I. INTRODUCTION

Since the beginning of the global financial crisis, the Commission has issued five Communications which provided detailed guidance on the criteria for the compatibility of State support to banks with the requirements of Article 107(3)(b) of the Treaty on the Functioning of the European Union (TFEU). Three of those five documents set out the prerequisites for the compatibility of the main types of assistance granted by Member States—guarantees on liabilities, recapitalisations and asset relief measures—while the "Restructuring Communication" details the particular features that a restructuring plan (or a viability plan) has to display in the specific context of crisis-related State aid granted to financial institutions on the basis of Article 107(3)(b) TFEU. The "Restructuring Communication" was originally to apply for aid notified until 31 December 2010, but its application was prolonged by one year, until 31 December 2011, by the fifth Communication (the "Exit Communication").

All five Communications highlight the temporary nature of the admissibility of such aid measures; each states that such aid can only be justified as an emergency response to the unprecedented stress in financial markets and only as long as those exceptional circumstances prevail. The ultimate goal must be the return to the normal State aid regime for the rescue and restructuring of banks, based on Article 107(3)(c), which should re-apply as of 1 January 2012, market conditions permitting.

As early as 2 December 2009 the ECOFIN Council concluded on the necessity to design a strategy for the phasing-out of support measures which would be transparent and duly coordinated among Member States to avoid negative spill-over effects but also take into account the specific circumstances varying across Member States. The conclusions further set out that, in principle, the phasing-out process concerning the various forms of assistance to

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4 Those conclusions were endorsed by the European Council of 11 December 2009. In the same vein, the European Parliament insisted in its Resolution of 9 March 2010 on the Report on Competition Policy 2008 (http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2010-0050) that State support to financial institutions should not be unduly prolonged and that exit strategies should be elaborated as soon as possible.
banks should start with government guarantee schemes, incentivising the exit of sound banks and inducing other banks to address their weaknesses.

The Commission implemented the first step of that exit process by initiating the phasing-out of guarantee schemes (see also Chapter II below). A second exit step was put forward by the "Exit Communication" with the requirement that, as of 1 January 2011, every bank in the EU having recourse to State support under the form of capital or impaired asset measures will have to submit a restructuring plan, thereby removing, in that respect, the previously applied distinction between fundamentally sound and distressed banks.

Those steps have to be seen in the context of the broader strategy to restore financial stability, which comprise the forthcoming 2011 EU-wide stress test exercise run by the European Banking Authority, a strengthened economic surveillance framework and a financial assistance framework under strict conditionality as well as the setting up of a renewed regulatory and supervisory framework. It is also intended to be followed by further steps as of January 2012, market conditions permitting, to return to normal State aid rules for ailing banks.

II. CURRENT CONDITIONS FOR THE COMPATIBILITY OF GOVERNMENT GUARANTEES

As mentioned above, since 1 July 2010 the Commission has applied tighter conditions for the compatibility of government guarantees with Article 107(3)(b) TFEU. Tighter conditions came in the form of a) an increased guarantee fee and b) a new requirement of a viability plan for beneficiaries that have recourse to new guarantees and exceed a certain threshold of total outstanding guaranteed liabilities both in absolute terms and in relation to total liabilities.

No further adjustment of those conditions has appeared necessary since then: The "Exit Communication" specified that notified government guarantee schemes expiring at the end of 2010 could be authorised for another six months and until 30 June 2011 on the basis of the conditions introduced as of July 2010.

In line with previous practice, the Commission reassessed market developments, the use of government guarantees and the conditions for the compatibility of State guarantees beyond 30 June 2011, the main results of which are summarized in the following paragraphs.

III. MARKET DEVELOPMENTS AND USE OF GOVERNMENT GUARANTEES

6 With a flexibility clause permitting a re-assessment of the situation and appropriate remedies in the event of a severe new shock to the financial markets across the EU or in one or more Member States. None of the Member States that have notified an extension of their guarantee schemes until the end of 2010 have invoked that flexibility clause.
The last few months have seen a continued consolidation of economic recovery, further stabilisation of the interbank market, including an overall stabilisation of bank CDS spreads, as evidenced in the graph below showing the average CDS spread difference over time between financial and non-financial corporates.7

![Figure 1: CDS spread difference between financials and non-financials](image)

However, in addition to Greece and Ireland, Portugal will also be supported by the EU and IMF in the context of a macroeconomic adjustment programme. Moreover, for a number of Member States sovereign spreads compared to the German Bund remain high. In addition, a large amount of bank debt falls due within the next few months. The breakdown of State-guaranteed bonds issued by EU banks during the crisis (figure 2) gives an indication of the amount of bank debt maturing by the end of 2011 and Q1 2012.

![Figure 2: Breakdown of State-guaranteed bonds issued by EU banks by maturity](image)

7 However, that narrowing of average CDS spread difference does not exclude the existence of funding issues for some small- and medium-sized banks due to the fact the CDS are normally available for large- and some medium-sized banks only.
For those reasons, some Member States may seek to prolong their guarantee schemes. As a result, the use of State guarantees must be examined to ascertain if the conditions under which those schemes have been approved as of July 2010 remain appropriate in current circumstances.

As to the use of State guarantees the overall volume of guarantees effectively used by banks within the EU has generally decreased both in terms of nominal amounts and percentage of GDP. 64 emissions were guaranteed in the second semester of 2010 as opposed to a total of over 1150 State-guaranteed emissions recorded since October 2008 (which represents a share of 5.6% of total emission for H2 2010). For the whole EU, outstanding guarantees represented 7.9% of GDP in August 2009 but only 5.3% in April 2011.

Recent country-to-country data on the use of guarantees confirm the decrease in the outstanding amount of guarantees, also between October 2010 and April 2011, except in a very few number of countries.

![Figure 3: Guarantees on bank liabilities (% of GDP), October 2009 – April 2011](image)

*Note: IE went down from 172.3% in October 2009 to 76.8% in April 2011. The countries not listed did not have any guarantees on bank liabilities.*

*Source: Commission services (DG ECFIN)*

Furthermore, the number of existing guarantee schemes has decreased from 15 at the end of 2010 to 8 schemes (9, if the Hungarian liquidity scheme, which has been assessed under the guarantee scheme criteria, is included). Indeed, Ireland (scheme on existing liabilities), Denmark (schemes on both existing liabilities and new debt), Slovenia, Netherlands, Latvia, and Germany have decided to not prolong their schemes in the last months of 2010.

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8 The analysis is based on reports submitted by Member States on the use of their guarantee schemes between June and October 2010, on data on the use of guarantees from the Bloomberg data base and data collected by DG ECFIN among the EFC members end April 2011.

9 Austria, Greece, Ireland, Lithuania, Poland, Portugal, Spain, Sweden.

10 It should be noted, however, that the end of the Irish scheme on existing liabilities (CIFS) does not necessarily represent a reduction in the use of State guarantees by Irish banks since another scheme on new liabilities (ELG) continues with a coverage almost as broad as the CIFS (since it also covers, in particular, deposits).
Consequently, according to Member States' reports the number of individual banks using an existing guarantee scheme has also decreased, from about 130 in December 2009 to 35 in the period from 1 July to 31 December 2010. Most of those banks are already under restructuring obligations.

IV. CONCLUSIONS

One can infer from the analysis that with the price increase in May 2010 the right incentives were set in order to trigger an exit from the reliance on State guarantees, most probably helped by a more favourable market environment in most Member States has rendered State guarantees less attractive for potential users. The residual use of State guarantees is mainly attributable to banks in restructuring, or belonging to countries facing some challenges with their banking system.

Having in mind the above, no evidence suggests that a further price increase and/or tightening of viability requirements would be necessary.

Notified government guarantee schemes can therefore be authorised for another six months and until 31 December 2011 on the basis of the conditions introduced as of July 2010.