II

(Information)

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EUROPEAN COMMISSION

Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication')

(Text with EEA relevance)

(2013/C 216/01)

1. INTRODUCTION

1. Since the beginning of the financial crisis, the Commission has adopted six communications ('Crisis Communications') ([1]). They have provided detailed guidance on the criteria for the compatibility of State aid with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union for the financial sector during the financial crisis.

2. The Crisis Communications provide a comprehensive framework for coordinated action in support of the financial sector so as to ensure financial stability while minimising distortions of competition between banks and across Member States in the single market. They spell out the conditions for access to State aid and the requirements which need to be ensured to find such aid compatible with the internal market in light of State aid principles set out in the Treaty. Through the Crisis Communications, State aid rules governing public assistance to the financial sector have been regularly updated where necessary to adapt to the evolution of the crisis. Recent developments require a further update of the Crisis Communications.

Legal basis

3. The Crisis Communications, as well as all individual decisions on aid measures and schemes falling within the scope of those Communications, were adopted on the basis of Article 107(3)(b) of the Treaty, which exceptionally allows for aid to remedy a serious disturbance in the economy of a Member State.

4. Significant action has been taken since the start of the crisis to address the financial sector's difficulties. The evolution of the crisis has required the adaptation of some provisions of the State aid framework

([1]) Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ('2008 Banking Communication') (OJ C 270, 25.10.2008, p. 8); Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition ('Recapitalisation Communication') (OJ C 10, 15.1.2009, p. 2); Communication from the Commission on the treatment of impaired assets in the Community financial sector ('Impaired Assets Communication') (OJ C 72, 26.3.2009, p. 1); Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules ('Restructuring Communication') (OJ C 195, 19.8.2009, p. 9); Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis ('2010 Prolongation Communication') (OJ C 329, 7.12.2010, p. 7) and Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis ('2011 Prolongation Communication') (OJ C 356, 6.12.2011, p. 7).

dealing with the rescue and restructuring of firms in difficulty while not ruling out the possibility of accessing, exceptionally, significant public support. Notwithstanding the exceptional deployment of fiscal and monetary instruments which helped avert further worsening of the crisis, the economic recovery remains very fragile and uneven across the European Union. The financial sectors in some Member States face further challenges in accessing term funding and in asset quality, stemming from the economic recession and public or private debt deleveraging. The stress in financial markets and the risk of wider negative spill-over effects persist.

5. The persistence of tensions in sovereign debt markets forcefully illustrates the continued volatility in financial markets. The high level of interconnectedness and interdependence within the financial sector in the Union continues to give rise to market concerns about contagion. The high volatility of financial markets and the uncertainty in the economic outlook and the resulting persistent risk of a serious disturbance in the economy of Member States justifies maintaining, as a safety net, the possibility for Member States to grant crisis-related support measures on the basis of Article 107(3)(b) of the Treaty in respect of the financial sector.

6. In those circumstances of persisting stress in financial markets and given the risk of wider negative spill-over effects, the Commission considers that the requirements for the application of Article 107(3)(b) of the Treaty to State aid in the financial sector continue to be fulfilled. The application of that derogation remains, however, possible only as long as the crisis situation persists, creating genuinely exceptional circumstances where financial stability at large is at risk.

Financial stability as overarching objective

7. In its response to the financial crisis, and under the Crisis Communications, financial stability has been the overarching objective for the Commission, whilst ensuring that State aid and distortions of competition between banks and across Member States are kept to the minimum. Financial stability implies the need to prevent major negative spill-over effects for the rest of the banking system which could flow from the failure of a credit institution as well as the need to ensure that the banking system as a whole continues to provide adequate lending to the real economy. Financial stability remains of central importance in the Commission's assessment of State aid to the financial sector under this Communication. The Commission shall conduct its assessment taking account of the evolution of the crisis from one of acute and system-wide distress towards a situation of more fundamental economic difficulties in parts of the Union, with a correspondingly higher risk of fragmentation of the single market.

8. That overarching objective is reflected not only in the possibility for banks in distress to access State aid when necessary for financial stability, but also in the way restructuring plans are assessed. In that respect it has to be underlined that financial stability cannot be ensured without a healthy financial sector. Capital raising plans must therefore be assessed in close collaboration with the competent supervisory authority with a view to ensuring that viability can be regained within a reasonable time frame and on a solid and lasting basis; otherwise the failing institution should be wound down in an orderly manner.

9. When applying State aid rules to individual cases, the Commission nevertheless takes account of the macroeconomic environment which affects both banks' viability and the need for the real economy of a given Member State to continue to have access to credit from healthy banks. The Commission will, in its assessment of banks' restructuring plans, continue to take account of the specificities of each institution and Member State. It will, in particular, undertake a proportionate assessment of the long-term viability of banks where the need for State aid stems from the sovereign crisis and is not a result of excessive risk-taking (2), and will reflect in its assessment the need to maintain a level playing field across the single market, having regard in particular to the evolution of burden-sharing in the Union.

10. Moreover, where large parts of a Member State's financial sector need to be restructured, the Commission endeavours to take a co-ordinated approach in its assessment of individual banks'

(2) See 2011 Prolongation Communication, point 14.

restructuring plans so as provide for a system-wide response. In particular, the Commission has taken that approach for those Member States under an economic adjustment programme. The Commission should thereby take into account specifically the aggregate effects of restructuring of individual institutions at the level of the sector (for example in terms of market structure) and on the economy as a whole, notably as regards the adequate provision of lending to the real economy on a sound and sustainable basis.

11. Furthermore, in its assessment of burden-sharing and measures to limit distortions of competition the Commission assesses the feasibility of the proposed measures, including divestments, and their impact on the market structure and entry barriers. At the same time, the Commission has to ensure that solutions devised in a particular case or Member State are coherent with the goal of preventing major asymmetries across Member States which could further fragment the single market and cause financial instability, impeding recovery within the Union.

Evolution of the regulatory framework and need for revision of the Crisis Communications

12. Since the start of the crisis, the Union has undertaken a number of institutional and regulatory changes aimed at strengthening the resilience of the financial sector and improving the prevention, the management and the resolution of banking crises. The European Council has agreed to undertake further initiatives to put the Economic and Monetary Union on a more solid footing through the creation of a Banking Union, starting with a single supervisory mechanism (SSM) and a single resolution mechanism for credit institutions established in a Member State participating in the SSM. Member States have also agreed to set up a stability mechanism by which financial resources could be provided to members and their banks in case of need.

13. Those measures inevitably involve a degree of phasing-in, for example in order to allow legislation to enter into force or for resolution funds to build up. Some of them remain confined to the euro area. In the meantime an increasing divergence in economic recovery across the Union, the need to reduce and consolidate public and private debt and the existence of pockets of vulnerability in the financial sector have led to persistent tensions in the financial markets and fragmentation with increasing distortions in the single market. The integrity of the single market needs therefore to be protected including through a strengthened State aid regime. Adapting the Crisis Communications can help to ensure a smooth passage to the future regime under the Commission's proposal for a directive for the recovery and resolution of credit institutions ([3]) ('BRRD') by providing more clarity to markets. The adapted Crisis Communications can also ensure more decisive restructuring and stronger burden-sharing for all banks in receipt of State aid in the entire single market.

14. Exercising State aid control for the financial sector sometimes interacts with responsibilities of supervisory authorities in Member States. For example, in certain cases, supervisory authorities might require adjustments in matters such as corporate governance and remuneration practices which for banks benefitting from State aid are often also set out in restructuring plans. In such cases, whilst fully preserving the Commission's exclusive competence in State aid control, coordination between the Commission and the competent supervisory authorities is of importance. Given the evolving regulatory and supervisory landscape in the Union and, in particular, in the euro area, the Commission will liaise closely — as it does already today — with supervisory authorities to ensure a smooth interplay between the different roles and responsibilities of all the authorities involved.

Burden-sharing

15. The Crisis Communications clearly spell out that even during the crisis the general principles of State aid control remain applicable. In particular, in order to limit distortions of competition between banks and across Member States in the single market 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 ([4]). State support should be granted on terms which represent an adequate burden-sharing by those who invested in the bank.

([3]) Proposal for a directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms of 6 June 2012, COM(2012) 0280 final.

([4]) See e.g. Restructuring Communication, point 22.

16. Since the start of the crisis, when examining the compatibility of aid to banks the Commission has required at least a minimum degree of burden-sharing relative to the amount of aid received by those banks, in particular by absorbing losses with available capital and by paying an adequate remuneration for State interventions. Furthermore, in order to prevent the outflow of funds, it has introduced rules on the buyback of hybrid instruments and coupon and dividend bans. However, the Commission did not set *ex ante* thresholds for own contributions or any further requirements [5].

17. In the first phases of the crisis, Member States did not generally go beyond the minimum requirements set by State aid rules with regard to burden-sharing *ex ante*, and creditors were not required to contribute to rescuing credit institutions for reasons of financial stability.

18. The sovereign crisis has, however, made clear that such a policy could not ensure financial stability in the long term, in particular for Member States in which the cost of bank bail-outs significantly weakened their fiscal position. Indeed some Member States had to go beyond minimum requirements under State aid rules and by introducing new legal frameworks enforce stricter *ex ante* burden-sharing requirements. That development led to diverging approaches to burden-sharing across Member States, namely those that have limited themselves to the minimum requirements under State aid rules and those which have gone beyond those requirements, requiring bail-in of investors or creditors. Such differences in the approach to burden-sharing between Member States have led to divergent funding costs between banks depending on the perceived likelihood of a bail-in as a function of a Member State's fiscal strength. They pose a threat to the integrity of the single market and risk undermining the level playing field which State aid control aims to protect.

19. In the light of the above developments, the minimum requirements for burden-sharing should be raised. Before granting any kind of restructuring aid, be it a recapitalisation or impaired asset measure, to a bank all capital generating measures including the conversion of junior debt should be exhausted, provided that fundamental rights are respected and financial stability is not put at risk. As any restructuring aid is needed to prevent the possible disorderly demise of a bank, in order to reduce the aid to the minimum those burden-sharing measures should be respected regardless of the initial solvency of the bank. Therefore, before granting restructuring aid to a bank Member States will need to ensure that the bank's shareholders and junior capital holders arrange for the required contribution or establish the necessary legal framework for obtaining such contributions.

20. In principle, the application of measures to limit distortions of competition depends on the degree of burden-sharing, and also takes into account the evolving level of burden-sharing of aided banks across the Union. All other matters being equal, enhanced burden-sharing therefore implies a reduced need for measures addressing competition distortions. In any event, measures to limit distortions of competition should be calibrated in such a way so as to approximate as much as possible the market situation which would have materialised if the beneficiary of the aid had exited the market without aid.

An effective restructuring procedure and further modernisation of the framework

21. Whilst it is necessary to retain certain support facilities for banks so as to address continued turmoil on the financial markets, certain procedures and conditions should be improved and further developed. It is also necessary to pursue the process of aligning the legal framework to market evolution, which started in June 2010 with the increase of the guarantee fee [6] and continued with the 2010 Prolongation Communication [7].

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(5) Ibid., point 24.

(6) See DG Competition Staff working document of 30 April 2010 'The application of State aid rules to government guarantee schemes covering bank debt to be issued after 30 June 2010'.

(7) That Communication sets out the requirement to submit a restructuring plan for all banks benefitting from State support in the form of capital or impaired asset measures, independent of the aid amount.

22. The 2008 Banking Communication enabled Member States to put rescue schemes in place whilst at the same time not excluding the availability of ad hoc interventions. Given the scale of the crisis and the general erosion of confidence within the whole EU financial sector with, inter alia, the drying-up of the interbank market, the Commission decided that it would approve all necessary measures taken by Member States to safeguard the stability of the financial system, including rescue measures and recapitalisation schemes. The temporary approval of rescue aid both in the form of guarantees as well as recapitalisation and impaired asset measures succeeded in averting panic and restoring market confidence.

23. However, in the changed market conditions, there is less need for structural rescue measures granted solely on the basis of a preliminary assessment which is based on the premise that practically all banks need to be rescued and which postpones the in-depth assessment of the restructuring plan to a later stage. Whilst such an approach helped prevent the irremediable collapse of the financial sector as a whole, restructuring efforts of individual beneficiaries were often delayed. Late action to address banks' problems has resulted in some cases in a higher final bill to the taxpayers. This Communication establishes the principle that recapitalisation and impaired asset measures will be authorised only once the bank's restructuring plan is approved. This approach ensures that the amount of aid is more accurately calibrated, that the sources of the bank's problems are already identified and addressed at an early stage and that financial stability is assured. Guarantee schemes will continue to be available in order to provide liquidity to banks. Such schemes can, however, only serve as a means to provide liquidity to banks without a capital shortfall as defined by the competent supervisory authority ([8]).

24. This Communication sets out the necessary adaptations to the parameters for the compatibility of crisis-related State aid to banks as from 1 August 2013. In particular, this Communication:

(a) replaces the 2008 Banking Communication, and provides guidance on the compatibility criteria for liquidity support;

(b) adapts and complements the Recapitalisation and Impaired Assets Communications;

(c) supplements the Restructuring Communication by providing more detailed guidance on burden-sharing by shareholders and subordinated creditors;

(d) establishes the principle that no recapitalisation or asset protection measure can be granted without prior authorisation of a restructuring plan, and proposes a procedure for the permanent authorisation of such measures;

(e) provides guidance on the compatibility requirements for liquidation aid.

2. **SCOPE**

25. The Commission will apply the principles set out in this Communication and all Crisis Communications ([9]) to 'credit institutions' (also referred to as 'banks') ([10]). Credit institutions exhibit a high degree of interconnectedness in that the disorderly failure of one credit institution can have a strong negative effect on the financial system as a whole. Credit institutions are susceptible to sudden collapses of confidence that can have serious consequences for their liquidity and solvency. The distress of a single complex institution may lead to systemic stress in the financial sector, which in turn can also have a strong negative impact on the economy as a whole, for example through the role of credit institutions in lending to the real economy, and might thus endanger financial stability.

([8]) 'Competent supervisory authority' means any national competent authority designated by participating Member States in accordance with Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (OJ L 177, 30.6.2006, p. 1) or the European Central Bank in its supervisory tasks as conferred in Article 1 of the Commission proposal for a Council regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions for credit institutions established in a Member State participating in the single supervisory mechanism.

([9]) See footnote 1.

([10]) As defined in Article 4(1) of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast).

26. The Commission will apply the principles set out in this Communication and all Crisis Communications where appropriate *mutatis mutandis* to insurance companies within the meaning of Article 6 of Directive 73/239/EEC [11], Article 4 of Directive 2002/83/EC [12] or Article 1(b) of Directive 98/78/EC [13].

27. All aid to such institutions incorporated in a Member State, including subsidiaries of such institutions, and having significant activities in a Member State will be examined under this Communication.

3. RECAPITALISATION AND IMPAIRED ASSET MEASURES

28. Recapitalisations and impaired asset measures including asset guarantees are typically granted to cover a capital shortfall. A 'capital shortfall' for the purposes of this Communication refers to a capital shortfall established in a capital exercise, stress-test, asset quality review or an equivalent exercise at Union, euro area or national level, where applicable confirmed by the competent supervisory authority. Such public support is normally of a permanent nature and cannot be easily undone.

29. Given the irreversibility of such measures in practice and the fiscal implications for the granting Member States and in the light of the Commission's decisional practice during the crisis, the Commission can in principle only authorise them once the Member State concerned demonstrates that all measures to limit such aid to the minimum necessary have been exploited to the maximum extent. To that end, Member States are invited to submit a capital raising plan, before or as part of the submission of a restructuring plan. A capital raising plan should contain in particular capital raising measures by the bank and potential burden-sharing measures by the shareholders and subordinated creditors of the bank.

30. A capital raising plan, in conjunction with a thorough asset quality review of the bank and a forward looking capital adequacy assessment, should enable the Member State, jointly with the Commission and the competent supervisory authority, to determine precisely the (residual) capital shortfall of a bank that needs to be covered with State aid. Any such residual capital shortfall which needs to be covered by State aid requires the submission of a restructuring plan.

31. The restructuring plan involving restructuring aid will, with the exception of the requirements on capital raising and burden-sharing which must be included in the capital raising plan as set out in points 32 to 34, submitted prior to or as part of the restructuring plan, continue to be assessed on the basis of the Restructuring Communication.

3.1. Addressing a capital shortfall — pre-notification and notification of restructuring aid

32. As soon as a capital shortfall that is likely to result in a request for State aid has been identified, all measures to minimise the cost of remedying that shortfall for the Member State should be implemented. To that end, Member States are invited to enter into pre-notification contacts with the Commission. In the course of those voluntary pre-notification contacts, the Commission will offer its assistance on how to ensure compatibility of the restructuring aid and in particular on how to implement the burden-sharing requirements in accordance with State aid rules. The basis for the pre-notification will be a capital raising plan established by the Member State and the bank and endorsed by the competent supervisory authority. It should:

    (a) list the capital raising measures to be undertaken by the bank and the (potential) burden-sharing measures for shareholders and subordinated creditors;

    (b) contain safeguards preventing the outflows of funds from the bank which could, for example, occur by the bank acquiring stakes in other undertakings or paying dividends or coupons.

[11] First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance (OJ L 228, 16.8.1973, p. 3).

[12] Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance (OJ L 345, 19.12.2002, p. 1).

[13] Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group (OJ L 330, 5.12.1998, p. 1).

33. The Member State should provide a detailed methodology and input data used to determine the capital shortfall, validated by the competent supervisory authority. The methodology needs to be presented on a business segment basis.

34. After the submission of the capital raising plan and the incorporation of the results of the asset quality review of the bank and a forward looking capital adequacy assessment, the Member State must determine the residual capital shortfall that has to be covered by State aid. The Commission will offer to the Member State to discuss the restructuring plan before its notification. Once agreement on the restructuring plan has been achieved, the Member State may formally notify the restructuring plan. The Commission will authorise any recapitalisation or impaired asset measure as restructuring aid only after agreement on the restructuring plan has been reached.

3.1.1. *Capital raising measures by the bank*

35. In the capital raising plan endorsed by the competent supervisory authority, the beneficiary should identify and to the extent possible, without endangering viability, carry out all capital raising measures that can be implemented. Such measures should include in particular:

(a) rights issues;

(b) voluntary conversion of subordinated debt instruments into equity on the basis of a risk-related incentive;

(c) liability management exercises which should in principle be 100 % capital generating if the capital shortfall cannot be overcome in full and therefore State aid is required;

(d) capital-generating sales of assets and portfolios;

(e) securitisation of portfolios in order to generate capital from non-core activities;

(f) earnings retention;

(g) other measures reducing capital needs.

36. If the identified measures are indicated in the capital raising plan as ones that cannot be implemented within six months from the submission of that plan, the Commission will consult the competent supervisory authority to assess whether it should take those proposed measures into account as capital raising measures.

37. There should be incentives for banks' managements to undertake far-reaching restructuring in good times and, thereby, minimise the need to recourse to State support. Accordingly, if recourse to State aid could have reasonably been averted through appropriate and timely management action, any entity relying on State aid for its restructuring or orderly winding down should normally replace the Chief Executive Officer of the bank, as well as other board members if appropriate.

38. For the same reasons, such entities should apply strict executive remuneration policies. This requires a cap on remuneration of executive pay combined with incentives ensuring that the bank is implementing its restructuring plan towards sustainable, long-term company objectives. Thus, any bank in receipt of State aid in the form of recapitalisation or impaired asset measures should restrict the total remuneration to staff, including board members and senior management, to an appropriate level. That cap on total remuneration should include all possible fixed and variable components and pensions, and be in line with Articles 93 and 94 of the EU Capital Requirements Directive (CRD IV) ([14]).

([14]) Directive of the European Parliament and of the Council on the access to the activity of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (OJ L 176, 27.6.2013, p. 338).

The total remuneration of any such individual may therefore not exceed 15 times the national average salary in the Member State where the beneficiary is incorporated ([15]) or 10 times the average salary of employees in the beneficiary bank.

Restrictions on remuneration must apply until the end of the restructuring period or until the bank has repaid the State aid, whichever occurs earlier.

39. Any bank in receipt of State aid in the form of recapitalisation or impaired asset measures should not in principle make severance payments in excess of what is required by law or contract.

3.1.2. *Burden-sharing by the shareholders and the subordinated creditors*

40. State support can create moral hazard and undermine market discipline. To reduce moral hazard, aid should only be granted on terms which involve adequate burden-sharing by existing investors.

41. Adequate burden-sharing will normally entail, after losses are first absorbed by equity, contributions by hybrid capital holders and subordinated debt holders. Hybrid capital and subordinated debt holders must contribute to reducing the capital shortfall to the maximum extent. Such contributions can take the form of either a conversion into Common Equity Tier 1 ([16]) or a write-down of the principal of the instruments. In any case, cash outflows from the beneficiary to the holders of such securities must be prevented to the extent legally possible.

42. The Commission will not require contribution from senior debt holders (in particular from insured deposits, uninsured deposits, bonds and all other senior debt) as a mandatory component of burden-sharing under State aid rules whether by conversion into capital or by write-down of the instruments.

43. Where the capital ratio of the bank that has the identified capital shortfall remains above the EU regulatory minimum, the bank should normally be able to restore the capital position on its own, in particular through capital raising measures as set out in point 35. If there are no other possibilities, including any other supervisory action such as early intervention measures or other remedial actions to overcome the shortfall as confirmed by the competent supervisory or resolution authority, then subordinated debt must be converted into equity, in principle before State aid is granted.

44. In cases where the bank no longer meets the minimum regulatory capital requirements, subordinated debt must be converted or written down, in principle before State aid is granted. State aid must not be granted before equity, hybrid capital and subordinated debt have fully contributed to offset any losses.

45. An exception to the requirements in points 43 and 44 can be made where implementing such measures would endanger financial stability or lead to disproportionate results. This exception could cover cases where the aid amount to be received is small in comparison to the bank's risk weighted assets and the capital shortfall has been reduced significantly in particular through capital raising measures as set out in point 35. Disproportionate results or a risk to financial stability could also be addressed by reconsidering the sequencing of measures to address the capital shortfall.

46. In the context of implementing points 43 and 44, the 'no creditor worse off principle' ([17]) should be adhered to. Thus, subordinated creditors should not receive less in economic terms than what their instrument would have been worth if no State aid were to be granted.

([15]) As published by the OECD on its website under Average Annual Wages in constant prices for the last available year, http://stats.oecd.org/Index.aspx

([16]) As defined by Article 26 of the Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (OJ L 176, 27.6.2013, p. 1).

([17]) This can for example be achieved by creating a holding company. The ownership of the bank would be recorded on the asset side of the holding company, whereas the equity, hybrids and subordinated debt existing in the bank prior to the State aid interventions constitute the liability side of the holding company with the same seniority structure as the one existing in the bank prior to the intervention.

3.1.3. *Preventing the outflow of funds prior to a restructuring decision*

47. In order to limit the aid to the minimum necessary, outflows of funds must be prevented at the earliest stage possible. Therefore, from the time capital needs are known or should have been known to the bank, the Commission considers that the bank should take all measures necessary to retain its funds. In particular, from that moment on, institutions which have identified or should have identified capital needs:

(a) must not pay dividends on shares or coupons on hybrid capital instruments (or any other instruments for which the coupon payment is discretionary);

(b) must not repurchase any of their own shares or call hybrid capital instruments for the duration of the restructuring period without prior approval by the Commission; and

(c) must not buy back hybrid capital instruments, unless such a measure, possibly in combination with others, allows the institution to fully absorb its capital shortfall, and occurs sufficiently close to current market levels ([18]) and at not more than 10 % above the market price; any buy back is subject to prior approval by the Commission;

(d) must not perform any capital management transaction without prior approval by the Commission;

(e) must not engage in aggressive commercial practices; and

(f) must not acquire a stake in any undertaking, be it a asset or share transfer. That requirement does not cover: (i) acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms; and (ii) the acquisition of stakes in undertakings provided that the purchase price paid is less than 0,01 % of the last available balance sheet size of the institution at that moment and that the cumulative purchase prices paid for all such acquisitions from that moment until the end of the restructuring period is less than 0,025 % of its last available balance sheet size at that moment; (iii) the acquisition of a business, after obtaining the Commission's approval, if it is, in exceptional circumstances, necessary to restore financial stability or to ensure effective competition;

(g) must refrain from advertising referring to State support and from employing any aggressive commercial strategies which would not take place without the support of the Member State.

48. As it needs to be ensured that the aid is limited to the minimum necessary, if a bank undertakes actions which are not in line with the requirements listed in point 47 at a point in time when its need for additional capital should have been evident to a well-run business, the Commission will, for the purpose of establishing the required measures to limit distortions of competition, add an amount equivalent to the outflow of funds to the aid amount.

3.1.4. *Covering the residual capital shortfall with restructuring aid*

49. If after the implementation of the capital raising and burden-sharing measures a capital shortfall remains, it can in principle be covered by public recapitalisation, impaired asset measures or a combination of the two. In order for such aid to be compatible, a restructuring plan has to be submitted to the Commission which needs to comply with the relevant sections of the Crisis Communications.

3.2. **Rescue aid in the form of recapitalisation and impaired asset measures**

50. Once the Commission begins to apply the principles set out in this Communication, a Member State will have to notify a restructuring plan to the Commission and obtain State aid approval before any recapitalisation or impaired asset measures are taken. However, such measures can exceptionally be authorised by the Commission to be granted by the Member State on a temporary basis as rescue aid before a restructuring plan is approved, if such measures are required to preserve financial stability. If

([18]) For example if the buy-back occurs at a double digit discount in percentage points of nominal value from the market price (or, in the absence of a market, a proxy of the market price) to generate profits, or if the buy-back is part of an exchange providing the credit institution with higher quality capital reducing the shortfall.

a Member State invokes this financial stability clause, the Commission will request an *ex ante* analysis from the competent supervisory authority confirming that a current (not prospective) capital shortfall exists, which would force the supervisor to withdraw the institution's banking license immediately if no such measures were taken. Moreover, any such analysis will have to demonstrate that the exceptional risk to financial stability cannot be averted with private capital within a sufficiently short period of time or by any other less distorting temporary measure such as a State guarantee.

51. Any rescue measure falling under point 50 has to be notified to the Commission. In order to be temporarily approved by the Commission, such a measure must comply with the rules governing the remuneration and burden-sharing of such measures set out in the Recapitalisation Communication, the 2011 Prolongation Communication and, where applicable, the Impaired Asset Communication.

52. Moreover, rescue aid in the form of recapitalisation and impaired asset measures must not prevent compliance with the burden-sharing requirements set out in this Communication. Consequently, either the required burden-sharing measures must be implemented as part of the rescue aid, or the recapitalisation or impaired asset measures must be arranged in a manner that allows for the implementation of the burden-sharing measures *ex post*. Such *ex post* implementation may be achieved by, for example, equity recapitalisation in a form that is senior to existing capital and subordinated debt instruments, whilst being compliant with the applicable regulatory and supervisory framework.

53. Following the authorisation of rescue aid, the Member State must submit a restructuring plan in line with the Restructuring Communication within two months of the date of the decision temporarily approving the aid. The restructuring plan will be assessed on the basis of the Restructuring Communication, taking into account the principles of burden-sharing described in this Communication.

3.3. **Schemes for recapitalisation and restructuring of small institutions**

54. Aid to small banks tends to affect competition less than aid granted to larger banks. For that reason and to ensure a proportionate administrative treatment, it is appropriate to allow for a simpler procedure in relation to small banks whilst ensuring that competition distortions are limited to the minimum. Therefore, the Commission is willing to authorise schemes for recapitalisation and restructuring of small institutions where such schemes have a clear remit and are limited to a six-month period, provided they respect the principles set out in the Crisis Communications and in particular the burden-sharing requirements of this Communication. The application of any such scheme must furthermore be restricted to banks with a balance-sheet total of not more than EUR 100 million. The sum of the balance-sheets of the banks that receive aid under the scheme must not exceed 1,5 % of the total assets held by banks in the domestic market of the Member State concerned.

55. The Commission will evaluate any such scheme so as to verify whether it achieves its objective and is implemented correctly. To that end, the Member State must provide a report on the use of the scheme on a six-monthly basis after the scheme's authorisation.

4. **GUARANTEES AND LIQUIDITY SUPPORT OUTSIDE THE PROVISION OF CENTRAL BANK LIQUIDITY**

56. Liquidity support and guarantees on liabilities temporarily stabilise the liability side of a bank's balance sheet. Therefore, unlike recapitalisation or impaired asset measures which in principle must be preceded by the notification of a restructuring plan by the Member State concerned and approval by the Commission before they can be granted, the Commission can accept that Member States notify guarantees and liquidity support to be granted after approval on a temporary basis as rescue aid before a restructuring plan is approved.

57. Guarantees and liquidity support can be notified individually to the Commission; in addition the Commission may also authorise schemes providing for liquidity measures for a maximum period of six months.

58. Such schemes must be restricted to banks which have no capital shortfall. Where a bank with a capital shortfall is in urgent need of liquidity, an individual notification to the Commission is required ([19]). In such circumstances, the Commission will apply the procedure set out in points 32 to 34 *mutatis mutandis*, including the requirement for a restructuring or wind-down plan, unless the aid is reimbursed within two months.

([19]) Banks which have already received approved rescue aid at the date of entry into force of this Communication but have not yet obtained a final approval of the restructuring aid may receive support under a liquidity scheme without individual notification.

59. In order to be approved by the Commission, guarantees and liquidity support must meet the following requirements:

(a) guarantees may only be granted for new issues of credit institutions' senior debt (subordinated debt is excluded);

(b) guarantees may only be granted on debt instruments with maturities from three months to five years (or a maximum of seven years in the case of covered bonds). Guarantees with a maturity of more than three years must, except in duly justified cases, be limited to one-third of the outstanding guarantees granted to the individual bank;

(c) the minimum remuneration level of the State guarantees must be in line with the formula set out in the 2011 Prolongation Communication;

(d) a restructuring plan must be submitted to the Commission within two months for any credit institution granted guarantees on new liabilities or on renewed liabilities for which, at the time of the granting of the new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of that decision) exceed both a ratio of 5 % of total liabilities and a total amount of EUR 500 million;

(e) for any credit institution which causes the guarantee to be called upon, an individual restructuring or wind-down plan must be submitted within two months after the guarantee has been activated;

(f) the recipients of guarantees and liquidity support must refrain from advertising referring to State support and from employing any aggressive commercial strategies which would not take place without the support of the Member State.

60. For guarantee and liquidity support schemes, the following additional criteria must be met:

(a) the scheme must be restricted to banks without a capital shortfall as certified by the competent supervisory authority in line with point 28;

(b) guarantees with a maturity of more than three years must be limited to one-third of the total guarantees granted to the individual bank;

(c) Member States must report to the Commission on a three-monthly basis on: (i) the operation of the scheme; (ii) the guaranteed debt issues; and (iii) the actual fees charged;

(d) Member States must supplement their reports on the operation of the scheme with available updated information on the cost of comparable non-guaranteed debt issuances (nature, volume, rating, currency).

61. In exceptional cases guarantees may also be approved covering exposures of the European Investment Bank towards banks for the purpose of restoring lending to the real economy in countries with severely distressed borrowing conditions compared to the Union average. In assessing such measures the Commission will examine in particular whether they do not confer an undue benefit that could for example serve to develop other business activities of those banks. Such guarantees may only cover a period of up to seven years. If approved by the Commission, such guarantees do not trigger an obligation for the bank to present a restructuring plan.

5. PROVISION OF LIQUIDITY BY CENTRAL BANKS AND INTERVENTION OF DEPOSIT GUARANTEE SCHEMES AND RESOLUTION FUNDS

62. The ordinary activities of central banks related to monetary policy, such as open market operations and standing facilities, do not fall within the scope of the State aid rules. Dedicated support to a specific credit institution (commonly referred to as 'emergency liquidity assistance') may constitute aid unless the following cumulative conditions are met [20]:

[20] In such cases, the measures will subsequently be assessed as part of the restructuring plan.

(a) the credit institution is temporarily illiquid but solvent at the moment of the liquidity provision which occurs in exceptional circumstances and is not part of a larger aid package;

(b) the facility is fully secured by collateral to which appropriate haircuts are applied, in function of its quality and market value;

(c) the central bank charges a penal interest rate to the beneficiary;

(d) the measure is taken at the central bank's own initiative, and in particular is not backed by any counter-guarantee of the State.

63. Interventions by deposit guarantee funds to reimburse depositors in accordance with Member States' obligations under Directive 94/19/EC on deposit-guarantee schemes ([21]) do not constitute State aid ([22]). However, the use of those or similar funds to assist in the restructuring of credit institutions may constitute State aid. Whilst the funds in question may derive from the private sector, they may constitute aid to the extent that they come within the control of the State and the decision as to the funds' application is imputable to the State ([23]). The Commission will assess the compatibility of State aid in the form of such interventions under this Communication.

64. State aid in the form of interventions by a resolution fund will be assessed under this Communication in order to assess its compatibility with the internal market.

6. SPECIFIC CONSIDERATIONS IN RELATION TO LIQUIDATION AID

6.1. General principles

65. Member States should encourage the exit of non-viable players, while allowing for the exit process to take place in an orderly manner so as to preserve financial stability. The orderly liquidation of a credit institution in difficulty should always be considered where the institution cannot credibly return to long-term viability.

66. The Commission recognises that, due to the specificities of credit institutions and in the absence of mechanisms allowing for the resolution of credit institutions without threatening financial stability, it might not be feasible to liquidate a credit institution under ordinary insolvency proceedings. For that reason, State measures to support the liquidation of failing credit institutions may be considered as compatible aid, subject to compliance with the requirement specified in point 44.

67. The goal of the orderly liquidation must be the cessation of the ailing credit institution's activity over a limited period of time. That goal implies that no new third party business may be undertaken. However, it does not prevent existing business from being executed, if doing so reduces the liquidation costs. Moreover, liquidation must as much as possible aim at selling off parts of the business or assets by means of a competitive process. The orderly liquidation procedure requires that the proceedings of any sale of assets contribute to the liquidation costs.

68. Member States may choose a number of tools for the organisation of the liquidation of ailing credit institutions. Any State aid measures implemented to support such a liquidation must comply with the principles specified in points 69 to 82.

6.2. Conditions for the authorisation of liquidation aid

69. Member States must provide a plan for the orderly liquidation of the credit institution.

70. The Commission will assess the compatibility of aid measures to be implemented with a view to resolving credit institutions on the same lines, *mutatis mutandis*, as set out in Sections 2, 3 and 4 of the Restructuring Communication for restructuring aid.

([21]) Directive 94/19/EC of the European Parliament and of the Council on deposit-guarantee schemes (OJ L 135, 31.5.1994, p. 5).
([22]) See, by analogy, Case T-351/02 *Deutsche Bahn* v *Commission* [2006] ECR II-1047, as well as Case C-460/07 *Puffer* [2009] ECR I-3251, paragraph 70.
([23]) See Danish winding-up scheme (OJ C 312, 17.11.2010, p. 5).

71. The particular nature of orderly liquidation gives rise to the considerations set out in points 72 to 78.

6.2.1. *Limitation of liquidation costs*

72. Member States should demonstrate that the aid enables the credit institution to be effectively wound up in an orderly fashion, while limiting the amount of aid to the minimum necessary to keep it afloat during the liquidation in view of the objective pursued and complying with the burden-sharing requirements of this Communication.

6.2.2. *Limitation of competition distortions*

73. To avoid undue distortions of competition, the winding-up phase should be limited to the period strictly necessary for the orderly liquidation.

74. As long as the beneficiary credit institution continues to operate, it must not actively compete on the market or pursue any new activities. Its operations must in principle be limited to continuing and completing activities pending for existing customers. Any new activity with existing customers must be limited to changing the terms of existing contracts and restructuring existing loans, provided that such changes improve the respective asset's net present value.

75. The pricing policy of the credit institution to be wound down must be designed to encourage customers to find more attractive alternatives.

76. Where a banking licence is necessary, for example for a rump bank or a temporary institution created for the sole purpose of orderly liquidation of a credit institution ('bridge bank'), it should be limited to the activities strictly necessary for the winding up. The banking licence should be withdrawn as soon as possible by the competent supervisory authority.

6.2.3. *Burden-sharing*

77. In the context of orderly liquidation, care must be taken to minimise moral hazard, particularly by preventing additional aid from being provided to the benefit of the shareholders and subordinated debt holders. Therefore, the claims of shareholders and subordinated debt holders must not be transferred to any continuing economic activity.

78. Sections 3.1.2 and 3.1.3 must be complied with *mutatis mutandis*.

6.3. **Sale of a credit institution during the orderly liquidation procedure**

79. The sale of a credit institution during an orderly liquidation procedure may entail State aid to the buyer, unless the sale is organised via an open and unconditional competitive tender and the assets are sold to the highest bidder. Such competitive tender should, where appropriate, allow for sale of parts of the institution to different bidders.

80. In particular, when determining if there is aid to the buyer of the credit institution or parts of it, the Commission will examine whether:

(a) the sales process is open, unconditional and non-discriminatory;

(b) the sale takes place on market terms;

(c) the credit institution or the government, depending on the structure chosen, maximises the sales price for the assets and liabilities involved.

81. Where the Commission finds that there is aid to the buyer, the Commission will assess the compatibility of that aid separately.

82. If aid is granted to the economic activity to be sold (as opposed to the purchaser of that activity), the compatibility of such aid will be subject to an individual examination in the light of this Communication. If the liquidation process entails the sale of an economic entity which holds a significant market share, the Commission will assess the need for measures to limit distortions of competition brought about by the aid to that economic entity and will verify the viability of the entity resulting from the sale. In its viability assessment, the Commission will take into due consideration the size and strength of the buyer relative to the size and strength of the business acquired.

6.4. **Conditions for the authorisation of orderly liquidation schemes**

83. The implementation by Member States of regimes to deal with distressed credit institutions may include the possibility of granting aid to ensure the orderly liquidation of distressed credit institutions, while limiting negative spillovers on the sector and on the economy as a whole.

84. The Commission considers that liquidation aid schemes for credit institutions of limited size ([24]) can be approved, provided they are well designed so as to ensure compliance with the requirements on burden-sharing by shareholders and subordinated debt-holders set out in point 44 and to remove moral hazard and other competition concerns.

85. The compatibility of such schemes will be assessed in the light of the conditions set out in Section 3. When notifying a scheme to the Commission, Member States must therefore provide detailed information on the process and on the conditions for the interventions in favour of beneficiary institutions.

86. As the degree to which competition is distorted may vary according to the nature of the beneficiary institution and its positioning in the market, an individual assessment might be necessary to ensure that the process does not lead to undue competition distortions. Therefore, aid measures under an approved scheme in favour of credit institutions with total assets of more than EUR 3 000 million must be individually notified for approval.

6.5. **Monitoring**

87. Member States must provide regular reports, at least on an annual basis, on the operation of any scheme authorised pursuant to Section 6.4. Those reports must also provide the information for each credit institution being liquidated pursuant to Section 6.4.

88. In order to allow the Commission to monitor the progress of the orderly liquidation process and its impact on competition, Member States must submit regular reports (on at least a yearly basis) on the development of the liquidation process of each bank in liquidation and a final report at the end of the winding-up procedure. In certain cases, a monitoring trustee, a divestment trustee or both may be appointed to ensure compliance with any conditions and obligations underpinning the authorisation of the aid.

7. DATE OF APPLICATION AND DURATION

89. The Commission will apply the principles set out in this Communication from 1 August 2013.

90. Notifications registered by the Commission prior to 1 August 2013 will be examined in the light of the criteria in force at the time of notification.

91. The Commission will examine the compatibility with the internal market of any aid granted without its authorisation and therefore in breach of Article 108(3) of the Treaty on the basis of this Communication if some or all of that aid is granted after the publication of the Communication in the *Official Journal of the European Union*.

92. In all other cases it will conduct the examination on the basis of the Crisis Communications in force at the time at which the aid is granted.

93. The Commission will review this Communication as deemed appropriate, in particular so as to cater for changes in market conditions or in the regulatory environment which may affect the rules it sets out.

94. The 2008 Banking Communication is withdrawn with effect from 31 July 2013.

95. Point 47 and Annex 5 of the Impaired Assets Communication are withdrawn.

96. The Restructuring Communication is adapted as follows:

    In point 4 the first sentence is replaced by the following: 'Where a financial institution has received State aid, the Member State should submit a restructuring plan in order to confirm or re-establish individual banks' long-term viability without reliance on State support.'

([24]) See e.g. N 407/10, Danish winding-up scheme for banks (OJ C 312, 17.11.2010, p. 7).

Footnote 4 relating to point 4 is withdrawn.

Point 7 third indent is replaced by the following: '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.'

Point 8 is withdrawn.

In footnote 1 relating to point 21 the first sentence is replaced by the following: 'See Section 6 of the 2013 Banking Communication.'

Point 25 is replaced by the following: 'Any derogation from an adequate burden-sharing *ex ante* which may have been exceptionally granted before a restructuring plan is approved 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.'