SPEECH/09/

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An EU perspective on National Intervention and State aid in the current financial and economic crisis

Kreab&Gavin Anderson Roundtable

Brussels, 3 June 2009

Ladies and Gentlemen

Let me thank you for the opportunity to say a few words at this breakfast meeting before we enter into the discussion.

I do not have to explain in this circle the entirely new environment that the financial sector is living since Lehman&Brothers last autumn. For the Commission it has meant a substantial rethinking of the future regulatory framework of the financial market in Europe, formulating a European position in the international debate on the future of the international markets, and of coping with the immediate consequences of the crisis on the banking sector and on the real economy in the Union. In the latter context, the role of the European Commission in State aid control very rapidly took the front stage. And I would like to concentrate in this debate on this latter aspect.

In autumn last year we found ourselves in the State aid control field in an immediate emergency situation:

- We had to re-position the application of State aid rules within the crisis situation, both as regards the financial sector as such and the spill over into the real economy,

- For the first time in fifty years we had to use broadly the concept of a “serious disturbance of the economy”, as enshrined in Article 87(3)(b) of the Treaty—up to this period used very rarely, in fact a single time during the eighties with regard to Greece,

- We had to re-organise our own operation and procedures, to turn into a kind of rapid reaction force

- At the same time, we had to keep in mind the longer term principles that would lead us out of the crisis, once the immediate emergency tackled.

[*Purpose of State aid control in the current crisis*]

As you all know, the European Commission rapidly set up a new framework for application of state aid rules to the banking sector and adopted in rapid sequence a large number of decisions dealing with aid in the banking sector and more recently in the real economy sector. As our special edition[1] of the State aid score board of last April shows, since October 2008 up to the end of March 2009 the Commission adopted more than fifty State aid decisions in the context of the financial crisis—twelve comprehensive guarantee schemes, five major recapitalisation schemes, five framework schemes comprising a combination of these measures and a substantial number of ad-hoc measures concerning certain banks—and this figure has been rising every week since. Taken together the schemes and measures approved until end of March summed up to an aid framework of 3 trillion Euros, or 24% of the GDP of the European Union, out of which 2.3 trillion for possible guarantees. This contrasts quite substantially—to say the least—with our figures on overall state aid only a year before where we were proud to announce that aid falling under our rules had been brought down to a total of 0.5% of GDP.

[1] State Aid Scoreboard – Spring 2009 Update, Special edition on State Aid interventions in the current financial and economic crisis, COM(2009) 164, 08.04.2009

Of course, these figures represent the upper level of possible risk shields, rescue and restructuring packages and other measures that Member States have been authorised to undertake. The actual aid element will be substantially lower—even if banks have now taken up the schemes and guarantees massively. The current take-up rate in the Union amounts to 30% for Member States' guarantees and over 50% for recapitalisation measures within schemes and including ad-hoc measures outside of schemes. The figures illustrate that Europe has entered into a new phase of economic management—quite far away from the belief in the market economy which has always been the very basis of common economic convictions in the Union and of course also the very basis of State aid control.

We are now in the critical phase where the Union will have to decide where it wants to move. This is true for the future regulatory framework for the financial markets and the proposals the Commission has made in this field following the de Larosiere report. It is also true for our future State aid policy as regards the financial sector and more widely the real economy.

We are therefore now entering a new phase of restructuring and crisis management in the banking sector, as the flurry of State aid decisions recently taken has shown. The cleaning up of the balance sheets and required analysis and restructuring will be the dominant topic over the next weeks and months. And an evolving discussion on the ultimate goal of public intervention and a sustainable exit route from the current aid schemes will be as well.

Let me limit myself here to some more general comments on our approach and the relationship between the application of State aid rules and general policy measures taken to manage the crisis and re-establish financial stability.

The Commission has addressed the crisis in a broad policy framework, as set forth in the European Recovery Plan submitted to the European Council in November of last year and further developed in its subsequent communications. Given the distribution of roles and competencies concerning fiscal and economic policy management between the European Institutions and the Member States, major measures fall inevitably to Member States. Member States' measures addressing specific banks or other enterprises will generally fall under Article 87 of the Treaty which entrusts the Commission with the task of reviewing Member States action in these fields. The application of State aid rules therefore played a pivotal role in crisis management in the European Union from the start. But the application of State aid rules must be seen in the context of broader regulatory, monetary, and fiscal policies put in place by the Union, the European Central Bank and the Member States to manage the crisis.

It is true that the crisis initially led to calls by some to suspend the application of State aid control altogether, in order to give Member States maximum freedom for crisis management. However, those calls quickly subsided, at the latest when certain Member States tried to establish initially aid schemes that would have been blatantly discriminatory with regard to other Member States if they would have been left unchanged by us—and now with the discussions around the GM / Opel interventions. All this has led I believe to an underlying consensus between Member States, the industry and the Union's institutions that the application of State aid rules remains vital precisely in a crisis situation—when we have to be careful to get out of the hole, instead of digging deeper into it.

The fact is that EU State aid rules have helped Member States to find coordinated solutions, have enforced the necessary adjustments to the schemes and have given legal certainty, and have contributed to maintaining for the future a level playing field.

The Commission has shown that it was able to react to the requirements for saving the EU's banking sector from a melt down without sacrificing sound long term principles. This was particularly demonstrated by the rapid development of the policy framework for application of Article 87(3)(b): State aid for institutions of systemic importance for the whole of the economy "to remedy a serious disturbance of the economy" of Member States.

[***The new State aid policy framework in the financial sector***]

It is in this context that the Commission has issued in rapid sequence the three communications setting out a clear framework for the application of State aid rules on the basis of Article 87(3)(b) to the measures undertaken—establishing common principles but also ensuring necessary discipline in assistance to banks. In establishing this policy framework, we have worked in close coordination with the Economic and Financial Committee composed of the Member States and the ECB, and the Commission—

another major innovation generated by the crisis.

In the **banking communication of 13 October 2008**[2], the Commission clarified its general approach and justified the use of Article 87(3)(b) as a legal basis against which the compatibility of aid measures will be verified in the crisis situation. We provided guidance on a number of types of State intervention, in particular on State guarantees for bank liabilities which were the most widespread response to the crisis in the first phase, when the re-launching of the inter-bank markets was the main target.

However, it was made clear that there was no blank cheque. The Commission maintained key principles:

– Non-discriminatory access to a national scheme by making sure that eligibility for a support scheme is not based on nationality,

– Limitation in time—support only to be provided as long as necessary to cope with the current turmoil in financial markets. State support has to be reviewed, adjusted or terminated as soon as improved market conditions so permit—all inherent in the temporary nature of measures based on Art. 87(3) (b),

– State support to be clearly defined and limited in scope to what is necessary to address the acute crisis while excluding unjustified benefits for shareholders of financial institutions at the taxpayer's

[2] Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p. 8 ("the Banking Communication")

expense,

– An appropriate contribution of the private sector. This implies that there should be an adequate remuneration for general support schemes and the private sector is to cover at least a significant part of the cost of assistance granted,

– There must be sufficient behavioural rules for beneficiaries that prevent an abuse of State support—no expansion and aggressive market strategies on the back of a State guarantee.

A main target of Commission intervention was to prevent subsidy races between Member States that could undermine financial stability at the EU level, instead of promoting it—such as some measures envisaged initially in certain Member States that would have exported their own problems to their neighbours and resulted in a zero-sum game.

In a second phase measures for the recapitalization of banks became a key focus, particularly when lending to the real economy started to dry up, as banks began the process of de-leveraging. Guidance on the conditions under which banks' recapitalization by the States would be compatible with the State aid rules was urgently needed. The main principles for the assessment of such measures under State aid rules were set out in the recapitalization **communication[3] of 5 December 2008:**

[3] Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.01.2009 ("the Recapitalisation Communication")

- The price that beneficiaries had to pay for State funding, depending on the risk profile of the bank, in order to limit the distortive effect to the minimum necessary—again worked out on the basis of ECB recommendations and developed further in close dialogue with the ECB,

- An exit strategy from reliance on State capital for fundamentally sound banks,

- In-depth restructuring or liquidation for distressed banks, however taking account of the overriding goal of financial stability.

The two communications guided the large number of Commission decisions on schemes and ad-hoc cases concerning guarantees and recapitalisation measures to which I referred. We believe that on the basis of the communications we were able to provide for the necessary coordination between Member States and the necessary coherence of measures, in order to achieve the intended stabilisation effect for the whole of the Union.

The Union's banking sector is now moving into the third phase towards re-establishing stability and trust required for a return to normal operation of our banking sector—cleaning up of the balance sheets and removal of toxic and other impaired assets which were at the very root of the world-wide crisis in the first place. On 25 February 2009 the Commission provided **guidance for the treatment of impaired assets**.[4] This third communication addressed the implications of the introduction of asset

[4] Communication from the Commission on the Treatment of Impaired assets in the Community Banking Sector, OJ C 72, 26.03.2009 ("the Impaired Assets Communication")

relief measures (the purchase of such assets or their guarantee against further losses by the Member States). It contains guidelines for the application of the State aid rules to such measures and is based on the principles of transparency and disclosure, adequate burden sharing between the State and the beneficiary, and prudent valuation of assets based on their real economic value.

We must be careful that we move towards re-establishing long term stability. As regards guarantee and recapitalisation schemes, we are in the process of preparing the review announced in the communications, based on the reports provided by Member States, in order to assess their effectiveness and need for a prolongation and any necessary changes.

As regards the forthcoming assessment of viability and restructuring where required by the communications, important decisions have been taken during the last weeks. Let me just mention the Commerzbank decision[5] and the decision on WestLB[6], as well as the opening of in-depth investigations on a number of other important financial institutions. We are working on how the restructuring practice under State Aid rules should be adjusted to the overriding goal of financial stability without jeopardizing the proven principles of rescue and restructuring as set down in previous guidelines and cases—long term viability which must include submitting the plans of the banks concerned to substantive stress tests; fair burden sharing; no undue distortion of competition.

[5] Commission press release, IP/09/711, 07.05.2009, State aid: Commission approves recapitalisation of Commerzbank
[6] Commission press release, IP/09/741, State aid: Commission approves aid package for German bank WestLB

[***Access to credit for the real economy***]

As is well known, the financial crisis has had a direct impact on the EU's real economy. Banks are deleveraging. Companies are experiencing difficulties with access to credit. A serious downturn is affecting the wider economy. As a consequence the Union and the Member States have put major economic stimulus programmes in place, additional to the monetary measures decided by the ECB and other Central Banks.

Under the very specific circumstances of this deep crisis, Member States need the necessary flexibility to put into immediate effect economic stimulus policies that allow a countercyclical effect. Again, the Commission decided to use Article 87(3)(b) as the instrument to provide for temporary measures to this effect, as far as the economic stimulus measures fall under State aid rules. Far from being a straitjacket impeding effective economic stimulus action by Member States, we believe that Article 87(3)(b) provides the necessary flexibility to the application of State aid rules needed at Member States' level in the current crisis, in parallel and within the framework of the European Recovery Plan established at the Union level.

The Temporary Framework[7] for State aid measures to support access to finance in the current financial and economic crisis, adopted in December on the basis of Article 87(3)(b) serves that very purpose.

The temporary aid measures pursue three main objectives:

[7] Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis ("the Temporary Framework"), OJ C 16, 22.01.2009, p.1. The consolidated version, integrating the amendments adopted by the Commission on 25.02.2009 is published in OJ C 83, 07.04.2009, p.1

- To immediately unblock bank lending and thereby help providing for continuity in companies' access to finance;

- To ensure that aid reaches recipients in the most rapid and effective way;

- To link to the maximum to the long term investment goals of the Union, such as the development of green products.

Without going too much into detail, a quick recall of the main measures possible under the Temporary Framework:

- €500,000 per company for the next two years in the context of comprehensive nation-wide schemes. This aid can be cumulated with *de minimis*, but within the limit of €500,000 for the period 2008-2010,

- State guarantees for loans at a reduced premium where we have gone a long way to take account of the crisis situation,

- Aid in the form of subsidised interest rates, which will be calculated on the basis of the central bank overnight rate, instead of the one year inter-bank offered rate , plus a premium[8]

- subsidised loans for the production of green products,

[8] equal to the difference between the average one year interbank rate and the average of the central bank overnight rate over the period from 1 January 2007 to 30 June 2008 plus the credit risk premium corresponding to the risk profile of the recipient, as stipulated by the Commission Communication on the revision of the method for setting the reference and discount rates.

- extended risk capital aid,

- extended facilities for aid in the export credit insurance market.

These new facilities have been taken up massively by Member States. The special March edition of the State aid score board on the financial and economic crisis testifies to this.

Measures under the Temporary Framework target relief for the difficulties due to the financial crisis and its spill over into the real economy. They are not intended to remedy pre-existing structural issues. Therefore, it should be stressed that the Temporary Framework does not apply to companies whose problems pre-date the current crisis. To that effect, a cut-off date was introduced in the Temporary Framework, i.e. the Framework can only be applied to firms not in difficulty on 1 July 2008. For firms already in difficulty by that date, the rescue and restructuring guidelines remain the most adequate tool to restore long-term viability.

Where the conditions are fulfilled, the Temporary Framework and the schemes approved under it apply to all sectors, including high profile sectors such as the car industry. Of course, aid measures will have to comply with **all** conditions set out in the Temporary Framework, such as the total annual wage bill cap on the maximum loan to be covered by the guarantees.[9]

[9] The maximum loan must not exceed the total annual wage bill of the beneficiary (including social charges as well as the cost of personnel working on the company site but formally in the payroll of subcontractors) for 2008

[*Conclusions*]

At this stage we are half-way. In the banking sector the major cleaning up operation as regards toxic or other impaired assets is still ahead. We have still not seen in Europe a general stress testing exercise comparable with the Geithner operation in the United States. We still have to test the willingness of Member States to restructure in depth where this is needed and required under State aid provisions—be it in the banking or the real economy sectors. As I have mentioned, a number of cases are ongoing, and we are discussing main principles for restructuring under the current crisis situation with the Economic and Financial Committee and the Member States, as far as the banking sector is concerned.

The Commission has approved the measures in favour of banks so far under the condition that aid beneficiaries are to demonstrate the ability to operate on the market in the long term without State support. In essence, this emphasises our belief that in the long term the economic order of the market economy should prevail—though thoroughly ring-fenced by better regulation. In consequence, we have maintained throughout the crisis the requirement that we must be shown the exit when aid is given. At the same time, and in follow up to the de Larosière report and the discussions in the global G20 context, the Commission is tabling substantial reforms of the regulatory framework of the financial markets which should facilitate return to market conditions. Both State aid control and regulatory reform should allow attaining the overall objective: stabilisation of the financial system and return to market conditions—and return to market conditions should re-establish normal working of credit markets and provision of funding to the real economy.

But it is also clear that the crisis has changed our approach to State aids and restructuring. In the current situation, we clearly have to give primacy to the reestablishment of financial stability, and we have to see the other traditional goals of State aid control in restructuring—burdensharing between the private sector and the State, and preventing distortions of competition—in that context. However, in all public interventions we have to be shown that at the end of tunnel we will see a re-establishment of sound market conditions—as the solid basis for future economic and social development in the Union.

Let me end on this note. Thank you.