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STATE AID IN BANKING SECTOR

J. Mikušová

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Abstract

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The financial crisis has hit Europe with a truly unprecedented power, which has in early 2008 expected only a very small circle of pessimists. After the first cracks began to appear on the mortgage market in the U.S., however, started an avalanche that rolls until today. In today's globalized world, it would be very naive to believe that this would not have an impact on the European Union internal market.

With the crisis in the banking sector, the Member States of the European Union fought against the crisis in various ways. Allocation of the state aid in the first months of the crisis took place within the existing rules, yet it was necessary to enclose these huge expenditures by rules and regulations issued by the European Commission.

This article discusses the types of state aid, which were used at the time from the first wave of state aid granted by Member States from 2008 to 2010 and also assess the current situation together with the evaluation of the approach of the European Commission.

state aid, banking sector, crisis, European union

The financial crisis started at 2008, but the roots of this problem was settled many years ago. After three years, the problem is still hindering the economic growth in Europe, USA and has had a big impact on Asian economics. Nevertheless European Commission focused its power to backup internal market; the financial crisis grew up into an enormous problem and had the European Union face the crisis of its currency, the EURO.

Banking sector as a specific branch of financial system has been hit by lack of liquidity, undercapitalization, debt write-offs and much more. This created a pressure on member states that was followed by granting pumping state aid into this sector. During the crisis the European Commission had to deal with 15 recapitalization schemes, 20 bank guarantees and 44 cases of individual bank aid cases[1]. The state aid committed reached nearly 13% of the GDP of the European Union. The scale of the crisis, in both territorial terms and economic figures, is unprecedented in the Community's history and has thus significantly changed the environment and parameters for State aid control by the Commission. It was only in mid-2008 that the true scale of the economic effects of the banking crisis started to unfold, and then the reform drive of the Commission was noticeably held up, albeit not brought fully to a stop.

The purpose of this paper is to explore the rules on state aids and their exceptions as included in the Treaty, and assess their application particularly in the banking sector. I will attempt to do so, by looking at the relevant case law and the way those cases have been resolved. Furthermore, I shall refer to the new legislation adopted by the Commission aimed to help to solve the bank crisis.

1 LANNOO, K., NAPOLI, CH., 2010: *Bank State Aid In The Financial Crisis, Fragmentation Or Level Playing Field?* p. 6.

METHODS AND RESOURCES

The in-dept analysis was based on certain cases, such as Dexia[2], ING, KBC, Lloyds.

RESULTS

This paper is aimed to analyse the state aids in banking industry. The main provisions concerning state aids in the primary law of European Union can be found in article 107 (1) (ex. Article 87) Treaty on the Functioning of the European Union (further on TFEU). This article provides that "Save as otherwise provided in the Treaties, 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, in so far as it affects trade between Member States, be incompatible with the internal market." In this article are laid down the basic foundation of the state aid, nevertheless it is not directly applicable[3]. The question concerning state aids is what the meaning of the term "state aid" is. Some guidance can be found in other provisions of the article 107, but the thorough approach and deep investigation of the term was done by ECJ.

State aid rules apply only to measures that satisfy all of the criteria listed in Article 107(1) of TFEU, and in particular[4]:

(a) Transfer of State resources

State aid rules cover only measures involving a transfer of state resources (including national, regional or local authorities, public banks and foundations, etc.).

It may also be granted by a private or public intermediate body appointed by the State. The aid can be granted by many means of financial transfer included, tax exemptions, loan guarantees, capital injections, etc.

(b) Economic advantage

The aid should constitute an economic advantage that the undertaking would not have received in the normal course of business. The economic advantage is weighted by a private market investor principle[5].

(c) Selectivity

State aid must be selective and thus affect the balance between certain firms and their competitors. Measures which apply without distinction across the board to all companies in all economic sectors in a Member State are not seen as selective.

(d) Effect on competition and trade

Aid must have a potential effect on competition and trade between Member States.

Not all State Aids are regarded to be incompatible with the common market. According to Article 107(2), the following does not constitute state aid in the meaning of article 107 (1):

a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
b) aid to make good the damage caused by natural disasters or exceptional occurrences;
c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

According Article 107 (3) the following shall not constitute state aid ic some circumstances:

a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;
e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

Accordingly Article 108(3) asserts that the Member States are required to notify the Commission and report any aid prior to granting it. As in every other rule, there are certain exceptions to this rule too. For example, when an existing aid arrangement already approved by the Commission for a certain amount, increases without exceeding 20% of the agreed subsidy, notification is not necessary. Another exception is the so called "de minimis"

2 The newest news concerning case Dexia appeared few days ago, see Dexia's Belgian rescue arrangements temporarily approved. http://www.europolitics.info/business-competitiveness/dexia-s-belgian-rescue-arrangements-temporarily-approved-art315969-3.html.
3 TSAKATOURA, A., 2002: *EU Banking: State Aids in the EU Banking Industry*, page 2.
4 EUROPEAN COMMISSION, 2008: *Vademecum, Community Law on State Aid*, page 6.
5 RYDELSKI, M., S., 2006: *The EC state aid regime: distortive effects of state aid on competition and trade.* Cameron May, ISBN 1905017340, page. 240.

doctrine. The de minimis rule, first introduced in a Notice published in 1996, was established by Regulation (EC) No 69/2001. The ceiling for the de minimis amounted up to 100 000[6] Euros to be granted over a three year period, this limit was risen in 2007 to 200 000 Euros[7] and in 2008 as a response to the on-going crisis was this limit risen again to up 500 000 Euros based on the temporary community framework[8]. De minimis aid shall not necessarily be notified to the Commission pursuant to Article 108(3).

The state aid in banking sector

Two categories cited above that is „aid … to remedy a serious disturbance in the economy of a Member State"; and "aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest" has been used by the Commission to consider whether the aid is incompatible with common market or not. The approach of Commission has changed during the crisis as the first provision was only rarely used because of the strictness interpretation of „serious disturbance".

The most important role plays the Commission, because i tis only the Commission that can rule whether the aid is compatible or not. In the past two, three years, the Commission had to handle a huge amount of cases.

In the vast majority of cases, the Commission so as to keep market stability approved notifications of member states on new grant schemes, albeit on a provisional basis, categorising the measures in question as a „rescue" aid and requiring the member state to revert to the Commission – usually within six months – with a plan for the restructuring of the bank, aimed at ensuring its long-term viability without further aid.

On the basis of the restructuring plan, after discussions with the member state in question and after investigating the vitality of bank the Commission could issue a final decision approving the aid in question.

The measuers adopted by member states were usually:

- Equity capital support (Hypo real estate – Germany)
- Debt support
  - participation in debt issues (ING)
  - underwriting of subordinated debt
  - guarantee of bank deposits (BAWAG, France – debt guarantee of €360 billion)
  - overall guarantee of bank liabilities
  - guarantees for interbank lending and bank bonds
- Short-term liquidity support (Roskilde Bank, Fionia Bank – Denmark).

Support for impaired assets in asset support programmes and „bad ban" schemes (KBC, Dexia, adopted by Denmark, Landesbank Baden Württemberg - Germany).

Despite the case difficulty ant lack of time the Commission has handled the cases well, though some cases are still waiting for thorough investigation. The Commission acted autonomously in accordance with its „classical"[9] role in the state aid field under Articles 107-109 TFEU; the Commission also developed its approach pragmatically through non-binding Communications[10], setting out its intended approach under the fundamental Treaty provisions; and made maximum use of the flexibility inherent in the Treaty, especially the "derogations" allowed under Article 107(3) (a)–(c).

At the time, when Lisbon Treaty was ratified and implemented, the Commission acted as a very rational player on the internal market, nevertheless, it could be seen, that some of the provisions of the states and restructuring plans lead only to acquisition of the bank by the state, so they were not successful.

The question is how necessary were all of the provisions and measures adopted by the member states and whether it was economical. Reynders[11] in his paper tried to answer the question, whether the state aid leads to less competition and whether the state aid granted by state hinder the competition. He found that there was no impact on the competition, or the impact was rather positive. My opinion is different, because he weighed only the impact on the competition between competing companies, but the thing is that provision of the Article 107 TFEU is not talking about competition between companies, but rather overall disturbances on the market, that mean that it would be necessary to weight also negative impact on consumers on the market.

6 Commission Regulation (EC) No. 69/2001 of 12 January 2001, on the application of Articles 87 and 88 of the Treaty to de minimis aid.

7 Commission Regulation (EC) No. 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid.

8 Communication from the Commission — Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis (OJ 2009/C 16/01).

9 As a guardian of the treaties.

10 Communication of the Commission — Temporary Union framework for State aid measures to support access to finance in the current financial and economic crisis Text with EEA relevance, Communication from the Commission on the treatment of impaired assets in the Community banking sector.

11 REYNDERS, P., VERBIST, T., 2010: *The effect of state aid on competition in the belgian banking sector,* p. 32.

SUMMARY

With the crisis in the banking sector, the Member States of the European Union fought against the crisis in various ways. Allocation of the state aid in the first months of the crisis took place within the existing rules, yet it was necessary to enclose these huge expenditures by rules and regulations issued by the European Commission.

This article focused on the provisions of the Treaty on the Functioning of the European Union that are applicable to state aids in banking industry, the types of state aid, which were used at the time from the first wave of state aid granted by Member States from 2008 to 2010 and also assess the current situation together with the evaluation of the approach of the European Commission.

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Address

Ing. Bc. Jana Mikušová, Ph.D., Ústav práva a humanitních věd, Mendelova univerzita v Brně, Zemědělská 1, 613 00 Brno, Česká republika, e-mail: xmikusov@mendelu.cz