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COMMISSION COMMUNICATION

The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules

1. Introduction

- (1) At its meetings on 20 March 2009 and of 18-19 June 2009, the European Council confirmed its commitment to restoring confidence and the proper functioning of the financial market, which is an indispensable precondition for recovery from the current financial and economic crisis. In view of the systemic nature of the crisis and the interconnectivity of the financial sector, a number of actions have been initiated to restore confidence in the financial system, preserve the internal market and secure lending to the economy¹.
- (2) These initiatives need to be complemented by action at the level of individual financial institutions to make sure that they are able to withstand the economic crisis and return to long-term viability without reliance on State support in order to perform their lending function on a sounder basis. The Commission is already dealing with a number of State aid cases, resulting from interventions by Member States to avoid liquidity, solvency or lending problems. The Commission has provided guidance, in three successive communications, on the design and implementation of State aid in favour of banks². Those communications recognised that the severity of the crisis justified the granting of aid pursuant to Article 87(3)(b) of the Treaty establishing the European Community and provided a framework for the coherent provision by Member States of public guarantees, recapitalization and impaired asset relief measures. The primary rationale of those rules is to ensure that rescue measures can fully attain the objectives of financial stability and maintenance of credit flows, while also ensuring a level playing-field between banks³ located in different Member States as well as between banks which receive public support and those which do not, avoiding harmful subsidy

¹ In its Communication to the European Council of 4 March 2009 on 'Driving the European Recovery' COM(2009)114 final, the Commission has announced a reform programme to address more general weaknesses in the regulatory framework applicable to financial institutions which operate in the Community.

² See the 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* ("the Banking Communication") (OJ C 270, 25.10.2008, p. 8), the 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* ("the Recapitalisation Communication") (OJ C 10, 15.1.2009, p. 2) and the Communication from the Commission on the *Treatment of Impaired assets in the Community Banking Sector* ("the Impaired Assets Communication") (OJ C 72, 26.3.2009, p.1). For an overview of the Commission's decision-making practice, see State aid Scoreboard – Spring 2009 Update, Special edition on State aid interventions in the current financial and economic crisis, COM(2009) 164 of 8.4.2009.

³ The application of this Communication is limited to financial institutions as stipulated in the Banking Communication. Guidance provided in the next sections refers to banks for ease of reference. However it applies, *mutatis mutandis* to other financial institutions where appropriate.

rices, limiting moral hazard and ensuring the competitiveness and efficiency of European banks in Community and international markets

- (3) State aid rules provide a tool to ensure the coherence of measures taken by those Member States which have decided to act. However, the decision whether to use public funds, for example to shelter banks from impaired assets, remains with the Member States. In some instances, financial institutions will be in a position to handle the crisis without major adjustment or additional aid. In some other cases, State aid may be necessary, in the form of guarantees, recapitalization or impaired asset relief.
- (4) Where a financial institution has received State aid, Member States should submit a viability plan or a more fundamental restructuring plan, in order to confirm or re-establish individual banks' long-term viability without reliance on State support. Criteria have been established to delineate the conditions under which a bank may need to be subject to more substantial restructuring, and when measures are needed to cater for distortions of competition resulting from the aid⁴. This Communication does not alter those criteria. It complements them, with a view to enhancing predictability and ensuring a coherent approach, by explaining how the Commission will assess, the compatibility of restructuring aid⁵ granted by Member States to financial institutions in the current circumstances of systemic crisis, under Article 87(3)(b) of the Treaty.
- (5) The Communications recall the basic principles which apply to intervention by Member States in the rescue and restructuring of firms in difficulty⁶. Those principles require, first and foremost, that restructuring aid should lead to the restoration of viability of the firm in the longer term without State aid. They also require restructuring aid to be accompanied, to the extent possible, by adequate burden sharing and by measures to minimise distortions of competition, which would in the longer term fundamentally weaken the structure and the functioning of the relevant market.

⁴ The criteria and specific circumstances which trigger the obligation to present a restructuring plan have been explained in the Banking Communication, the Recapitalisation Communication and the Impaired Assets Communication. They refer in particular, but not exclusively, to situations where a distressed bank has been recapitalised by the State, or when the bank benefiting from asset relief has already received State aid in whatever form that contributes to coverage or avoidance of losses (except participation in a guarantee scheme) which altogether exceeds 2% of the total bank's risk weighted assets. The degree of restructuring will depend on the seriousness of problems of each bank. By contrast, in line with those Communications (in particular point 40 of the Recapitalisation Communication and Annex 5 of the Impaired Assets Communication), where a limited amount of aid has been given to banks which are fundamentally sound, Member States are required to submit a report to the Commission on the use of State funds comprising all the information necessary to evaluate the bank's viability, the use of the capital received and the path towards exit from reliance on State support. The viability review should demonstrate the risk profile and prospective capital adequacy of these banks and evaluate their business plans.

⁵ That is to say, aid which was temporarily authorised by the Commission as rescue aid under the Community Guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244, 1.10.2004, p.2) or aid temporarily authorised under Article 87 3 (b) of the Treaty, as well as any new aid that may be notified as needed for restructuring. This Communication will therefore be applied instead of the Guidelines on State aid for rescuing and restructuring firms in difficulty for the assessment of restructuring aid to banks in the current circumstances of systemic crisis.

⁶ Community Guidelines on State aid for rescuing and restructuring firms in difficulty. In the past, the Commission has adopted a number of decisions relating to restructuring aid (granted under Article 87(3)(c) of the Treaty) to ailing banks, on the basis of a comprehensive restructuring process which allowed the beneficiaries to regain their long-term viability without the aid unduly harming

- (6) The integrity of the internal market and the development of banks throughout the Community must be a key consideration in the application of those principles; fragmentation and market partitioning should be avoided. European banks should be in a strong global position on the basis of the single European financial market, once the current crisis has been overcome. The Commission also reaffirms the need to anticipate and manage change in a socially responsible way and underlines the need to comply with the national legislation implementing EU Directives on information and consultation of workers that apply under such circumstances⁷.
- (7) This Communication explains how the Commission will examine aid for the restructuring of banks in the present crisis, taking into account the need to modulate past practice in the light of the nature and the global scale of the present financial crisis, the systemic role of the banking sector for the whole economy, and the possible systemic effects arising from the need of a number of banks to restructure within the same period.
- The restructuring plan will need to include a thorough *diagnosis* of the bank's problems. In order to devise sustainable strategies for the restoration of viability, banks will therefore be required to stress test their business. This first step in restoration of viability should be based on common parameters which will build to the extent possible on appropriate methodologies agreed at Community level. Banks will also be required, where applicable, to disclose impaired assets⁸.
 - Given the overriding goal of financial stability and the prevailing difficult economic outlook throughout the Community, special attention will be given to the design of a restructuring plan, and in particular to ensuring a sufficiently flexible and realistic timing of the necessary implementation steps. Where the immediate implementation of structural measures is not possible due to market circumstances, intermediate behavioural safeguards should be considered.
 - The Commission will apply the basic principle of appropriate burden sharing between Member States and the beneficiary banks with the overall situation of the financial sector in mind. Where significant burden sharing is not immediately possible due to market circumstances at the time of the rescue, this should be addressed at a later stage of the implementation of the restructuring plan.
 - Measures to limit distortion of competition by a rescued bank in the same Member State or in other Member States should be designed in a way that limits any disadvantage to other banks while taking into account the fact that the

competitors. Typical restructuring strategies included reorientation of business models, closure or divestments of businesses divisions, subsidiaries or branches, changes in the asset-liabilities management, sale as a going concern or break-up and sale of different parts of business to viable competitors. See for instance Commission Decision 98/490/EC of 20 May 1998 concerning aid granted by France to the Crédit Lyonnais group (OJ L 221, 8.8.1998, p. 28), Commission Decision 2005/345/EC of 18 February 2004 on restructuring aid implemented by Germany for Bankgesellschaft Berlin AG (OJ L 116, 4.5.2005, p. 1) Case C 9/2008 *Sachsen LB* (not yet published) and the 2006 State Aid Scoreboard, COM (2006) 761 final, p. 28 (http://ec.europa.eu/comm/competition/state_aid/studies_reports/2006_autumn_en.pdf), with a special survey on rescue and restructuring aid.

⁷ See also: Communication on 'Restructuring and Employment' of 31 March 2005 and the good practice on restructuring agreed by the European social partners in November 2003

⁸ In line with the Impaired Assets Communication.

systemic nature of the current crisis has required very widespread state intervention in the sector.

– Provision of additional aid during the restructuring period should remain a possibility if justified by reasons of financial stability. Any additional aid should remain limited to the minimum necessary to ensure viability.

- (8) Section 2 applies to cases where the aid beneficiary is under an obligation to present a restructuring plan⁹. The principles underlying section 2 apply by analogy to cases where the aid beneficiary is not under a formal obligation to present a restructuring plan, but is nonetheless required to demonstrate viability¹⁰. In the latter case, and save situations where there are doubts, the Commission will normally request less detailed information¹¹. In case of doubt, the Commission will in particular seek evidence of adequate stress testing, in line with paragraph 13 below, and of validation of its results by the competent national authority. Sections 3, 4 and 5 will only apply to those aid beneficiaries that are under an obligation to present a restructuring plan¹². Section 6 deals with the temporary scope of this Communication and applies to both aid beneficiaries required to present a restructuring plan and beneficiaries only required to demonstrate their viability.

2. RESTORING LONG-TERM VIABILITY

- (9) Where, on the basis of previous Commission guidance or decisions, a Member State is under an obligation to submit a restructuring plan¹³, that plan should be comprehensive, detailed and based on a coherent concept. It should demonstrate how the bank will restore long-term viability without State aid as soon as possible¹⁴. The notification of any restructuring plan should include a comparison with alternative options, including a break-up, or absorption by another bank, in order to allow the Commission to assess¹⁵ whether more market oriented less costly or less distortive solutions are available consistent with maintaining financial stability. In the event that the bank cannot be restored to viability, the restructuring plan should indicate how it can be wound up in an orderly fashion.
- (10) The restructuring plan should identify the causes of the bank's difficulties and the bank's own weaknesses and outline how the proposed restructuring measures remedy the bank's underlying problems.

⁹ In line with the Banking Communication, the Recapitalisation Communication and the Impaired Assets Communication. See point 4 of this Communication.

¹⁰ In line with the Banking Communication, the Recapitalisation Communication and the Impaired Assets Communication, where a limited amount of aid is granted to fundamentally sound banks, Member States are required to submit a viability review to the Commission.

¹¹ In line in particular with point 40 of the Recapitalisation Communication and Annex 5 of the Impaired Assets Communication.

¹² See point 4 of this Communication.

¹³ As explained in point 8 of this Communication, where section 2 refers to a restructuring plan, the principles underlying section 2 apply by analogy also to viability reviews.

¹⁴ An indicative model for a restructuring plan is reproduced in the Annex.

¹⁵ Where appropriate the Commission will ask for the advice of an external consultant to examine the notified restructuring plans in order to assess viability, burden sharing and minimising competition distortions. It may also request certification of various elements by supervisors.

- (11) The plan should provide information on the business model of the beneficiary, including in particular its organisational structure, funding (demonstrating viability of the short and long term funding structure¹⁶), corporate governance (demonstrating prevention of conflict of interest as well as necessary management changes¹⁷), risk management (including disclosure of impaired assets and prudent provisioning for expected non performing assets), and asset-liability management, cash-flow generation (which should reach sufficient levels without State support), off-balance sheet commitments (demonstrating their sustainability and consolidation when the bank bears a significant exposure¹⁸), leveraging, current and prospective capital adequacy in line with applicable supervisory regulation (based on prudent valuation and adequate provisioning), and the remuneration incentive structure¹⁹, demonstrating how it promotes the beneficiary's long-term profitability).
- (12) Viability should be analysed for each business activity and centre of profit with the necessary breakdown. The return to viability of the bank should mainly derive from internal measures. It may be based on external factors such as variations in prices and demand over which the company has no great influence, but only if the market assumptions made are generally acknowledged. Restructuring requires a withdrawal from activities which would remain structurally loss making in the medium term.
- (13) Long-term viability is achieved when a bank is able to cover all its costs including depreciation and financial charges and provide an appropriate return on equity, taking account of the risk profile of the bank. The restructured bank should be able to compete in the marketplace for capital on its own merits in compliance with relevant regulatory requirements. The expected results of the planned restructuring need to be demonstrated under a base case scenario as well as under "stress" scenarios. For this, restructuring plans need to take account, *inter alia*, of the present state of and future prospects of the financial markets, reflecting base-case and worst-case assumptions. Stress testing should consider a range of scenarios, including a combination of stress events and a protracted global recession. Assumptions should be compared with appropriate sector-wide benchmarks, adequately amended to take account of the new elements of the present crisis in financial markets. The plan should include measures to address possible requirements emerging from stress testing. The stress testing should to the extent possible be based on common parameters agreed at Community level (such as a methodology developed by the Committee of European Banking Supervisors) and where appropriate adapted to cater for country- and bank-specific circumstances.
- (14) In the current crisis governments have recapitalised banks on terms chosen primarily for reasons of financial stability rather than for a return which would have been acceptable to a private investor. Long-term viability therefore requires

¹⁶ See for instance, Commission Decision of 2 April 2008 in case NN 1/2008 *Northern Rock*, OJ C 135, 3.6.2008, p. 21, and Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

¹⁷ See Commission Decision of 4 June 2008 in Case C 9/2008 *SachsenLB*, not yet published.

¹⁸ Except in duly justified circumstances. See Commission Decision of 21 October 2008 in case C10/2008 *IKB*, not yet published.

¹⁹ In line with the Commission Recommendation of 29 April 2009 on remuneration policies in the financial services sector (C(2009) 3159

that any State aid received is either redeemed over time, as anticipated at the time of the granting of the aid, or is remunerated according to normal market conditions, thereby ensuring that any form of additional State aid is terminated. As the Treaty is neutral as to the ownership of property, State aid rules apply irrespective of whether a bank is in private or public ownership.

- (15) While the restructuring period should be as short as possible so as to restore viability quickly, the Commission will take into account the current crisis conditions and may therefore allow some structural measures to be completed within a longer time horizon than is usually the case, notably to avoid depressing markets through fire sales²⁰. However, restructuring should be implemented as soon as possible and last not more than five years²¹ to be effective and allow for a credible return to viability of the restructured bank.
- (16) Should further aid not initially foreseen in the notified restructuring plan during the restructuring period be necessary for the restoration of viability, this will be subject to individual *ex ante* notification and any such further aid will be taken into account in the Commission's final decision.

Viability through sale of a bank

- (17) The sale of an ailing bank to another financial institution can contribute to restoring long-term viability, if the purchaser is viable and capable of absorbing the transfer of the ailing bank and may help restoring market confidence. It may also contribute to the consolidation of the financial sector. To this end, the purchaser should demonstrate that the integrated entity will be viable. In the case of a sale, the requirements of viability, own contribution and limitations of distortions of competition also need to be respected.
- (18) A transparent, objective, unconditional and non-discriminatory competitive sale process should generally be ensured to offer equal opportunities to all potential bidders²².
- (19) Furthermore, without prejudice to the merger control system that may be applicable, and while recognising that the sale of an aided ailing bank to a competitor can both contribute to restoring long-term viability and result in increased consolidation of the financial sector, where this would result *prima facie* in a significant impediment of effective competition, it should not be allowed unless the distortions of competition are addressed by appropriate remedies accompanying the aid.
- (20) The sale of a bank may also involve State aid to the buyer and/ or to the sold activity.²³ If the sale is organised via an open and unconditional competitive tender and the assets go to the highest bidder, the sale price is considered to be the market price and aid to the buyer can be excluded²⁴. A negative sale price (or

²⁰ Understood as selling large quantities of assets at current low market prices which could lower the prices further.

²¹ The Commission practice has been to accept two to three years as the duration of a restructuring plan.

²² See also point 20.

²³ See for example Commission Decision of 4 June 2008 in Case C 9/2008 *SachsenLB*, not yet published.

²⁴ The absence of the tender as such does not automatically mean that there is State aid to the buyer.

financial support to compensate for such a negative price) may exceptionally be accepted as not involving State aid if the seller would have to bear higher costs in case of liquidation²⁵. For the calculation of the liquidation cost in such circumstances, the Commission will take account of only those liabilities which would have been entered into by a market economy investor.²⁶ This excludes liabilities stemming from State aid.²⁷

- (21) An orderly winding-up or the auctioning off of a failed bank should always be considered where a bank cannot credibly return to long term viability. Governments should encourage the exit of non-viable players, while allowing for the exit process to take place within an appropriate time frame that preserves financial stability. The Banking Communication provides for a procedure in the framework of which such orderly winding up should take place²⁸. Acquisition of the "good" assets and liabilities of a bank in difficulty may also be an option for a healthy bank as it could be a cost effective way to expand deposits and build relationships with reliable borrowers. Moreover, the creation of an autonomous "good bank" from a combination of the "good" assets and liabilities of an existing bank may also be an acceptable path to viability, provided this new entity is not in a position to unfairly distort competition.

3. OWN CONTRIBUTION BY THE BENEFICIARY (BURDEN SHARING)

- (22) In order to limit distortions of competition and address moral hazard, aid should be limited to the minimum necessary and an appropriate own contribution to restructuring costs should be provided by the aid beneficiary. The company and its capital holders should contribute to the restructuring as much as possible with their own resources. This is necessary to ensure that rescued banks bear adequate responsibility for the consequences of their past behaviour and to create appropriate incentives for their future behaviour.

Limitation of restructuring costs

- (23) Restructuring aid should be limited to covering costs which are necessary for restoring viability. This means that a firm should not be endowed with public resources which could be used to finance market-distorting activities not linked to the restructuring process. For example, acquisitions of shares in other firms or new investments cannot be financed through State aid unless this is essential for restoring a firm's viability.²⁹

Limitation of the amount of aid, significant own contribution

²⁵ This would normally result in an aid to the sold economic activity.

²⁶ Joined Cases C-278/92, C-279/92 and C-280/92 *Hytasa* [1994] ECR I-4103, paragraph 22.

²⁷ See Case C-334/99 *Gröditzter Stahlwerke* [2003] ECR I-1139, paragraph 134 et seq. and Commission Decision of 30 April 2008 in case C 56/2008, *Bank Burgenland*, not yet published.

²⁸ See points 43 to 50 of the Banking Communication. In order to enable such orderly exit, liquidation aid may be considered compatible, when for instance needed for a temporary recapitalisation of a bridge bank or structure or satisfying claims of certain creditor classes if justified by reasons of financial stability. For examples of such type of aid and conditions under which it was found compatible, see Commission decision of 1.10.2008 in in case NN 41/2008 UK, *Rescue aid to Bradford&Bingley*, and the Commission decision of 5.11.2008 in case NN39/2008 DK, *Aid for liquidation of Roskilde Bank*.

²⁹ See Case T-17/03 *Schmitz –Gotha* [2006] ECR II- 1139.

- (24) In order to limit the aid amount to the minimum necessary, the companies should first use their own resources to finance restructuring. This may involve, for instance, the sale of assets. State support should be granted on terms which represent an adequate burden-sharing of the costs³⁰. This implies that the costs associated with the restructuring are not only borne by the State but also by those who invested in the bank, by absorbing losses with available capital and by paying an adequate remuneration for State interventions³¹. Nonetheless, the Commission considers that *ex ante* fixed thresholds concerning burden-sharing are not appropriate in the context of the present systemic crisis, having regard to the objective to facilitate access to private capital and the return to normal market conditions.
- (25) Any derogation from an adequate burden-sharing *ex ante* which may have been exceptionally granted in the rescue phase for reasons of financial stability has to be compensated by a further contribution at a later stage of the restructuring, for example in the form of claw-back clauses and/or by farther-reaching restructuring including additional measures to limit distortions of competition.³²
- (26) The banks should be able to remunerate capital, also in the form of dividends and coupons on outstanding subordinated debt, out of profits generated by their activities. However, banks should not use State aid to remunerate own funds (equity and subordinated debt) when those activities do not generate sufficient profits. Therefore, in a restructuring context, the discretionary offset of losses (for example by releasing reserves or reducing equity) by beneficiary banks in order to guarantee the payment of dividends and coupons on outstanding subordinated debt, is in principle not compatible with the objective of burden sharing³³. This may need to be balanced with ensuring the refinancing capability of the bank and the exit incentives³⁴. In the interests of promoting refinancing by the beneficiary bank, the Commission may favourably regard the payment of coupons on newly issued hybrid capital instruments with greater seniority over existing subordinated debt. In any case, banks' should not normally be allowed to purchase their own shares during the restructuring phase.
- (27) Provision of additional aid during the restructuring period should remain a possibility if justified by reasons of financial stability. Any additional aid should remain limited to the minimum necessary to ensure viability.

³⁰ As already developed in previous Commission Communications, in particular the Impaired Assets Communication, see points 21 et seq.

³¹ The Commission has provided detailed guidance regarding the pricing of State guarantees, recapitalisations and asset relief measures respectively in the Banking Communication, the Recapitalisation Communication and the Impaired Assets Communication. To the extent that such a price is being paid, the shareholders of the bank see their position diluted in a financial sense.

³² Impaired Asset Communication, points 24 and 25. See also Section 4 of this Communication.

³³ See Commission Decision of 18 December 2008 in case N 615/2008 *Bayern LB*, not yet published. However, this does not prevent the bank from making coupon payments when it is under a binding legal obligation to do so.

³⁴ See Impaired Asset Communication, point 31, and the nuanced approach to dividend restrictions in the Recapitalisation Communication, points 33, 34 and 45, reflecting that although temporary dividend or coupon bans may retain capital within the bank and increase the capital cushion and hence improve the solvency of the bank, they may equally impede the bank's access to private finance sources, or at least increase the cost of new future financing.

4. LIMITING DISTORTIONS OF COMPETITION AND ENSURING A COMPETITIVE BANKING SECTOR

Types of distortion

- (28) Whereas State aid can support financial stability in times of systemic crisis, with wider positive spillovers, it can nevertheless create distortions of competition in various ways. Where banks compete on the merits of their products and services, those which accumulate excessive risk and/or rely on unsustainable business models will ultimately lose market share and, possibly, exit the market while more efficient competitors expand on or enter the markets concerned. State aid prolongs past distortions of competition created by excessive risk-taking and unsustainable business models by artificially supporting the market power of beneficiaries. In this way it may create a moral hazard for the beneficiaries, while weakening the incentives for non-beneficiaries to compete, invest and innovate. Finally, State aid may undermine the single market by shifting an unfair share of the burden of structural adjustment and the attendant social and economic problems to other Member States, whilst at the same time creating entry barriers and undermining incentives for cross-border activities.
- (29) Financial stability remains the overriding objective of aid to the financial sector in a systemic crisis, but safeguarding systemic stability in the short-term should not result in longer-term damage to the level playing field and competitive markets. In this context, measures to limit competition distortions due to State aid play an important role, *inter alia* for the following reasons. First, banks across the Community have been hit by the crisis to a very varying degree and State aid to rescue and restructure distressed banks may harm the position of banks that have remained fundamentally sound, with possible negative effects for financial stability. In a situation of financial, economic and budgetary crisis, differences between Member States in terms of resources available for State intervention become even more pronounced, and harm the level-playing field in the single market. Second, national interventions in the current economic crisis will, by their very nature, tend to promote focus on the national markets and hence seriously risk leading to retrenchment behind national borders and to a fragmentation of the single market. Market presence of aid beneficiaries needs to be assessed with a view to ensuring effective competition and preventing market power, entry barriers and disincentives for cross-border activities against the interest of European businesses and consumers. Third, the current scale of the public intervention necessary for financial stability and the possible limits to normal burden sharing are bound to create even greater moral hazard that needs to be properly corrected to prevent perverse incentives and excessively risky behaviour to reoccur in the future and to pave the way for a rapid return to normal market conditions without state support.

Applying effective and proportionate measures limiting distortions of competition

- (30) Measures to limit the distortion of competition should be tailor-made to address the distortions identified on the markets where the beneficiary bank operates following its return to viability post restructuring, while at the same time adhering to a common policy and principles. The Commission takes as a starting point for its assessment of the need for such measures, the size, scale and scope of the activities that the bank in question would have upon implementation of a credible restructuring plan as foreseen in section 2. Depending on the nature of the

distortion of competition, it may be addressed through measures in respect of liabilities and/or in respect of assets³⁵. The nature and form of such measures will depend on two criteria: first, on the amount of the aid and the conditions and circumstances under which it was granted and, second, on the characteristics of the market or markets on which the beneficiary bank will operate.

- (31) As to the first criterion, measures limiting distortions will vary significantly according to the amount of the aid as well as the degree of burden sharing and level of pricing. In this context, the amount of State aid will be assessed both in absolute terms (amount of capital received, aid element in guarantees and asset relief measures) and in relation to the bank's risk-weighted assets. The Commission will consider the total amount of aid granted to the beneficiary including any kind of rescue aid. In the same vein, the Commission will take into account the extent of the beneficiary's own contribution and burden sharing over the restructuring period. Generally speaking, where the extent of burden sharing and own contribution is higher, the negative consequences resulting from moral hazard are fewer. Therefore the need for further measures is reduced³⁶.
- (32) As to the second criterion, the Commission will analyse the likely effects of the aid on the markets where the beneficiary bank operates post restructuring. First of all, the size and the relative importance of the bank on its market or markets, once it is made viable, will be examined. If the restructured bank has limited remaining market presence, additional constraints, in the form of divestments or behavioural commitments, are less likely to be needed. The design of the measures will be tailored to market characteristics³⁷ to make sure that effective competition is preserved. In some areas, divestments may generate adverse consequences and may not be necessary in order to achieve the desired outcomes, in which case the limitation of organic growth may be preferred to divestments. In some other areas, especially those involving national markets with high entry barriers, divestments may be needed to enable entry or expansion of competitors. Measures limiting distortions of competition should not compromise the prospects of the bank's return to viability.
- (33) Finally, the Commission will pay attention to the possible risk that restructuring measures undermine the Single Market and will view positively measures that contribute to national markets remaining open and contestable. While aid is granted to maintain financial stability and lending to the real economy in the granting Member State, where such aid is also conditional upon the beneficiary bank respecting certain lending targets in Member States other than the aid-granting State, this may be regarded as an important additional positive effect of the aid. This will particularly be the case where the lending targets are substantial relative to a credible counterfactual, where achievement of such targets is subject to adequate monitoring (for example, through cooperation between the home and host State supervisors), where the host State is one whose banking system is dominated by banks with headquarters abroad and where such lending

³⁵ See point 21.

³⁶ If the Commission has, pursuant to Banking Communication, the Recapitalisation Communication or the Impaired Assets Communication, exceptionally accepted aid that departed from the principles required by those communications, the resulting additional distortion of competition will require additional structural or behavioural safeguards; see point 58 of the Impaired Assets Communication.

³⁷ In particular, concentration levels, capacity constraints, the level of profitability, barriers to entry and to expansion will be taken into account.

commitments have been coordinated at Community level (for example, in the framework of liquidity assistance negotiations).

Setting the appropriate price for State aid

- (34) Adequate remuneration of any State intervention generally is one of the most appropriate limitations of distortions of competition, as it limits the amount of aid. When the entry price has been set at a level significantly below the market price for reasons of financial stability, it should be ensured that terms of the financial support are revised in the restructuring plan³⁸ so as to reduce the distortive effect of the subsidy.

Structural measures – divestiture and reduction of business activities

- (35) On the basis of an assessment in accordance with the criteria of this Section, banks benefiting from State aid may be required to divest subsidiaries or branches, portfolios of customers or business units, or to undertake other such measures³⁹, including on the domestic retail market of the aid beneficiary. In order for such measures to increase competition and contribute to internal market, they should favour entry of competitors and cross-border activity⁴⁰. In line with the requirement of restoration of viability, the Commission will take a positive view of such structural measures if they are undertaken without discrimination between businesses in different Member States, thus contributing to the preservation of an internal market in financial services.
- (36) A limit on the bank's expansion in some business or geographical areas may also be required, for instance via market-oriented remedies such as specific capital requirements, when competition in the market would be weakened by direct restrictions on expansion or to limit moral hazard. At the same time, the Commission will pay particular attention to the need to avoid retrenchment within national borders and a fragmentation of the single market.
- (37) Where finding a buyer for subsidiaries or other activities or assets appears objectively difficult, the Commission will extend the time period for the implementation of those measures, if a binding timetable for scaling down businesses (including segregation of business lines) is provided. However, such time period should last not more than five years.
- (38) In assessing the required scope of structural remedies to distortions of competition in a given case, and with due regard to the principle of equal treatment, the Commission will take into account the measures provided for in cases relating to the same markets or market segments at the same time.

Avoiding the use of State aid to fund anti-competitive behaviour

³⁸ For example by favouring early redemption of State aid.

³⁹ See for example Commission Decision of 21 October 2008 in Case C10/2008 *IKB*, not yet published and Commission decision of 7 May 2009 in case N244/2009 *Capital injection into Commerzbank*, OJ C 147/2009.

⁴⁰ It should be noted that balance-sheet reductions due to asset write-offs, which are partly compensated with State aid, do not reduce the bank's actual market presence and cannot therefore be taken into account when assessing the need for structural measures.

- (39) State aid must not be used to the detriment of competitors which do not enjoy similar public support⁴¹.
- (40) Subject to paragraph 41, banks should not use State aid for the acquisition of competing businesses⁴². This condition should apply at least for three years and may continue until the end of the restructuring period depending on the scope and size and duration of the aid.
- (41) In exceptional circumstances and upon notification, acquisitions may be authorised by the Commission where they are part of a consolidation process necessary to restore financial stability or to ensure effective competition. The acquisition process should respect the principles of equal opportunity for all potential acquirers and the outcome should ensure conditions of effective competition in the relevant markets.
- (42) Where the imposition of divestitures and/or the prohibition of acquisitions are not appropriate, the Commission may accept the imposition by the Member State of a claw-back mechanism, for example in the form of a levy on the aid recipients. This would allow recovery of part of the aid from the bank after it has returned to viability.
- (43) Where banks receiving State support are requested to fulfil certain requirements as to lending to the real economy, the credit provided by the bank must be on commercial terms⁴³.
- (44) State aid cannot be used to offer terms (for example as regards rates or collateral) which cannot be matched by competitors which are not in receipt of State aid. However, in cases where limitations on pricing behaviour of the beneficiary may not be appropriate, for example because they may result in a reduction of effective competition, Member States should propose other, more suitable, remedies to ensure effective competition, such as measures that favour entry. In the same vein, banks may not invoke State support as a competitive advantage when marketing their financial offers⁴⁴. These restrictions should remain in place depending on the scope, size and duration of the aid for a period ranging between three years and the entire duration of the restructuring period. They would then also serve as a clear incentive to repay the State as soon as possible.
- (45) The Commission will also examine the degree of market opening and the capacity of the sector to deal with bank failures. In its overall assessment the Commission may consider possible commitments by the beneficiary or commitments from the

⁴¹ See for example Commission decision of 19 November 2008 in case NN 49/2008, NN 50/2008 and NN 45/2008 *Guarantees to Dexia* (not yet published), point 73, Commission decision of 19 November 2008 in case N 574/2008 *Guarantees to Fortis Bank* (OJ C 38, 17.2.2009, p.2), point 58 and Commission decision of 3 December 2008 in case NN 42/2008, NN 46/2008 and NN53/A/2008 *Restructuring aid to Fortis Bank and Fortis Bank Luxemburg* (not yet published), paragraph 94. For instance a bank may, in certain circumstances, be prohibited from proposing the highest interest rates offered on the market to retail depositors.

⁴² It is recalled that restructuring costs have to be limited to the minimum necessary for the restoration of viability. See point 22.

⁴³ Credit provided on non-commercial terms might constitute State aid and might be authorised by the Commission, upon notification, if it is compatible with the common market, for example under the Communication from the Commission - Temporary framework for State aid measures to support access to finance in the current financial and economic crisis, OJ C 83, 7.4.2009, p.1.

⁴⁴ Commission Decision of 12 November 2008 in Case N 528/2008 *ING* at point 35.

Member State concerning the adoption of measures⁴⁵ that would promote more sound and competitive markets, for instance by favouring entry and exit. Such initiatives could, in appropriate circumstances, accompany the other structural or behavioural measures that would normally be required of the beneficiary in question. The Member State's commitment to introduce mechanisms to deal with bank difficulties at an early stage may be regarded positively by the Commission as an element promoting sound and competitive markets.

5. MONITORING AND PROCEDURAL ISSUES

- (46) In order to verify that the restructuring plan is being implemented properly, the Commission will request detailed regular reports. The first report will normally have to be submitted to the Commission not later than six months after approval of the restructuring plan.
- (47) Upon notification of the restructuring plan the Commission has to assess whether the plan is likely to restore long term viability and to limit distortions of competition adequately. Where it has serious doubts as to the compliance of the restructuring plan with the relevant requirements, the Commission is required to open a formal investigation procedure, giving third parties the possibility to comment on the measure and thereby ensuring a transparent and coherent approach while respecting the confidentiality rules applicable in State aid proceedings⁴⁶.
- (48) Nevertheless the Commission does not have to open formal proceedings where the restructuring plan is complete and the measures suggested are such, that the Commission has no further doubts as to compatibility in the sense of Article 4 (4) of the Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 (now Art.88) of the EC Treaty⁴⁷. This might, in particular, be the case where a Member State has notified the Commission of an aid accompanied by a restructuring plan which meets all of the above conditions, in order to obtain legal certainty as to the necessary follow-up. In such cases the Commission might adopt a definite decision stating that rescue aid as well as restructuring aid is compatible under Article 87(3)(b) of the Treaty.

6. TEMPORARY SCOPE OF THE COMMUNICATION

- (49) This Communication is justified by the current exceptional financial sector crisis and will be applied until 31 December 2010. Bearing in mind that this Communication is based on Article 87(3)(b) of the Treaty, the Commission may review its content and duration according to the development of market conditions, the experience gathered in the treatment of cases and the overriding interest in maintenance of financial stability. The Commission will apply this guidance when assessing cases of restructuring aid notified to the Commission before the end of 2010. As regards non-notified aid, the Commission notice on

⁴⁵ See for example Commission Decision 2005/418/EC of 7 July 2004 on the aid measures implemented by France for Alstom, OJ L 150 , 10.6.2005, p. 24, point 204.

⁴⁶ Commission communication C(2003) 4582 of 1 December 2003 on professional secrecy in State aid decisions; OJ C 297, 09.12.2003, p. 6.

⁴⁷ OJ L 83/1, 27.03.1999, p. 1-9.

the determination of the applicable rules for the assessment of unlawful State aid⁴⁸ will apply.

⁴⁸ OJ C 119, 22.5.2002, p. 22.

Annex - Model restructuring plan

INDICATIVE TABLE OF CONTENTS FOR RESTRUCTURING PLAN⁴⁹

- 1 Information on the financial institution (description of the company structure etc.)
(NB: Information previously submitted may be reproduced but shall be integrated into this document and where necessary updated)
- 2 Market description and market shares
 - 2.1 Description of the main relevant product markets (distinction at least between: retail, wholesale, capital markets etc)
 - 2.2 Calculations of market shares (e.g. national and European wide, depending on the geographical scope of the relevant markets)
- 3 Analysis of the reasons why the institution run into difficulty (internal factors)
- 4 Description of the state intervention and assessment of State aid
 - 4.1 Information on whether the financial institution or its subsidiaries have already received a rescue or restructuring aid in the past.
 - 4.2 Information on form and amount of the State support or financial advantage related to support. Information should contain all State aid received as individual aid or under a scheme during the restructuring period (NB: all aid needs to be justified within the restructuring plan as indicated in the following).
 - 4.3 Assessment of State support under the State aid rules and quantification of aid amount.
- 5 Restoration of viability
 - 5.1 Presentation of the different market assumptions
 - 5.1.1 Initial situation in the main product markets
 - 5.1.2 Expected market development in the main product markets
 - 5.2 Presentation of the scenario without the measure
 - 5.2.1 Required adjustment to the initial business plan
 - 5.2.2 Past, current and future capital ratios (tier 1, tier 2)
 - 5.3 Presentation of the proposed future strategy for the financial institution and how this will lead to viability
 - 5.3.1 Starting position and overall framework
 - 5.3.2 Individual frameworks per business line of the financial institution

⁴⁹ Information required for the viability assessment may comprise bank's internal data and reports as well as reports prepared by/for the Member State's authorities, including the regulatory authorities.

- 5.3.3 Adoptions to changes in regulatory environment (enhancement of risk management, increased capital buffers, etc.)
- 5.3.4 Confirmation regarding full disclosure of impaired assets
- 5.3.5 If adequate, change in ownership structure
- 5.4 Description and overview of the different measures planned to restore viability, their costs and their impact on the P&L/balance sheet
 - 5.4.1 Measures at group level
 - 5.4.2 Measures per business lines
 - 5.4.3 Impact of each measure on the P&L/balance sheet
- 5.5 Description of effect of the different measures to limit distortions of competition (cf. point 7) in view of their costs and their impact on the P&L/balance sheet
 - 5.5.1 Measures at group level
 - 5.5.2 Measures in the fields of business
 - 5.5.3 Impact of each measure on the P&L/balance sheet
- 5.6 Comparison with alternative options and brief comparative evaluation of the economic and social effects on the regional, national and Community level (elaboration is mainly required where bank may not meet prudential requirements in the absence of aid)
 - 5.6.1 Alternative options: orderly winding up, break up, or absorption by another bank and resulting effects
 - 5.6.2 General Economic Effects
- 5.7 Timetable for the implementation of the different measures and the final deadline for implementation the restructuring plan in its entirety (please indicate issues of confidentiality)
- 5.8 Description of the repayment plan of the state aid
 - 5.8.1 Underlying assumptions to the exit planning
 - 5.8.2 Description of the State's exit incentives
 - 5.8.3 Exit or repayment planning until full repayment/exit
- 5.9 Profit and loss accounts/balance sheets for the last three and next five years including key financial ratios and sensitivity study based on best/worst case
 - 5.9.1 Base case
 - 5.9.1.1 Profit and Loss Statement/balance sheet group level
 - 5.9.1.2 Key Financial ratios on group level (RAROC as a benchmark for internal criteria for risk adjusted profitability, CIR, ROE, etc.)

- 5.9.1.3 Profit and Loss Statement/balance sheet per business unit
- 5.9.1.4 Key Financial ratios per business unit (RAROC as a benchmark for internal criteria for risk adjusted profitability, CIR, ROE, etc.)
- 5.9.2 Best case scenario
 - 5.9.2.1 Underlying assumptions
 - 5.9.2.2 Profit and Loss Statement/balance sheet group level
 - 5.9.2.3 Key Financial ratios on group level (RAROC as a benchmark for internal criteria for risk adjusted profitability, CIR, ROE, etc.)
- 5.9.3 Worst case scenario – Where a stress test has been performed and/or validated by the national supervisory authorities, the methodologies, the parameters, and the results of such a test will have to be provided⁵⁰.
 - 5.9.3.1 Underlying assumptions
 - 5.9.3.2 Profit and Loss Statement/balance sheet group level
 - 5.9.3.3 Key Financial ratios on group level (RAROC as a benchmark for internal criteria for risk adjusted profitability, CIR, ROE, etc.)
- 6 Burden sharing – contribution to restructuring by the financial institution itself and other shareholders (accounting and economic value of holdings)
 - 6.1. Limitation of restructuring costs to those necessary for restoring viability
 - 6.2. Limitation of the amount of aid (including information on eventual provisions for limiting dividends and interest payments on subordinated debt)
 - 6.3. Provision of significant own contribution (including information on the size of contribution from shareholders or subordinated creditors)
- 7 Measures to limit distortion of competition
 - 7.1. Justification of scope of measures in view of the size and effect of the State aid
 - 7.2. Structural measures, including proposal on timing and milestones for divestments of assets or subsidiaries/ branches or other remedies
 - 7.3. Behavioral commitments, including to refrain from mass marketing invoking State aid as an advantage in competitive terms
- 8 Monitoring (possible arrangement of a trustee)

⁵⁰ The stress testing should to the extent possible be based on common parameters agreed at Community level (such as a methodology developed by the Committee of European Banking Supervisors) and where appropriate adapted to cater for country- and bank-specific circumstances. Where appropriate, reverse stress tests or other equivalent exercises could also be considered.