia,* [2009] OJ C 181/09
[107] Ibid.
[108] Jenny p.6.

limiting the guarantee to Dixia's refinancing needs, with a maximum maturity of three years, which should limit Dexia's possibilities to increase its position in the market. Dexia also committed to waive advertisement of its status as a bank with State guarantee, limit growth of its balance sheet, and not to offer remuneration conditions to private individuals as the guarantee would have caused exceptionally good rates.

Norther Rock

Banks in danger due to reckless risk and poor management offer no economic nor legal rationale to save. Aid granted in these circumstances would be highly distortive on competition. Some banks in this category are however of such a size and importance, that their failure could have an external effect. Even though the rescue or restructuring of the bank would be highly distortive on competition, it might still be justified as saving the market as such will weigh heavier than its anticompetitive effect.

Northern Rock is an example of such a bank. Before its troubles started in the second half of 2007 Northern Rock was the 5th biggest UK mortgage bank. In the decision evaluating under Article 10(3)(c) TFEU[109] the restructuring plan[110] presented after the granting of rescue aid to Northern Rock, the Commission observed "that the problems of NR are due to specific (risky) activities of significant size compared to the overall size of the bank. Therefore, the present case seems rather to be based on individual problems, and thus requires tailor made remedies, which can be addressed under the rules for companies in difficulties"[111].

Northern Rocks dependence on wholesale funding caused difficulties in the second half of 2007 when the mortgage securitization market collapsed. The funding problems led the UK authorities to provide loans and guarantees which were approved as rescue aid until 17 March 2008. Following this rescue a comprehensive restructuring was initiated, including the division of the bank into BankCo and AssetCo. Due to its broad scope and distortive features the restructuring plan was subject to an in-depth, and extended in-depth investigation, as in a number of areas the Commission did not agree that the conditions were sufficient to justify

[109] The Commission later changed the provision, and made its final evaluations under Article 107(3)(b)
[110] Resulting in an extended in-depth investigations due to several issues raised by the Commission.
[111] NN 1/2008 *Northern Rock* [2008]OC J 135/21 para. 101

the distortion on competition. The plan was finally accepted in October 2009, almost two years after the aid was granted.

Having regard of competition considerations only, Northern Rock should have been wounded-up rather than restructured. Thus, an extensive list of nine conditions to limit distortion of competition were included in the restructuring plan[112]. One of these conditions was the separation of BankCo and AssetCo, which in itself would limit the distortion of competition as these banks would not be among UKs leading banks.

When comparing Dexia and Northern Rock, it is clear that the prior had a more legitimate reason to be rescued than the latter as its rescue was less distortive on competition. Northern Rock is however subject to very stringent conditions which should, at least to some extent, redress the anticompetitive effects of the aid it received.

Even though a number of measures were taken to limit distortion of competition in the two cases, the aid nevertheless had a distortive nature. Distorted competition is more beneficial for competitors than a potential collapse of the market, thus the aid was considered compatible as it was apt to "remedy a serious disturbance in the economy".

This approach allows to minimise distortion of competition when States can distinguish between "good" and "bad" aid, and on that basis impose appropriate aid measures and conditions. However, it can be extremely difficult to distinguish which banks fall in to which group when operating under serious time pressure. Some banks may also fall in more than one category, as it is demonstrated by the two examples mentioned above, making it difficult to determine if the bank should be granted aid or not. The approach is also problematic as it has been necessary to rescue and recapitalise banks in the last category, like Northern Rock, due to the potential effect of their failure. Even though such banks in many cases have received aid at less favourable conditions to limit the distortive effect, this has not always been possible, as some banks were in a financial situations that did not allowed such conditions. Thus, in the aim to save the economy, aid has been granted despite its distortive effect on the competition.

[112] C14/2008 *Northern Rock* [2010] OJ L112/38 See Article 2 of the Decision.

3.2.2 CORRECTING UNDUE DISTORTION OF COMPETITION

Banks may receive aid, which is considered incompatible with the internal market. This can be either because (i) the aid is granted without prior notification and approval from the Commission or the Authority, (ii) the aid is granted while subject to in-depth investigation to determine its lawfulness (iii) the aid has been granted under certain conditions, which are not being fulfilled, or (iiii) because has been found incompatible with the internal market by the Court of Justice of the European Union or the EFTA Court.

Lack of prior notification

Aid of the first kind is not necessarily incompatible with the internal market, and thus unlawful, but the procedure for lawfully granting the aid has been breached[113]. The consequences of a breach of the procedural rules are not severe, the Commission or the Authority will conduct an assessment and come to a view as to whether the aid is compatible with the internal market. Where the aid is found to be incompatible, it must be recovered by the State that has granted it. Member States cannot be sanctioned for a breach of procedural regulations.

Once they are informed that an aid has been granted or even *ex officio*, the Commission or the Authority will open an investigation into the aid in question and request detailed information about the measure. For instance, this has been the case with the aid granted by the Icelandic authorities to their three main banks, Glitnir Bank, Kaupthing Bank and Landsbanki, the Authority opened formal investigations to determine the compatibility of the aid. These cases are still pending, but the possible outcome will either be that the Authority determines that the aid is (i) compatible with the internal market, (ii) compatible under certain conditions, or (iii) partly or fully incompatible so that the aid must be recovered in whole or in part from the banks.

In-depth investigation

[113] Article 108(3) TFEU

The rescue aid to Dexia is an example of aid granted while an investigation was pending. In the case of Dexia, the Commission approved the granting of State aid in a very quick procedure which gave Dexia a financial advantage over its competitors. To determine if the aid would actually restore Dexia to long-term viability, while causing minimum distortion to the market, the Commission opened an in-depth investigation when granting the aid. This procedure has been used in many similar cases. Such in-depth investigations have allowed the Commission to immediately approve the aid, and later to determine the conditions and lawfulness of the aid.

Recovery of the aid

The aid granted to Banco Privado Português ("BPP"), a Portuguese bank, is a good example of aid approved subject to conditions. A rescue aid had been cleared, under the condition that a restructuring plan would have been presented within six month from the approval of the aid. The plan was not presented, and the Commission opened a formal investigation to evaluate the aid, finding it incompatible with the internal market as it caused an undue distortion of competition. To correct the distortion, the Commission concluded that the aid had to be recovered from the bank in accordance with Article 7(5) and 14(1) of Council Regulation (EC) No 659/1999[114].

Court

In the BPP case, in which as mentioned above, the Commission ordered the recovery of the aid. The bank has introduced an action for the annulment of the Commission's decision which is currently pending before the General Court[115]. This is the first and only decision regarding Article 107(3)(b) that having been brought before the General Court. A Commission decision can also be challenged by the State or the competitors of the recipient of the aid. Since the only decision regarding Article 107(3)(b) that has been brought before the court is the action for annulment by BPP one may conclude either that banks have not found aid measures to be unduly distortive to competition, or that the general fear of a collapse of a

[114] Banco Privado Português, S.A. and Massa insolvente do Banco Privado Português raised action against the Commission on September 9, 2011. The case is pending at the court. Case T-487/11, [2011] OJ C 340/28.
[115] Case T-487/11, [2011] OJ C 340/28

bank, has opened for a greater acceptance of distortion of competition, because of the seriousness of the situations. We would propend for the later assumption.

4 CONCLUDING REMARKS

It has been claimed that the Commission by applying the rescue and restructuring principles in combination with Article 107(3)(b) TFEU to the review of financial crisis aid has made a master stroke[116]. The decision to apply Article 107(3)(b) TFEU has allowed the Commission to interpret this rule adapting it to the particular political and economic circumstances of the banking crisis when identifying what types of government assistance it would regard as acceptable and on what terms.[117]. Applying the R&R principles has helped limit the distortive effect of the aid on competition, due to the strict implementation plan the banks are required to submit, and the restrictions in granting extensions of the aid schemes or other acts that would further distort competition.

The severity of the financial crisis has created strong political pressure to grant aid, making it virtually unthinkable that the approval of rescue aid would be refused. Had such aid been approved with a permanent nature, it would have meant a *de facto* suspension of the EU and EEA State aid rules. Through the application of the principles of the R&R guidelines, the Commission and the Authority have efficiently, flexibly yet provisionally approved rescue aid to secure the stability of the financial system, while making the final approval of the aid conditional upon a positive evaluation of a restructuring plan[118].

It is important to point out that one cannot simply assume that because aid was granted and some banks needed aid more than others, distortion of competition in the market arouse. Given the systemic nature of the crisis and the specific features of the financial markets, any distortion of competition arising from the aid is likely to have been limited and mostly related to moral hazard. Aid has been approved in all cases except one, and few market competitors have complained about the distortive nature of the financial support granted to certain banks.

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[116] Gilliams, p. 10
[117] Doleys, p.7
[118] Gilliams, p. 10

Furthermore, most of the banks that could opt out from rescue, restructuring or recapitalisation schemes have done so, suggesting that the schemes actually do not confer an advantage over competitors, given the strings and conditions attached to them. It is however also possible that the competitors of aid beneficiaries have not complained due to the fear that if aid were not granted the financial stability of the banking system would have been put in jeopardy.

Most of the recapitalisation aid granted during the financial crisis has been granted through recapitalisation schemes to sound banks. These are banks that under normal market conditions would not be struggling. When such aid is granted in a non-discriminatory way it is not likely to have strong distortive effect.

That said, it is impossible to grant rescue or restructuring aid without distorting the competition, as inefficient banks normally should quit the market. One may therefore argue that the expansion of the possibility of granting State aid, through Article 107(3)(b) TFEU has resulted in a lenient assessment thus causing a significant distortion of competition. This is especially true for the decision to accept a merger between two Icelandic banks, Byr and Islandsbanki. Both banks had received aid, which under normal condition would prevent Islandsbanki from buying its competitor, Byr. The Authority has in any even found the merger compatible with Article 61(3)(b) of the EEA Agreement because it could have the effect of stabilizing the banking market.

Without the reliance on a new legal basis, aid to banks and financial institutions could have not been granted in such a large scale and as quickly as it has been. The extensive recourse to aid has however helped preserve the stability of the financial system and avoided that the failure of a bank could have a domino effect on other banks. The benefits of the aid on competitors have thus been greater than those that could have resulted from aid granted under the “normal” rules.

By distinguishing between fundamentally sound banks and un-sound banks, the communications have allowed the approval of aid in a way that minimizes the distortion of competition. The Commission and the Authority have accepted that “illiquid but otherwise fundamentally sound financial” players deserve a more lenient attitude than those who needed

to be rescued by the State as a result of their specific business model, excessive risk taking or inefficiency[119].

Through this distinction, the regulations allow and legalize discrimination between banks that have financial problems due to the financial crisis and those that have operational problems for other reasons. This distinction is justified due to general competition considerations. Banks struggling because of their specific business model, risk taking etc., should normally quit the market which means that the rescuing would be highly distortive on competition. Banks that are fundamentally sound are, on the other hand, only struggling due to the general lack of liquidity. The rescue of these institutions does not represent the same threat to competition than the rescue of inefficient banks. Furthermore, should these institutions not receive temporary access to financing the collapse of the market would be more than a simple risk.

In conclusion, to what extent should then State aid to banks and financial institutions be allowed in the future? And to what extent is distortion of competition acceptable? Based on the balancing-test no there is no definitive answer to these questions. It all depends on the balancing of the benefits and negative effects of the aid.

State aid for rescuing and restructuring has given rise to some of the most controversial State Aid cases and is among the most distortive type of State aid. It cannot be the norm that a company who gets into financial difficulties is rescued by the State. Hence, the general principle of the prohibition of State aid should remain the rule and derogation from that rule should be limited[120]. Furthermore, under normal market conditions it would not be justified for the State to recapitalise sound banks so that such aid should also be avoided.

How far central banks and governments should intervene and how far distortion of competition should be permitted, ultimately depends on how relevant a financial institutions is for the financial system[121].

[119] Banking Communication point 2 and 14, Gilliams, p. 11
[120] Bellamy and Child 2, p. 1732
[121] Ojo 1, p.513

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