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EU State aid control & financial stability

A brief overview of the role of State aid control during the crisis
& a glimpse at the challenges ahead

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Agenda

1 – EU State aid control: Balancing competition & financial stability in the common interest

2 – Coordinating the bank bailouts of the crisis

3 – State aid rules for the financial crisis

4 – Significance of crisis aid control

5 – Evolution of State aid control

6 – Changing regulatory and supervisory landscape for bank resolution

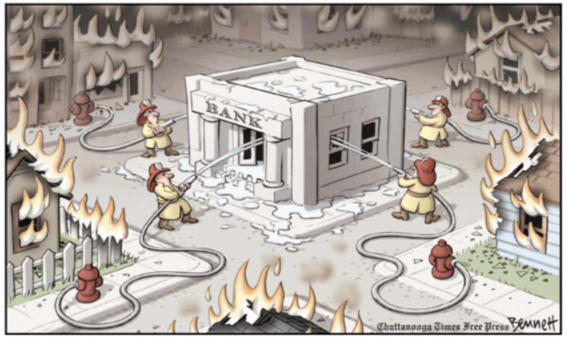
7 – Challenges going forward

1- EU State aid control: Balancing competition & financial stability in the common interest

- EU Treaty → State aid to firms subject to the Commission scrutiny to ensure a level playing field in the single market
  - Exclusive Commission competence
  - Ex-ante assessment (stand-still clause)
- Aid can be allowed when it is in the "common interest"
  - Common interest = remedy to a market failure or equity gap
  - Financial stability overarching interest rooted in externality of bank failures (systemic risk)
- Aid has to be necessary, appropriate and proportionate
- → Commission bound to balance benefits for financial stability with potential distortions of competition

2- Coordinating the bank bailouts of the crisis

- Financial crisis (as of autumn 2008) forces Member States to grant support to banks at unprecedented scale
    - Crisis management/resolution tools are, if existent, national
- No dedicated mechanism at EU-level to ensure consistent approach to bank rescue - internal market in jeopardy



The Rescue Plan

» E.g. deposit flows to Ireland following the announcement of blanket guarantee on bank liabilities

» Risk of uneven level of support, different terms of support

- State aid control as the only EU-level coordination tool for bank rescue and restructuring

3- State aid rules for the financial crisis (1/2)

- Commission guidance on use of bail-out instruments
  - On debt guarantees, recapitalisations, impaired asset measures
  - Overarching principle: Bail-outs should happen at the same terms
  - Remuneration requirements (established in cooperation with ECB) key to minimise distortions (moral hazard, crowding out)
- Guidance on restructuring/resolution built on 3 pillars:

VIABILTIY	BURDENSHARING	COMPETITION
Return to long term viability, remuneration of capital	Minimisation of cost for the State / the taxpayer	Proportionate remedies, reflecting a) market characteristics
No more public support after restructuring	Mitigation of moral hazard	b) relative/absolute size of the aid

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3- State aid rules for the financial crisis (2/2)

- State aid crisis rules
  - Are more flexible and more targeted than "normal" rules
    - Possibility to inject capital but on predefined terms
    - Possibility for Member States to get a scheme authorisation (to grant aid to several recipients based on one Commission decision) but subject to 6 month evaluation
  - Entail procedural innovations
    - Temporary approvals of structural measures to cope with urgency, followed by in-depth analysis / negotiation of restructuring plans
    - Speedier Commission internal decision making, enabling the Commission to provide legal certainty within 2 days from notification
  - Are enforced by the Task Force Financial Crisis in DG Competition
    - Team of 54 FTEs
    - Largely consisting of experts recruited from regulators and industry

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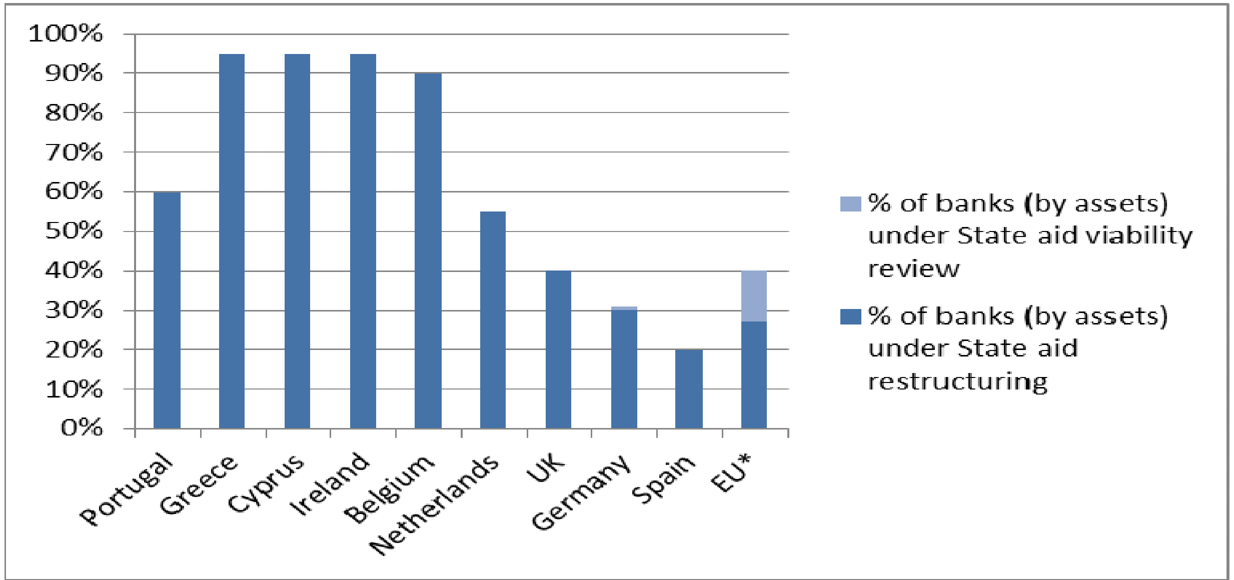
4 - Significance of crisis aid control

- So far 59 banks restructured (thereof 19 resolved), 29 cases ongoing; 44 schemes, ~400 decisions
- ~ € 4.9 trillion of aid approved (39% GDP), thereof € 1.7 trillion used (13.5% GDP)
- Large parts of banking sector under State aid scrutiny



5 - Evolution of State aid control

- Crisis rules have been constantly adapted to changing market circumstances
  - E.g. Revised pricing of state guarantees to cater for sovereign crisis
- Adapted role in programme countries
  - Assessment: From micro/bank-level to system-wide approach
  - Increasing involvement in the design of restructuring/ resolution plans through ex-ante approval: No (ESM) funds disbursed before plans are approved
  - Stronger burden-sharing requirements, imposed by Euro Group: Partial bail-in of shareholders and junior creditors

6 – Changing regulatory and supervisory landscape for bank resolution

- Single Supervisory Mechanism ("SSM") for Eurozone banks
  - Supervisory powers and responsibilities centralised at the ECB
  - Expected to be operational as of mid-2014
  - Prerequisite for ESM direct recapitalisations
- Commission proposals for directives on bank resolution ("BRRD") and deposit guarantee schemes ("DGSD")
  - Expected to enter into force in 2015
  - Will create harmonised but national resolution systems
  - Bail-in of stakeholders foreseen as of 2018
- In addition, Commission to make a proposal for a Single Resolution Mechanism ("SRM") in the course of 2013

7 – Challenges going forward

- Any interventions in the next years will involve SA and be subject to SA control (time needed to build up resolution fund(s), bail-in provisions only as of 2018). How to organise collaboration between SA control and new actors during this phase?
- How can SA control facilitate the effectiveness of the overall regulatory landscape over next few years?
- Different choices by Member States on burdensharing (e.g. under adjustment programme) lead to divergences in the internal market; SSM/SRM are established for the Eurozone+. How can we better protect the internal market and prevent distortions of competition at EU27 level?