EFTA SURVEILLANCE AUTHORITY DECISION

No 57/11/COL
of 2 March 2011

amending, for the 82nd time, the procedural and substantive rules in the field of State aid by introducing a new chapter on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis

THE EFTA SURVEILLANCE AUTHORITY (‘the Authority’),

HAVING REGARD to the Agreement on the European Economic Area (‘the EEA Agreement’), in particular to Articles 61,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (‘the Surveillance and Court Agreement’), in particular to Article 24 and Article 5(2)(b),

WHEREAS under Article 24 of the Surveillance and Court Agreement, the Authority shall give effect to the provisions of the EEA Agreement concerning State aid,

WHEREAS under Article 5(2)(b) of the Surveillance and Court Agreement, the Authority shall issue notices or guidelines on matters dealt with in the EEA Agreement, if that Agreement or the Surveillance and Court Agreement expressly so provides or if the Authority considers it necessary,

WHEREAS, on 1 December 2010, the European Commission adopted a Communication on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis (1),

WHEREAS this Communication is also of relevance for the European Economic Area,

WHEREAS uniform application of the EEA State aid rules is to be ensured throughout the European Economic Area in line with the objective of homogeneity established in Article 1 of the EEA Agreement,

WHEREAS, according to point II under the heading ‘GENERAL’ on page 11 of Annex XV to the EEA Agreement, the Authority, after consultation with the Commission, is to adopt acts corresponding to those adopted by the European Commission,

HAVING consulted the European Commission,

HAVING consulted the EFTA States by letters dated 10 February 2011 on the subject,

HAS ADOPTED THIS DECISION:

Article 1

The State Aid Guidelines shall be amended by introducing a new chapter on the application, from 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis.

The new chapter is set out in the Annex to this Decision.

Article 2

Only the English version of this Decision is authentic.

Done at Brussels, 2 March 2011.

For the EFTA Surveillance Authority

Per SANDERUD
President

Sabine MONAUNI-TÖMÖRDI
College Member

1. Introduction

1. Since the beginning of the global financial crisis in the autumn of 2008, the EFTA Surveillance Authority ('the Authority') has adopted four sets of Guidelines (1) which provide detailed guidance on the criteria for the compatibility of State support to financial institutions (2) with the requirements of Article 61(3)(b) of the Agreement on the European Economic Area ('the EEA Agreement'). The chapters of the Guidelines in question are the application of State aid rules to measures taken in relation to financial institutions (3) (the Banking Guidelines); the recapitalisation of financial institutions in the current financial crisis (4) (the Recapitalisation Guidelines); the treatment of impaired assets in the EEA banking sector (5) (the Impaired Assets Guidelines) and return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules (6) (the Restructuring Guidelines). Three of those four Guidelines, the Banking, Recapitalisation and Impaired Assets Guidelines, set out the prerequisites for the compatibility of the main types of assistance granted by EFTA States — guarantees on liabilities, recapitalisations and asset relief measures — while the Restructuring Guidelines detail the particular features that a restructuring plan (or a viability plan) has to display in the specific context of crisis-related State aid granted to financial institutions on the basis of Article 61(3)(b) of the EEA Agreement.

2. All four chapters of the Guidelines highlight the temporary nature of the acceptability of such aid measures; each states that any such aid measure can only be justified as an emergency response to the unprecedented stress in financial markets and only as long as those exceptional circumstances prevail. The Restructuring Guidelines are valid for restructuring aid notified by 31 December 2010 whilst the other Guidelines do not have an expiry date.

3. These Guidelines set out the parameters for the temporary acceptability of crisis-related assistance to banks as from 1 January 2011.

2. The continued applicability of Article 61(3)(b) EEA and the extension of the Restructuring Guidelines

4. The Authority's Guidelines on crisis-related aid to banks, as well as all individual decisions on aid measures and schemes falling within the scope of those Guidelines, are adopted on the legal basis of Article 61(3)(b) of the EEA Agreement, which exceptionally allows for aid to remedy a serious disturbance in the economy of an EFTA State. In the most acute stage of the crisis, the condition of a serious disturbance was unquestionably met across the EEA in view of the extraordinary stress in financial markets, later combined with an exceptionally severe contraction in the real economy.

5. The economic recovery, which has slowly taken hold since the beginning of 2010, has been proceeding at a somewhat faster pace than expected earlier in 2010. While recovery is still fragile and uneven across the EEA, some states are showing modest or even more robust growth rates. In addition, despite some pockets of vulnerability, in broad terms the health of the banking sector has improved compared with the situation one year ago. As a result, the existence of a serious disturbance in the economy of the EFTA States is no longer as self-evident as in earlier stages of the crisis. While it is aware of those developments, the Authority still considers that the requirements for State aid to be approved pursuant to Article 61(3)(b) of the EEA Agreement are fulfilled in view of the recent reappearance of stress in financial markets and the risk of wider negative spill-over effects, for the reasons set out in these Guidelines.

6. The re-emergence 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 EEA has given rise to market concerns about contagion. The high volatility of financial markets and the uncertainty about the economic outlook justifies maintaining, as a safety net, the possibility for EFTA States to argue the need to have recourse to crisis-related support measures on the basis of Article 61(3)(b) of the EEA Agreement.

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(2) For the convenience of the reader, financial institutions are referred to simply as ‘banks’ in this document.


(6) Decision 472/09/COL of 23.11.2009.
7. Therefore, the Banking, Recapitalisation and Impaired Assets Guidelines, which provide guidance on the criteria for the compatibility of crisis-related aid to banks on the basis of Article 61(3)(b) of the EEA Agreement — most notably in the form of government guarantees, recapitalisations and asset relief measures — need to stay in place beyond 31 December 2010. In the same vein, the Restructuring Guidelines, which address the follow-up to such support measures, also have to remain applicable beyond that date. The temporal scope of the Restructuring Guidelines — the only one of the four Guidelines with a specified expiry date, 31 December 2010 — should therefore be extended to restructuring aid notified by 31 December 2011.

8. The Guidelines, however, need to be adapted with a view of preparing the transition to the post-crisis regime. In parallel, new, permanent State aid rules for bank rescue and restructuring in normal market conditions will have to be drawn up and should, market conditions permitting, apply as of 1 January 2012. The possible continued need for crisis-induced extraordinary State aid to the financial sector has to be evaluated with that objective in mind. It must be addressed by setting the requirements for the compatibility of such assistance in a way that best prepares for the new regime for the rescue and restructuring of banks based on Article 61(3)(c) of the EEA Agreement.

3. The advancement of the exit process

9. The continued availability of aid measures pursuant to Article 61(3)(b) of the EEA Agreement in the face of exceptional market conditions should not obstruct the process of disengagement from temporary extraordinary support measures for banks. At its meeting on 2 December 2009 the Economic and Financial Affairs Council concluded on the necessity to design a strategy for the phasing out of support measures which should be transparent and duly coordinated among EU Member States to avoid negative spill-over effects but take into account the different specific circumstances across EU Member States (1). The conclusions further set out that, in principle, the phasing-out process concerning the various forms of assistance to banks should start with the unwinding of government guarantee schemes, encouraging the exit of sound banks and inducing other banks to address their weaknesses.

10. In the following paragraphs, the Authority will set out the steps of a gradual phasing out with regard to recapitalisation and impaired asset measures.

3.1. Tighter conditions for the compatibility of government guarantees under Article 61(3)(b) of the EEA Agreement

11. From 1 January 2011 the Authority will apply tighter conditions for the compatibility of government guarantees under Article 61(3)(b) of the EEA Agreement by introducing an increased guarantee fee and the requirement of a viability plan for beneficiaries that have recourse to new guarantees and exceed a certain threshold of total outstanding guaranteed liabilities both in absolute terms and in relation to total liabilities (2). Considering the current market these conditions appear necessary at present. Government guarantee schemes can therefore be authorised until 30 June 2011, on the basis of the following conditions introduced as of 1 January 2011. The Authority will reassess the conditions for the compatibility of state guarantees beyond 30 June 2011 in the first half of 2011.

3.1.1. Pricing conditions

12. Access to the government guarantees has been subject to a fee, which is determined following the ECB recommendations. In the case of a bond with maturity over one year, the fee comprises a flat charge of 50 basis points augmented by each bank’s median five-year senior debt credit default swap (CDS) spread observed in the period 1 January 2007 to 31 August 2008 (3).

13. The credit risk element in the current pricing model is based upon data that predates the most acute phase of the crisis in 2008. CDS spread differentials across banks are currently significantly higher than pre-crisis and are likely to remain so. Up to now, this has been considered necessary to facilitate banks’ access to external funding and thereby safeguard financial stability. However, financial-market developments in the two years since 31 August 2008, including changes in the banks’ credit status, are not taken into account. Thus, while access to market financing has generally improved, banks which have been downgraded are still benefiting from their pre-crisis credit rating and perceived creditworthiness. This increases the likelihood of competition distortions. Evidence shows that banks with low rating benefit disproportionately more from guarantees than banks with higher rating because they would normally pay a higher market price due to their low rating.

(1) These conclusions were endorsed by the European Council at its meeting on 11 December 2009. In the same vein, the European Parliament insisted in its Resolution of 9 March 2010 on the Report on Competition Policy 2008 (http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-_TA-2010-0030) that state support to financial institutions should not be unduly prolonged and that exit strategies should be elaborated as soon as possible.

(2) With a flexibility clause permitting a re-assessment of the situation and appropriate remedies in the event of a severe new shock to the financial markets across the EEA or in one or more EFTA States.

(3) See http://www.ecb.int/pub/pdf/other/recommendations_on_guaranteesen.pdf
14. In order to address these distortions, the pricing of government support should be brought closer to current market conditions, better reflecting individual banks’ current creditworthiness. De facto, this requires that the guarantee fee payable by beneficiary institutions would be increased.

15. A coordinated approach among EFTA States should promote a gradual phasing out of guarantee schemes while retaining a certain degree of flexibility to take account of the different situations of EFTA States and their banks. To this end, the Authority considers it appropriate to introduce a minimum increase in the fee for guarantees that should be differentiated according to the beneficiary bank’s creditworthiness. The differentiation based on creditworthiness strengthens the price signal for weaker banks, allows to better align the price of guarantees with the risk profile of the beneficiary institution thus lowering distortions of competition between institutions and contributing to the protection of a level playing field across banks in the single market.

16. The approval of the extension of a guarantee scheme (1) beyond 1 January 2011 would therefore require the fee for a government guarantee (2) to be higher than under the pricing formula recommended by the ECB in October 2008 at least:

— by 20 basis points for banks with a rating of A+ or A (3),

— by 30 basis points for banks rated A- (4), and

— by 40 basis points for banks rated below A-. Banks without rating will be considered to belong to the category of banks with a BBB rating (5).

17. EFTA States would have the possibility to go beyond these minimum requirements in defining the top-ups for the guarantee fee. As a further element of flexibility allowing EFTA States to adjust the conditions to the specific circumstances prevailing in their financial sectors, the Authority would accept a different model for the calculation of a fee increase provided that it can be unequivocally demonstrated that this formula leads at least to the minimum rise set out above for the banks concerned (6).

3.1.2. Viability review of banks still dependent on government debt guarantees

18. At the current juncture in the evolution of market conditions, access to liquidity on the market no longer represents a serious obstacle for banks across the board as in the more acute crisis period. Accordingly, it seems justified to introduce a differentiation in the conditions attached to the use of state guarantees based on the extent to which banks rely on them. While limited usage could be allowed without prompting further scrutiny, a larger usage both in absolute terms and in relation to the bank’s total amount of liabilities should trigger the requirement of a viability review as a prerequisite for the conformity of the further extension of guarantee schemes with Article 61(3)(b) EEA. A persistent failure to obtain a considerable proportion of the funding needed without government guarantees may indicate a lack of confidence in the viability of a bank’s business model. It should be avoided that a bank retains a heavy reliance on guarantee schemes, which were designed to tackle unprecedented difficulties in access to financing, even when these exceptional circumstances have subsided, thereby possibly allowing that bank to postpone necessary structural adjustments.

19. Therefore, the Authority considers it appropriate that guarantee schemes to be prolonged beyond 1 January 2011 should include a threshold concerning the ratio of total guaranteed liabilities outstanding over total liabilities of a bank and the absolute amount of guaranteed liabilities which, if exceeded, triggers the requirement of a viability review. For any bank that requests government guarantees under a scheme covering new or renewed debt to be issued as from 1 January 2011 which takes or keeps the total amount of outstanding guaranteed liabilities beyond this threshold in relation to both of its elements (absolute and relative size) (7) the EFTA State concerned would be required to submit a review demonstrating the bank’s long-term viability to the Authority within three months of the granting of guarantees.

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(1) Individual notifications of government guarantees outside a scheme will generally require a guarantee fee along the same lines. Where the beneficiary is under restructuring obligations and a lower fee may be justified depending on the specific circumstances this deviation will have to be taken into account in the overall assessment of the restructuring and the measures necessary to minimise distortions of competition.

(2) This includes guarantees covering liabilities of one year or less.

(3) Or A1 and A2 depending on the rating system employed.

(4) Or A3 depending on the rating system employed.

(5) In the case of divergent assessments by different rating agencies the relevant rating for the calculation of the fee increase should be the higher rating. The material time for the rating in the determination of the guarantee fee is the day on which the guarantee is granted in relation to a specific bond issuance by the beneficiary.

(6) E.g., an update of the CDS reference period stipulated in the ECB recommendations of October 2008 that demonstrably leads to an increase of at least 20 bp for banks rated A+ and A, 30 bp for banks rated A- and 40 bp for banks rated below A-.

(7) The assessment will be carried out when an EFTA State receives the application for an approval of guarantees for the issuance of new or renewed debt as from 1 January 2011 and will include the amount of debt to be covered by the requested guarantees as well as all existing outstanding guaranteed liabilities in relation to total liabilities/balance sheet at the material time. Outstanding liabilities that exceed the threshold due to issuances before 1 January 2011 do not trigger a viability review unless the bank resorts to the issuance of new debt keeping the guaranteed liabilities above the threshold.
20. This mechanism does not apply to banks that are already in restructuring or are obliged to present a restructuring plan or that are already subject to a pending viability review at the material time. In those scenarios the award of additional State aid will have to be taken into account within the framework of the ongoing restructuring/viability review process (1).

21. The threshold is set at a ratio of 5 % of outstanding guaranteed liabilities over total liabilities and at a total amount of guaranteed debt of EUR 500 million. The determination of this trigger threshold is based on a comparative analysis which illustrates that the vast majority of banks that use guarantees and are presently not under restructuring obligations (and even a significant proportion of banks that are subject to such obligations) stay well below this level. For the small but not negligible group of banks exceeding this limit, it is warranted to scrutinise whether the considerable reliance on guarantees for funding indicates a more structural weakness of their business models. The trigger function provides an incentive for sound banks to initiate a swift process of return to funding predominantly or exclusively on undistorted market terms. For all banks undergoing a thorough viability review either their long-term viability will be confirmed or doubts in that respect will indicate the need to confront the necessity of a farther-reaching restructuring.

22. In relation to the content to be provided in a viability review exercise, reference can be made to the Restructuring Guidelines which set out that the principles concerning the analysis of a bank’s situation with a view to the restoration of long-term viability in a restructuring plan apply by analogy to cases where the aid beneficiary is not under a formal obligation to present a restructuring plan but is nonetheless required to demonstrate long-term viability. In particular the bank will have to demonstrate the solidity of its funding capacity and, where necessary, to undergo a liquidity stress test (2). A viability review should also take account of any factors specific to the beneficiary financial institutions (3) or to the EFTA State concerned (4) and the situation of its financial markets that have an impact on the viability assessment and on the indicative value of the ratio of guaranteed liabilities over total liabilities. As a general rule, the more significant the reliance on government guarantees is and the more it is combined with the use of other forms of State assistance and/or a low creditworthiness (5) the stronger the indication of a need to undergo changes in the business model in order to ensure long-term viability.

23. The mechanism triggering the requirement of a viability review conveys the signal that banks have to prepare for a return to normal market mechanisms without state support as the financial sector gradually emerges from crisis conditions and represents an incentive for individual institutions to scale down the reliance on government guarantees or to refrain from their use altogether. At the same time, it affords sufficient flexibility to duly take account of potentially diverse circumstances affecting the situation of different banks or national financial markets and also caters for the possibility of an overall deterioration in relation to financial stability which cannot be excluded at this stage given the residual fragility in the recovery of financial markets.

4. Removal of the distinction between sound and distressed banks for the purposes of submitting a restructuring plan

24. At the beginning of the crisis, the Authority established a distinction between unsound/distressed financial institutions and fundamentally sound financial institutions, that is to say, financial institutions suffering from endogenous, structural problems linked, for instance, to their particular business model or investment strategy and financial institutions whose problems merely and largely had to do with the extreme situation in the financial crisis rather than with the soundness of their business model, inefficiency or excessive risk taking. The distinction is defined in particular on the basis of a number of indicators set out in the Recapitalisation Guidelines: capital adequacy, current CDS spreads, current rating of the bank and its outlook as well as, inter alia, the relative size of the recapitalisation. Regarding the latter, the Authority deems aid received under the form of recapitalisation and asset relief measures of more than 2 % of the bank’s risk weighted assets to be an indicator to distinguish between fundamentally sound and distressed banks. The recapitalisation of a distressed bank triggers the requirement to submit a restructuring plan to the Authority, while the recapitalisation of a sound bank triggers the requirement to submit a viability plan.

(1) For example, where a bank is already undergoing a viability review because of a recapitalisation and the threshold for guarantees is exceeded, the review has to be extended to address the reasons why the bank continues to rely on state guarantees, to include a liquidity test, and to analyse if and to what extent further use of state guarantee is foreseen.

(2) Restructuring Guidelines, point 8 and section 2, also pointing to the related sections in point 40 of the Recapitalisation Guidelines and Annex V to the Impaired Assets Guidelines.

(3) Including, for example, a higher ratio of guaranteed debts that is explained by a particular effort to sustain or increase lending to the real economy in the public interest and with the backing of the EFTA State concerned provided that such conduct is compatible with the common market.

(4) Having due regard to the macro-economic situation of the EFTA State in general and in particular to those elements such as the sovereign risk that have a direct bearing on the terms of access to funding for banks located in the EFTA State.

(5) As expressed in the beneficiary’s rating or CDS spread.
25. The original rationale for establishing that distinction and for setting a range of indicators, including a threshold of 2 % of the bank's risk weighted assets, was the fear that capital needs resulting from impairments, higher expectations of the markets as to the capital levels of banks and temporary difficulties in raising capital on markets would otherwise lead to sound banks diminishing their lending to the real economy in order to avoid having to submit a restructuring plan when having recourse to State resources. At present, however, the banking sector overall faces fewer difficulties in raising capital on the markets or, inter alia, through retained earnings (1) and can therefore meet their capital needs without recourse to State aid (2). The amount of capital raised by financial institutions on the market has significantly increased over the course of 2009 and 2010, demonstrating renewed access for financial institutions to capital markets as well as anticipation of new regulatory requirements (3).

26. The distinction between sound and distressed banks therefore no longer seems relevant in order to determine which banks should enter into a discussion about their restructuring with the Authority. As a result, banks which still have recourse to the State in 2011 for raising capital or for impaired assets measures should be required to submit to the Authority a restructuring plan showing the bank's determination to undertake the necessary restructuring efforts and return to viability without undue delay. Thus, as of 1 January 2011, a restructuring plan will be required from every beneficiary of a new recapitalisation or an impaired asset measure (4).

27. In assessing the restructuring needs of banks, the Authority will take into consideration the specific situation of each institution, the degree to which such a restructuring is necessary to restore viability without further state support as well as prior reliance on State aid. As a general rule, the more significant the reliance on State aid, the stronger the indication of a need to undergo in-depth restructuring in order to ensure long-term viability. In addition, the individual assessment will take account of any specific situation on the markets and will apply the restructuring framework in an appropriately flexible manner in the event of a severe shock endangering financial stability in one or more EFTA States.

28. Requiring a restructuring plan for banks benefiting from structural aid (that is to say, recapitalisation and/or impaired asset measures) — while at the same time accepting that the mere use of refinancing guarantees would still not trigger the requirement to submit a restructuring plan — conveys the signal that banks have to prepare for a return to normal market mechanisms without state support as the financial sector gradually emerges from crisis conditions. It provides an incentive for individual institutions that still need aid to accelerate the necessary restructuring. At the same time, it affords sufficient flexibility to duly take account of potentially diverse circumstances affecting the situation of different banks or national financial markets. It also caters for the possibility of an overall or country-specific deterioration in relation to financial stability, which cannot be excluded at present, given the residual fragility in the situation of financial markets.

5. Temporal scope, general outlook

29. The continued applicability of Article 61(3)(b) of the EEA Agreement and the extension of the Restructuring Guidelines will be from 1 January 2011 until 31 December 2011 (5). This extension under changed conditions should also be seen in the context of a gradual transition to a more permanent regime of State aid guidelines for the rescue and restructuring of banks based on Article 61(3)(c) of the EEA Agreement which should, market conditions permitting, apply as of 1 January 2012.

(1) In order to increase capital buffers, banks have decided to sell non-strategic assets such as industrial participations, or to focus on specific geographical sectors. See on this point European Central Bank, ‘EU Banking Sector Stability, September 2010’.

(2) According to the European Central Bank, banks’ overall solvency ratio increased substantially in the course of 2009 in all EU Member States. In addition, information for a sample of large banks in the European Union suggests that the improvement in capital ratios continued into the first half of 2010, supported by an increase in retained earnings as well as by further private capital raising and public capital injections for some banks. See European Central Bank: ‘EU Banking Sector Stability, September 2010’.

(3) The future regulatory environment drawn up by the Basel Committee on the Banking Supervision (BCBS), so-called Basel III, sets a path for the implementation of the new capital rules which should allow banks to meet the new capital needs over time. In this context, it is interesting to note that, first, most of the largest banks in the European Union have reinforced their capital buffers over the last two years to increase their loss absorption capacity and, second, the other banks in the European Union should have sufficient time (up to 2019) to build up their capital buffer using, inter alia, retained earnings. It should also be noted that the transitional arrangements provided by the new regulatory framework have established a ‘grandfathering period’ until 1 January 2018 for existing public sector capital injections. Moreover, a quantitative impact assessment done by the Basel Committee, confirmed by Commission calculations, points to a rather moderate impact on bank lending. Therefore, the new capital requirements are not expected to impact the proposal outlined in these Guidelines.

(4) This will apply to all recapitalisation or impaired asset measures, irrespective of whether they are designed as individual measures or granted in the context of a scheme.

(5) Existing or new bank support schemes (irrespective of the support instruments they contain: guarantee, recapitalisation, liquidity, asset relief, other) will only be prolonged/approved for a duration of six months to allow for further adjustments, if necessary, in mid-2011.