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**Analysis of Effects of Rescue and Restructuring State Aid to
Financial Undertakings on Competition in Internal Market**

Bachelor Thesis

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I hereby declare that I am the sole author
of this Bachelor Thesis and it has
not been presented to any other
university of examination.

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The Bachelor Thesis meets the established requirements

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Abbreviations

EBA	European Banking Authority
ECB	European Central Bank
EIOPA	European Insurance and Occupational pensions authority
ESA	European Supervisory authority,
ESFS	European system of financial supervisors,
ESMA	European securities and Markets authority,
ESRB	European Systemic Risk Board
R&R State aid	Rescue and Restructuring State aid
SME	Small and Medium size enterprises
TFEU	Treaty on the Functioning of the European Union

Introduction

The main reasoning behind the choice of topic is that during the financial crisis the Commission has an exclusive authority to grant Rescue and Restructuring State aid (R&R State aid) to financial undertakings under 107 (3) (b) TFEU in order to remain the proper functioning of the internal market. However, the rescue and restructuring aid is granted under certain conditions and has implications on competition within internal market. Additionally, the financial undertakings have a decisive impact on real market through lending and investments. Therefore, the distortion of competition within internal market has effects on real market and proper functioning of the citizens' lives. The Commission has applied several Crisis Communications during their decision-making process and these Communications are the base of this Thesis. The main goal of this thesis is to analyze the criteria the Commission applies during the financial crisis and whether the R&R aid has an effect on competition in the internal market. Additionally, the author analyses the conflict between legislation and social benefits. The comparison between the EU and USA State aid policies is analyzed and the effects of R&R State aid in the Baltic region are examined.

Hypothesis of this Thesis is that the Rescue and Restructuring State aid distorts competition within the internal market because of its nature, and the research question is **Does the R&R State aid distort competition between financial undertakings in the internal market, and if so, do the current Communications address the effects and implications of R&R State aid in a sufficient manner?** The legal problem in this Thesis is the lack of current legislation and its effectiveness in comparison to distortion of competition. Mechanisms the Commission can apply during financial crisis to secure the proper functioning of the market are also examined. The author questions what are the principles the Commission has to apply during the decision-making process and whether the Commission should favour social benefits or limit the distortion of competition.

The structure of the thesis is as follows; firstly the author examines the main principles of the R&R aid procedure and the specific requirements that the Commission has to take into account during their decision-making process. Secondly, the author examines the mechanism of the R&R

aid and the requirements that the undertaking have to fulfil in order to gain R&R State aid. Thirdly, the author analyze the effects of R&R State aid on competition in internal market and the other perspectives, such as USA and Baltic region. The author will also analyze the balance between regulations and social benefits and provide solutions what the Commission should take into consideration in their decisions. Additionally, the compensatory measures to limit the distortion of competition are examined and analyzed.

My analysis is in legal nature. I do not take sides whether the Commission decisions are politically sound or correct. The methods used in this Thesis are legal analysis, case studies and literature review. The main method is legal analysis where the author analyses the six Crisis Communications, Banking-, Recapitalisation-, Impaired Assets-, Restructuring-, Prolongation Communication 2010, Prolongation Communication 2011, other regulations and directives. Additionally, the author analyses the research question based on case-law and legal journals. E-materials are used to provide information about the relevant market shares in Estonia and US. The sources used in this Thesis are mostly legal journals, articles, books and case-law. Sources are relevant under this research topic as the effects of the previous financial crisis can be seen this year after the restructuring plans are implemented to undertakings' businesses. In case-law the author examines the Commission's decision and other case law from Court of Justice of European Union.

The scope of the subject is related to R&R State aid and the measures the Commission can use in decision-making process. The effects of the Commission decision are not researched. The author focuses on effects on competition and real economy. The scope is extended to mechanism the government can use in order to resume the proper functioning of the market. The subject has interest for contemporary research as the effects of R&R on competition is researched but on internal market and real economy not.

1. Rescue and Restructuring State Aid to financial undertakings

1.1 General scope of the chapter

This chapter explains the basic principles of the R&R State aid and the current situation in the legislation. The author will analyze the effectiveness of the current Communications and the need for new regulations. Additionally, this chapter will explain the principles which the Commission applies during the R&R aid cases, as well as, why conditionality of the aid is necessary to prevent the distortion of competition.

1.2 Definition of Rescue Aid and Restructuring State Aid

When examining the Banking Communication¹ and case-law, it should be kept in mind that there is a difference between rescue aid and restructuring aid.² Both of these support measures are generally distortive on competition when granted without restrictions, and therefore have effects on competition in internal market. The main difference between rescue aid and restructuring aid is that rescue aid is granted for a period no longer than six months while restructuring aid is granted by the State after restructuring plan is developed, submitted and authorized by the Commission.³ It must be recognized that there should be a need for rescue aid to prevent insolvency and restructuring aid which enables the undertakings to remain its long-term viability.⁴ The Commission bases its decision on three pillars; 1) viability 2) burden-sharing and 3) competition.⁵

¹ 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'), OJ, C 216/01, 30.07.2013

² Pasaresi N., Mamdani G. Latest Developments in the Rules on State Aid for the Rescue and Restructuring of Financial Institutions in Difficulty. *European State Aid Law Quarterly* 2012, p 768.

³ *Ibid*

⁴ Shutte M. Revising the Rescue and Restructuring Aid Guidelines for the Real Economy. *European State Aid Law Quarterly* 4/2012, p 816.

⁵ De Kok J. Competition Policy in the Framework and Application of State Aid in the Banking Sector. *European State Aid Law Quarterly* 2015, p 224.

1.2.1 The definition of undertaking in difficulty

The common criteria for Rescue aid and Restructuring aid is that the undertaking has to be in difficulty.⁶ There is no Treaty or secondary legislation definition of ‘a firm in difficulty’⁷, but the Commission considers a firm in difficulty when it is unable to stem its losses without intervention by the public authorities.⁸ Therefore, it is a case-by-case interpretation by the Commission whether the undertaking is considered ‘a firm in difficulty’.⁹ In most cases the relevant authority of the Member State confirms that the undertaking is in difficulty, but the final decision is made by the Commission who approves the rescue aid. An example can be found in cases *Roskilde*¹⁰ and *Probanka d.d.*¹¹ where the authorities confirmed by providing documents of the bank’s balance sheet that the banks were in difficulty. After the relevant authorities submitted the documents, the Commission approved the rescue aid to banks.

1.2.2 Rescue aid

Rescue aid is meant to give breathing room to undertaking in difficulty.¹² Current Banking Communication mentions rescue aid,¹³ and it can be seen in case-law¹⁴ that the national authorities have granted support measures before the Commission has granted the restructuring aid.¹⁵ The aid enables the undertaking to continue its usual business plan until restructuring aid is

⁶ Pasaresi N. Mamdani G.,(2012), *supra* nota 1, p 768.

⁷ Shutte M. (2012), *supra* nota 1, p 816.

⁸ Communication from the Commission community guidelines on State aid for rescuing and restructuring firms in difficulty, OJ C 244/02, 1.10.2004

⁹ 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’) OJ, C 216/01, 30.07.2013, Art. 1 (4)

¹⁰ Commission decision NN 36/2008 – Denmark - *Roskilde Bank A/S*

¹¹ Commission Decision SA. 37314 (2013/N) – Slovenia Rescue aid in favour of Probanka d. d.

¹² Gilliams H. Stress testing the regulator: review of state aid to financial institutions after the collapse of Lehman. *European Law Review* 2011, 36(1), p 3-25.

¹³ 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’) OJ, C 216/01, 30.07.2013, para. 50

¹⁴ Commission decision SA.38228 (2014/N) – Restructuring of Abanka Vipa Group - Slovenia, para. 1-2, 21.

¹⁵ Commission decision SA.34720 (2015/C) – Denmark Aid for the restructuring of Vestjysk Bank, Ch. 2.2.

granted. However, the aid can be granted for a period no longer than six months and this may cause problems to undertakings, who have long-term investment plans, as rescue aid decisions may create uncertainty inside the company. The rescue aid is rarely planned beforehand as financial difficulties or rescue situations are less foreseeable, and in most cases other options are firstly exhausted before rescue aid is requested.¹⁶ The situation can escalate quickly when customers and shareholders starts to pull their shares and money out of the undertaking.¹⁷

The author argues that the two months time limit is too short for the period of creating an effective restructuring plan and determine its balance sheet when examining banks, which are doing their business in many areas, such as insurance and real estate. Therefore, longer time seems appropriate to these undertakings.¹⁸ However, it is understandable that six months is a long time and during that time there can be effects to the real economy as the company usually hinders its lending to Small and Medium size enterprises's (SME's) and customers. This may have consequences for internal market and competition as prices raises. The rescue aid does not have such an impact on competition within the internal market because it is only granted for a short period of time and it will give the undertaking a breathing room to prepare its restructuring plan. However, the general criteria concerning R&R aid is that it shall be remunerated in order not to distort competition in the internal market.¹⁹ Therefore, rescue aid cannot be granted before the Commission's approval otherwise it would be considered unlawful aid and incompatible within the EU State aid law.

1.2.3 Restructuring Aid

The main goal of the restructuring aid to financial undertakings is to remain long-term viability of the undertaking and normalise market functioning in the EU internal market.²⁰ From a competition law perspective, restructuring aid is highly distortive as it keeps undertakings in the

¹⁶ Shutte M. (2012), *supra* nota 2, p 815.

¹⁷ *Ibid*

¹⁸ *Ibid*, p 816.

¹⁹ Pasaresi N., Mamdani G., (2012), *supra* nota 2, p 770.

²⁰ Bomhoff A., Jarosz-Friis A., Pasaresi N. Restructuring banks in crisis — overview of applicable State aid rules. Competition Policy Newsletter, Number 3 2009, p 54.

market, which would have in usual competition circumstances existed.²¹ Therefore, the Commission has set strict conditions when the restructuring aid can be granted. The remedies and other requirements for restructuring aid will be discussed later.

Restructuring State aid is also socially undesirable as it creates moral hazard.²² The impact of restructuring aid to certain undertakings creates situations where other undertakings in the relevant market may consider the competition distorted through restructuring aid and this creates uncertainty in the market, because competitors do not know what will happen in the near future.

1.3 General principles of compatibility of Rescue and Restructuring aid

The general understanding of when the R&R State aid is compatible with the current legislation is the situation when it does not distort competition within internal market. The State aid cases during the financial crisis are considered under Art. 107 (3) (b) TFEU which states “[...] *to remedy a serious disturbance in the economy of a Member State*”. The Art. 107 (3) (b) is rarely used because the problem must have effect of the whole national economy.²³ The Commission based its decision mostly on Art. 107 (3) (b) TFEU during the financial crisis because it acknowledged that global financial crisis can have serious disturbance in the economy of the Member States.²⁴ Currently Banking Communication and Art. 107 (3) (c) TFEU are the basis on R&R aid decisions during the normal market situations.

There are three general principles for R&R aid not to be distortive; 1) necessity 2) proportionality and 3) contain safeguards to prevent undue distortion of competition, that has to be taken into consideration when the R&R State aid is compatible with the current legislation.²⁵

²¹ Ahlborn C., Piccinin D. The Application of the Principles of Restructuring Aid to Banks during the Financial Crisis. *European State Aid Law Quarterly*. Vol. 2010. Issue 1 2010, p 54.

²² *Ibid*

²³ Craig P., de Burca G. *EU Law, Text, Material, Cases*. Oxford University Press 2015, p 1141.

²⁴ Ahlborn C., Piccinin D. (2010), *supra* nota 1, p 49-50.

²⁵ Petzold H. A. Rescue and Restructuring (R&R) Guidelines - Thoughts and Comments on the Commission's Draft. *European State Aid Law Quarterly* 2/2014, p 292.

1.3.1 Principle of necessity

The goal of the principle of necessity is the aid to be necessary to achieve its objective.²⁶ The objective in R&R aid cases is the proper functioning of the market and long-term viability of the undertaking. Also, it is relevant for the functioning of the market that the beneficiary bank remains its viability because it keeps the stability and competitiveness in the market as banks are connected to each other through lending. Additionally, it is beneficial for the consumers that the competition keep the prices low and integrates the market. These are also general objectives of EU Competition law.

Nevertheless, necessity of the state intervention is required because otherwise the market share of the beneficiary undertaking could rise, and thus distort the competition. The national authorities have a notable role and responsibility because they have to confirm that the undertaking is in difficulty. In case the authorities give false information, it could distort the competition. The principle also requires that the aid is redeemed over time or remunerated according to normal market conditions.²⁷

1.3.2 Principle of proportionality

Principle of proportionality is closely linked to burden-sharing²⁸ as the R&R State aid should be limited to the minimum necessary to achieve its object²⁹ and legitimate purpose.³⁰ Additionally, the goal of the proportionality is to limit the spill-over effect.³¹ Burden-sharing will be discussed later in this thesis, but it has been the most relevant issue when discussing R&R aid's effects on competition within the internal market. The Commission has presented two options for

²⁶ Petzold H. A. (2014), *supra* nota 1, p 293.

²⁷ Pasaresi N., Mamdani G., (2012), *supra* nota 3, p 770.

²⁸ 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'), OJ C 216/01, 30.07.2013, para. 15

²⁹ Petzold H. A. (2014), *supra* nota 2, p 290.

³⁰ Hatton C., Coumes J-M. Commission adopts guidance on state aids to the financial sector. *European Competition Law Review* 2009, 30(2), p 1.

³¹ Commission decision SA. 37314 (2013/N) – Slovenia Rescue aid in favour of Probanka d. d.

proportionality of the aid. Both options mostly states that shareholders and investors shall carry minimum 50% of the total share of the losses.³² However, the percentage shall be considered in comparison to undertakings size because when examining banks and their balance sheets, the 50% responsibility appears to be unreasonable, in author's opinion, because banks have assets and liabilities over millions of euros. In case where most of the shareholders are private households, the case is more complicated because firstly private persons would carry most of the losses, and then the State would give R&R aid to this undertaking where most of the money is taxpayers money. There is a conflict in economy and proportionality of the aid is troublesome to determine.

The Commission has admitted that the Communication requires an examination of the structure of the market where the undertaking operates.³³ The market where the banks operate plays also a part in principle of proportionality because the size of the market shall determine the amount of aid. Thus, the amount of aid may be the factor which also distorts competition within that market. Usually the relevant market for banks in the EU is the internal market, but smaller banks may operate only in national markets. Therefore, it is decisive by the Commission to examine what is the relevant market for that undertaking. Additionally, by determining the market the distortion of competition is minimized because by granting R&R aid to undertaking in low price market would distort the undertakings competitive position in the internal market.³⁴

1.3.3 Contain safeguards to prevent undue distortion of competition

Safeguards generally means behavioural and structural remedies which prevent the beneficiary undertaking to increase its market-share or acquire more shares from other undertakings.³⁵ One of the safeguard due to measures mentioned above is to prevent moral hazard and spill-over effect to other undertakings as lending is one of the bank's most necessary business. The safeguards are notable element in the process because through these the competition is not

³² Petzold H. A. (2014), *supra* nota 3, p 50.

³³ Sutton A., Lannoo K., Napoli C. Bank State Aid in the financial crisis fragmentation or level playing field? Centre for European Policy Studies 2010, p 40.

³⁴ Foecking J., Ohrlander P., Ferdinandusse E. Competition and the financial markets: The role of competition policy in financial sector rescue and restructuring. European Competition Policy Newsletter, 2009 No. 1, 3, p 1

³⁵ Ahlborn C., Piccinin D. (2010), *supra* nota 2, p 55.

distorted as much as it could be without the safeguards and effective legal measures, such as claim against the beneficiary by competitors.

1.4 Specific requirements set by the Commission for R&R aid to be compatible with the internal market

In order of R&R State aid to be compatible with the internal market, the Commission has set certain requirements which must be fulfilled. According to Rescue and Restructuring Guidelines³⁶ the first criteria is that the aid has to contribute to the common interest.³⁷ During the financial crisis the common interest is clearly the proper functioning of the markets because financial stability is beneficial for the undertakings as well as to consumers who wish to remain their savings, etc.³⁸ Secondly, there has to be a need for State intervention because of market failure.³⁹ These criteria go hand-to-hand with the first criteria.

The third criteria is the appropriateness of the aid measure which basically means that the remedies and the disturbance to the economy shall be limited to a minimum necessary.⁴⁰ Appropriateness also means that the aid has to be well-targeted to remain the long-term viability of the undertaking, but also the investors and shareholders should firstly carry their responsibility before the aid can be granted.⁴¹ This measure then indicates where the aid shall be targeted and what kind of remedies should be applied. The well-targeted aid does not distort competition between the banks as much as aid which is granted without clear targets. Fourthly, the aid shall have an incentive effect.⁴² These criteria basically mean that the aid shall keep the undertaking in the relevant market. The aid shall raise the undertaking to take care of its business and not to cause moral hazard to competitors. Fifth criteria is the proportionality of the aid which was

³⁶ Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (2014/C 249/01)

³⁷ Petzold H. A., (2014), *supra* nota 4, p 292.

³⁸ 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'), OJ C 216/01, 30.07.2013, para. 7

³⁹ Petzold H. A., (2014) *supra* nota 5, p 292.

⁴⁰ *Ibid*

⁴¹ *Ibid*

⁴² *Ibid*

discussed earlier.⁴³ Unlimited aid can have harmful consequences and it cannot be used in accordance with the requirements.

One notable criteria from the competition point of view is the criteria to avoid undue negative effects on competition and trade between Member States.⁴⁴ The proper functioning of the market requires competition because otherwise major undertakings could abuse their position in the market. Additionally, preventing the distortion of competition has been the Commission's main objective since the financial crisis.⁴⁵ In this context the 'negative spill-over effect' can be added. It basically means that the financial crisis also has an impact to SME's as banks are unable to lend money or invest to SME's. In a nutshell, the whole economy suffer because of the crisis. The avoidance of undue negative effects on trade is a notable point which is also closely related to proper functioning of the single market in case of financial crisis. Many EU countries are dependence of trade between the countries and therefore crisis have impact on the economy.

The last criteria is the transparency of the aid.⁴⁶ Transparency is a decisive principle because it relates to legal certainty which shall be always taken into account in Commission's decisions. Effective transparency raises questions about the rights of competitors to contest the approved aid measures.⁴⁷ The competitors have a right to claim for approved aid measures if they prove that it distort competition in the internal market. The role of the Commission is notable when considering transparency of the aid. They shall take State aid cases case-by-case basis when examining measures set by the restructuring plan and always consider cases from single market perspective.⁴⁸ There have been certain concerns during the financial crisis that the Commission has taken a package of decision by relying on the same conditions which does not improve the

⁴³ *Ibid*

⁴⁴ *Ibid*

⁴⁵ 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'), OJ C 216/01, 30.07.2013, para. 2.

⁴⁶ Petzold H. A. (2014), *supra* nota 6, p 292.

⁴⁷ Nikolaidis P., Rusu I.E. The conflicting roles of state aid control: support of financial institutions versus safeguarding the internal market. The conflicting roles of State Aid Control. Maastricht Journal of European and Comparative law 2010, p 226.

⁴⁸ 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') OJ C 216/01, 30.07.2013, para. 8.

transparency of the decisions.⁴⁹ However, if the Commission gives package decisions they shall take in consideration policy decision in the other field as well. The problem also in this field is that most of the Commission's decisions are not public because they contain business secrets. It may create moral hazard to the market.

1.4.1 Conditionality of the R&R State aid

It is commonly agreed that unconditional R&R State aid distort competition in the internal market.⁵⁰ Therefore, it is relevant for the proper functioning of the financial markets during the financial crisis that the aid is not granted unconditionally. The current situation in conditionality is unclear as there is no public reporting if the goals of the restructuring plan have been achieved. Nevertheless, it is obvious that if the undertaking remains in the market after five years, which is the time the plan must be implemented, the undertaking has completed the goals set in restructuring plan.

R&R aid is generally considered under 'one time, last time' principle which means that restructuring aid can be granted once every 10 years.⁵¹ One time last time principle relates to market functioning as if the banks do not use the restructuring aid planned by the restructuring plan the Commission has right to claim it incompatible. The Commission does not apply this principle because of the uncertainty about the recovery outlook.⁵² There are certain exceptions to the principle because during the restructuring period there remains a possibility for additional aid if it is justified by the financial stability. This was the case in Anglo Irish Bank⁵³, which received a capital injection on 26 June 2008, because of the financial crisis the bank suffered more losses and based on the exception the Irish authorities decided to provide a second capital injection.

⁴⁹ Sutton A., Lannoo K., Napoli C. (2010), *supra* nota 1, p 37.

⁵⁰ Ahlborn C., Piccinin D. (2010), *supra* nota 3, p 47-64.

⁵¹ Gilliams H. (2011), *supra* nota 1, p 9-10.

⁵² Bomhoff A., Jarosz-Friis A., Pesaresi N. (2009), *supra* nota 1, p 5.

⁵³ Commission decisions NN12/2010 and C11/2010

Active remuneration is also part of the conditionality of the aid. Remuneration plays a central role in the Commission's scheme of the control of State aid during the financial crisis.⁵⁴ Additionally, remuneration is also a key element in restricting the distortion of competition as the R&R aid is only a temporary measure to remain the proper functioning of the markets. The beneficiary shall pay the received aid back with interest or through restructuring plan with normal market conditions. Through restructuring plan method means that by behavioural or structural measures the beneficiary is able remunerate the R&R aid and not to increase its market share.

In case law it can be found that even the undertaking would have gone bankruptcy, it does not call into the question that unlawful aid must be recovered.⁵⁵ Therefore, the undertaking is not able to take more risk when it receives R&R aid from the government.

1.5 Current legislation

The current EU legislation consists six communications which are commonly called 'Crisis Communications'; Banking-⁵⁶ Recapitalisation-⁵⁷ Impaired Assets-⁵⁸ Restructuring-⁵⁹ Prolongation Communication 2010⁶⁰ and Prolongation Communication 2011.⁶¹ The general approach to all State aid cases are based on the Art. 107 (1) TFEU which states '[...] *any aid*

⁵⁴ Pasaresi N., Mamdani G. (2012), *supra* nota 4, p 770.

⁵⁵ KG Holding NV v Commission, Case T-81/07 (5)

⁵⁶ 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'), OJ C 216/01, 30.07.2013, p 8

⁵⁷ 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 10/2, 15.01.2009, p 2

⁵⁸ Communication from the Commission on the treatment of impaired assets in the Community financial sector ('Impaired Assets Communication'). OJ C 72, 26.03.2009, p 1

⁵⁹ 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 19.08.2009, p 9

⁶⁰ 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

⁶¹ 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

granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market’.

Basically, some elements shall be shown in case the aid is incompatible with the internal market, and these elements also applies to R&R aid cases when the Commission starts its investigation based on whether there is State aid or not under Art. 107 (1) TFEU. The criteria are 1) granted through State resources, which can be any public or private undertaking which exercises public money 2) granting economic advantage 3) favouring certain undertaking, which means that the aid is not available to every undertaking 4) distortion of competition and 5) an adverse effect on trade between Member States.

It must be kept in mind that the ‘Crisis Communications’ are not legally binding documents as presented in preliminary ruling in case *Kotnik and others*.⁶² The EJC stated that the Banking Communication is not able to impose independent obligations on the Member State but still ensures that the State aid granted to the banks is compatible with the internal market.⁶³ There is also secondary law, such as ‘BRRD’⁶⁴ Regulation which lays down detailed rules for the application of Art. 107 TFEU⁶⁵ and gives guidance to the Commission’s decisions.

1.6 Effectiveness of the current legislation

Effectiveness of the current legislation has not been tested as most of the Communication are implemented after the previous financial crisis. Therefore, the legislation raises couple concerns about legal certainty and predictability. The general understanding is that the legal basis cannot

⁶² ECJ 19.07.2016, C-526/14, *Kotnik and Others*

⁶³ *Ibid*, para. 44

⁶⁴ Directive 2014/59/EU of the European parliament and of the council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council

⁶⁵ Commission regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 140/1 30.04.2004

be thrown away during the financial crisis as the effect to other market sectors are not predictable and those markets have an impact on the economy of the Member State as a whole.⁶⁶ The Commission has stated that even during the financial crisis, it is important to follow the EU State aid law.

Legal certainty is a decisive issue in all State aid cases because the rules shall be clear and precise. The Commission has been more flexible in its decision concerning R&R aid to undertakings in difficulty in order to remain financial stability of financial markets.⁶⁷ It still remains unclear under which conditions the deviation of the legislation is possible, and the Commission has not specifically expressed what kind of proof is needed to authorize the aid in case there is uncertainty on the issue.⁶⁸ Therefore, it is hard to predict beforehand what the Commission is deciding.

Legal predictability in State aid and in specially in R&R aid cases is necessary because the undertaking in difficulty must create a restructuring plan which will keep it on the market. The unpredictability of the Commission decisions creates uncertainty to the undertaking and to the market as investors do not know what the Commission is going to decide. Therefore, the competition can be distorted. The reaction to the market may be notable as investors and shareholders start to sell their shares and financial markets becomes unstable. As mentioned, the goal of the R&R State aid is to create stability to financial markets, and thus the predictability of the Commission's decisions is relevant. The author finds a question that is there a need for more regulations, directives on R&R aid?

1.6.1 Need for new regulations and monitoring organisations

New regulations and directives could change the direction of banking because stricter rules would certainly change banks business plans. Stricter rules could also make an exit effect in internal market as banks are constantly looking to maximize their profit. The current regulations

⁶⁶ Lyons B., Competition Policy, Bailouts, and the Economic Crisis. Competition Policy International 2009, Vol. 5, No. 2, p 25.

⁶⁷ Nikolaides P., Rusu I.E. (2010), *supra* nota 1, p 779.

⁶⁸ Petzold H. A. (2014), *supra* nota 7, p 291.

only support Communications and gives guidance to national authorities how to interpret legislation. On the other hand, stricter regulations could prevent the next financial crisis as the control of the Commission may be extended. Still, national authorities play an essential role by monitoring banks operating in their Member State. However, the establishment of the ESRB (European Systemic Risk Board), ESFS (European system of financial supervisors), ESA (European Supervisory authority), European Banking Authority (EBA), European securities and Markets authority, European Insurance and Occupational pensions authority started on January 2011 and have moved power from national authorities to supranational institutions. The impact of these institutions to current legislation is notable as the monitoring is more effective and financial crisis can be prevented in advance. The prevention of new financial crisis is a cornerstone where the Commission should put more effort.

The author argues that the rules have become less strict because the financial crisis has ended and new Banking Communication is being applied. It can be still argued that financial markets nor real economy would function without state support in its current forms through capital injections, guarantees, loans or tax reliefs.⁶⁹ It is an interesting question whether the current legislation would be effective enough during the possible future financial crisis as the legislation is drafted based on the mistakes made in the previous crisis. Therefore, the legislation is always a step behind the current situation, and because the financial crisis could escalate quickly, the author argues that the Commission should have effective measures to solve problems related to financial crisis.

⁶⁹ Nikolaidis P., Rusu I.E. (2010), *supra* nota 2, p 779.

2. Rescue and Restructuring State aid to banks in the context of financial crisis

2.1 General scope of the chapter

The purpose of this chapter is to present the measures the State can apply in order to rescue a failing undertaking, and what requirements the current legislation has set to the process of applying a restructuring aid. Additionally, the author will discuss the remedies and compensatory measures which will limit the distortion of competition within internal market.

2.2 R&R State aid mechanisms to banks during financial crisis

States have certain measures which they can apply to rescue a failing bank during financial crisis and remain the viability in the market. First, the state can give capital injections (recapitalisation) which means to improve the bank's capital position for possible future losses.⁷⁰ Additionally, it enables the bank to reach the regulatory limit of capital. Secondly, guarantee schemes, such as, credit or deposit guarantees addresses banks funding problems raised in the wholesale banking sector.⁷¹ Thirdly, the impaired assets relief mechanism is aimed to protect the banks from future unexpected impairments on their business plans.⁷² There are also other additional measures, such as loans, tax reliefs or balance sheet reductions.⁷³ Banking Communication establishes a principle that recapitalisation and impaired assets measures will be authorized only once the bank's restructuring plan is approved.⁷⁴ In the context of financial crisis the nationalisation of banks is not a form of state aid but capital injection is.⁷⁵ A notable issue concerning State aid mechanisms is that central banks are not allowed to grant direct aid to the financial system because it is forbidden by the Treaty.⁷⁶

⁷⁰ Ahlborn C., Piccinin D. (2010), *supra* nota 4, p. 48.

⁷¹ *Ibid*

⁷² *Ibid*

⁷³ See Commission decision SA.34720 (2015/C) – Denmark Aid for the restructuring of Vestjysk Bank, para. 27

⁷⁴ 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'), OJ, C 216/01, 30.07.2013, para. 23

⁷⁵ Sutton A., Lannoo K., Napoli C. (2010), *supra* nota 2, p 9.

⁷⁶ *Ibid*

2.2.1 Capital injection - recapitalisation

Capital injection, mostly referred as recapitalisation is the first measure of R&R State aid schemes. Recapitalisation can be granted only when the restructuring plan has been approved by the Commission.⁷⁷ However, recapitalisation can be used in exception before the approval of the restructuring plan if such measure is required to preserve financial stability.⁷⁸ Capital injections refer to programs where governments inject money to banks in exchange for direct equity, shares or subordinated debt because of the capital shortfall of the bank. Through recapitalisation measure the bank can continue its normal functioning by lending money to SME and private persons. This prevent the negative spillover effect to real markets. Recapitalisation enables the proper functioning of the market most effectively, but it requires strict conditionality of the target where the capital shall be used.

Capital injections are referred as direct State aid because the money is directly granted to the bank. In case the capital injection measure is used, it can distort the competition between the relevant undertakings in the same market as only some banks are recapitalised. The Commission has stated that recapitalising one bank in a Member State should not give undue advantage over banks in another Member State.⁷⁹ This is primarily related to Commission objective to limit the distortion of competition during financial crisis. Therefore, the state interventions should be proportionate and temporary. By temporality the Commission meant that recapitalisation should be provided in a way that the bank would be able to redeem its market position as soon as market circumstances permit.

⁷⁷ 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'), OJ, C 216/01, 30.07.2013, para. 23

⁷⁸ 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'), OJ, C 216/01, 30.07.2013, para. 50

⁷⁹ 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 10/2, 15.01.2009

2.2.2 Guarantee schemes

Guarantee schemes are mostly used R&R aid measure during financial crisis.⁸⁰ There are two different guarantee scheme measures such as, debit and credit methods which are intended to protect the capital shortfall of the bank. Additionally, the government can participate in debt issues, underwrite subordinate debts, guarantee bank deposits or guarantees for inter banking lending and banking bonds. In case *Probanka*⁸¹ the State granted guarantees over EUR 490 million which presented the 50% of the total assets of the bank. The author argues that this is rather high percentage and the need for proper functioning of the market must have been extremely important. Debit guarantee, usually referred as deposit guarantee means that the state is an insurer and it does not require any premium to be paid before the guarantee is granted.⁸² In case the deposit guarantees are fixed to maximum price and planned for retail banking, it does not constitute State aid issue. The idea behind guarantee scheme measures are to continue the proper functioning of the bank's business and stabilize the market by enabling banks to lend money to SMEs and consumers. The guarantee schemes allow also banks to refund themselves against more attractive rates.⁸³

The author argues that the guarantee schemes are better mechanism to stabilise the market than recapitalisation because guarantee schemes allows banks to market their products with better rates and therefore the bank remains its competitive position in the market. However, the guarantee schemes should not allow bank to decrease the interest rates or grant bad loans as these actions could distort the competition same way than recapitalisation. The key point in these schemes is conditionality of the granted aid. Guarantee schemes do not distort the competition as much as recapitalisation as the guarantee scheme can be set to certain maximum where the recapitalisation can be granted all in one time.

⁸⁰ See Annex I

⁸¹ Commission decision SA. 37314 (2013/N) – Slovenia Rescue aid in favour of Probanka d. d.

⁸² Gilliams H. (2011), *supra* nota 3, p 4.

⁸³ Ayadi R., De Groen W. P., Thyri P. State Aid to Banks and Credit for SMEs: Is there a need for Conditionality? Policy department A: Economic and Scientific Policy 2015, p 20.

2.2.3 Impaired assets relief

The general idea behind the assets relief measure is to safeguard financial stability and underpin bank lending.⁸⁴ The notable issue is that impaired assets relief can be granted only after the restructuring plan has been approved by the Commission.⁸⁵ However, this measure can be used in exception before the approval of the restructuring plan if such measure is required to preserve financial stability. Assets relief is considered to support financial stability when the banks do not have to register either their losses or a reserve a possible losses on its impaired assets. The requirement for assets relief is that the problem has to be clearly defined and the magnitude of the bank's assets related problems shall be identified. As a State aid mechanism the assets relief would address the issue of uncertainty, but help to revive the confidence in the banking sector through facing the problem in banks' balance sheets. Distortion of competition should be taken into account by the bank because they should set appropriate prices and conditions to loans.

2.3 Requirement of restructuring plan and capital raising plan

According to Banking Communication the restructuring plan requires firstly a capital raising plan which is examined by the Commission.⁸⁶ The capital raising plan is a part of the restructuring plan and it should contain capital raising and burden-sharing measures.⁸⁷ The capital raising plan should enable the Member State, jointly with the Commission and relevant supervisory authority, to examine the amount of capital shortfall and calculate the amount State aid needed in order to stabilise the market. The bank is required to communicate with the Member State, usually national supervisory authority, when it notifies the capital shortfall and then create a notification to the Commission.⁸⁸ The Commission would firstly examine the capital shortfall through a three-step test which includes; capital exercise, stress test and assets

⁸⁴ Communication from the Commission on the Treatment of Impaired Assets in the Community Banking Sector, OJ C 72 of 26.03.2009, Recital 4

⁸⁵ 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'), OJ C 216/01, 30.07.2013, para. 23

⁸⁶ *Ibid*, Art. 3 (28)

⁸⁷ *Ibid*, para. 29

⁸⁸ *Ibid*, para. 8

quality review⁸⁹. After these tests the scores shall be authorised by the national supervisory authority.

2.3.1 Restructuring plan

The three primary objects of the restructuring plan is to remain the long-term viability of the undertaking, ensure contributors to the restructuring (burden-sharing) and limit possible competition distortions.⁹⁰ The restructuring plan should include a throughout diagnosis of the bank's problems. Long-term viability is achieved when the bank is able to cover all its costs and provide an appropriate return on equity.⁹¹ The first requirement for the bank is to apply stress test to their business and through this way examine the problems. The Member State shall submit a restructuring plan within two months of the decision temporarily approving the aid⁹² and it shall be in accordance with the requirements set in the Restructuring Communication.⁹³ For the consumers and public the restructuring plan is planned to verify whether the bank is able to stand in its own feet without further state support.⁹⁴

The restructuring plan has two essential broad issues which the Commission examines when they decide whether the restructuring plan can be approved. Firstly, the Commission examines the existence of the aid.⁹⁵ The existence basically means that the Commission will examine whether the State measure constitutes State aid under the Treaty. The Commission uses different types of tests to analyse the State measures and whether they constitute State aid.⁹⁶ The tests are mostly

⁸⁹ 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'), OJ, C 216/01, 30.07.2013, para. 28

⁹⁰ *Ibid*, para. 32

⁹¹ *Ibid*, Art. 2 (13)

⁹² *Ibid*, para. 53

⁹³ 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 19.08.2009, Recital 7

⁹⁴ Didžiokaitė Z., Gort M. Restructuring in the banking sector during the financial crisis: the Northern Rock case, EC Competition Policy Newsletter 2010 No. 1, p 3.

⁹⁵ Laprevote F. C. Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules. European State Aid Law Quarterly 2012, p 94.

⁹⁶ *Ibid*, p 95.

related to exceptional market conditions. Secondly, the Commission will examine the qualification of the aid which means the calculation of the aid.⁹⁷ As an example, the Commission concluded in *Volksbanken AG* case that measures taken by the state constituted State aid in under the Treaty because those were targeted for the restructuring of the *Volksbanken AG*.⁹⁸ Therefore, the restructuring plan was approved by the Commission as it occurred that it will remain the long-term viability of the bank.

The Restructuring Communication⁹⁹ sets five criteria in which the Commission examines the restructuring plan;

- The plan should contain the depth analysis of the bank's problems
- Appropriate burden-sharing shall be presented in the plan
- The plan should be timely realistic and sufficiently flexible
- Measures that would prevent the distortions of competition within internal market shall be taken into account
- Additional aid can only be provided only for financial stability reasons and for minimum amount

The implementation of the restructuring plan can last up to five years which is rather long time when considering economic development in the countries. During this time the evaluation of whether the bank will remain its long-term viability is hard to determine if the monitoring is done poorly. The restructuring plans are not available to public, and therefore can create moral hazard as the other competing undertakings does not know what is the situation of the beneficiary undertaking.

⁹⁷ *Ibid*, p 94.

⁹⁸ Commission Decision of 19 September 2012 on the State aid SA.31883 (2011/C) (ex N516/10) which Austria implemented and is planning to implement for Österreichische Volksbanken AG, para. 93

⁹⁹ 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 19.08.2009, Recital 7

2.4 Responsibility of the investors — burden-sharing

One of the main principles of the Restructuring Communication and Banking Communication is adequate burden-sharing.¹⁰⁰ The primary object in burden-sharing is that the capital shareholders should contribute to the restructuring as much as possible with their own resources by reducing the State aid to minimum.¹⁰¹ Thus, the moral hazard shall be limited to minimum and therefore the aid shall be granted on the terms which involve adequate burden-sharing. The Banking Communication states that adequate burden-sharing can be contributed either by direct equity or write-down of the principles of the instruments.¹⁰² Burden-sharing is critical element in R&R State aid cases because public money should be the last resort when rescuing banks during financial crisis.

Goodhart C. and Schoenmaker D. establishes two different methods to resolve burden-sharing during financial crisis.¹⁰³ They state that burden-sharing in international banking crisis is a problem. The author argues that burden-sharing is a necessary element of R&R State aid as otherwise taxpayers money would be used without the risk carried by the shareholders. The first method is a general fund where all European countries, through European Central Bank (ECB), would invest money and during financial crisis the fund would restructure the banks without taxpayers money. Obviously this method would prevent the quick need for public money during the R&R procedure. On the other hand, this method would decrease the level of investments by the bank if they should prepare for next financial crisis beforehand.

In the second method, only countries where the bank is present are responsible of the burden-sharing. A form of this method is currently applied in R&R cases when only shareholders of that failing bank are required to burden-sharing. In this method each participating country would pay the reasonable part of the burden. The author argues that this method is not equal between

¹⁰⁰ Bomhoff A., Jarosz-Friis A., Pesaresi N. (2009), *supra* nota 2, p 4.

¹⁰¹ 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'), OJ, C 216/01, 30.07.2013, para. 15

¹⁰² *Ibid*, para. 41

¹⁰³ Goodhart C., Schoenmaker D. Fiscal Burden Sharing in Cross-Border Banking Crises. *International Journal of Central Banking* 3 2009, p 148.

Member States as the internal market is connected. The solution could be found in the EU level where the Commission would decide who would be responsible for the burden-sharing. Additionally, this method could distort the competition because banks are constantly looking for countries where they do not have to pay large crisis fund payments.

In case law, it can be seen in case *Monte dei Paschi di Siena S.p.A. (“MPS”)*¹⁰⁴, that the Commission approved additional restructuring aid because the bank committed a proper repayment schedule for previous restructuring aid. Therefore, it is admitted by the Commission that even repayment schedule is relevant burden-sharing method. However, the exceptional aid requires an unanimous decision of EU Member States.¹⁰⁵

2.4.1 Negative effects of bail-out to internal market

The bail-out means that the government rescues the failing undertaking by using public money.¹⁰⁶ On the contrary, bail-in means a situation where the creditors cover the losses.¹⁰⁷ In the current situation, bail-out is considered the last resort after bail-in is done. Bail-in can be referred to burden-sharing and in the last scenario bail-out by the government is needed.

The negative effects of bail-out to internal market is the moral hazard which makes the market unstable. Through bail-out the competition within internal market is distorted. Additionally, State financed bail-outs top market forces to sanction unsustainable undertakings.¹⁰⁸ Nevertheless, the competition is distorted thus more efficient undertakings are not able to expand their business because the beneficiary undertaking will remain in the market. On the other hand, if the beneficiary undertaking would not be kept in the market through State financed bail-out, there is

¹⁰⁴ Commission decision SA. 36175 (2013/N) – Italy MPS - Restructuring, para. 142

¹⁰⁵ Groendahl B., Chilcote R., Sirletti S. Italy Explores Bank-Rescue Options With EU on Brexit Losses, Bloomberg, <https://www.bloomberg.com/news/articles/2016-06-28/eu-italy-in-talks-on-aid-options-for-banks-dombrovskis-says> (14.02.2017)

¹⁰⁶ Rowley E. The Greek bail-out: what does it mean and why is it happening? The telegraph <http://www.telegraph.co.uk/finance/financialcrisis/8653966/The-Greek-bail-out-what-does-it-mean-and-why-is-it-happening.html> (23.02.2017)

¹⁰⁷ European Commission, EU Bank Recovery and Resolution Directive (BRRD): Frequently Asked Questions, Memo, 15.04.2014 http://europa.eu/rapid/press-release_MEMO-14-297_en.htm (23.02.2017)

¹⁰⁸ Bomhoff A., Jarosz-Friis A., Pesaresi N. (2009), *supra* nota 3, p 5.

a risk for dominant position of other undertaking if that undertaking receives the market shares of the failed undertaking. Additionally, the bail-out prevent other undertakings to invest and innovate, but the cross-border element is necessary when economic problems creates barriers entry to other Member State's market.¹⁰⁹

2.5 Compensatory measures for competitors

One of the most necessary condition of granting restructuring aid is the limit the distortion of competition through adequate remedies or compensatory measures to competitors. Additionally, compensatory measures are meant to prevent moral hazard and remain stable competition between undertakings.¹¹⁰ Compensatory measures can be divided into two groups; structural remedies and behavioural remedies. Both of these compensatory measures can be used in a same restructuring process, but principle of proportionality shall be applied. The Commission has applied different methods in their decisions.¹¹¹ Additionally, the primary purpose of the Commission is to reduce the market presence of the failing undertaking and limit its possibility to expand its business. The Commission also requires the beneficiary to focus on its primary functions and committing banks to divesting its core assets and businesses.¹¹²

2.5.1 Structural remedies

Structural remedies are a part of the restructuring process and the object is to limit the moral hazard within the competitors as these remedies are a concrete way to show that the undertaking will focus on its core business. Structural remedies are mostly considered divestment where the undertaking has to either sale or reduce its businesses.¹¹³ The Commission has applied different types of structural remedies, such as divesting core assets or businesses.¹¹⁴

¹⁰⁹ *Ibid*

¹¹⁰ Ahlborn C., Piccinin D. (2010), *supra* nota 5, p 55.

¹¹¹ Commission decision SA.39402 (2014/N) – Spain Restructuring of Catalunya Banc S.A. through its acquisition by BBVA, para. 46

¹¹² Ahlborn C., Piccinin D. (2010), *supra* nota 6, p 16.

¹¹³ Gilliams H. (2011), *supra* nota 4, p 12.

¹¹⁴ Commission decision SA.39402 (2014/N) – Spain Restructuring of Catalunya Banc S.A. through its acquisition by BBVA, para. 50

The Commission can require the undertaking to sell its subsidiaries or branches in other Member States. There are certain requirements set by the Commission about the sale process of branches or other functions of the undertaking. The sale shall be completed in a normal market price and within two year period which is rather long time, in author's opinion. The Commission has to accept the sale, in specific circumstances, in four year period but they typically expect the divestment to occur in two years after the granted restructuring aid.¹¹⁵ In *West LB*¹¹⁶ case the bank was required by the Commission to sell part of its business that did not qualify for the new undertaking which was established to continue the business as before. The requirement of sale by the Commission clearly shows the interest of keeping the market stabilized and minimize the distortion of competition. Additionally, it shows that the moral hazard is limited to minimum as the failing undertaking does not have a possibility to compete in the market same way as before.

The balance sheet reduction is also a structural remedy that the Commission can require the undertaking to complete¹¹⁷ and, for example, in *IKB*¹¹⁸ case the Commission required the undertaking to reduce 47% of its balance sheet. This may distort competition if the Commission requires to decrease the market share of the beneficiary to a level where it is not able to compete with other undertakings. In this case the Commission considered that the benefit of remaining the undertaking in the market is more relevant than letting it exit the market.

The most radical divestment measure is liquidation where the failing undertaking receives additional aid to reach the regulatory capital limit.¹¹⁹ This measure by the Commission is highly questionable as the social benefit shall be greater than the failing bank exiting the market. The liquidation plan can be seen, for example, in *Roskilde*¹²⁰ case where the Danish authorities envisaged two scenarios to protect the financial stability in Danish market and through this remain the stability in internal market. The liquidation plan can also include quick sale of the

¹¹⁵ *Ibid*, p 13.

¹¹⁶ Commission Decision of 20 December 2011 on the State aid C 40/2009 and C 43/2008 for the restructuring of WestLB AG, para. 66

¹¹⁷ Gilliams H. (2011), *supra* nota 5, p 12.

¹¹⁸ Ahlborn C., Piccinin D. (2010), *supra* nota 7, p 50.

¹¹⁹ Laprevote F. C. Selected Issues Raised by Bank Restructuring Plans under EU State Aid Rules. European State Aid Law Quarterly 2012, p 102.

¹²⁰ Commission decision NN 39/2008 Roskilde – Denmark

part of the business to other financial undertakings. In *Roskilde*¹²¹ case, the Danish authorities stabilized the situation by selling quickly parts of the *Roskilde*¹²² to other undertakings and increasing the capital of the bank to regulatory level. However, when considering the sale of business parts of the undertaking from competition law perspective, there is a risk that the market shares of the buyer would reach a level where they can be in dominant position. This could distort the competition if the buyer uses its market position wrongly by increasing prices.

The last measure and mostly encouraged by the Commission is so-called ‘bad bank’ scenario where the most unimportant parts of the business are transferred to State-owned bank.¹²³ Through this the sale of the ‘good bank’ to another undertaking does not distort competition within internal market.¹²⁴ This measure can be used in a combination with the liquidation measure where only the healthier parts of the bank are sold to other undertakings while the bad bank is liquidated.¹²⁵ There are also additional measures used by the Commission to remain the proper functioning of the internal market. These measures can be, such as limitations to undertakings business activities or limits of banks amount to grant new loans. These additional measures are rarely used as they can almost be considered behavioural remedies.

2.5.2 Behavioural remedies

The behavioural remedies are considered more challenging for the competition as they set the undertaking in difficulty to a position where it cannot compete normally and thus softening the rival’s incentives to compete as the failing undertaking does not have the same prerequisites as competitors.¹²⁶ Behavioural remedies can be, for example, restrictions on price increase, bonus restrictions, acquisition bans and advertising bans.¹²⁷ All of these measures have a heavy impact

¹²¹ Commission decision NN 39/2008 Roskilde – Denmark

¹²² *Ibid*

¹²³ Sutton A., Lannoo K., Napoli C. (2010), *supra* nota 3, p 8.

¹²⁴ Laprevote F. C. (2012), *supra* nota 1, p 102.

¹²⁵ *Ibid*

¹²⁶ Ahlborn C., Piccinin D. (2010), *supra* nota 8, p 55.

¹²⁷ Gilliams H. (2011), *supra* nota 6, p 12.

on the commercial plan of the undertaking. The aim of the behavioural remedies are to limit the distortion of competition and restore the bank long-term viability by preventing it to exercise risky business.¹²⁸

Price and margin limitations are considered the most heaviest behavioural remedies as they prevent the company to compete in the market.¹²⁹ The objective of these measures are to prevent the beneficiary to use the aid in order to increase its prices or market share. In some cases the Commission has applied a price leadership ban where this gives competitors more efficient way to compete against the beneficiary undertaking.¹³⁰ The price limitations are usually set to a business area where the competitive element is the most likely to occur. Thus, the remedy is well targeted and focuses on to the market where the undertaking is the most likely to compete. This measure, naturally, requires the determination of the relevant market by the Commission.

The second measure is acquisition ban which duration varies in years and therefore those are usually tailor-made.¹³¹ Acquisition bans are divided into two categories, such as, bans which applies to any acquisition and bans which applies to control of the acquisition of control.¹³² There is no harmonized practise of these two categories as the Commission has decided in each case the length of the acquisition ban considering the market shares and relevant market. The acquisition ban may have some effect on competition as the undertaking which is limited, by the Commission, to acquire shares of other undertakings is not able to increase its market share or business activities for a long time. This also have impact on investments as the undertaking is not considered interesting as it would have been without acquisition ban. Additionally, the Commission does not specify if the acquisition ban prevents the undertaking to acquire shares of other undertaking which operates in different market.

¹²⁸ *Ibid*

¹²⁹ Laprevote F. C. (2012), *supra* nota 1, p 105.

¹³⁰ Case T-68/03, Olympic Airways, 2007, para. 3 (p)

¹³¹ Laprevote F. C. (2012), *supra* nota 2, p 105.

¹³² *Ibid*

The third measure, as mentioned, is advertising ban that is mostly applied in situations where State guarantee measures are used.¹³³ The basic idea behind the advertising ban is to prevent the undertaking to advertise that they have received public money.¹³⁴ It is hard to determine whether the money have been used for advertising purposes as the bail-out usually receives media interest.¹³⁵ The advertising ban does not have an impact on competition because the advertisement costs are not considerably large in some undertakings and during restructuring process as the restructuring aid is not allowed to be used for advertising purposes the interest of advertising the business is low.

Tailor-made remedies are mostly used by the Commission as there is no one-size fits all remedies.¹³⁶ The Commission has considered the adequate remedies for each undertaking individually as the market shares and relevant market varies around the internal market.¹³⁷ During financial crisis the decision process by the Commission is pressured by the decisions, but still the one-size fits all types of remedies are not applied as the effects of these remedies are not evaluated.

2.6 The role of the Commission during financial crisis and monitoring

During financial crisis the Commission enjoys substantial discretion under Art. 107 (3) (b) TFEU.¹³⁸ The Commission will take the economic and social assessment into consideration once the Union and Member States' court have allowed the broad discretion to the Commission in the decision-making process. It must be kept in mind that the Commission is responsible for securing the competition, but not for supervising how Member States allocates the resources.¹³⁹ Additional function of the Commission during financial crisis is the monitoring where the

¹³³ Laprevote F. C. (2012), *supra* nota 3, p 105-106.

¹³⁴ *Ibid*, p 106-107.

¹³⁵ *Ibid*, p 105.

¹³⁶ *Ibid*, p 99.

¹³⁷ *Ibid*

¹³⁸ Ayadi R., De Groen W. P., Thyri P. (2015), *supra* nota 1, p 23.

¹³⁹ Zimmer D., Blaschczok M. The role of competition in European state aid control during the financial markets crisis. *European Competition Law Review* 2011, p 2.

beneficiary undertaking must send yearly reports about their restructuring process.¹⁴⁰ The Commission has also set monitoring trustees which report to the Commission every six months.¹⁴¹ Additionally, it must be recognised that State aid control by the Commission cannot entirely avoid the distortion of competition because the solutions are mainly based on Member States.¹⁴²

The author argues that the Commission should have a relevant role in restructuring decision as it has the best overall picture about the situation in internal market. However, the legal protection has to be applied as the competitors have a right to challenge the decision made by the Commission. Thus, the competitor should not be allowed to sue the beneficiary itself. After the financial crisis, the EU has established Banking Union and European Supervisory Authority (ESA) whose object is to prevent future crises.¹⁴³ However, the national authorities remain the main monitoring authority in daily basis.¹⁴⁴

During the financial crisis the Commission has applied a 24-hour decision making mechanism.¹⁴⁵ The 24-hour mechanism and decision made during the weekend enables that the rumours of the possible bankruptcy do not even start.¹⁴⁶ The author argues that the financial problems shall be solved beforehand and the period of 24 hour decision is too short for the Commission to take into consideration all the necessary measures to grant or decline the restructuring aid.

¹⁴⁰ 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'), OJ, C 216/01, 30.07.2013, para. 88

¹⁴¹ Ayadi R., De Groen W. P., Thyri P., (2015), *supra* nota 2, p 27.

¹⁴² Commission Staff working paper, The effects of temporary State aid rules adopted in the context of the financial and economic crisis, 10/2011, p 89.

¹⁴³ *Ibid*, para. 12

¹⁴⁴ Kapsis I. (2012), *supra* nota 1, p 8.

¹⁴⁵ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225/1, 30.07.2014

¹⁴⁶ Weismaan P. Banking crisis and banks in crisis: from state aid to bank resolution. European Competition Law Review 2016, p 2-3.

3. Effects and implications of R&R State aid on competition between banks and internal market

3.1 General scope of the chapter

The purpose of this chapter is to discuss the effects and implications of the R&R State aid on competition between banks and internal market. Additionally, this chapter provides the analysis of the balance between regulation and competition, and the perspective of the USA as well as multinational undertakings.

3.2 General effects on competition

The Banking Communication distinguishes two different types of distortion of competition, such as competition between banks and across the EU.¹⁴⁷ In general, there are four types of competition distortion;¹⁴⁸ reinforcement of market shares, distorting the incentives of unaided competitors, moral hazard and harm to single market. In case law it can be seen that the Commission assumes the R&R State aid to be highly distortive in all cases.¹⁴⁹ The Commission's approach to distortion of competition relates to Banking Communication where the central importance of the Commission's assessments is to remain financial stability.¹⁵⁰ Additionally, the Commission has stated that State aid should not be used to prevent non-liable firms to exit the market.¹⁵¹ Nevertheless, there is a conflict between the social benefit and the regulation as the Commission has to power to decide whether the undertaking should remain on the market and prevent the possible crisis or keep the undertaking in the market and distort the competition. The Commission has to balance between the social benefits and distortion of competition.

¹⁴⁷ De Kok J. (2015) *supra* nota 1, p 228.

¹⁴⁸ Ahlborn C., Piccinin D. (2010), *supra* nota 9, p 54.

¹⁴⁹ *Ibid*

¹⁵⁰ 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'), OJ, C 216/01, 30.07.2013, para. 2

¹⁵¹ Jenny F. Competition and State Aid Policy in the European Community. Fordham International Law Journal. Vol. 18. Issue 2 1994, p 525-554.

3.3 The effects of compensatory measures on competition

The compensatory measures as mentioned in the previous chapter are meant to limit the distortion of competition between the undertakings. It is clear that national interventions tend to promote national markets and through the structural remedies the bank which had branches in other Member State would have to sell these branches because of the restructuring plan.¹⁵² In this case the compensatory measures has a distortive element because the remaining undertakings are able to receive market shares and control the market. In case Eurobank Group¹⁵³ the bank was required to sell its insurance business to other undertaking. The author argues that this would distort the competition in the insurance market more than in the banking sector as the remedies enable to remain the market stabilized. The R&R State aid in one Member State should not give an undue advantage over banks in other Member States and the risk of subsidy race shall be limited to minimum.¹⁵⁴ Additionally, in divestment cases the markets are not evaluated and the social benefit overrides the distortion of competition.

3.4. Effects of R&R aid on internal market

It has been researched that during the last financial crisis that top ten banks that received public funding at the end of 2010 received more than 50 percent of the total support granted by European Member States.¹⁵⁵ The author argues that the amount granted is considerably large by taking into account the internal market and it definitely has an impact on internal market. Therefore, the effects of R&R State aid on competition, when the public funding is concentrated only to certain undertakings, are the risk of dominant position and cartel. Additionally, it cannot be denied that R&R State aid has either negative and positive effects on internal market. Seyad S., argued that the EU, and specially the Commission does not have credible or effective mechanism that enables it to respond swiftly to an emergency, and this has an effect on internal

¹⁵² *Ibid*, p 229.

¹⁵³ Commission Decision of 29.04.2014 on the State aid SA.34825 (2012/C), SA.34825 (2014/NN), SA.36006 (2013/NN) SA.34488 (2012/C) (ex 2012/NN)SA.31155 (2013/C) (2013/NN) (ex 2010/N), 416

¹⁵⁴ De Kok J. (2015), *supra* nota 3, p 228.

¹⁵⁵ Kapsis I. Competition law and policy for the EU banking sector in a period of increased economic uncertainty. *International Journal of Law and Management* 2012, p 11.

market. The author argues that the current mechanisms that the Commission applies in its decisions are effective enough to respond to financial crisis, but the effects of the R&R State aid decisions on internal market are not sufficiently considered. Seyad S., based on its arguments to decision-making process which could take years but in R&R aid cases the decisions are taken faster as the situation can change within weeks. The effects of the decisions to internal market are relevant as financial institutions have a great role in internal market. The decision can have impacts to SME's, consumers and other actors in the market. Therefore, the R&R aid granted to certain undertakings may have effects to whole economy as the failing undertaking would remain in the market and the potential spill-over effect to real market is prevented.¹⁵⁶

3.4.1 Analysis of limiting the distortion on competition between banks in internal market

The positive impacts on competition in internal market comes mostly through bail-outs as those shift the burden of structural adjustments to changing market circumstances and forces undertakings to focus on their core business.¹⁵⁷ Due to this, the suitable remedies set by the Commission and effective restructuring plan may have positive impact on competition within internal market. By focusing on their core businesses the consumers can benefit from R&R aid as the failing undertaking will remain in the market and keep its prices low because of the remedies. The R&R aid in this case is not concerned to distort the competition in the internal market because the positive effects override the negative effects. Thus, the bank finance provides required oil to the entire economic system by allowing firms to make investments. Therefore, it is a common interest to keep an undertaking in the market and distort the competition.¹⁵⁸

When the R&R State aid is limited and well-targeted it will not distort the competition, but national interventions during the crisis are by their nature bound to promote a focus on the national markets which itself may have either positive or negative impacts on competition

¹⁵⁶ 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'), OJ, C 216/01, 30.07.2013, para. 7

¹⁵⁷ Bomhoff A., Jarosz-Friis A., Pesaresi N. (2009), *supra* nota 5, p 7.

¹⁵⁸ Bryons B. Competition Policy, Bailouts, and the Economic Crisis. Competition Policy International 2009, p 29.

between the relevant undertakings.¹⁵⁹ Additionally, the Member States would encourage the beneficiary to favour home market, but only undertakings which have international operations and due to restructuring plan they are forced to sell their branches in other Member States.¹⁶⁰ However, this may have positive impacts on consumers because the focus on national markets may increase the market shares of an undertaking which operates in the market where the failing undertaking was forced to leave because of the restructuring plan.

The public interest has a notable role when considering the effects of R&R aid to competition and internal market. When the public interest is towards national markets and loyalty to local banks are in the high level, the other Member States banks may have difficulties to enter the market. However, when the consumers are interested in their national market and loyal to their local banks, they are tended to be more stable. Through this the distortion of competition is limited because there is not many undertaking to compete in the same national market. On the other hand, there is a risk of an abuse of dominant position when the bank the only relevant undertaking in that market.

3.4.2 Analysis of effects of distortion of competition to internal market

The collapse of a large bank contagious and contaminates the whole banking system.¹⁶¹ Basically, by the collusion of a large bank, the competition would be naturalized as one of the undertaking would exit the market. On the other hand, when a large bank exit the market, the other undertakings are able to receive even more market shares and the competition may be distorted through price increase, etc. As the R&R aid is not planned to restrain or restrict import from other Member States, but it clearly has effects to real economy when the banks are not able to lend money. Additionally, by limiting the trade between Member States the R&R aid has effects on competition because it reinforces the position of an undertaking vis-a-vis competitors in intra-Community trade.¹⁶² The behavioural remedies have a notable role because some

¹⁵⁹ *Ibid*

¹⁶⁰ Ahlborn C., Piccinin D. (2010), *supra* nota 11, p 61.

¹⁶¹ Bryons B. (2009), *supra* nota 1, p 28.

¹⁶² Jenny F. (1994), *supra* nota 1, p 536.

companies would try to transfer their tax benefits to ‘tax havens’ such as Panamas, etc. One of the problems arising from R&R aid to banks is that, in case the banks stop lending money to other undertakings because of capital shortfall, the payment system will be stopped. Therefore, by granting R&R aid to failing undertaking the competition remains stable.

3.5 Regulation vs Competition and social benefits

The R&R State aid is constantly considered distortive while the effect of granting R&R aid to failing bank may cause problems to national markets as the Commission or Banking Communication does not set regulations concerning risk taking. Therefore, there is a conflict between regulation and competition. During the financial crisis the capital requirements may be loosened in order to stabilize the market through lending. However, by loosening capital requirements the powerful undertakings can control the market by giving cheap loans to SME’s, and the small undertakings may have to take even larger risks competing in the market. The small undertakings are not required to take larger risks, but in case they refuse to take risks the powerful undertaking may drive the small undertaking out of the market. These types of situations are hard for the Commission because by loosening the capital requirements the excessive aid in one Member State could also enable a subsidy race and create difficulties Member State have not introduced recapitalisation measures.¹⁶³ Therefore, the effects of the R&R aid may be larger than effects only to banking sector. The position of monetary institutions in daily life is decisive, and loosening capital requirements may have effects on internal market overall.

The Commission’s State aid unit has a mandate the divestments of foreign entities of state aided banks, and the focus on core market which may reduce the competition in internal market.¹⁶⁴ In this situation the problem is that the Commission has to balance between regulations and social benefits. In R&R State aid cases the stability of the internal market provides social benefits as the financial crisis is prevented, but on the other hand the undertakings which did not receive R&R aid has to take even larger risks in order to remain in the market. Therefore, the author

¹⁶³ Lowe P. State Aid Policy in the context of the financial crisis. Competition Policy Newsletter. Number 2 2009, p 5.

¹⁶⁴ Sutton A., Lannoo K., Napoli C. (2010), *supra* nota 4, p 18.

argues that the R&R distorts competition between the undertakings and the measures taken by the Commission should be implemented and monitored effectively in order to prevent the future crisis.

3.5.1 The counterfactual

The counterfactual is a scenario in which the R&R aid shall be measured.¹⁶⁵ In restructuring aid cases, in Art. 107 (3) (c) TFEU, the counterfactual would be the scenario where the Member State in question does not provide any aid and the potential beneficiary is forced to exit the market.¹⁶⁶ By applying the counterfactual to Art. 107 (3) (b) TFEU the social benefits shall be taken into account. In case the failing undertaking exited the market and economic meltdown the Commission has in its decisions stated the proper functioning of the market is more important element than distorting the competition. The author argues that the counterfactual shall be used to determine the suitable remedy. When determining the proportional remedies in comparison to counterfactual Ahlborn C. and Piccinin D. established a three-step analysis¹⁶⁷ 1) the competition distortions would be assessed by ignoring the benefits of the aid 2) it would be assessed how much the distortion of competition would reduce by the planned compensatory measures, and 3) the reduction of distortion of competition would be balanced against any effect of the remedies. All of these steps has to be taken into account when analyzing the effects of R&R aid to internal market because the effects will be examined beforehand and the aid can be granted without knowing the possible effects.

3.6 Who are we protecting — consumers or financial markets?

The main purpose of the competition law is consumer welfare and market integration. The relevant question in R&R State aid cases is who are we protecting by bailing-out banks. If we want to protect the consumers by keeping the undertaking in difficulty in the market and remain the trust to the overall banking system by letting a bank to fail, the loss of confidence to overall

¹⁶⁵ Ahlborn C., Piccinin D. (2010), *supra* nota 10, p 57.

¹⁶⁶ *Ibid*

¹⁶⁷ *Ibid*

banking system may cause problems. By its decisions the Commission can remain the confidence in the market, but the relevant regulations does not indicate any solutions to whether the Commission shall grant the aid. Thus, it is case-by-case when the Commission decides whether the protection of financial markets or consumer welfare is more relevant. One aim of the R&R State aid is to create conditions which foster the development of the competitive markets after crisis.¹⁶⁸ Therefore, the public money should be used only as a last resort and in a case the social benefits exceed the costs of recapitalisation via tax payers money.¹⁶⁹ The author agrees that by protecting the consumers the recapitalisation via tax payers should be the last resort. Other solution could be the lending from other undertakings to survive the bank but this may cause moral hazard in the market.

By limiting the ability of the aid recipient to compete would be harmful for the consumers because the more dominant undertakings could increase the prices. In this case we are protecting the financial markets as the failing undertaking is kept in the market in order to limit the distortion of competition. On the other hand, when the failing undertaking is kept in the market the consumers receive a fair share as the prices would not necessarily increase. Therefore, the author argues that the interconnectedness between financial markets and consumers is hard to distinguish. By keeping the failing undertaking in the market the prices would be kept lower. During financial crisis the failing undertaking exiting the market would create even more problems to the competition as there would not be as many competitors and consumers would be the receiver of this harm. Finally, the balance between protecting financial markets and consumer welfare is rather visible because the consumers rely on financial markets, and on the other hand the financial markets requires consumer welfare and confidence.

¹⁶⁸ Bomhoff A., Jarosz-Friis A., Pesaresi N. (2009), *supra* nota 4, p 4.

¹⁶⁹ Goodhart C., Schoenmaker D. (2009), *supra* nota 1, p 142.

3.7 Multinational undertakings

The multinational banks are considered undertakings which operate in different markets, such as USA and EU.¹⁷⁰ While the banks are international, the legislation is still mostly national.¹⁷¹ However, in the EU the banking system is mostly regulated by the EU and the monitoring powers have been transferred to monitoring authorities.¹⁷² The implications of the absence of common State aid regulations may distort the competition in other State while in other market the bank is stable. For example if the host government grants R&R aid to failing undertaking, this may give competitive advantage also in other host countries.¹⁷³ There have been cases where the foreign owned banks are excluded from the R&R procedure, and an example can be seen in countries where the R&R is only made available to banks having their headquarters in the country.¹⁷⁴ In the global context the WTO, G20 and international organizations monitoring authorities have a great role considering the State aid granted to multinational undertakings. WTO Members must not limit the aid to domestic banks and excluded foreign-owned banks.¹⁷⁵

3.7.1 The consideration of multinational undertakings

The Commission has reservations about State aid granted to multinational undertakings because they often operate on a global level, and State aid planned to help failing undertakings to restructure is not necessarily in the interest of the Community.¹⁷⁶ The Commission has problems also with the adequate burden-sharing because organizing such measures to truly international banks that have a large part of their business outside EU.¹⁷⁷ The problem of adequate burden-sharing is relevant when considering the distortion of competition because burden-sharing is one of the criteria that has to fulfilled in order to R&R aid to compatible with the internal market. As

¹⁷⁰ Fillat J., Garetto S., Götz M. Multinational banks, 7.12.2013, p 15.

¹⁷¹ Sutton A., Lannoo K., Napoli C. (2010), *supra* nota 5, p 46.

¹⁷² *Ibid*

¹⁷³ *Ibid*

¹⁷⁴ *Ibid*

¹⁷⁵ *Ibid*, p 51.

¹⁷⁶ Jenny F. (1994), *supra* nota 2, p 541.

¹⁷⁷ *Ibid*

the banks are interconnected through lending systems¹⁷⁸, the R&R aid granted in the EU may fall to multinational companies. Additionally, as the R&R aid forces banks to focus on their national market the multinational undertakings are not considered beneficial for the economy.¹⁷⁹

When examining the multinational undertakings the place of business, such as headquarters, shall be the place where the R&R aid should be granted. The place of business is a notable element because it determines where the aid should be granted and what are the effect to that market. In case of multinational undertakings the aid granted, for example, to US company which operates also in the internal market may have effects on the competition in the internal market because in the US, as mentioned, do not have comprehensive legal framework for State aid.

3.8 R&R State aid regulations in the USA and comparison to EU

The R&R aid restructuring process in the US is different in comparison to the EU where the Commission plays an essential role. In the US the recapitalisation of the banks during the financial crisis was done without divestures or other conditions.¹⁸⁰ This may have effects to banking business where is international competition. The Obama administration advocated to limit the size and scope of the failing banks in order to protect the market.¹⁸¹ In the USA there is no comprehensive State aid legislation but the courts have had several cases rules against aid by the local government on the grounds that it discriminate interstate commerce.¹⁸² Vives X. states that what the EU Commission tries to accomplish with the State aid control, the US does the same by regulations. In the US the government tried to stabilize the market by recapitalising banks which were too big to fail (TBTF). However, in the US the antitrust law has a sufficient power which prohibits mergers and acquisition of the banks. As Vives X. stated, that by limiting

¹⁷⁸ 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'), OJ, C 216/01, 30.07.2013, para. 5

¹⁷⁹ De Kok J. (2015), *supra* nota 4, p 229.

¹⁸⁰ Vives X. Competition policy in Banking. Oxford Review of Economic Policy 2011, p 21.

¹⁸¹ *Ibid*, p 22.

¹⁸² Erbach G., EU and USA Competition policies, Similar objectives, different approaches. European Parliamentary research service 27.03.2014, p 5.

the size of the bank they remain competitive. After the crisis, the five largest banks owned nearly 50% of the market in the US because during the crisis some failing banks were forced to sell their business to one of the five banks.¹⁸³ Therefore, the author argues that, as the difference between the US and the EU State aid control is sufficiently different, the banks which operate in both of these market distort the competition within internal market because the lack of control in the US.

3.9 Analysis of the effect to Baltic Region banking system

In Baltic region the banking system is dominated by foreign banks, in particular Swedish banks.¹⁸⁴ ¹⁸⁵ Therefore, there is a particular risk of collapse of the entire banking system in case of financial crisis.¹⁸⁶ In the context of financial crisis, the Baltic region can be considered as a good example for the case where divestment can have enormous impacts. The role of the Commission in deciding whether these banks operating in Baltic region should have R&R aid, is necessary. In case the Commission refuses to grant R&R aid to undertakings operating in Baltic region, it could have impact on competition between the banks as the relevant market is considerably small. Seyad S. M., argues that the stability and unity of EU internal market mostly depends on the restoration of normalcy in the eastern part of the EU.¹⁸⁷ However, during the financial crisis the Baltic countries survived without markable distortion of competition because the amount granted was relevantly low in comparison to Nordic countries.¹⁸⁸

The author argues that the Baltic region and specially small countries, such as Estonia have a notable part on competition between the undertakings because in the small countries the volume of foreign operators is large. Therefore, in the case of divestments, in these small countries the

¹⁸³ Cox J., 5 biggest banks now own almost half the industry, CNBC, <http://www.cnbc.com/2015/04/15/5-biggest-banks-now-own-almost-half-the-industry.html>, (13.02.2017)

¹⁸⁴ Banking System, <http://www.koda.ee/en/services/banking-finance-and-insurance/banking-system/> (10.02.2017)

¹⁸⁵ Seyad S. M. A Legal Analysis of the Global Financial Crisis from an EU Perspective. European Policy Analysis 2009, p 4

¹⁸⁶ *Ibid*

¹⁸⁷ *Ibid*

¹⁸⁸ See Annex II

situation can escalate quickly and the Commission has only an option to grant the R&R aid and try to limit the distortion of competition. Additionally, the banks are interconnected to each other by lending in the Baltic States and these may have effect to whole Baltic region economy, thus the whole internal market. In the Nordic States the concern has been in the spill-over effect where undertakings in difficulty have received R&R aid and thus distorted the competition.¹⁸⁹ The distortion of competition in the small market, such as Nordic market have effects to national markets and thus to internal market. In case of Baltic region, the negative effects of R&R aid to competition can be seen more quickly.

3.10 After 2008 financial crisis and its legal implications

After the previous crisis the EU established Banking Union and European Central Banks' Supervision which are planned to monitor banks and their balance sheets.¹⁹⁰ Additionally, the focus in the banking sector is now on traditional banking and margin-business has regained its importance.¹⁹¹ The legal implications after the crisis has been the establishment of Crisis Communication and especially Banking Communication which states the current rules concerning the restructuring of the failing banks. Additionally, the BRRD provides for a harmonized procedural resolution. Based on these implications and new regulations the Commission would be prepared to potential financial crises.

¹⁸⁹ Competition Policy and Financial Crises, Report from the Nordic competition authorities No. 1/2009, p 48.

¹⁹⁰ 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'), OJ, C 216/01, 30.07.2013, para. 12

¹⁹¹ Vives X. (2011), *supra* nota 1, p 6.

4. Conclusion

4.1 General scope of the chapter

This chapter concludes the main ideas of the author, the problem between competition and regulation, the need for new regulations and future challenges in the field of rescue and restructuring State aid. The author will also conclude why we need R&R State aid and what are the author's solution for R&R State aid not to distort competition and remain beneficial for all relevant actors in the market.

4.2 Competition vs regulation and future challenge

Reducing the level of competition in response to the crisis does not seem a good choice because the competition was not the main reason for the previous financial crisis.¹⁹² The author argues that competition was one reason for the crisis, because the undertaking remained in the market where banks gave loans to unstable customers, caused a situation where banks had to take even larger risk to remain in the market or grow their market shares. Therefore, the competition drove some banks to take larger risks and created unstableness to the market. The regulations the Commission applied during the crisis did not require banks to take fewer risks but the R&R State aid granted to certain undertakings distorted the competition and forced stable undertakings to take more risks in order to remain their position in the market.

The conflict between competition and regulation in today's internal market can be seen in Iceland where the authorities loosened the capital requirements for the first time after the financial crisis. Iceland's banks were not able to compete in the internal market because their capital requirement was in a level where they couldn't compete against larger banks in EU.¹⁹³ Therefore, the author states that preventing financial crisis through R&R State aid does distort competition within internal market because banks which did not receive aid may have to take risks in order to remain in the market and this creates moral hazard which leads to distortion of competition.

¹⁹² Kapsis I. (2012), *supra* nota 2, p 9.

¹⁹³ Hartikainen J., Islanti purkaa pääomarajoitukset - tärkeä merkkipaalu pankkikriisistä elpyvälle maalle, Helsingin Sanomat <http://www.hs.fi/paivanlehti/13032017/art-2000005124643.html>, (20.03.2017)

Future challenges in the field of R&R State aid are, in author's opinion, in competition between regulations between Member States as certain States has funds which are planned to prevent the future crisis. This obviously expels banks from that country as they try to maximise their profit. However, the stable market is beneficial for all undertakings operating in that market.

4.3 Need for new regulations?

The author states that new directives and regulations would clarify the Communication and solve the problem of social benefits because the conflict between social benefits and competition is always balanced by the Commission in their decisions. Stricter rules may cause an exit effect from the internal market because banks are always looking opportunities to maximise their profit. New regulations could clarify the situation as banks are able to predict what would be the possible outcome of the Commission decision. An example can be found in Nordea where the bank is constantly searching new location for its headquarter because Swedish authorities are increasing the crisis fund.¹⁹⁴ Therefore, the new harmonised regulations concerning R&R State aid would clarify the situation where banks are required to pay certain amount from their turnover to crisis fund in order to prevent financial crisis. Additionally, there is always competition between the countries inside the internal market on location where the banks could maximise their profit.

The new rules in state measures would, in author's opinion, clarify the situations how the Banking Communication should be interpreted and how the Commission could work together with the relevant authorities during the restructuring process. Then the R&R State aid process would benefit all the undertakings operating in the same relevant market because by regulating the process stricter, the competition would not be distorted as much as today.

¹⁹⁴ Nordea CEO says could move headquarters out of Sweden, Reuters, <http://www.reuters.com/article/nordea-bank-sweden-idUSL5N1GR48I>, (20.03.2017)

4.4 Why we need R&R State aid?

The protection of proper functioning of the market and spill-over effect is relevant for the internal market. Securing the market by saving a failing undertaking is beneficial for all actors in short term. The author argues that by keeping the failing undertaking in the market the competition is distorted and in the long run the risk of the failing undertaking to become effective player in the market is questionable. However, the Commission has an exclusive mandate to grant or decline the R&R State aid and through this measure control the competition in internal market.

The relevancy of R&R State aid is multi-dimensional because on the other hand by keeping an undertaking in the market, it gives to undertaking a chance to become a relevant competitor in the market. It is also questionable whether it would be better for the competition that the undertaking had exited the market and established again under better grounds? The author also questions that by merging or selling the failings parts of the undertaking the competition is distorted in the internal market because the failing undertaking would have to establish these business areas again and the buyer would have an enormous advantage in the market because of its market shares. The current legislation and Commission decisions seems to secure the situations and does not look to the future and the impacts of their decisions.

4.5 Problems in the field of competition regarding R&R State aid

The problem in the field of R&R State aid is that it distorts competition in internal market indirectly because once the undertaking is forced to sell its business areas to other undertakings, the competition is distorted in this area. Additionally, the Commission does not take part of the impacts of their decisions as it delivers the monitoring the relevant authorities. The distortion of competition harms competitors and consumers because the market is changed through market share changes. The stable undertakings are able to take more risks in order to even increase their market shares. Additionally, the author argues that the amount of State aid in general to banks

during financial crisis was in a level that is highly questionable because there has to a balance between proper functioning of the market and amount of aid.¹⁹⁵

4.6 Solutions for R&R State aid not to distort competition in internal market

The author provides several solutions for R&R State aid not to distort competition. However, the author agrees that the current measures are a good start and provenly helps to stabilize the market. By new regulations and impact assessments the distortion of competition could be limit to the minimum even better. The impact assessment by the Commission would show to the competitors what the Commission expects to happen and the moral hazard could be minimized. Additionally, an example case of an undertaking going into bankruptcy would give a general idea what could be done better in the future. Also, by taking an example of the banks which survived the financial crisis without consequences, such as Nordic banks, shall be kept as example to other banks in the internal market. The stable Banking Union in the internal market is still beneficial for all actors.

The author also states that the counterfactual analysis shall be always applied in all R&R State aid cases because then the Commission could see what would have happened without the aid. However, this does not override the impact assessment because the impact assessment would be a long time analysis of the effects while counterfactual analysis only the analysis of what would have happened.

4.7 Novelty of this Thesis and answer to the research question

The novelty of this Thesis is to show how to competition is distorted in the internal market and that the R&R State aid distort competition within internal market. An answer to the research question whether the R&R State aid distort competition within internal market is positive as the beneficiary will stay in the market as it would have in normal market conditions exited but in the long run the competition may not be distorted through R&R State aid.

¹⁹⁵ See Annex I

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Aid instrument	Amount of State aid approved		Amount of State aid used	
	EUR billion	% of 2015 EU GDP	EUR billion	% 2015 EU GDP
Recapitalisation	820,9	5,6 %	465,6	3,2 %
Impaired asset measures	604,3	4,1 %	188,6	1,3 %
Guarantee schemes	3311,2	22,6 %	1188,1	8,1 %
Liquidity and other measures	229,7	1,6 %	105,0	0,7 %

Annex I

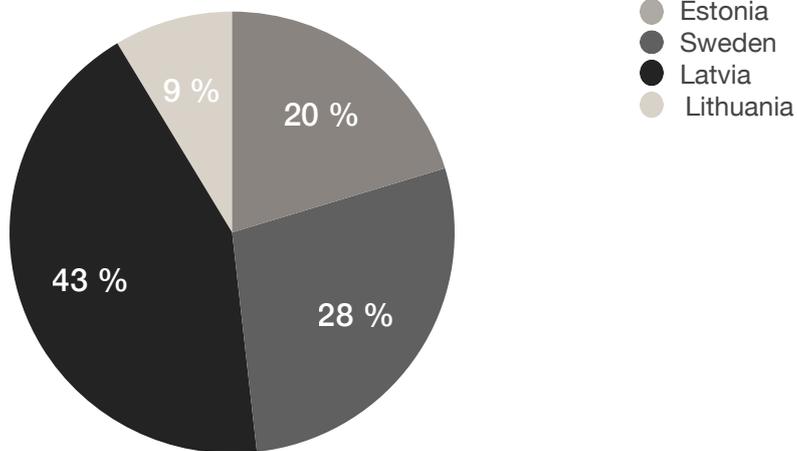
The measures used to stabilise the market functioning.¹⁹⁶

¹⁹⁶ European Commission, State Aid scoreboard 2016, http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html (22.03.2017)

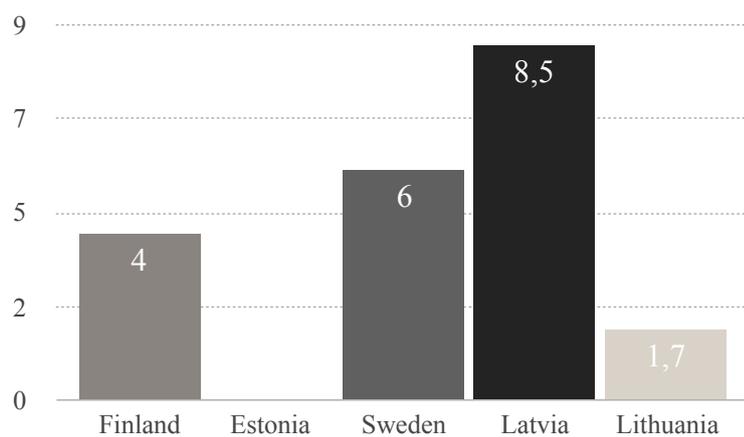
R&R aid granted (EUR billion)

COUNTRY	AMOUNT (TOTAL 2008-2014)
Finland	4
Estonia	0
Sweden	6
Latvia	8,5
Lithuania	1,7

Aid granted (percentage)



R&R aid granted (EUR)



Annex 2

The amount of approved in State aid cases during 2008-2014 in relevant countries.¹⁹⁷

¹⁹⁷ European Commission, State Aid scoreboard 2016, State aid approved, http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html (22.03.2017)