

# **INTERACTION BETWEEN NEW FINANCIAL REGULATORY MEASURES AND STATE AID IN THE FINANCIAL CRISIS**

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## Pre-crisis and crisis situation

### FRAGMENTED REGULATORY LANDSCAPE



### COMMISSION'S COMPETENCE ON STATE AID CLEARANCE

- DG COMP acted as *de facto* crisis-management and resolution authority at EU level



State aid rules are no substitute for regulation

## The Commission proposal for a „banking union“

- *“The European banking union is not a new legal instrument to be drafted. It is a political vision for more EU integration, which will build on recent major steps to strengthen the regulation of the banking sector.”*  
**EU Commission statement, 6 June 2012**
- *“An integrated financial framework to ensure financial stability in particular in the euro area and minimise the cost of bank failures to European citizens. Such a framework elevates responsibility for supervision to the European level, and provides for common mechanisms to resolve banks and guarantee customer deposits.”*  
**Towards a genuine economic and monetary union<sup>2</sup>, EU Council President Herman Van Rompuy, 26 June 2012**
- *“It is not sufficient that banks operate in an environment only with somewhat harmonized rules about bank resolution. It is necessary that there is a unified legal framework that clearly and unequivocally specifies rules and procedures in case of a bank resolution. An effective euro area wide resolution scheme would be an essential element of a Banking Union ”*  
**Vítor Constâncio, Vice-President of the ECB, 7 September 2012**

## Four pillars of the „banking union“

### Integrated banking supervision system

- European Systemic Risk Board (ESRB): macro-prudential oversight of the financial system
- European Banking Authority (EBA): supervision of recapitalisation, national supervisors' coordination and dispute settlement
- European insurance and occupational pensions Authority (EIOPA): insurance supervision
- Single banking supervision mechanism in the euro area, built around the ECB

### Single-rule book for financial institutions

- Directive on capital requirements (CRD IV)
- New rules on financial services, incl the regulation of shadow banking, stricter rules on hedge funds, short selling and derivatives, regulation of Credit Rating Agencies, revision of rules on trade in financial instruments, market abuse and investment funds, regulation of banking pays and reform of audit and accounting, review of Markets in Financial Instruments (MiFID) and Market Abuse directives

### Enhanced protection of bank depositors in case of bank failure

- Improving harmonisation and simplification, pay-out procedures, financing of schemes

### Common EU-wide framework for the managed resolution and recovery of banks/financial institutions

- Provides regulators with adequate tools to prevent banks' crises or address them early on
- Mechanisms that national authorities need to put in place to resolve banks in an orderly fashion
- Creation of national resolution funds paid for by national banks

+ Expert Group's report on structural reforms of EU banks

## Interconnection with State aid policy and open issues

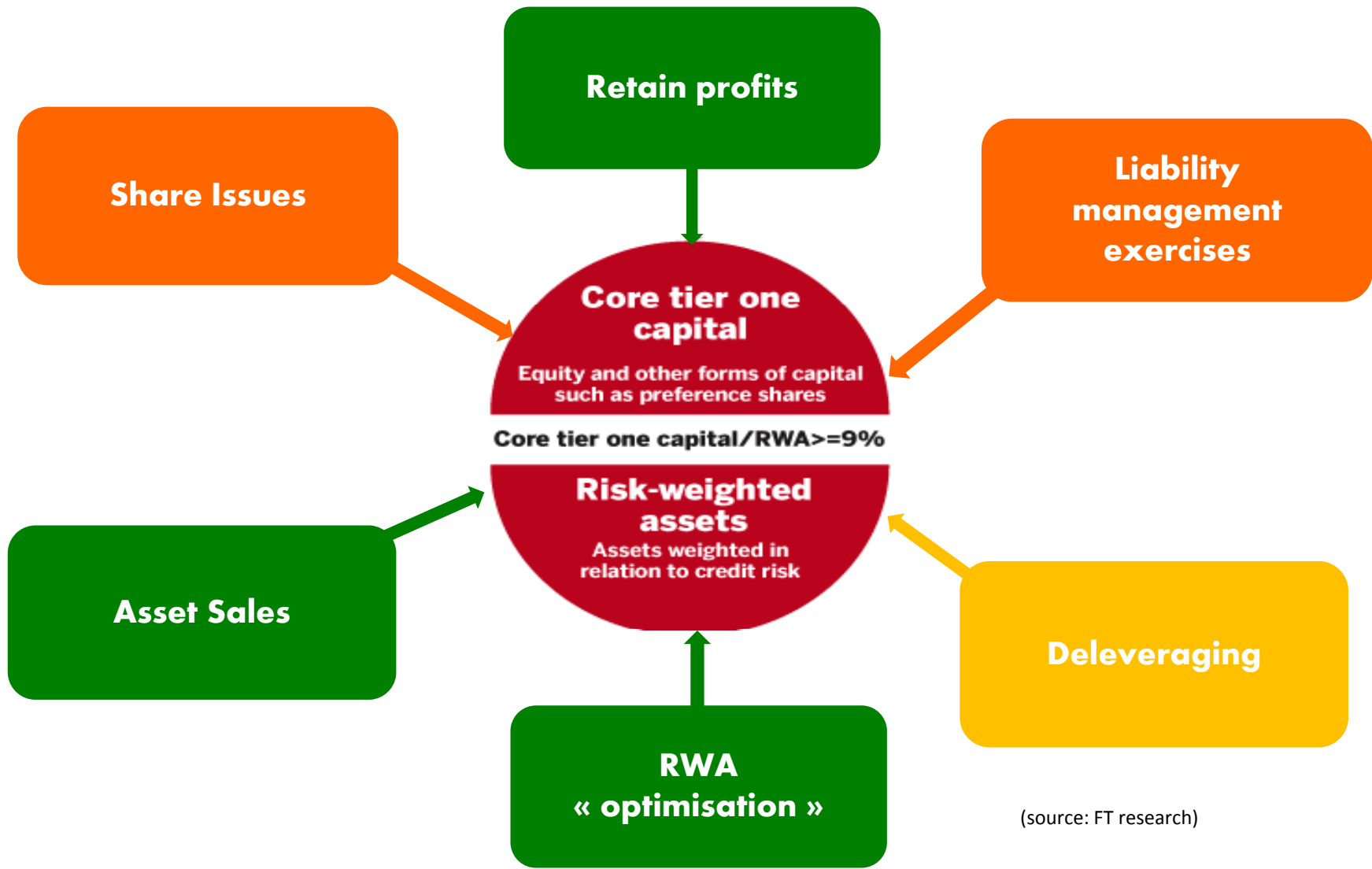
### Bank recapitalisation requirements

- Commission's viability assessment in State aid cases is based *inter alia* on whether the bank will be able to fulfill regulatory ratios, including in stress situation  
-> who will make the assessment in the future?
- Will regulatory requirements justify a more favorable assessment by the Commission?  
-> Nord LB : "a quick decision when a bank has received capital support merely to meet the new capital requirements"  
-> Prolongation Communication for banks hit by the sovereign risk

### Recovery and resolution framework

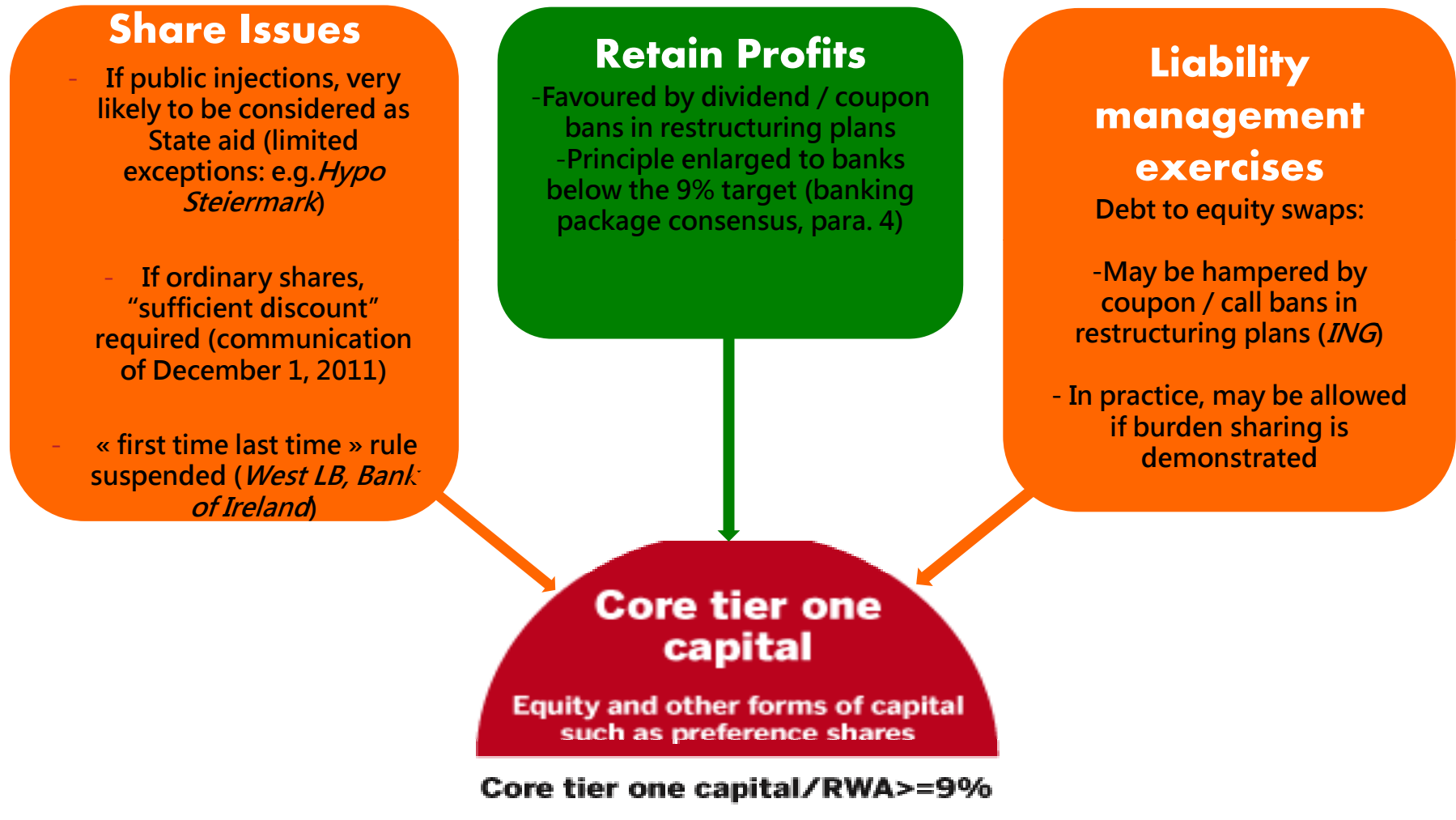
- The proposed directive makes it easier for authorities to intervene at a sufficient early stage or to orderly and safely resolve financial institutions in a harmonised legal environment
- Creation of *ex ante* resolution funds financed with private resources in order to reduce recourse to state aid
- Financial institutions will be required to draw up recovery and resolution plans under the authority's supervision  
-> Could reduce negotiations of restructuring plans under State aid rules if Commission accepts them  
-> Could re-focus Commission on impact of State aid on competition
- Invasive preventive powers that are similar to the remedies imposed by the Commission under the State aid rules
- Most resolution tools imply state financial support that must comply with State aid rules

# 9% CT 1 capital: how to get there?

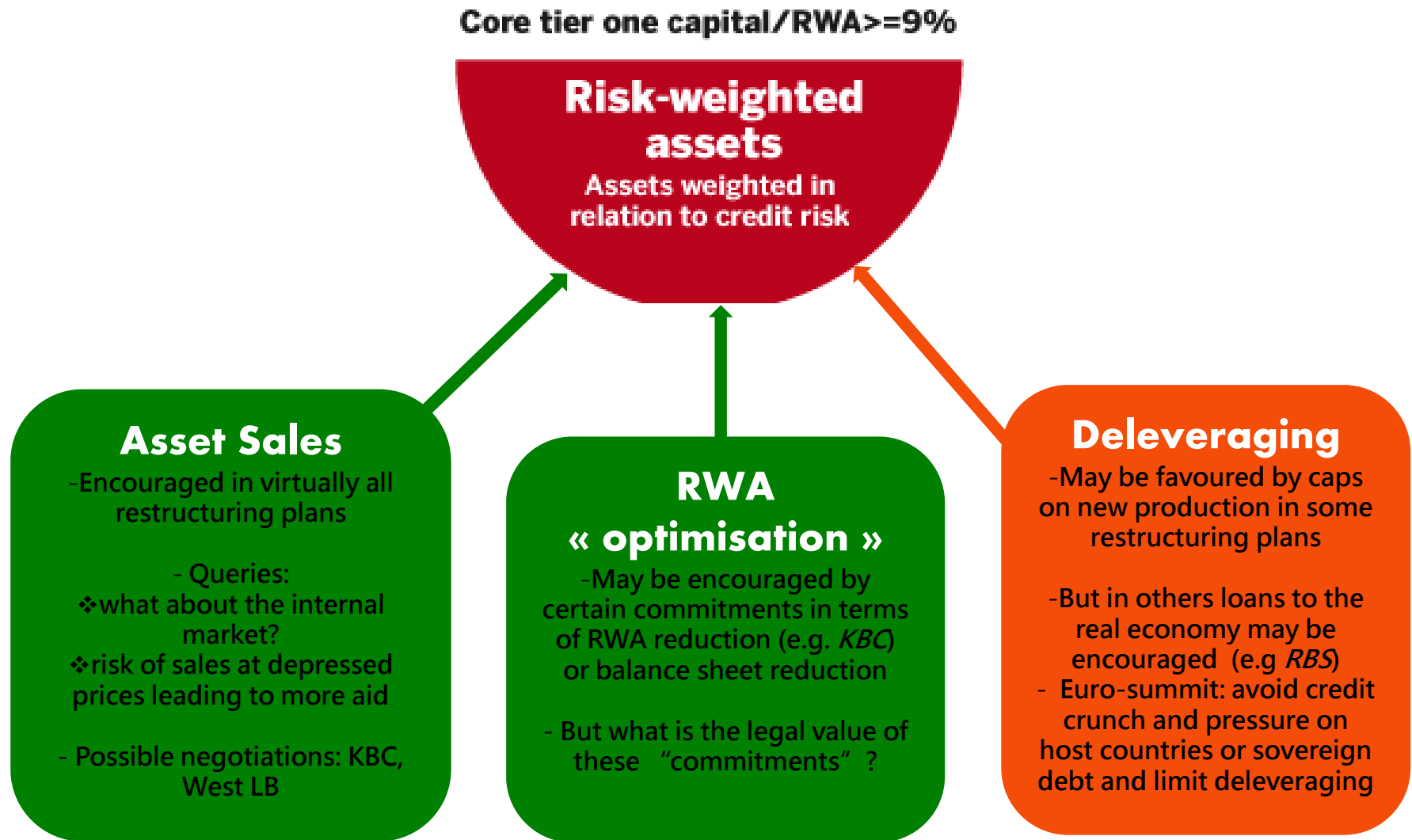


(source: FT research)

## State aid practice and the 9% target (1)

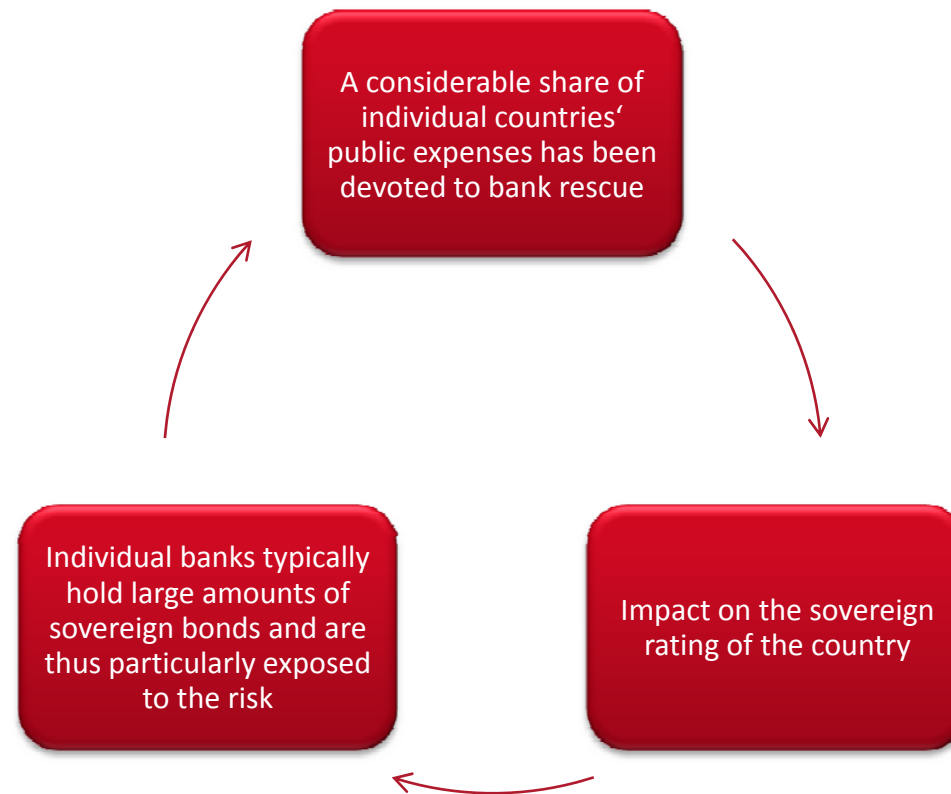


## State aid practice and the 9% target (2)





## The „feedback loop“ between the banking and the sovereign crisis



In addition, measures taken by banking institutions to restore viability typically involve a reduction of new credit production which may lead to a credit crunch, thus adding to the recessionary impact of austerity measures

## Issues raised by feedback relation

### Timing

- Some bank vulnerabilities might not be addressed in due time, neither national nor international

### Inequality

- Different access to State aid among Member States

### Cross-border institutions

- As most interventions were managed at a national level, it has been difficult to address cross-border issues efficiently

## EU Financial assistance mechanisms (II)

### EFSM

- Council Regulation 407/2010 on the basis of Art 122 (2) TFEU
- Allows Commission to borrow up to €60 billion on the open market on behalf of the EU under an implicit EU budget guarantee and to on-lend the proceeds to the Member States
- Assistance rests on a request by the Member State, proposal by the Commission and decision by the Council
- Subject to parallel assistance by the IMF and general economic conditions summarized in Memorandum of Understanding with Member State

### EFSF

- Intergovernmental agreement
- Temporary company registered in Luxembourg
- Can issue bonds, guaranteed on a bilateral basis by each of the Eurozone Member States, for „on-lending“ to States
- Authorized to provide loans to countries in financial difficulties, intervene in the debt primary and secondary markets, act on the basis of a precautionary program and finance recapitalisations of financial institutions through loans to governments
- Assistance is monitored by Troika (IMF, ECB, Commission)

### ESM

- Permanent facility
- Replaces EFSM and EFSF
- After national ratification procedures, operational as of 2013
- Based on an amendment to Art 136 TFEU, adopted under the simplified revision procedure
- Intergovernmental organisation under public international law

## Possible interaction with State aid process

### Will rescue programs effectively funded by international assistance (EU or IMF) be considered State aid?

- Decisional practice: only national subsidies, not if funded by EU budget
- European Council's conclusions regarding banking package and state aid crisis framework: regardless of the origin of the funds
- ECB interventions not covered as long as they take place in the context of monetary policy and are not influenced or backed by the States
- What status for the ESM in future State aid negotiations ?

### To what extent should the Commission take into account the specific situation of banks exposed to the sovereign crisis?

- Prolongation Communication: „proportionate assessment“ of banks restructuring plans
- Conditions might be interpreted narrowly (e.g., only investments in the sovereign, not the private sector, no solution if exposed to several sovereign risks or sovereign risk outside EEA)
- Open how proportionality principle is implemented in practice

### How will the Commission's state aid control policy be coordinated with other policies encouraged by the Troika in programme countries?

- Commission seems to have deferred in its State aid decisions to macro-economic assumptions validated with the Troika
- Coordination or contradiction of remedies required by State aid decisions and remedies prescribed by the Troika
- Tension between competition and financial stabilization objectives ?