



European Commission

Competition

ACE workshop on Antitrust and Regulation
Milan, 08.10.2009

State aid in times of crisis, the European perspective

Dr. Vincent Verouden
Senior Economist, European Commission (DG COMP/CET)

Disclaimer (EN): the views expressed are those of the author and cannot be regarded as stating an official position of the European Commission

European Commission,
DG Competition, CET

1



European Commission

Competition

Overview

- EU State aid control: purpose and main rules
- State aid control in the financial and economic crisis

European Commission,
DG Competition, CET

2



I. EU State aid control: purpose and main rules



“Two sides” of State aid

- State aid may pursue sound public policy objectives of the MS
- State aid may distort competition and trade
 - negative spill-overs on other MS
 - undermine functioning of internal market



Art. 87 EC: a two step approach

- Article 87(1) EC: notion of state aid and general **prohibition**
"Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market".
- Articles 87(2) and 87(3), 86(2) EC: **derogations** (aid compatible with Treaty)



Compatible aid under Art. 87(3) EC

- Art. 87(3) EC: the following types of aid "may be considered" **compatible**
 - (a) economic development of most disadvantaged regions of Community
 - (b) important common European project or serious disturbance in the economy of a Member State
 - (c) development of certain economic activities or certain economic areas
 - (d) culture and heritage conservation
 - (e) other categories as may be specified by a decision of the Council
- Margin of discretion → frameworks and guidelines, block exemption regulations



European Commission

Competition

Compatible aid

Regional development Art. 87(3)(a) +(c)	<ul style="list-style-type: none">• Aid for initial investment in assisted areas• Operating aid in exceptional circumstances
R&D&I Art. 87(3)(c) + exceptionally (b)	<ul style="list-style-type: none">• Aid for fundamental research• Aid for industrial research• Aid for precompetitive development activities• Aid for innovation
SME promotion Art. 87(3)(c)	<ul style="list-style-type: none">• Aid for initial investment• Aid for advisory services and participation in trade fairs• Aid for R&D
Employment Art. 87(3)(c)	<ul style="list-style-type: none">• Aid for net job creation• Aid for disadvantaged workers/ handicapped people
Training Art. 87(3)(c)	<ul style="list-style-type: none">• Aid for general or specific training of employees

European Commission,
DG Competition, CET

7



European Commission

Competition

Compatible aid

Environment Art. 87(3)(c)	<ul style="list-style-type: none">• Aid for environmental investment• Operating aid
Risk capital Art. 87(3)(c)	<ul style="list-style-type: none">• Aid for risk capital measures
Rescue & restructuring Art. 87(3)(c)	<ul style="list-style-type: none">• Rescue aid: temporary aid to keep ailing firms afloat (to "buy time")• Aid to restructure firms to restore viability
Services of General Economic interest Art. 86(2)	<ul style="list-style-type: none">• Aid for the provision of SGEI

European Commission,
DG Competition, CET

8



State Aid Action Plan (2005)

- Main goal of State aid reform in recent years: “Less and better targeted aid”
 - à **enhance effectiveness** of state aid control by striking a better balance between
 - benefits of state aid (objective/effectiveness)
 - costs of state aid (distortions)
- Formulated as a “balancing test” (under Art. 87(3)(c) EC)
- Architecture of state aid rules: block exemption -- standard assessment -- more in-depth analysis



II. State aid control in the financial and economic crisis



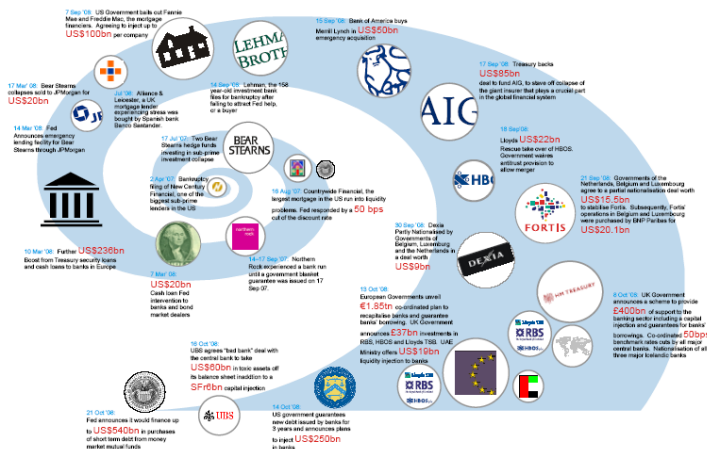
Bank run



European Commission,
DG Competition, CET

11

Tsunami of state interventions...



European Commission,
DG Competition, CET



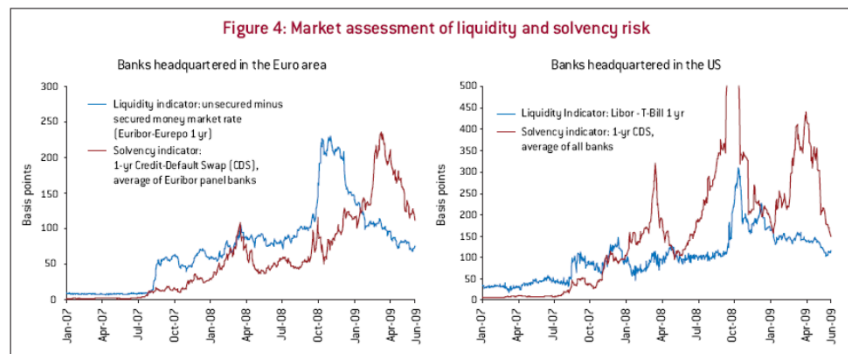
Liquidity and solvency under pressure...

- Reduced liquidity
 - Evaporating interbank market and wholesale funding
 - Increased cost of funding
 - Inability to securitize assets
 - Several committed credit lines get drawn upon (SIVs)
- Deteriorating solvency
 - Write-downs
 - Increasing capital requirements



Liquidity and solvency under pressure...

Figure 4: Market assessment of liquidity and solvency risk



Source: Datastream, European Banking Federation, British Banking Association, series ending 2 June 2009. Methodology based on Jens Eisenschmidt and Jens Taping, 'Liquidity risk premia in unsecured interbank money markets', *ECB Working Paper 1025*, March 2009.



European Commission

Competition

Estimated write-downs (2007-2010)

Estimated exposure (bn USD)	US assets	UK assets	EU ex UK	Japan assets	EM assets	TOTAL
US banks	10.364	369	509	191	507	11.940
UK banks	965	4.045	779	160	380	6.329
EU banks ex UK	2.839	2.500	16.151	600	2.034	24.124
Asian banks	968	483	639	7.195	241	9.526
Total	15.136	7.397	18.078	8.146	3.162	51.919

Estimated write-downs (bn USD)	US assets	UK assets	EU ex UK	Japan assets	EM assets	TOTAL
US banks	966	22	24	3	35	1.049
UK banks	72	174	30	2	37	316
EU banks ex UK	198	111	622	6	172	1.109
Asian banks	116	33	29	141	16	337
Total	1.352	340	705	152	260	2.811

	US assets	UK assets	EU ex UK	Japan assets	EM assets	TOTAL
Write-down intensities	8,9%	4,6%	3,9%	1,9%	8,2%	5,4%

Source: IMF. ("Exposure": total bank assets less interbank operations)

European Commission,
DG Competition, CET

15

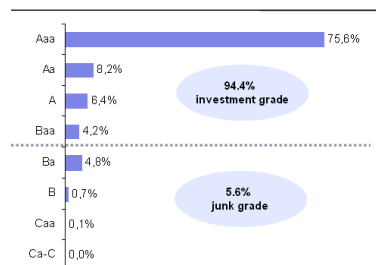


European Commission

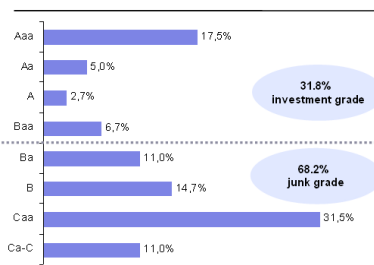
Competition

Massive rating downgrades...

Split by Moody's rating as of 31/12/2008
In % of total rated securities



Split by Moody's rating as of 31/03/2009
In % of total rated securities



European Commission,
DG Competition, CET

16



European Commission

Competition

Sharply increasing capital requirements given rating downgrades

Capital requirement and ratings of MBS tranches

Rating	Risk weights	Capital ratio	Nominal amount	Capital requirement	Capital multiplier
AAA	20%	8%	100%	1,6%	1,0 x
AA	20%	8%	100%	1,6%	1,0 x
A	50%	8%	100%	4,0%	2,5 x
BBB	100%	8%	100%	8,0%	5,0 x
BB	350%	8%	100%	28,0%	17,5 x
• B+	1250%	8%	100%	100,0%	62,5 x

Downgrades sharply increase capital requirements for banks

European Commission,
DG Competition, CET

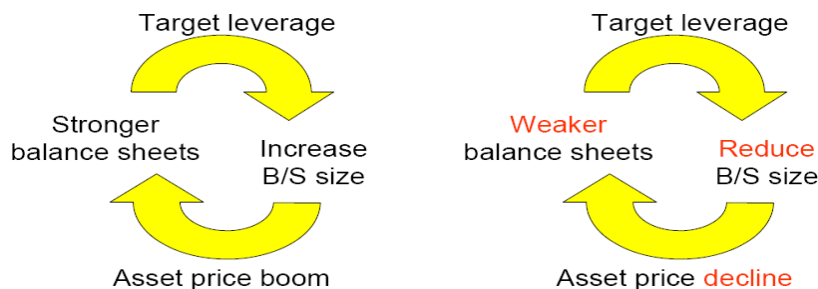
17



European Commission

Competition

With severe real economy feedback loops ...



European Commission,
DG Competition, CET

18



The State to the rescue

- Aid to banks vs. aid to other firms
 - Systemic role of banks decisive
 - Systemic effects from bank failures: an externality such the social cost by far exceeds the private cost
 - Crisis of confidence (coordination failure within the market)
- Main forms of State aid to banks:
 - Recapitalisations
 - Guarantees on bank liabilities
 - Impaired asset relief



Implementation of measures

	EU public interventions in the banking sector							
	Capital injections		Liability guarantees		Asset relief		TOTAL	
	Committed	Effective	Committed	Effective	Committed	Effective	Total committed	Total effective
EA (€bn)	226	113	1.912	632	224	50	2.362	795
EA (% GDP)	3%	1%	21%	7%	2%	1%	26%	9%
EU (€bn)	308	160	2.373	781	903	612	3.584	1.552
EU (% GDP)	3%	1%	20%	7%	8%	5%	30%	13%

Source: ECB



Need for a coordinated EU response

- Important cross border dimension
 - Banks compete across national jurisdictions
 - Member states do not tend to internalise effects beyond their own jurisdictions
 - Different ability and willingness to support banks
- à Repercussions for
 - Financial stability in the EU
 - Functioning of internal market for banking



E.U. response to the bank crisis - A bird's eye perspective

- Agreement on general principles (ECOFIN, Oct 08)
- Coordinated implementation through EC state aid control (EC Communications Oct 08, Jan 09, Feb 09 & Aug 09; application to cases)
- Institutional response (de Larosière Report, Feb 09)
- Pan-European stress testing (CEBS, May-Sep 09)
- ECB, other central banks



EC State aid control in the banking crisis

- Commission initiatives to facilitate (and continue to control) State aid to banks in order to preserve financial stability
 - Instrument used: Art. 87(3)(b) EC
 - Essentially involving a balancing:
 - Addressing a market failure
 - Systemic effects from bank failures (negative externalities)
 - Crisis of confidence - a coordination failure
 - Distortions of competition
 - For the recipient: moral hazard
 - For its competitors: incentives to compete are affected because rents are allocated ex post by the state
 - Internal market perspective



EC Communications

- Coordinated implementation of state aid measures through EC state aid control:
 - Oct 2008: Banking communication (general principles; principle of non discrimination; pricing of guarantees of bank liabilities)
 - Jan 2009: Recapitalizations (pricing, exit incentives, fundamentally sound banks and other banks)
 - Feb 2009: Impaired asset relief measures (transparency, pricing)
 - Aug 2009: Bank restructuring (ensuring long term viability, stress testing, burden sharing, competition measures)



Some pending cases

- Cases under formal investigation procedure as per 09.09.2009
 - Restructuring of Dexia (BE)
 - Asset relief measure in favour of KBC Group (BE)
 - Aid package for Hypo Real Estate (DE)
 - Aid package for Bayern LB (DE/AT)
 - Asset relief measure for LBBW (DE)
 - Aid package for JSC Parex Banka (LT)
 - Restructuring aid for Northern Rock (UK)
 - ING Illiquid asset facility (NL)
 - State measures for Fortis Bank Nederland (FBN) and ABN Amro (NL)



The State to the rescue (cont'd) – The real economy

- In the wake of the financial crisis, also an economic crisis
- Commission initiatives to facilitate (and continue to control) State aid for the real economy
 - Instrument used: Art. 87(3)(b)
 - Implementation through Temporary Framework



Temporary Framework

- Specific aid instruments:
 - New “de minimis” scheme (EUR 500.000 per company)
 - Subsidized state guarantees
 - Subsidized loans (adjusted reference rates)
 - Subsidized loans for the development of green products
 - Increased flexibility for risk capital
 - Simplified requirements for export credit



Outlook

- State aid control: part of the solution
 - Imperative to continue to limit negative cross border externalities (“export of problems”)
 - State aid rules bring greater certainty to the market place