Commission Guidelines on Restructuring Aid to Banks

Following the Commission Communication of October 13, 2008 on *the application of State aid rules to measures by Member States in relation to financial institutions in the context of the current global financial crisis – the "Banking Communication"* – (Mayer Brown Legal Update, October 16, 2008[1]) and Commission Communication of December 5, 2008 on *the recapitalization of financial institutions in the current financial crisis – the "Recapitalization Communication"* – (Mayer Brown Legal Update, December 12, 2008[2]), and the *Impaired Asset Paper* of February 25, 2009, on July 22, 2009 the Commission has published the expected Communication on restructuring aid, i.e. the communication concerning *the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules – the "Bank Restructuring Guidelines"*.[3]

Scope and Aim of the Bank Restructuring Guidelines

The latest Communication provides new guidelines on the Commission's approach to its assessment of restructuring aid given by Member States to banks. The Bank Restructuring Guidelines complement but do not change the Commission's earlier guidance on State aid rules, in particular, the Communication of October 13, 2008, which states the requirement that any aid granted under the general scheme to keep an insolvent institution afloat, has to be followed up by adequate steps leading to restructuring or liquidation of the respective bank as soon as the situation in the financial markets permits.

The Bank Restructuring Guidelines aim at enhancing predictability and ensuring a coherent approach by explaining how the Commission will assess the compatibility of restructuring aid granted by Member States to financial institutions in the current circumstances of systemic crisis. The Bank Restructuring Guidelines 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.

Principles

The Commission has formulated three fundamental principles underlying the Bank Restructuring Guidelines, namely

- that aided banks must be made viable in the long term without further state support,
- that aided banks and their owners must carry a fair burden of the restructuring costs, and
- that measures must be taken to limit distortions of competition in the single market.

Restoring Long-Term Viability

The Bank Restructuring Guidelines do not dictate to banks *how* to restructure, but indicate the type of information required by the Commission for the viability assessment. Pursuant to the previous Commission Communications, which remain in force, a Member State must in particular notify a restructuring plan to the Commission if it has recapitalized a distressed bank or provides State aid (other than within a guarantee scheme) exceeding 2 percent of the bank's total risk weighted assets. No restructuring

[1] *http://www.mayerbrown.com/publications/article.asp?id=5738&nid=6*
[2] *http://www.mayerbrown.com/publications/article.asp?id=5941&nid=6*
[3] *http://ec.europa.eu/competition/state_aid/legislation/restructuring_paper_en.pdf*

plan will be required for banks, which are not distressed, and receiving limited aid. Instead, a viability review will have to be submitted.

If a restructuring plan must be submitted, this plan should

- be comprehensive, detailed and based on a coherent concept;
- demonstrate how the bank will restore long-term viability without State aid as soon as possible;
- include a comparison with alternative options, including a break-up, or absorption by another bank;
- 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;
- include an analysis of viability for each business activity and center of profit with the necessary breakdown;
- demonstrate the expected results of the planned restructuring under a base case scenario, as well as under "stress" scenarios.

Any State aid received by the bank must either be redeemed over time or remunerated according to normal market conditions.

The Commission acknowledges the current crisis conditions and, therefore, allows the restructuring to be implemented in a period of up to five years (instead of the regular two to three years), so as to avoid in particular depressing the markets through fire sales.

Should further aid not initially foreseen be necessary for the restoration of viability then it will be subject to individual *ex ante* notification. Thus, the Commission will not necessarily apply the "*one time last time*" rule to restructuring aid to banks in times of crisis, in order to reflect *inter alia* the uncertainty regarding the recovery outlook.

The Bank Restructuring Guidelines acknowledge that long-term viability can also be achieved by the sale of an ailing bank to another financial institution. The sale should be effected in a transparent, objective, unconditional and non-discriminatory competitive sale process. A sale in such process to the highest bidder is considered to be a sale at market price and, therefore, no State aid to the buyer. A negative sale price or 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 liquidation.

Burden Sharing

Given the Commission's endeavor to limit distortions of competition in the single market, the Bank Restructuring Guidelines place particular emphasis on the need for burden-sharing. Thus, banks receiving State aid, as well as their capital holders, shall be required to bear adequate responsibility for their behavior in the past and contribute their own resources to any necessary restructuring measures, whether immediately or at a later stage (e.g. through claw-back clauses), by appropriate remuneration of the state for any aid obtained by the respective banks. The aid received should not be used to pay remuneration to stakeholders.

However, the bank's own contribution to the restructuring costs may, subject to a case by case assessment, be lower than the 50 percent threshold fixed in the rescue and restructuring guidelines, to allow the difficulties to access private capital in the current crisis to be taken into consideration. Moreover, banks will be able to continue to make coupon payments on subordinated debt, if legally obliged to do so. Similarly, coupon payments on newly issued hybrid capital instruments with greater seniority than existing subordinated debt may be viewed favorably by the Commission.

Limiting Distortions of Competition and Ensuring a Competitive Banking Sector

Finally, the Bank Restructuring Guidelines provide for certain measures designed to counter distortions of competition resulting from State aid to banks. In this respect, the Commission emphasizes that safeguarding financial stability in the short-term must not result in prejudice to the primary objective of restoring the long-term viability of the banking sector based on a level playing field for banks and competitive financial markets.

The nature and form of measures to limit distortion of competition will depend on

- the amount of the aid (absolute and in relation to the banks' risk-weighted assets) and the conditions and circumstances under which it was granted, and
- the characteristics of the market or markets on which the beneficiary bank will operate.

Requested measures include adequate remuneration of the State intervention, as well as structural measures, such as divestitures (spread over a timeframe of up to five years where appropriate), and behavioral measures, such as constraints on acquisitions and aggressive pricing, as well as marketing strategies funded by State aid, which could not be matched by competitors without state support. For a period of at least three years State aid may only be used for the acquisition of competing businesses in exceptional circumstances and subject to the Commission's prior approval.

The use of State aid will be monitored and kept under constant examination by the Commission. The first report will normally have to be submitted to the Commission no later than six months after approval of the restructuring plan.

Timeline

Based on Article 87.3(b) of the EC Treaty, which authorizes State aid to remedy a serious disturbance in the economy of a Member State, the Bank Restructuring Guidelines will remain in force until December 31, 2010. After this date, the regular rules on rescue and restructuring pursuant to Article 87.3(c) of the EC Treaty are intended to resume.

If you have any questions or require specific advice on any matter discussed in this publication, please contact one of the lawyers listed below:

Dr. Jens Peter Schmidt
T: +32 2 502 5517
jpschmidt@mayerbrown.com

Dr. Ulrike Binder
T: +49 69 7941 1297
ubinder@mayerbrown.com

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