

PART VIII: TEMPORARY RULES REGARDING FINANCIAL CRISIS

CHAPTER ON THE RETURN TO VIABILITY AND THE ASSESSMENT OF RESTRUCTURING MEASURES IN THE FINANCIAL SECTOR IN THE CURRENT CRISIS UNDER THE STATE AID RULES¹

1 Introduction

- (1) Restoring confidence and the proper functioning of the financial market is an indispensable precondition for recovery from the current financial and economic crisis.² The EFTA Surveillance Authority (hereinafter “the Authority”) notes that, in view of the systemic nature of the crisis and the interconnectivity of the financial sector, a number of actions have been initiated at Community level to restore confidence in the financial system, preserve the internal market and secure lending to the economy.³
- (2) The Authority concurs that those initiatives need to be complemented by action at the level of individual financial institutions to enable them to withstand the current crisis and return to long-term viability without reliance on state support in order to perform their lending function on a sounder basis. At Community level, the Commission is already dealing with a number of state aid cases resulting from interventions by EC States to avoid liquidity, solvency or lending problems. The Authority has provided guidance, in three successive chapters of its Guidelines on the design and implementation of state aid in favour of banks.⁴ Those Chapters recognise that the severity of the crisis justified the granting of aid, which can be considered compatible pursuant to Article 61(3)(b) of the EEA Agreement, and provided a framework for the coherent provision of public guarantees, recapitalisation and impaired asset relief measures by EFTA States. 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 banks⁵ located in different EEA States as well as between banks which receive public support and those which do not, avoiding harmful subsidy races, limiting moral hazard and ensuring the competitiveness and efficiency of EEA banks in EEA and international markets.

¹ This Chapter corresponds to the Communication of the European Commission (hereinafter “the Commission”) on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the state aid rules, OJ C 195 of 19.8.2009, p. 9.

² At point 1 of its Communication cited in footnote 1 above, the Commission referred to a respective commitment made by the European Council at its meetings on 20 March 2009 and on 18 and 19 June 2009.

³ In its Communication to the European Council of 4 March 2009 on “Driving the European Recovery” COM(2009) 114 final, the Commission announced a reform programme to address more general weaknesses in the regulatory framework applicable to financial institutions which operate in the Community.

⁴ See the chapters of the Guidelines on the application of state aid rules to measures taken in relation to financial institutions (hereinafter “the Banking Guidelines”), on the recapitalisation of financial institutions in the current financial crisis (hereinafter “the Recapitalisation Guidelines”) and on the treatment of impaired assets in the EEA banking sector (hereinafter “the Impaired assets Guidelines”).

⁵ The application of this Chapter is limited to financial institutions as referred to in the Banking Guidelines. Guidance provided in this Chapter refers to banks for ease of reference. However it applies, *mutatis mutandis*, to other financial institutions where appropriate.

- (3) State aid rules provide a tool to ensure the coherence of measures taken by those EFTA 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 EFTA States. In some instances, financial institutions will be in a position to handle the current crisis without major adjustment or additional aid. In other cases, state aid may be necessary, in the form of guarantees, recapitalisation or impaired asset relief.
- (4) Where a financial institution has received state aid, the EFTA State 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 already 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 aid⁶. This Chapter does not alter those criteria. It complements them, with a view to enhancing predictability and ensuring a coherent approach, by explaining how the Authority will assess the compatibility of restructuring aid⁷ granted by EFTA States to financial institutions in the current circumstances of systemic crisis, under Article 61(3)(b) of the EEA Agreement.
- (5) The Banking Guidelines, the Recapitalisation Guidelines and the Impaired Assets Guidelines recall the basic principles set out in the Guidelines on state aid for rescuing and restructuring firms in difficulty.⁸ Those principles require, first and foremost, that restructuring aid should lead to the restoration of viability of the undertaking in the longer term without state aid. They also require restructuring aid to

⁶ The criteria and specific circumstances which trigger the obligation to present a restructuring plan have been explained in the Banking Guidelines, the Recapitalisation Guidelines and the Impaired Assets Guidelines. They refer in particular, but not exclusively, to situations where a distressed bank has been recapitalised by the State, or where a 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 the problems of each bank. By contrast, in line with those Guidelines (in particular point 40 of the Recapitalisation Guidelines and Annex V to the Impaired Assets Guidelines), where a limited amount of aid has been given to banks which are fundamentally sound, EFTA States are required to submit a report to the Authority 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.

⁷ That is to say, aid which was temporarily authorised by the Authority as rescue aid under the Guidelines on state aid for rescuing and restructuring firms in difficulty or aid temporarily authorised under Article 61(3)(b) of the EEA Agreement, as well as any new aid that may be notified as needed for restructuring. This Chapter 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.

⁸ At Community level, the Commission has, in the past, adopted a number of decisions relating to restructuring aid (compatible under Article 87(3)(c) of the EC 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 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), Commission Decision 2009/341/EC of 4 June 2008 on State aid C 9/2008 (ex NN 8/2008, CP 244/07) implemented by Germany for Sachsen LB (OJ L 104, 24.4.2009, p. 34) and the autumn 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.

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.

- (6) The integrity of the internal market and the development of banks throughout the EEA must be a key consideration in the application of those principles; fragmentation and market partitioning should be avoided. EEA banks should be in a strong global position on the basis of the single EEA financial market, once the current crisis has been overcome. The Authority also reaffirms the need to anticipate and manage change in a socially responsible way and underlines the need to comply with national legislation implementing Community Directives on information and consultation of workers that apply under such circumstances.
- (7) This Chapter explains how the Authority will examine aid for the restructuring of banks in the current crisis, taking into account the need to modulate past practice in the light of the nature and the global scale of the crisis, the systemic role of the banking sector for the whole economy, and the systemic effects which may arise 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 the restoration of viability should be based on common parameters which will build to the extent possible on appropriate methodologies agreed at EEA level. Banks will also be required, where applicable, to disclose impaired assets.⁹
 - Given the overriding goal of financial stability and the prevailing difficult economic outlook throughout the EEA, 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 Authority will apply the basic principle of appropriate burden sharing between EFTA 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 EFTA State or in other EEA States should be designed in a way that limits any disadvantage to other banks while taking into account the fact that the 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 of this Chapter applies to cases where the EFTA State is under an obligation to notify a restructuring plan.¹⁰ The principles underlying Section 2 apply by analogy to cases where the EFTA State is not under a formal obligation to notify a

⁹ In accordance with the Impaired Assets Guidelines.

¹⁰ In accordance with the Banking Guidelines, the Recapitalisation Guidelines and the Impaired Assets Guidelines. See point 4 of this Chapter.

restructuring plan, but is nonetheless required to demonstrate viability¹¹ of the beneficiary bank. In the latter case, and save situations where there are doubts, the Authority will normally request less detailed information.¹² In case of doubt, the Authority will, in particular, seek evidence of adequate stress testing, in accordance with point 13, and of validation of the results of the stress testing by the competent national authority. Sections 3, 4 and 5 only apply to cases where the EFTA State is under an obligation to notify a restructuring plan. Section 6 deals with the temporal scope of this Chapter and applies both to EFTA States required to notify a restructuring plan for the aid beneficiary and to EFTA States required only to demonstrate the viability of aid beneficiaries.

2 Restoring long-term viability

- (9) Where, on the basis of previous guidance or decisions by the Authority, an EFTA 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 possible.¹⁴ 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 Authority 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.
- (11) The restructuring 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 conflicts 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

¹¹ In accordance with the Banking Guidelines, the Recapitalisation Guidelines and the Impaired Assets Guidelines, where a limited amount of aid is granted to fundamentally sound banks, EFTA States are required to submit a viability review to the Authority.

¹² In accordance, in particular, with point 40 of the Recapitalisation Guidelines and Annex V to the Impaired Assets Guidelines.

¹³ As explained in point 8 of this Chapter, 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 Authority 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.

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 Decision 2009/341/EC in Case C 9/2008 *Sachsen LB*.

¹⁷ See Decision 2009/341/EC in Case C 9/2008 *Sachsen LB*.

¹⁸ Except in duly justified circumstances. See Commission Decision of 21 October 2008 in case C 10/2008 *IKB*, not yet published.

prudent valuation and adequate provisioning), and the remuneration incentive structure¹⁹, (demonstrating how it promotes the beneficiary's long-term profitability).

- (12) The viability of each business activity and centre of profit should be analysed, 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 undertaking 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 into account the risk profile of the bank. The restructured bank should be able to compete in the market place 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 current state 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 current 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 such as those 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 that any state aid received is either redeemed over time, as anticipated at the time the aid is granted, or is remunerated according to normal market conditions, thereby ensuring that any form of additional state aid is terminated. As the EEA Agreement 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 Authority 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 sales.²⁰ However, restructuring should be implemented as soon as possible and should not last 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 be necessary during the restructuring period for the restoration of viability, this will be subject to

¹⁹ In accordance with the principles set in Commission Recommendation 2009/384/EC of 30 April 2009 on remuneration policies in the financial services sector (OJ L 120, 15.5.2009, p. 22).

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

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

individual *ex ante* notification and any such further aid will be taken into account in the Authority's final decision.

Viability through sale of a bank

- (17) The sale of an ailing bank to another financial institution can contribute to the restoration of long-term viability, if the purchaser is viable and capable of absorbing the transfer of the ailing bank, and may help to restore 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 bidders.²²
- (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 the restoration of long-term viability and result in increased consolidation of the financial sector, where such a sale 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 excluded.²⁴ 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 the event of liquidation.²⁵ For the calculation of the cost of liquidation in such circumstances, the Authority will only take account of 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 Guidelines provide for a procedure in the framework of which such orderly winding up should take place.²⁸ Acquisition of the "good" assets and liabilities of a

²² See also point 20.

²³ See for example Commission Decision 2009/341/EC in Case C 9/2008 *Sachsen LB*.

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

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

²⁶ See 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 2008/719/EC of 30 April 2008 on state aid C 56/2006 (ex NN 77/2006) *Bank Burgenland* (OJ L 239, 6.9.2008, p. 32).

²⁸ See points 43 to 50 of the Banking Guidelines. 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 aid and conditions under which it was found compatible, see Commission Decision of 1 October 2008 in case NN 41/2008 UK, Rescue aid to *Bradford & Bingley* (OJ C 290, 13.11.2008, p. 2) and

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 unduly 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 bank 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 the restoration of viability. This means that an undertaking 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 undertakings or new investments cannot be financed through state aid unless this is essential for restoring an undertaking's viability.²⁹

Limitation of the amount of aid, significant own contribution

- (24) In order to limit the aid amount to the minimum necessary, banks 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 costs.³⁰ This means 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 interventions.³¹ Nonetheless, the Authority considers that it is not appropriate to fix thresholds concerning burden-sharing *ex ante* in the context of the current systemic crisis, having regard to the objective of facilitating access to private capital and a 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 must 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

the Commission Decision of 5 November 2008 in case NN 39/2008 DK, *Aid for liquidation of Roskilde Bank* (OJ C 12, 17.1.2009, p. 3).

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

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

³¹ The Authority has provided detailed guidance regarding the pricing of state guarantees, recapitalisations and asset relief measures respectively in the Banking Guidelines, the Recapitalisation Guidelines and the Impaired Assets Guidelines. 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 Guidelines points 24 and 25. See also Section 4 of this Chapter.

- (26) Banks should be able to remunerate capital, including 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 sharing.³³ This may need to be balanced with ensuring the refinancing capability of the bank and the exit incentives.³⁴ In the interests of promoting refinancing by the beneficiary bank, the Authority 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.

4 Limiting distortions of competition and ensuring a competitive banking sector

Types of distortion

- (28) Whilst 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 EFTA 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 distortions of competition due to state aid play an important role, *inter alia* for the following reasons. First, banks across the EEA 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

³³ See Commission Decision of 18 December 2008 in case N 615/2008 *Bayern LB* (OJ C 80, 3.4.2009, p. 4). 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 Guidelines, point 31, and the nuanced approach to dividend restrictions in the Recapitalisation Guidelines, 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.

sound, with possible negative effects for financial stability. In a situation of financial, economic and budgetary crisis, differences between EFTA 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 crisis will, by their very nature, tend to 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 to the detriment of EEA 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 from reoccurring 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 Authority 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 of this Chapter. Depending on the nature of the distortion of competition, it may be addressed through measures in respect of liabilities and/or in respect of assets.³⁵ The nature and form of such measures will depend on two criteria: first, the amount of the aid and the conditions and circumstances under which it was granted and, second, the characteristics of the market or markets on which the beneficiary bank will operate.
- (31) As regards 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 the 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 Authority will consider the total amount of aid granted to the beneficiary including any kind of rescue aid. In the same vein, the Authority will take into account the extent of the beneficiary's own contribution and burden sharing over the restructuring period. Generally speaking, where there is greater burden sharing and the own contribution is higher, there are fewer negative consequences resulting from moral hazard. Therefore, the need for further measures is reduced.³⁶
- (32) As regards the second criterion, the Authority will analyse the likely effects of the aid on the markets where the beneficiary bank operates after the 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 measures will be tailored to market

³⁵See point 21.

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

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 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 Authority will pay attention to the risk that restructuring measures may undermine internal market and will view positively measures that help to ensure that national markets remain open and contestable. While aid is granted to maintain financial stability and lending to the real economy in the granting EFTA State, where such aid is also conditional upon the beneficiary bank respecting certain lending targets in EFTA States other than the State which grants the aid, 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 banking system of the host State is dominated by banks with headquarters abroad and where such lending 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. Where the entry price has been set at a level significantly below the market price for reasons of financial stability, it should be ensured that the 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 the internal market, they should favour the entry of competitors and cross-border activity.⁴⁰ In line with the requirement of restoration of viability, the Authority will take a positive view of such structural measures if they are undertaken without discrimination between businesses in different EFTA States, thus contributing to the preservation of an internal market in financial services.
- (36) A limit on the bank's expansion in certain business or geographical areas may also be required, for instance via market-oriented remedies such as specific capital

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

³⁸ For example by favouring early redemption of state aid.

³⁹ See for example Commission Decision of 21 October 2008 in Case C 10/2008 IKB, not yet published and Commission Decision of 7 May 2009 in case N 244/2009 Capital injection into Commerzbank (OJ C 147, 27.6.2009, p. 4).

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.

requirements, where competition in the market would be weakened by direct restrictions on expansion or to limit moral hazard. At the same time, the Authority 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 Authority 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, the time period for implementing those measures should not exceed five years.
- (38) In assessing the scope of structural remedies required to overcome distortions of competition in a given case, and with due regard to the principle of equal treatment, the Authority 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

- (39) State aid must not be used to the detriment of competitors which do not enjoy similar public support.⁴¹
- (40) Subject to point 41, banks should not use state aid for the acquisition of competing businesses.⁴² This condition should apply for at least three years and may continue until the end of the restructuring period, depending on the scope, size and duration of the aid.
- (41) In exceptional circumstances and upon notification, acquisitions may be authorised by the Authority 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 Authority may accept the imposition by the EFTA 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 fulfill certain requirements as to lending to the real economy, the credit provided by the bank must be on commercial terms.⁴³
- (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 the pricing behaviour of the beneficiary may

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 NN 53/A/2008 *Restructuring aid to Fortis Bank and Fortis Bank Luxembourg* (OJ C 80, 3.4.2009, p. 7), 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 23.

⁴³ Credit provided on non-commercial terms might constitute state aid and might be authorised by the Authority, upon notification, if it is compatible with the functioning of the EEA Agreement, for example under the Guidelines — Temporary framework for State aid measures to support access to finance in the current financial and economic crisis.

not be appropriate, for example because they may result in a reduction of effective competition, EFTA States should propose other, more suitable, remedies to ensure effective competition, such as measures that favour entry. In the same vein, banks must not invoke state support as a competitive advantage when marketing their financial offers.⁴⁴ 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 Authority will also examine the degree of market opening and the capacity of the sector to deal with bank failures. In its overall assessment the Authority may consider possible commitments by the beneficiary or commitments from the EFTA 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. The EFTA State's commitment to introduce mechanisms to deal with bank difficulties at an early stage may be regarded positively by the Authority 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 Authority will request regular detailed reports. The first report will normally have to be submitted to the Authority not later than six months after approval of the restructuring plan.
- (47) Upon notification of the restructuring plan the Authority 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 Authority 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 proceedings.
- (48) Nevertheless the Authority does not have to open formal proceedings where the restructuring plan is complete and the measures suggested are such that the Authority has no further doubts as to compatibility in the sense of Article 4(4) of Part II of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice. This might, in particular, be the case where an EFTA State has notified the Authority of an aid accompanied by a restructuring plan which meets all of the conditions set out in this Chapter, in order to obtain legal certainty as to the necessary follow-up. In such cases the Authority might adopt a final decision stating that rescue aid as well as restructuring aid is compatible under Article 61(3)(b) of the EEA Agreement.

6 Temporary Scope of the communication

- (49) This Chapter is justified by the current exceptional financial sector crisis and should therefore only be applied for a limited period. For the assessment of restructuring aid notified to the Authority on or before 31 December 2010, the Authority will apply

⁴⁴ Commission Decision of 12 November 2008 in Case N 528/2008 ING (OJ C 328, 23.12.2008, p. 10), point 35.

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.

this Chapter. As regards non-notified aid, the Guidelines on the applicable rules for the assessment of unlawful State aid will apply. The Authority will therefore apply this Chapter when assessing the compatibility of non-notified aid granted on or before 31 December 2010.

- (50) Bearing in mind that this Chapter is based on Article 61(3)(b) of the EEA Agreement, the Authority 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.

ANNEX

Model restructuring plan

Indicative table of contents for restructuring plan [1]

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(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 EEA 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
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- 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
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- 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
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 - 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 EEA 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
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- 5.7. Timetable for the implementation of the different measures and the final deadline for implementation of the restructuring plan in its entirety (please indicate issues of confidentiality)
- 5.8. Description of the repayment plan of the state aid
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 - 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.)
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 - 5.9.1.4. Key Financial ratios per business unit (RAROC as a benchmark for internal criteria for risk adjusted profitability, CIR, ROE, etc.)
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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 provided [2]

5.9.3.1. Underlying assumptions

5.9.3.2. Profit and Loss Statement/balance sheet group level

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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)

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

[2] The stress testing should to the extent possible be based on common parameters such as those 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.

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