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Research Handbook on State Aid in the Banking Sector

17. Hand in hand or parallel paths? Reflections on the future coexistence of State aid control and bank resolution in the EU

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Since 2013-14 and the establishment of the "Banking Union", the regulatory landscape of the EU banking sector has evolved radically. New regulators, including the European Central Bank (ECB), acting within the framework of the Single Supervisory Mechanism (SSM) and the Single Resolution Board (SRB) have emerged and now in charge respectively of supervising, and if necessary resolving, EU systemic banks. Rules and schemes revamping the depositor guarantee funds and their role in case of a new banking crisis have been adopted or proposed. Despite initial reluctance, a limited form of solidarity between Member States has gradually taken place with the establishment of the European Financial Stability Fund (EFSF) and the European Stability Mechanism (ESM). Crucially, common rules on the resolution of banks have been adopted both at EU and euro-area level, with the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) Regulation.

Yet the new resolution framework and specifically, the application by the SRB of its resolution powers, remain largely untested.[1] At the same time, the EU State aid control rules (and the European Commission's DG COMP) retain a significant role in the restructuring and resolution of banks. Specifically, the State aid rules laid down in Articles 107 and 108 TFEU still confer on the Commission a fundamental role in any scheme aimed at the rescue or resolution of an EU bank that involves State-supported measures. Tellingly, the Commission's "temporary framework" adopted since 2008, and last amended in 2013 with the Revised Banking Communication,[2] has not been modified since then, despite the adoption of the BRRD and the SRM in 2014. On the contrary, the Commission seems to have considered that the Revised Banking Communication was anticipating the adoption of the new rules under the BRRD, thus implying that the purpose of the BRRD was simply to consolidate into law, and give full effect to, the Commission's approach pursuant to the Revised Banking Communication. In the end however, notwithstanding the Commission's powers under the State Aid framework, the EU legislators assigned the role of resolution authority for significant banks to the newly-created SRB, thereby upending the role of "*de facto* resolution authority" that the Commission held during the crisis.

The continued existence at EU level of two concurrent legal frameworks governing the restructuring and resolution of banks – the State Aid framework, on the one hand, and

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1 The BRRD was required to be implemented by Member States by January 1, 2015 and entered into force as of such date. However, the provisions of the BRRD regarding the bail-in tool were not required to enter into force until January 1, 2016. The SRB's resolution powers also entered into force on January 1, 2016. As a result, the SRB, which is competent with respect to the resolution of significant credit institutions, has not yet had the opportunity to exercise its resolution powers. The resolution of Banco Espirito Santo in August 2014 was carried out by the Portuguese Resolution Authority due to the fact that the SRB's powers were not yet in force. The resolution of HETA Asset Management in April 2016 was carried out by the Austrian resolution authority due to the fact that it is not a significant credit institution.

2 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 [2013] OJ C216/1-15 (the Revised Banking Communication).

the BRRD/SRM framework, on the other hand – raises the issue of possible conflicts, inconsistencies between applicable rules, or even among competent authorities as to the application of such rules, and of the possible avenues for resolving such issues. Will DG COMP and financial regulators emerging from the Banking Union work hand-in-hand in the future or will they tread parallel, even concurrent, paths? The answer is not obvious, for several reasons:

- The legal foundations of the two frameworks are different: while State aid control is based on Articles 107 and 108 TFEU regarding State aid control, the EU resolution framework is based on Article 114 TFEU regarding the harmonization of national legislation aimed at the establishment and functioning of the single market. While both legal bases arguably aim to establish a single market where undistorted competition conditions prevail, Article 107 and 108 are fundamentally based on a principle of prohibition, combined with derogations that are strictly controlled by the Commission, which is granted exclusive executive powers to implement the articles. By contrast, Article 114 is a provision based on a principle of harmonization of legislation which provides the EU with broad legislative powers, but does not grant EU institutions a general power of market regulation.[3]Finally, the ECB's supervisory powers are based on Article 127 (6) TFEU, which allows the Council to *'confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions'* and was the legal basis for the Regulation establishing the SSM.[4]

- As a result, the fundamental texts for the two frameworks have a different history. While the Revised Banking Communication has been entirely drafted and adopted by the Commission (following consultations with Member States), the BRRD and the SRM are the product of a complex legislative process requiring the agreement of the Council and the Parliament, following an initial proposal by the Commission. As a result, the BRRD reflects a compromise between several political options put forward by the Member States, while the 2013 Communication expresses the sole view of the Commission.

- The institutions (and their respective histories) are also different. State aid control has been managed by the Commission's DG COMP (or its predecessor Directorate-General for Competition) for several decades. Although national judges do play an important role in the assessment of the existence of State aid, DG COMP (with in practice up to three units dealing with financial institutions within a financial crisis taskforce) remains firmly in charge of assessing the compatibility of aid, subject to the limited judicial review of EU Courts. By contrast, the landscape of regulatory agencies dealing with the Banking Union is much more fragmented – and benefits from much more significant human resources. In total, the new recovery and resolution framework involves at least two agencies at European level (the ECB, acting

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[3] See Case C-376/98 *Germany v European Parliament and Council* [2000] ECR I-8419 (*Tobacco Advertising*), para. 83.

[4] Council Regulation 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63.

in the framework of the SSM, and the SRB), and more than 50 at national level, for an estimated total of approximately 3,000 officials overall.[5]

- The nature of the intervention also differ between State aid control and supervisory/resolution authorities. While DG COMP's control is essentially of an occasional, *a priori* nature (State aid control can only intervene if there is State aid in the first place), supervisory and resolution authorities carry out their role on a continuous basis, both before any State intervention is even contemplated and after State intervention has occurred. While the Commission attempted to introduce a form of preventative State aid control in the Revised Banking Communication (see Section II below) and *ex post* monitoring of restructuring plans, the preparation and monitoring of resolution plans now falls within the exclusive competence of the SRB and the national resolution authorities.
- Still, the powers and responsibilities of the Commission, on the one hand, and the supervisory/resolution authorities under the new framework are now closely intertwined. While the assessment of the existence and compatibility of State Aid falls within the exclusive competence of the Commission, the supervisory/resolution authorities are now in charge of assessing whether the institution is viable or should be placed in resolution, and in the latter case, which resolution tools to use. While on paper these roles are clearly defined, it appears that there will inevitably be some overlap. In particular, the supervisory/resolution authorities' views as to the need to place an institution in resolution and which resolution tools to use from a prudential standpoint may conflict with the Commission's view of the level of burden sharing required in order for any State Aid to be found compatible from a competition standpoint..

Against this background, the evolution of the regulatory landscape could follow several scenarios:

- Close cooperation: in this scenario, the Commission's DG COMP on the one hand and the various banking regulatory bodies on the other hand would closely cooperate in their respective tasks, exchanging information and consulting each other upfront on their respective decisions with a view to achieving consensus, thus ensuring full consistency.
- Subsidiarity and deferral: here, each regulator or institution would focus on its specific mandate (e.g. competition aspects for DG COMP, prudential aspects for bank regulators) and defer to the others for key elements of its own assessment. This would entail, for instance, DG COMP deferring to the banking supervisory bodies on the assessment of a bank's viability, or to the resolution authorities on the level of burden sharing to be required in a specific restructuring or resolution case.[6]

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5 Data as of October 2016. Specifically, the SRB employs approximately 250 <https://srb.europa.eu/vacancies> accessed 18 October 2016, and the SSM approximately 2,800 (i.e., about 800 supervisors at the ECB and another 2,000 supervisory staff in the euro area countries – <https://www.bankingsupervision.europa.eu/press/speeches/date/2015/html/se150911.en.html> accessed October 2016).

6 See Chapter 16: The New Regulatory Framework for Bank Resolution, by Stefano Micossi, Ginevra Bruzzone and Miriam Cassella.

- Regulatory competition and parallelism: in this scenario, cooperation and exchanges between regulators and the Commission would remain limited, and each would try to provide its own exhaustive assessment on various issues ranging from viability to burden sharing or the competitive impact of a given restructuring or resolution.

This Chapter does not propose to forecast which of these scenarios is the most likely. If the Commission's past relations with regulatory authorities in the crisis are any guide (and to the extent the Commission's exchanges with regulators are publicly known), all three scenarios can be considered equally likely:

- in some of its earlier decisions the Commission did appear to defer quite significantly to the analysis of certain national authorities, for instance in the Lloyds and RBS cases.[7]
- by contrast, in other cases the Commission more or less openly put into doubt the assessment of national or even European regulators – and in a few cases its remedies or decisions appeared to be directly at odds with their assessment;[8]
- in some countries subject to international assistance measures, the Commission did offer to work in close cooperation with regulatory entities, including in the framework of the Troika, although the smoothness of such cooperation may remain difficult to assess.[9]

In order to better assess these scenarios, this Chapter will (i) present the level of interaction between State aid control and banking supervision/resolution in the current legal framework; (ii) identify possible open questions on cooperation between these legal frameworks; and (iii) in conclusion, suggest a few measures for ensuring a robust and consistent regulatory landscape.

1. The interaction between State aid control and bank surveillance, restructuring and resolution – the legal framework

The legal framework regarding bank rescues and resolution has evolved dramatically since 2013, with the adoption of major pieces of legislation that, taken together, constitute the so-called "Banking Union". This new framework includes, with respect to bank recovery and resolution, the BRRD and the SRM Regulation. In addition, in the field of State aid, the Commission adopted in 2013 Revised Banking Communication, [significantly] amending its previous approach under the 2008 Banking Communication. The main provisions of these

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7 François-Charles Laprévote and Mélanie Paron, 'The Commission's Decisional Practice on State Aid to Banks: An Update' [2015] *European State Aid Law Quarterly* 1, 622.

8 *Ibid*.

9 Kerin Hope, 'Greece Reaches Deal with Lenders to Unlock €10bn Aid Tranche' [2014] *Financial Times* <http://www.ft.com/cms/s/0/7a3cfbdc-aeb4-11e3-8e41-00144feab7de.html#axzz4IKe6hsEp> accessed 25 August 2016; Peter Spiegel, 'Bailout Exposes Differences within Troika' [2013] *Financial Times* <http://www.ft.com/cms/s/0/57d0f842-9492-11e2-b822-00144feabdc0.html#axzz4IKe6hsEp> accessed 25 August 2016; Peter Wise, 'Portugal Reaches Deal on €78bn Bail-out' [2011] *Financial Times* <http://www.ft.com/cms/s/0/b8e251a8-75c7-11e0-82c6-00144feabdc0.html#axzz4IKe6hsEp> accessed 25 August 2016.

texts have been described elsewhere.[10] This Section will focus on the relationship between the two legal frameworks and their possible interaction.

a) From the Revised Banking Communication to the BRRD

The Commission's Revised Banking Communication was adopted in July 2013, before the main texts relating to the Banking Union were definitively adopted. At the time, however, these texts were already very close to adoption and one of the key stated objectives of the Communication was to anticipate their implementation.

The Revised Banking Communication thus states that in the Commission's response to the financial crisis, 'financial stability has been the overarching objective for the Commission, whilst ensuring that State aid and distortions of competition between banks and across Member States are kept to the minimum'.[11] Financial stability is itself aimed at 'prevent[ing] major negative spill-over effects for the rest of the banking system which could flow from the failure of a credit institution as well as […] ensur[ing] that the banking system as a whole continues to provide adequate lending to the real economy'.[12] In other words, the Communication seems to make clear that under the crisis framework in place since 2008, the traditional competition policy objectives of State aid control are to be subsumed under broader "real economy" objectives under the label of financial stability. According to the Communication, this hierarchy of policy objectives is to remain in place in the near future – '[f]inancial stability remains of central importance in the Commission's assessment of State aid to the financial sector under this Communication' – although the Commission acknowledges that the crisis has evolved from an 'acute and system-wide distress' to a more focused crisis in 'parts of the Union', i.e. in certain Member States.[13]

Against this background, the Communication calls for close cooperation between DG COMP and regulatory authorities. In particular, '[c]apital raising plans must […] be assessed in close collaboration with the competent supervisory authority with a view to ensuring that viability can be regained within a reasonable time frame and on a solid and lasting basis'.[14]

As explained above, at the time of the Communication the details of the Banking Union had not been adopted by the Union legislator, although the main principles of a single supervisory mechanism and a single resolution mechanism had been agreed on by the Council. The Communication acknowledges that these mechanisms will inevitably involve a degree of phasing-in and that '[a]dapting the Crisis Communications can help to ensure a smooth passage to the future regime under the Commission's proposal for a directive for the recovery and resolution of credit institutions […] by providing more clarity to markets'.[15]

Overall, the Communication contains numerous references to the 'competent supervisory authorities', which are defined as including (i) existing national authorities empowered to supervise banks under Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, *and* (ii) the ECB in its (then) future role as a

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10 See Chapter 3: State Aid and the Financial Sector - the Evolution of the Legal Framework of State Aid Law, by Violeta Iftinchi, as well as Chapter 16: The New Regulatory Framework for Bank Resolution, by Stefano Micossi, Ginevra Bruzzone and Miriam Cassella.

11 Revised Banking Communication, para. 7.

12 *Ibid*.

13 *Ibid.*

14 *Ibid.*, para. 8.

15 *Ibid.*, para. 13.

supervisor under the SSM.[16] In particular, under the Communication the Commission will expect the competent supervisory institutions to:

- confirm the existence and level of a capital shortfall (para. 28), validate the methodology used to determine this level (para. 33) and (jointly with the relevant Member States and the Commission) the share of such shortfall that must be covered by State aid (para. 30);
- endorse the capital raising plans established by the Member State and the bank (para. 32);
- be consulted by the Commission to assess capital raising measures that take more than six months to be implemented (para. 36);
- undertake supervisory action (to the extent possible) to overcome a capital shortfall before State aid is granted (para. 43);
- when the "financial stability clause" is invoked,[17] provide an *ex ante* analysis confirming that (i) the bank is faced with a current capital shortfall that if not addressed would lead to the withdrawal of the banking license and (ii) the exceptional risk to financial stability cannot be timely averted through private capital injections or other, less distortive, measures than State aid (para. 50);
- certify that banks benefiting from a guarantee scheme do not have a capital shortfall (para. 60 (a)); and
- in the case of an "orderly liquidation", withdraw as soon as possible the bank's license (para. 76).

Finally, regarding cooperation with regulatory authorities, the Communication recognizes that '[e]xercising State aid control for the financial sector sometimes interacts with responsibilities of supervisory authorities in Member States'. The Communication mentions in particular governance and remuneration issues, which are also sometimes covered by restructuring plans submitted to the Commission as a condition for State aid clearance. In such cases, the Communication provides that

> […] whilst fully preserving the Commission's exclusive competence in State aid control, coordination between the Commission and the competent supervisory authorities is of importance. Given the evolving regulatory and supervisory landscape in the Union and, in particular, in the euro area, the Commission will liaise closely – as it does already today – with supervisory authorities to ensure a smooth interplay between the different roles and responsibilities of all the authorities involved.[18]

Taken together, these provisions appear to point to a scenario of close cooperation between the Commission and regulatory or resolution authorities. The legal framework laid down by the Revised Banking Communication is clearly described as a means to anticipate and facilitate the gradual implementation of the principles of Banking Union, under the overarching objective of financial stability. The Commission professes to "liaise closely" with

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16 *Ibid*., footnote 8.

17 This clause allows the Commission exceptionally to clear a recapitalization measure before a proper restructuring plan is presented or validated.

18 Revised Banking Communication, para. 14.

the existing and new regulatory authorities, to which the Communication makes numerous references.

Another interpretation is, however, possible. First, the reminder of the Commission's exclusive competence in State aid control can imply that the Commission does not appear ready to relinquish or delegate any of its current powers under State aid rules In this respect, the Communication did not indicate any intention by the Commission to defer to other authorities on (even part of) its factual assessment. Topics for cooperation (a term that is used at no point in the Communication, which includes less binding terms such as 'consultation', 'collaboration' or 'liaison') appear limited to certain points such as the assessment of a bank's viability and capital shortfall, or corporate and remuneration measures. By contrast, the Communication does not mention that such collaboration would extend to, for instance, the determination of the timing or modalities of a bank's resolution (or, in the words of the Commission, its 'orderly liquidation'), or more generally the other (numerous) measures that the Commission might require under a restructuring plan – in particular the crucial question of burden sharing, which might have a direct impact on financial stability and the bank's ability to find private investors to contribute to its rescue in the future. The few decisions adopted since 2013-14 appear to confirm this view of a limited scope for the Commission and regulatory authorities' close cooperation. Indeed, while regulatory authorities' views are generally mentioned regarding the capital shortfall and the need for public support,[19] the sections of the Commission decisions regarding viability or burden sharing typically do not refer to specific exchanges with regulatory or resolution authorities.[20]

Notwithstanding the Commission's position in the Revised Banking Communication, the BRRD and the SRM Regulation, adopted in June 2014, allocate the power to assess the viability of an institution for the purpose of its placement in resolution exclusively to the banking supervisory authorities. Pursuant to Article 32(1) of the BRRD and Article 18.1 of the SRM Regulation, it is up to the supervisory authority, in consultation with the resolution authority, to assess whether an institution is failing or likely to fail, on the basis of a fair, prudent and realistic valuation of assets and liabilities carried out by an independent valuator.[21] If the institution is determined to be failing or likely to fail, it is then up to the resolution authority to assess whether the other two conditions for placement in resolution are met, i.e. whether (1) there is no reasonable prospect that any alternative private sector measures, or supervisory action would prevent failure within a reasonable timeframe and (2) a resolution action is necessary in the public interest. If the institution is placed in resolution, the resolution authority determines which resolution actions to take (e.g. whether to bail-in capital instruments and liabilities, implement a good bank/bad bank structure or sell assets and businesses, etc).

A distinction exists between significant institutions subject to resolution by the SRB, and less significant institutions subject to resolution by their national resolution authority. With respect to less significant institutions, resolution powers belong exclusively to the national resolution authorities. With respect to significant institutions subject to resolution by the SRB, resolution powers belong to the SRB, but the Commission and Council have a power of objection on two specific aspects (in addition to the Commission's role in assessing State Aid aspects). The Commission may object to any resolution scheme adopted by the SRB

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19 See, e.g., Commission Decision in Case SA.43367 (2015/N) – Cyprus, Cooperative Central Bank Ltd, 18 December 2015 (Case SA.43367), para. 1.1 (mentioning a letter from ECB confirming that the proposed public recapitalization was 'the minimum amount which […] promote the viability and sustainability of the bank').

20 See, e.g., Case SA.43367, paras. 83-110; Commission Decision in Case SA.43364 (2015/N) – Greece, Piraeus Bank, 29 November 2015 (Piraeus Decision), paras. 111-42; Commission Decision in Case SA.43365 (2015/N) - National Bank of Greece, 4 December 2015, paras. 119-52.

21 See Article 36 of the BRRD and Article 20 of the SRM Regulation.

by proposing to the Council (i) to object on the grounds that the scheme does not fulfill the public interest condition or (ii) to object to the amount of the Single Resolution Fund proposed to be used in connection with said resolution scheme. The resolution scheme enters into force only if the Commission and the Council have not objected within a 24-hour period from its transmission by the SRB. If the Council objects to the placing of an institution under resolution on the ground that the public interest criterion is not fulfilled, the relevant entity shall be wound up in an orderly manner in accordance with the applicable national law.

In addition, a representative of the Commission is required to be appointed to the SRB with observer status.[22] Since the SRB has not yet been tested, it remains to be seen whether the Commission will remain with the limits of the powers assigned to it under the BRRD and the SRM Regulation, and defer to the supervisory/resolution authorities' assessment as to viability, placement in resolution and choice of resolution tools, or will on the contrary view the SRB as a simple "execution agent" in charge of implementing the Commission's own position on viability and burden sharing requirements.

b) The BRRD and SRM: deferring to the Commission on State aid and extending the scope of State aid control

State intervention and its prevention is at the core of the new resolution and recovery regime set up under the BRRD and the SRM. The very first recital of the BRRD refers to State rescues of systemic banks – in other words, and in most cases, State aid – and states that 'the objective of a credible recovery and resolution framework is to obviate the need for such action to the greatest extent possible'. This overarching objective – a corollary of which is the need for a harmonized resolution regime within the EU – is congruent with the general principle of prohibition of State aid laid down in the Treaty and the principle of limiting any aid to the strict minimum necessary that has been consistently applied by the Commission, even at the peak of the crisis.

This objective of using State intervention as a last resort is apparent in the stringent rules laid down in the BRRD in case of such intervention, and in the very broad concepts used to define State intervention:

- The notion of State intervention is encapsulated in the concept of 'extraordinary public financial support' (EPFS) defined at Article 2(28) of the Directive as 'State aid within the meaning of Article 107(1) TFEU, or any other public financial support at supra-national level, which, if provided for at national level, would constitute State aid, that is provided in order to preserve or restore the viability, liquidity or solvency' of a banking institution covered by the BRRD. Interestingly, the notion is broader than that of State aid and includes support granted by supranational public organizations, which could arguably encompass e.g. the ESM, the European Investment Bank or the European Bank for Reconstruction and Development.

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22 The SRB is composed of a Chair, four other full-time members, a representative of each Member State's resolution authority. These members each have one vote. In addition, the Commission and the ECB each designate a representative which does not have a vote but instead observer status.

- The use of EPFS generally triggers a finding that the institution is failing or likely to fail – a key condition for placing the institution in resolution under Article 32 of the Directive.[23]

The BRRD contains explicit references to the State aid control framework and the role of the Commission in this respect. These references generally tend to confirm the role of State aid control as a key element of any resolution or recovery process that involves State-support measures:

- Article 56 of the BRRD provides that Member States may provide support to institutions in the form of "government financial stabilization tools" (GFSTs)– a form of EPFS that is implemented after the bank has been placed in resolution. GFSTs must be implemented under the leadership of the competent ministry or the government in close cooperation with the resolution authority. In addition, GFSTS are available only if the competent ministry or resolution authority determines that inter alia (i) the application of the resolution tools would not suffice to avoid a significant adverse effect on the financial system or (ii) the application of the resolution tools would not suffice to protect the public interest. It is also up to the competent ministry, after consulting the resolution authority, to determine whether the GFSTs meet the "last resort" condition, i.e. are used after having assessed and exploited the other resolution tools to the maximum extent practicable whilst maintaining financial stability. The BRRD also provides that GFSTs may be provided only if (i) there has been a minimum loss absorption of 8% of total liabilities by shareholders or creditors and (ii) the measures are conditional on prior and final approval under Union State aid rules. With respect to the Commission's role, Recital 57 of the BRRD clarifies that, when undertaking its State Aid assessment of GFSTs, it should separately assess whether the tool does not infringe this minimum absorption loss requirement, as well as whether there is a very extraordinary situation of a systemic crisis justifying the use of such a tool as set out in the Directive. Put simply, the Commission in its *a priori* State aid assessment must ensure that the corresponding provisions of the Directive are complied with on these two issues. This is in a way an application of the general principle that any measure cleared as compatible State aid must comply with "indissolubly linked" provisions of Union law (including its secondary legislation).[24] This recital also illustrates a situation of possible overlap and possibly conflict between the determination of the resolution authorities and that of the Commission in the assessment of whether specific tools are required in light of financial stability.
- Article 32(4)(d) of the BRRD relates to certain forms of precautionary EPFS aimed at remedying a serious disturbance in the economy of a Member State and that do not trigger a determination that an institution is failing or likely to fail. Under this provision, such measures – which include State guarantees on central bank liquidity lines, funding guarantees and pre-emptive recapitalizations – 'shall be conditional on final approval under the Union State aid framework'. From the strict point of view of EU State aid law, the scope of this provision raises three separate issues:

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[23] By way of exception, certain forms of EPFS do not trigger the finding of "failing or likely to fail", see below.

[24] Joined Cases C-134/91 and C-135/91 *Kerafina-Keramische v Greece* [1992] ECR I-5699, para. 20.

- First, the BRRD remains silent on the status of government measures that do *not* constitute State aid. Indeed, while EPSFs are defined in the BRRD as “State aid” (thus implying that non-aid government measures are not EPSF), not all types of measures listed under Article 32(4)(d) may qualify as State aid. While State guarantees to back liquidity facilities provided by central banks (Article 32(4)(d)(i)) are typically considered as State aid, State guarantees of newly issued liabilities (Article 32(4)(d)(ii)) may or may not be considered as State aid, depending on their terms and conditions, including their remuneration. Even more clearly, capital injections ‘on terms that do not confer an advantage upon the institution’ referred to in Article 32(4)(d)(iii) seem, by definition, not to entail any State aid since the existence of an advantage is a key criterion for defining State aid in the first place. In its decisions on Greek banks, the Commission has interpreted the ‘advantage’ criterion set out in Article 32(4)(d) as meaning ‘an *undue* advantage to the Bank, i.e. an advantage incompatible with the internal market under State aid rules’.[25]

- Second, the definition of ‘temporary’ recapitalizations under Article 32(4)(d)(iii) appears inherently contradictory with the definition of EPSFs under Article 2(28) BRRD, which provides that EPSFs necessarily involve State aid. This contradiction is significant since it relates to an often-used instrument that might well be the only precautionary option for public authorities to avoid a finding that a bank is failing or likely to fail. Again, in its decisions on Greek banks the Commission attempted to bridge this gap by considering that a “temporary” recapitalization under Article 32 (4) (d) (iii) could involve State aid - provided it remained of a temporary nature. In the case of Piraeus, the Commission laid emphasis on the facts that (i) a high proportion of the aid took the form of repayable capital instruments (Cocos); and (ii) under the Memorandum of Understanding signed with the Eurogroup the overall objective of the Greek State was to exit the capital of the Bank through privatisation and other means.[26]

- Third, the reference to “final approval” under the Union State aid framework as a condition for implementation of the measures also raises questions. The word “final” seems to imply that so-called “temporary” clearance decisions by the Commission would not be sufficient. This may raise issues of feasibility in the future since the Commission’s practice (especially on guarantees) has long been to “temporarily” authorize liquidity measures for three to six months before providing a “final” decision. The Commission had already begun to scale down on this practice under the 2013 Banking Communication, but the BRRD seems to make it even more difficult, if not impossible.

25 See Piraeus Decision, para. 164 [emphasis added].

26 See Piraeus Decision., para. 168.

c) ***Separate interpretation or subordination ? First lessons from the parallel application of the BRRD and State aid framework***

The first cases of implementation of the BRRD and the 2013 Communication shed some light on the way the Commission and supervisory or resolution authorities consider their respective roles and the interaction with each other.

In a recent speech regarding the BRRD, the Commission's Director-General for Competition acknowledged that in such scenario '[i]t is for the respective supervisor or resolution authority, and not for the Commission, to apply this EU law and put a bank in resolution. The responsibility of the Commission is to ensure that State aid used in resolution does not unduly distort competition.'[27] This seems to reflect a vision of two regulators each applying its own regulatory framework with its own each having its own objectives and criteria in mind.

The recent pattern of Commission decisions, however, seems to point to a different approach where supervisory or resolution authorities are rather viewed as subordinates to the Commission and in charge of taking individual (supervisory or resolution) decisions in the context of the application of a general framework whose ultimate guardian and regulator is the Commission, who may even issue instructions or guidance to this effect, or if necessary correct the assessment of national regulators. The *Banif* case is a good illustration of this approach:

- Banif, a Portuguese bank in distress, initially received in January 2013 a recapitalization, which was temporarily cleared by the Commission as rescue aid subject to the submission of a restructuring plan within two months. The Portuguese authorities and the Commission discussed several versions of this restructuring plan before the Commission opened the formal procedure in July 2015. At this point, the Commission expressed its doubts on the viability of the latest plan. In later exchanges, the Commission also mentioned that the solution envisaged by the Portuguese authorities (which consisted in separately selling a "clean bank" and toxic assets carved out from the main entity to private investors, while winding down the remaining bank) might involve additional State aid.
- Following these exchanges, the Commission urged the Bank of Portugal as a supervisory authority to carry out a comprehensive asset quality review (AQR) for Banif as soon as possible, with the involvement of the SSM and the ECB.[28] Further to this request, the Bank of Portugal submitted to the Commission various contingency scenarios that were being considered in the possible event of Banif's resolution. During these exchanges, the Commission issued several requests for information to the Bank of Portugal but does not appear to have been kept fully informed of the ongoing sale process.[29] The Commission finally considered that any State aid granted in this context would require the bank to be placed in resolution. As a result, when it became

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27 Speech by Johannes Laitenberger, 'From Bail Out to Bail In: Laying Foundations for a Restructured Banking Sector in Europe' (25 January 2016) <http://ec.europa.eu/competition/speeches/text/sp2016_04_en.pdf> accessed 18 October 2016, 7.

28 Commission Decision on State aid SA.43977 (2015/N) - Portugal – Resolution of Banif, 21 December 2015, para. 10.

29 Ibid., paras. 13-5.

clear, following an auction process, that the contemplated sales would require State aid the Portuguese authorities put Banif into resolution.[30]

- While Article 36 BRRD requires an independent valuation to be undertaken before any resolution action is carried out, the Commission declined to use this valuation (which was carried out by the resolution authority) for the purpose of evaluating the market and real economic value of impaired assets that were transferred from the remaining banks. The Commission instead relied on its own conservative valuation (and gave itself three additional months to come up with a more definitive valuation).
- Finally, in a specific section of its final decision, the Commission assessed whether the measures adopted by the Portuguese authorities complied with the BRRD. The Commission justified this review by reference to the *Meroni* and *Kerafina-Keramische v. Greece* case law,[31] which provide that the Commission's compatibility assessment of an aid measure must include a review of possible infringements of other provisions of EU law when the aspects related to such infringements are 'so indissolubly linked to the object of the aid that it is impossible to evaluate them separately'.[32] The Commission adopted a similar approach in all posterior cases involving the Greek and Cypriot bank: each of these decisions contains a specific section verifying whether the national authorities (including resolution authorities) have properly applied the BRRD and reminding that this assessment 'is without prejudice to the prerogative of the Commission to initiate infringement procedures against a Member State for breach of union law, including [a] breach of the provisions of [the BRRD]'.[33] In effect, this has allowed the Commission (and more specifically, DG COMP) to impose its own view on a number of points of interpretation of the BRRD through its State aid review prerogative. Whether this interpretation is correct as a matter of law, desirable as a matter of public policy or in line with the initial intentions of the EU legislator can be debated,[34] but this seems to confirm that in the Commission's opinion the bank resolution regulatory framework remains subordinated to the competition and State aid rules.

d) A key enforcement issue – comparison of the legal status of the BRRD and the Revised Banking Communication

In its recent *Kotnik* judgment, the Court of Justice ruled on the legal status of the Revised Banking Communication, indirectly highlighting a key difference between the State aid framework and the BRRD. One of the issues raised by the Slovenian Constitutional Court in

30 Ibid, para. 19. Although the Decision expressly draws a causal link between the requirement for State aid and the placement into resolution, it also mentions that the resolution authority did determine that the three conditions for resolution laid out in the BRRD (FLF finding, no private alternative, public interest) were met, see para. 51.

31 Joined Cases C-134/91 and 135/91 *Kerafina-Keramische v Greece* [1992] ECR I-5699, para. 20.

32 Case C-74/76 *Iannelli v Meroni* [1977] ECR 00557, para. 14.

33 See, e.g., Commission Decision in Case SA.43367 - Cyprus, Cooperative Central Bank Ltd, 18 December 2015, para. 131.

34 See, for instance, Amélie Champsaur, 'Italian Banks can Learn from EC State Aid Record' *International Financial Law Review* (12 July 2016) (Champsaur 2016).

this request for a preliminary ruling was whether the burden-sharing provisions of the Revised Banking Communication, which were invoked by the central bank to write-off subordinated instruments in the rescue of Slovenian banks, were binding on the Member States. In its judgment, the Court clarified that the Revised Banking Communication, like all other guidelines issued by the Commission in the context of its EU State aid review prerogative, was not binding on the Member States. Such guidelines do impose a limit on the Commission's discretion, which 'cannot, as a general rule, depart from those guidelines, at the risk of being found to be in breach of general principles of law such as equal treatment of the protection of legitimate expectations'.[35] But they do not relieve the Commission of its 'obligation to examine the specific exceptional circumstances relied on by a Member State in a particular case'[36] for the purpose of obtaining State aid clearance. As a result, a Member State retains the right to notify the Commission of proposed State aid which does not meet the (burden-sharing) criteria laid down in that Communication. In other words, first, the Commission may not be stricter than its own Guidelines, but it may be more lenient if the circumstances so justify. Second, a Member State is not compelled to impose on banks in distress the absorption of losses by holders of subordinated rights provided for in the Revised Banking Communication – but in this case, the Member State and the banks 'take the risk that a Commission decision declaring the aid incompatible with the internal market will stand in its way'.[37]

The *Kotnik* judgment confirms a fundamental difference between the State aid and the regulatory framework regarding bank rescues. While the principles laid down in the Revised Banking Communication are not binding for the Member States (and do not, for instance, compel Member States to "transpose" the burden sharing obligations into national law or systematically implement such burden-sharing in individual cases), the BRRD, like any other EU directive, is binding on Member States and must be transposed into national law, regardless of whether State aid takes place or not – failure to comply with the BRRD may expose Member States to infringement proceedings by the Commission and/or damages actions.[38] Similarly, resolution authorities that would fail to comply with the requirements of the BRRD or the SRM Regulation would be exposed to challenges before the courts for annulment as well as damages. In practice, however, the difference between the two regimes may be limited, to the extent that Member States may not want to take the risk of a negative State aid decision by the Commission and may therefore consider that the principles of the Communication are best complied with.

2. Possible issues of conflict or concurrence between the regulatory frameworks – a non-exhaustive shortlist

The State aid framework and the BRRD share several fundamental public policy objectives. Both frameworks highlight the need to ensure financial stability while preserving the interests of the taxpayers. Government intervention is clearly viewed in the BRRD as a measure of last resort – a concept that resonates with the traditional notion under EU State aid rules that State aid must be limited to the strict minimum. Both regimes highlight the need for shareholders (and some debt holders) to contribute to bank rescues, both as a way to minimize the cost to taxpayer and to avoid moral hazard. And both regimes aim to strengthen

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[35] Case C-526/14 *Kotnik et al. v Drzavni zbor Republike Slovenije et al.* [2016] ECR I-000 (Kotnik judgment), para. 40.

[36] *Ibid*., para. 41.

[37] *Ibid.,* para. 100.

[38] See, e.g., Case C-368/04 *Transalpine Ölleitung in Österreich* [2006] I-09957, para. 56.

the viability of European banks while ensuring that the exit of failed banks can take place in a manner that does not destabilize the overall economy. But precisely because the two regimes share similar objectives, some of their provisions might overlap or give rise to potential inconsistencies. The main possible topics for conflict or concurrence include preventative measures (A), burden sharing (B), and expert assessments of the viability and valuation of banks (C).

a) Preventative measures – a great idea but will they always work?

A key innovation of both the 2013 Banking Communication and the BRRD is the introduction of preventative measures aimed at addressing any difficulties early on and thus avoiding the need for governments to bail out banks in distress – a solution that is clearly presented in both texts as a last resort.[39] This imperative is, in a way, already present in State aid control through the concepts of "necessity" and proportionality of the aid: an aid measure can only be deemed compatible if it is necessary to attain the stated public policy objective and proportional to that goal.[40]

i) Preventative measures in the 2013 Revised Banking Communication

The 2013 Revised Banking Communication places new emphasis on the way capital shortfalls are addressed by banks internally in order to prevent as much as possible intervention by the State. In particular:

- The Communication encourages pre-notification contacts between the Member State and the Commission before the aid is notified to the Commission for approval. Such contacts should be established on the basis of a capital raising plan prepared by the bank and the Member State and endorsed by the supervisory authority. This plan should identify all possible internal capital raising measures, which could include:
    - rights issues;
    - voluntary conversion of subordinated debt instruments into equity on the basis of a risk-related incentive;
    - liability management exercises which should in principle be 100% capital generating if the capital shortfall cannot be overcome in full and therefore State aid is required;
    - capital-generating sales of assets and portfolios;
    - securitization of portfolios in order to generate capital from non-core activities;
    - earnings retention; and
    - other measures reducing capital needs.
- The Communication states that 'as soon as a capital shortfall that is likely to result in a request for State aid has been identified, all measures to minimise

39 Revised Banking Communication, para. 6; BRRD, Art. 56(3).

40 Communication from the Commission on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis [2008] OJ C270/8.

the cost of remedying that shortfall for the Member State should be implemented'.[41] Thus, before the aid is even notified the bank should carry out all capital raising measures that can be implemented 'to the extent possible, without endangering viability'.[42] By way of incentive to implement these measures, the Communication provides that 'if recourse to State aid could have reasonably been averted through appropriate and timely management action, any entity relying on State aid for its restructuring or orderly winding down should normally replace the Chief Executive Officer of the bank, as well as other board members if appropriate'.[43]

- Crucially, the Communication confirms that as a matter of principle the Commission will authorize structural aid (i.e. recapitalization or impaired asset measures) only after it has agreed on a restructuring plan with the Member State.[44] This new measure represents a significant change in the Commission's practice since the beginning of the financial crisis. Until then, banks could be granted structural State aid well before they obtained a formal positive decision from the Commission on their restructuring plan – such structural aid was typically approved on a temporary basis until the plan was agreed, and the negotiation of the restructuring plan could in some instances take months or even years.
- Finally, the Communication also underlines that a beneficiary bank should adopt all necessary measures in order to prevent the outflow of funds prior to a restructuring decision. Therefore, from the time capital needs are known or should have been known to the bank, and even before the restructuring plan is agreed and the aid is granted, the bank may not pay dividends on shares or coupons of hybrid capital instruments, repurchase its own shares, call hybrid capital instruments, perform capital management transactions, engage in aggressive commercial practices, acquire a share in undertakings or advertise by referring to State support.[45] If a bank fails to comply with these provisions in the pre-restructuring period, the Commission will add an amount equivalent to the corresponding outflow of funds that could have been prevented to the aid amount for the purposes of establishing the required measures to limit distortions of competition in the restructuring plan.[46] In other words, the less ambitious the pre-restructuring measures, the more the Commission will require painful compensation measures at the restructuring stage.

ii) Preventative measures in the BRRD

Preventative measures in the BRRD are based on the following key concepts:

- Recovery plans must be drawn up and updated at least annually by each financial institution. They include possible measures that could be taken by

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41 Revised Banking Communication, para. 32.
42 *Ibid.*, para. 35.
43 *Ibid.*, para. 38.
44 *Ibid.*, para. 23.
45 *Ibid.*, para. 47.
46 *Ibid.*, para. 48.

the bank to address a scenario of severe macroeconomic and financial stress. Recovery plans must not assume any access to EPFS (although they may assume access to central bank facilities against the provision of collateral). Supervisory authorities must review recovery plans and may order additional measures regarding the institution's strategy, funding or governance if the recovery plan is insufficient.[47]

- Resolution plans must also be prepared annually by the relevant resolution authority with the assistance of each institution. Such plans set out options for the resolution of the banks based on the resolution tools provided for in the BRRD (including sale of business, bail-in, bridge institution and asset separation) and must not assume any access to EPFS or emergency liquidity assistance from central banks. Resolution authorities are granted powers to address any *ex ante* impediments to a bank's resolvability.[48]
- Articles 27 to 30 of the BRRD provide for the possibility to impose early intervention measures when an institution infringes or is likely to infringe some of its regulatory requirements[49]. Such measures include implementation of the recovery plan, instructions by the supervisory authority to convene shareholders meetings and set the agenda, require changes to the bank's strategy or operational structure, or require the management to negotiate the restructuring of the bank's debt. In exceptional cases the supervisory authorities may require the replacement of senior management and appoint a temporary administrator.

iii) Possible issues raised by preventative measures

At the time this chapter was written, there were comparatively few cases where the Commission had applied the provisions of the 2013 Banking Communication regarding preventative.

The main open issue regarding preventative measures under the 2013 Banking Communication lies in their feasibility and the credibility of the Commission's statements that such measures must be implemented before State aid is granted. By definition, at the time such measures are carried out State aid has not been granted or even cleared by the Commission and there is therefore no legal obligation to implement these "voluntary" measures. Their effective implementation therefore rests on the credibility of the Commission's threats of retaliation at the stage of the clearance decision (by, for instance, denying its clearance, or requiring the removal of the management, or additional restructuring/ burden-sharing measures as conditions for authorizing any future aid). Such "retaliation" is allegedly not automatic and within the Commission's margin of discretion in its assessment of the compatibility of aid. It is difficult at this stage to assess this credibility, which can only be established through decisional practice. Before the 2013 Communication, the Commission had implemented this principle in only a few cases where the bank had paid discretionary coupons shortly before requesting State aid (such as the ING case[50]), without

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47 BRRD, Arts. 5-9.

48 *Ibid.*, Arts. 10-14.

49 This determination is to be based on a set of triggers that may include the institution's own funds requirement plus 1.5 percentage points (BRRD, Article 27.1).

50 See, e.g., Commission Decision in Case C10/2009 (ex N138/2009) - ING, 18 November 2009, para. 139.

precisely setting out the additional measures it had required solely on the basis of the bank's failure to prevent an outflow of funds.

It is precisely this credibility issue that the BRRD has addressed by directly granting supervisory authorities the power (which the Commission does not and cannot have under State aid rules) to implement early intervention measures, or have them implemented by removing the bank's management and appointing a temporary administrator. As a result, preventative measures are a much more tangible reality than they would be under the sole State aid but the purpose is narrowed: supervisory authorities such as the ECB) can implement early intervention measures only in case of actual prudential concerns related to the institution, not solely because there is a possibility that State Aid may be granted. Even preventative measures under the BRRD are not without limits, however: in particular, they do not bind the shareholders or debt-holders, who can still at this preventative stage decline to participate in a liability management or debt restructuring exercise.

The recapitalization of Greek banks at the end of 2015, following the political and liquidity crisis of the summer and the ensuing adoption of a third economic adjustment program with a budget of €86 billion (of which €25 billion were envisaged to cover possible bank recapitalizations), provides an interesting example of the feasibility and implementation of preventative measures under the 2013 Banking Communication.

For the four major Greek banks, the SSM realized a specific "comprehensive assessment" on the basis of an asset quality review and stress tests in a baseline and an adverse scenario. This exercise identified a cumulated capital shortfall of €4.4 billion in a baseline scenario and €10 billion in an adverse scenario. To cover this shortfall, the four banks (which had already raised new capital in 2013 and 2014) transmitted and implemented a restructuring plan including capital raising measures that all followed the same approach:

- A voluntary liability exercise proposing to the bank's senior unsecured and subordinated security holders to convert their bonds into new shares or (for some banks) a (very limited) amount of cash largely below the par;[51]
- A private capital increase subscribed by international and (in the case of NBG) Greek investors and aimed at covering at least the capital shortfall in the baseline scenario and at most the capital shortfall in the adverse scenario; the Hellenic Financial Stability Fund (HFSF) provided a backstop to cover any unsubscribed share of this capital increase;
- For some banks, the SSM also recognized some 'mitigating measures' related to excess pre-provision income in Q3 as compared with the SSM's initial projections.
- In the case of NBG, the Greek authorities committed to implementing a forced conversion (bail-in) for the remaining junior and senior binds and hybrid securities that did not accept the LME. In order to implement this bail-in, Greece revised its legislation concerning the HFSF and made the HFSF's intervention conditional on the implementation of a bail-in for both senior and junior/subordinated debt holders.
- Finally, for Piraeus and NBG, the above measures only covered the capital shortfall in the baseline scenario; the additional shortfall in an adverse

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[51] For instance for Piraeus, the senior notes were repaid at 43% of par value and the subordinated notes at 9%.

scenario was covered by a recapitalization by the HFSF, which was considered State aid.

Table 1. Summary of the capital needs and their coverage for Greek banks in 2015 (in € million)

Bank	Shortfall baseline	Shortfall adverse	LME	Private capital increase	Mitigating measures	HFSF injection
Alpha Bank	263	2,743	1,000	1,563	180	-
Eurobank	339	2,122	417	1,621	83	-
NBG	1,576	4,602	717 (+bail-in: 302)	757	120	2,706
Piraeus Bank	2,213	4,933	873	1,340	-	2,720
Total	**4,391**	**14,401**	**3,309**	**5,281**	**383**	**5,426**

Source: European Commission

On the face of it, this example shows that the Commission is fully able to convince shareholders and creditors to accept voluntary measures in the context of the State aid framework and that such measures can be quite effective in reducing the need for public funds. Indeed, the private sector covered nearly two thirds of the overall capital shortfalls, essentially through private capital increases and LMEs. But the Greek example also highlights some limits or uncertainties in the voluntary approach and its implementation under the State aid rules:

- First, the private capital increases all benefitted from a backstop provided by the HFSF, which was technically considered by the Commission as constituting State aid (although of a much lesser magnitude than straight recapitalizations).
- Second, the LMEs (and the bail-in implemented in the NBG case) went further than the requirements of both the 2013 Communication and the BRRD in two important respects: (i) they covered senior bonds, which are not included in the principle of burden sharing as expressed in the 2013 Communication; and (ii) although the bail-in power under the BRRD was not yet in force, a bail-in of subordinated and senior debt was implemented in accordance with special provisions of Greek law which did not require the placement of the corresponding banks in resolution, as would have been required (as far as senior debt is concerned) under the BRRD. It is also very likely that the success of the LMEs, which were taken up by a large majority of debt holders,[52] was driven by the threat of a bail-in that would have been implemented in the absence of voluntary participation by debt holders.
- Finally, and as will be explained in more detail below, in the Greek cases the Commission developed an interpretation of the BRRD regarding the conditions for resolution that has not yet been tested before the European

52 In the case of Piraeus, for instance, the participation rate was as high as 100%.

courts and can be questioned in light of the provisions of the Directive. In this respect, the Greek situation was arguably very specific since the national authorities (and indirectly, private investors) had very limited leverage in their discussions with the Commission. It remains to be seen whether voluntary measures will be convincing in less clear-cut cases where private investors might be more reluctant to participate and/or more ready to object to these measures.

b) The key issue of burden sharing and bail-in

The contribution by shareholders and certain debt holders to the rescue of banks is a key concept in both the State aid framework and the BRRD. The stated objectives of this contribution are to minimize the amounts of State aid and the moral hazard, thus incentivizing investors to discipline banks towards the path of viability. But the implementation of this principle raises complex issues of fairness and efficiency – and in the case of the EU, these difficulties are compounded by the existence of twin (and sometimes inconsistent) legal frameworks.

i) Burden-sharing and bail-in: a reminder of the legal framework

The State aid framework embodied by Revised Banking Communication and the BRRD/SRM framework both refer to burden sharing or the bailing-in of investors, although under slightly different approaches.

The State aid framework

Early in the crisis, the Commission had already imposed the principle of burden sharing by investors as a key tenet of its decisional practice relating to banks. In its 2009 Bank Restructuring Communication, the Commission thus asserted that 'the bank and its capital holders should contribute to the restructuring as much as possible with their own resources'.[53] The implementation of this principle differed somewhat depending on the cases and the types of 'capital holders' concerned:[54]

- For shareholders, the Commission nearly always required a prohibition to pay dividends during the restructuring period; in practice, a form of bail-in always took place through the decrease (and sometimes wipe-out) of the value of the shares following the State intervention, in particular if such intervention took the form of a subscription of ordinary shares at a discount over the market price. The Commission also sometimes imposed share purchase bans, which have become more systematic following the 2012 Spanish cases.

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[53] Communication from the Commission on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules [2009] OJ C195/9, para. 22.

[54] For a detailed description of the Commission practice, see Chapter 6 on Compensatory Measures by Nicole Robins and Sahar Shamsi. See also François-Charles Laprévote and Mélanie Paron, 'The Commission's Decisional Practice on State Aid to Banks: An Update' [2015] *European State Aid Law Quarterly* 1.

- For hybrid capital/subordinated debt holders, the Commission also requested a form of burden-sharing, which generally took the form of a ban on discretionary coupon payments. The Commission also gradually imposed bans or restrictions on calls or payback of these instrument; its practice in this matter was harmonized by an explanatory note published in 2012, whereby the Commission indicated that it would only allow buybacks made at less than 90% of the par and for a market premium not exceeding 10%.[55] Finally, while proper bail-in in the form of conversion of debt into ordinary shares or full wiping-out was initially not required, in practice such bail-in became part of the Memorandums of Understanding signed with program countries. For instance, in 2012 the Commission 'welcomed' the forced conversion (with a significant haircut) of subordinated debt in Spanish banks, which went further than the then applicable burden-sharing requirements under State aid rules but were imposed by the MoU concluded with the Troika and enacted by Royal Decree.[56]
- Burden-sharing could also take place indirectly, for instance by splitting the beneficiary into a bad bank where the historic shareholders and the subordinated debt holders would be lodged and a good bank that would be recapitalized by the State (for instance in the BES/Novo Banco case),[57] or by selling off the good assets and setting the remuneration of the State intervention at such level that shareholders (and so some extent junior bond holders) would have virtually no chance of recovering their investment (for instance in the Dexia case).[58]

The Revised Banking Communication confirmed the general toughening of burden sharing rules within the State aid Crisis Framework, with renewed impetus placed on bail-in of shareholders and junior debt holders:

- Under the Revised Banking Communication, burden sharing must take place *ex ante* i.e. be implemented "in principle" before aid is granted. The Communication therefore requires ensuring that banks losses are first absorbed by equity, hybrid capital and subordinated debt holders in order to reduce the capital shortfall to the maximum extent possible. This can for instance result in the conversion of subordinated debt into Common Equity Tier 1 or a write-down of the instruments' principal.[59]
- The Communication makes clear that the Commission will not require contributions from *senior* debt holders as a mandatory component of burden-sharing, although the Member State may unilaterally decide such extension, in which case it will presumably be taken into account by DG COMP

55 Explanatory note by staff of the EC's DG COMP, 'Buybacks of Hybrid Securities by Banks under Restructuring' (13 June 2012), 2.

56 See, e.g., Commission Decision in Case SA.35253 (2012/N) - BFA-Bankia, 28 November 2012 [2013] OJ C77, para. 201.

57 Commission Decision in Case SA.43976 (2015/N) - BES/ Novo Banco, 19 December 2015, IP/15/6381.

58 See Commission Decision of 28 December 2012 in Dexia case [2014] OJ L110/1, para. 620: 'As regards remuneration of the recapitalisation, the issue of new shares to the Belgian and French States…will thus ensure that shareholders contribute fully to the resolution, as the Commission requires, in that existing shareholders have no prospect of a return on their investment and the situation is equivalent to a complete financial expropriation of the shareholders.'

59 Revised Banking Communication, paras. 43 and 44.

to assess the overall proportionality of the burden-sharing in relation to the aid granted.[60]

- The Commission authorizes an exception to these stringent burden-sharing requirements where their implementation would endanger financial stability or lead to disproportionate results. This is for instance the case when the aid to be received is minimal compared to the bank's risk weighted assets and the bank's capital shortfall has been reduced significantly through some of the capital-raising measures. The implementation of bail-in must also comply with the "no creditor worse-off" principle i.e. no creditor should be treated less well than if no State aid had been granted.[61]

The BRRD

Bail-in and the contribution of capital and debt holders to banks resolution or recovery play a central role in the BRRD. The main provisions can be summarized as follows:

- A bank must be placed in resolution only if the resolution authority (acting, with respect to (i), in consultation with the supervisory authority) considers that three cumulative conditions are met: (i) the supervisory or resolution authority determines that the bank is "failing or likely to fail" (FLF); (ii) there is no reasonable prospect that any alternative private sector measures or supervisory action would prevent the failure of the institution within a reasonable timeframe and; (iii) the resolution is in the public interest.[62] A bank is considered FLF on the basis of a number of alternative criteria laid down in the Directive, among which the fact that the bank requires extraordinary public financial support (EPFS), i.e. State aid. By way of exception to this general principle, certain forms of "precautionary and temporary" EPFS (granted in the form of State guarantees for ELAs, funding guarantees or recapitalizations) do not trigger an FLF finding, provided notably that they are necessary to remedy a serious disturbance in the economy of a Member State and preserve financial stability, and are granted to solvent institutions and proportionate to the goal pursued. Precautionary recapitalizations must be limited to covering capital shortfalls established in national or Union stress tests, asset quality reviews or equivalent exercises and must not be used to offset existing or imminent losses.[63]
- When the bank is placed in resolution, as a matter of principle the shareholders of the institution under resolution bear first losses; creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings.[64] Resolution authorities may use the so-called "bail-in tool", which allows them to write-down or convert into equity all liabilities of the bank, except for a few "non-eligible" liabilities listed in the Directive (which

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60 *Ibid.*, para. 42.
61 *Ibid.*, paras. 45 and 46.
62 BRRD, Art. 32.1. See *Supra* regarding the specific resolution procedure in the context of the SRM Regulation.
63 *Ibid.*, Art. 32(4)(d).
64 *Ibid.*, Art. 34.

include notably covered deposits).[65] This tool (and the resolution more generally) is subject to (i) *ex ante* independent valuations[66], and (ii) the no creditor worse-off principle.[67]

- Before a bank meets the conditions for resolution, if it reaches the so-called non-viability point the resolution authority must convert or write-down its capital instruments, which include Core Tier 1, Additional Tier 1 and Tier 2 instruments if such write-down or conversion would be necessary to maintain viability. This power must be exercised without delay if, notably, the bank requires EPFS, except for the "precautionary and temporary EPFS" mentioned in Article 32(4)(d)(iii).[68]

In sum, the BRRD's "bail-in tool" covers a wider scope of liabilities than those mentioned in the "burden-sharing" rules of the State aid framework (including, in particular, senior debt). By contrast, the power to convert or write-down capital instruments before resolution covers similar instruments to those mentioned in the State aid framework, i.e. shares and hybrid capital/subordinated debt. However, the exception provided in the Directive for "precautionary and temporary" EPSF is not mentioned in the State aid framework.

iI) Burden sharing and bail-in: open issues

Triggering point

Since the end of 2015 and its decisions on Greek banks, the Commission has developed an ambitious (and still untested) position on the triggering point for bank resolutions and bail-in under the BRRD. This position was implicitly laid out in State aid decisions, where the Commission reviewed the compatibility of the rescue measures with BRRD, as well as in some press releases and other public statements by Commission officials. This opinion can be summarized as follows:

- If a bank experiences a capital shortfall in an Asset Quality Review (AQR)/base scenario and such capital shortfall is not covered by private investors, the ensuing public recapitalization cannot be considered as a "temporary and precautionary" measure under Article 32(4)(d)(iii) BRRD and the bank must therefore be considered as FLF.[69]
- In this case, the bank must be placed in resolution and the bail-in instrument must be used, thus ensuring that private investors and debt-holders cover the capital shortfall.[70]

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65 *Ibid*., Art. 44.
66 *Ibid*, Art. 36.
67 *Ibid*., Arts. 36 and 75.
68 *Ibid*., Arts. 59 and 60.
69 See for instance, *a contrario*, Piraeus Decision, para. 172.
70 See *ibid*., footnote 12 and para. 173. For more explicit statements on the allegedly automatic link between a failing and likely to fail and a bank's resolution, see also accompanying press release IP/15/6193: 'Furthermore, under the Bank Resolution and Recovery Directive, a bank in need of state aid has to be put in resolution. Only in narrowly defined exceptional conditions can state aid be provided to a bank outside

In practice, this very broad interpretation of the triggering point for banks resolution has probably contributed to the success of the LME and the capital increase launched in 2015 by the four main Greek banks, which helped raise around two thirds of the required capital shortfall: one can indeed suppose that, faced with the publicly-stated prospect of a bank resolution and bail-in, some existing private investors might have preferred to contribute to the bank's rescue instead. But the Commission position raises a number of legal questions that have not yet been tested before the Courts:[71]

- First, it is clearly incorrect to claim that a recapitalization that would not fulfill the conditions of Article 32(4)(d)(iii) BRRD for precautionary and temporary measures would automatically imply a requirement to place the bank in resolution. Under Article 32 BRRD, such a measure (assuming it constitutes State aid and can therefore be considered as EPFS) would indeed trigger a finding that the bank is FLF. But such a finding is only one of three cumulative conditions that need to be fulfilled for the bank to be placed into resolution. In particular, the national resolution authority must also find that that there are no viable private sector alternatives, and that such resolution is in the public interest – an assessment that the BRRD has conferred to resolution authorities (subject to the Commission's and Council's limited right of objection within the framework of the SRM – see above).
- Second, the Commission's position that precautionary recapitalizations cannot apply to capital shortfalls identified in base scenarios finds no support in the BRRD or the EBA guidelines regarding implementation of Article 32. None of these texts make a distinction between AQRs, base and adverse scenarios. In its *Piraeus* decision, the Commission argues that a precautionary recapitalization aimed at covering a shortfall in a base scenario is evidence of 'losses incurred or likely to be incurred in the near future'. This causal link is debatable: indeed, a bank may experience a base shortfall without being in imminent risk of incurring losses. Conversely a bank may be at risk of imminent losses (for example resulting from a massive fraud or fine) with no base or even adverse shortfall, as illustrated by the recent case of Deutsche Bank after facing an initial claim of up to USD 14 billion from the U.S. Department of Justice in a mortgage securities mis-selling case.[72] Furthermore, while a finding that an institution is FLF must be based on an independent and fair valuation of its assets (as laid down under Article 36 BRRD), a stress test, which consists of a partial review of some assets under a very specific set of adverse circumstances, can arguably not be considered as fulfilling these conditions.[73]
- Finally, the link made by the Commission between the lack of interest from the private sector and the qualification of a recapitalization measure as non-precautionary/temporary is also debatable. Indeed, the EU legislator expressly designed the Article 32(4)(d)(iii) exemption as a way for the State to intervene 'where an institution is required to raise new capital due to the

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resolution. Such exception defined in Article 32(4)(d)(iii) BRRD is referred to as "precautionary recapitalization".' See also in the case of Italy, letter dated 29 November 2015 by Commissioners Hill and Vestager to Pier Carlo Padoan, stating: 'If an assessment leads to the conclusion that the use of the deposit guarantee scheme is state aid, resolution of the bank will be triggered under the [BRRD].'

71 For a more complete review and criticism on the Commission's position, see Champsaur 2016.

72 See *Berlin urges US to treat Deutsche fairly in mis-selling case* (*Financial Times*, 16 September 2016).

73 See Champsaur 2016.

outcome of a scenario-based stress test […] but […] is unable to raise capital privately in markets'.[74]

Scope of bail-in and burden sharing – application to State and public authorities and the case of banks already in resolution

The BRRD does not provide for any exception to the principle of bail-in for capital or liabilities held by States or other publicly-held entities, including supranational organizations such as the EBRD or the ESM. On the contrary, as explained above, the provision of EPFS can be considered a trigger for a finding that the bank is failing or likely to fail and ultimately resolution. The bailing-in of States and public institutions can lead to paradoxical situations, since it results in increasing the taxpayer's losses that the State aid framework is otherwise designed to minimize. By way of example, in the case of Banif's resolution in 2015, Portugal's equity participation for a nominal amount of €700 million and the outstanding hybrid instrument for a nominal amount of €125 million, which were provided in the 2013 rescue, fully participated in the loss as part of the *ex ante* burden-sharing exercise.[75]

These taxpayer losses can be further magnified when the liabilities to be bailed-in are privately held but covered by a State guarantee initially cleared by the Commission. The absence of a grandfathering clause in the BRRD protecting the State's previous investments or guarantees can be particularly problematic in the case of banks that have already been placed in orderly resolution (or "liquidation/orderly winding-down" under the Commission State aid decisions) before implementation of the BRRD. In this case, the bank has already exited the market and extensive burden-sharing of private investors (at least capital holders) has already taken place. Requiring further bailing-in of residual investors in such cases may disproportionately hit the State without bringing clear public policy benefits.

A possible alternative is for the State to repeal its guarantee – a solution that was attempted in the case of Hypo Alpe Adria (later renamed Heta), which was subject to a winding-down plan approved by the Commission in September 2013 and, following additional losses, had imposed upon it a temporary debt moratorium on its outstanding debt, which partly benefitted from a State guarantee by the Land of Carinthia. However, this precedent also shows the limitations of such an approach: (i) the circumstances of the case were very specific, in particular because the initial guarantee was considered "existing aid" and was therefore not cleared by the Commission under the crisis framework; (ii) crucially, the case gave rise to a settlement with the senior and junior debt holders whereby creditors and Heta accepted a haircut that still allowed creditors (including junior creditors) to receive part of their investment (up to 75%, i.e. a 25% haircut, for senior creditors). This settlement was cleared by the Commission as not constituting State aid to the creditors – thus acknowledging that the State could not repeal its guarantee without facing significant litigation.[76]

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74 BRRD, Recital 41.

75 Commission Decision in Case SA.43977 (2015/N) - Resolution of Banif (Banco Internacional do Funchal), 21 December 2015, para. 141.

76 Commission Decision in Case SA.45940 (2016/N) – Austria – Repurchase Offer for Guaranteed Liabilities of Heta Asset Resolution AG, 1 September 2016.

Feasibility of burden sharing and bail-in measures absent resolution

A key question is whether the implementation of *ex ante* burden-sharing measures, as requested by the Revised Banking Communication, is feasible under applicable laws when the conditions for the bank's resolution are not met under the BRRD. The conversion or write-down of shares or subordinated debt promoted by the Communication are heavy-handed measures that encroach on contractual and/or property rights, which are granted constitutional value in most Member States and in the EU legal order. The BRRD acknowledges this in its recitals:

> The use of resolution tools and powers provided for in this Directive may disrupt the rights of shareholders and creditors. […] Accordingly, resolution action should be taken only where necessary in the public interest and any interference with rights of shareholders and creditors which results from resolution action should be compatible with the Charter of Fundamental Rights of the European Union (the Charter).[77]

There is no reason to consider that these same principles should not also be applied in the context of the implementation of State aid rules.

What should be the legal basis of justifying the implementation of burden-sharing measures in cases where resolution is not triggered? In the case of Slovenian banks, the central bank (which implemented a conversion/writing-down of subordinated debt) attempted to claim that the Banking Communication constituted a specific legal basis and compelled the Member States to adopt legislation (or individual measures) to enforce the burden-sharing principle. As explained above, in the *Kotnik* case, the Court of Justice rejected this position and held that the Banking Communication 'must be interpreted as meaning that it is not binding on the Member States'. Indeed, such communication 'does not […] relieve the Commission of its obligation to examine the specific exceptional circumstances relied on by a Member State, in a particular case'. The effect of the Banking Communication provisions on burden-sharing, according to the Court, was therefore that

> […] if a Member State notifies the Commission of proposed State aid which complies with those guidelines, the Commission must as a general rule authorize the proposed aid. On the other hand, the Member State retains the right to notify the Commission of proposed State aid which does not meet the criteria laid down by the communication and the Commission may authorize such proposed aid in exceptional circumstances.[78]

As a result, national authorities cannot invoke the Banking Communication as an autonomous legal basis for burden-sharing measures: if they consider that such measures are necessary (for instance to secure Commission clearance under State aid rules) they must adopt national measures – and presumably make sure that such measures can, as such, withstand a challenge in their own constitutional/internal legal order.

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77 BRRD, Recital 13.

78 Kotnik judgment, paras. 41-3. See also Section 1(d) above.

The Member State could in principle adopt a law transposing into its legal order the provisions of the Communication and the requirement for *ex ante* burden-sharing – a solution that was for instance adopted in Greece. It is, however, unclear whether such a law would be recognized in the legal order of other Member States if, for instance, it violated their own constitutional law. A number of the subordinated debt or hybrid capital instruments concerned by the burden-sharing are governed by the law of another Member State. This issue was recently highlighted in the difficulties encountered in the split-off of former Banco Espirito Santo in Portugal, where under Portuguese law a number of shares and debt instruments were located in the "bad bank" to be put in run-off, with no claim on the new good bank Novo Banco.[79] Some investors successfully challenged before English courts this form of expropriation on the ground that their (English-law governed) loan agreement with former Banco Espirito Santo had been transferred to Novo Banco.[80]

One could envisage that the *ex ante* burden-sharing might be rooted on firmer legal ground if it were expressly imposed as a formal condition in a conditional Commission decision clearing the aid based on Article 9(4) of Regulation 2015/1589 (the Procedural Regulation).[81] However, this leaves open two questions. First, it is unclear (and to this day, untested) whether such a Commission decision would necessarily entail the recognition of burden-sharing measures throughout the EU. Second, and crucially, such a decision could only be adopted if State aid were still necessary after the subordinated debt/hybrid capital had been converted or written-down – but what if this were not the case and the cushion of subordinated debt/hybrid capital was sufficient to absorb the capital shortfall? Absent State aid, it is difficult to see what the basis for a Commission decision would be.

Principle of necessity and proportionality

In the Revised Banking Communication, the Commission clearly stated that the implementation of the burden-sharing principle should be subject to the principles of necessity and proportionality, thus leaving open the possibility of derogations in exceptional cases. Under point 45 of the Communication, an exception to the burden-sharing requirements (i.e. the contribution by equity, hybrid capital and subordinated debt to the bank's losses prior to State intervention) can be made when such measures 'would endanger financial stability or lead to disproportionate results'. By way of example, the Communication contemplates the case where the amount of aid to be received is limited in comparison to the bank's risk-weighted assets and the capital shortfall has already been reduced significantly through capital raising measures. The Communication also contemplates the possibility of reconsidering the sequencing of measures to address the capital shortfall – in other words, to allow State aid to be implemented prior to burden-sharing.

In its *Kotnik* judgment, the Court of Justice gave a limited interpretation of this principle of proportionality. According to the Court, this principle implies that 'an obligation to effect the conversion, or write-down, of subordinated rights in their entirety before the granting of State aid cannot be imposed on a bank if, *inter alia*, the conversion, or write-down,

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79 Commission Decision in Case SA.39250 - Resolution of Banco Espírito Santo, 3 August 2014.

80 *Goldman Sachs International v Novo Banco SA* [2015] EWHC 2371 (Comm). This decision was overturned in November 2016.

81 In practice, the Commission has adopted few decisions based on article 9(4) in banking cases. See, e.g., Commission Decision in Case C14/2008 - United Kingdom-Northern Rock, 28 October 2009. Commission Decision in Case C9/2009 - Belgium-Restructuring of Dexia, 28 December 2012.

of a part of the subordinated rights would have been sufficient to overcome the capital shortfall of the bank concerned [emphasis added]'.[82] The term '*inter alia*' seems to indicate that there might be other scenarios where full conversion of write-down might not be required, but the Court steered clear of articulating such scenarios.

The BRRD also acknowledges several limitations to the bail-in principle and more generally the powers of resolution authorities. These include Article 16 of the Charter on Fundamental Rights of the European Union on the right to conduct business (mentioned in recitals 24, 29 and 130 of the BRRD); Article 52 of the Charter regarding the protection of property rights (recitals 49 and 130 of the BRRD); and the proportionality principle (recitals 27, 49, 50 of the BRRD), which plays a prominent role in all majors provisions of the Directive regarding the powers of resolution authorities.

The Commission's State aid decisional practice since 2013 provides some limited examples of derogations to the burden-sharing/bail-in rules and where the proportionality principle was invoked. For instance:

- In *SNS Reaal*, the Commission did not require any bail-in from the group's insurance arm for the following reasons: (i) the insurance and the banking arm of the group had separate capital accounts; (ii) the aid was only required for the group's banking arm; and (iii) SNS Reaal committed to refrain from any capital transfer between the two arms.[83]
- In *CEISS/Unicaja* the Commission considered that since the amount of aid accounted for less than 2% of the bank's risk-weighted assets, the authorities could implement a partial (rather than full) bail-in/burden-sharing to subordinated debt holders.[84] Interestingly, this 2% ratio was previously used by the Commission in the earlier stages of the crisis to distinguish between "fundamentally sound" banks and banks in difficulties.
- In the case of *Eurobank*, the Commission also applied the proportionality principle.[85] Since the aid only consisted of a commitment by the State-owned HFSF to recapitalize the bank should the public rights issue be insufficient, the Commission considered that requiring a full bail-in prior to the commitment itself would be disproportionate and that such a bail-in should only be triggered if the commitment was actually implemented (i.e. in case of insufficient take-up of the rights issue by the market). The Commission applied the same reasoning in 2015 regarding the second rights issue (and HFSF commitment) by Eurobank and other Greek banks.[86]

By contrast, in other cases national authorities seem to have applied in full the principle of bail-in/burden-sharing as the measures were considered necessary in light of the probable future losses. For instance:

- In the case of Slovenian banks (December 2013), Slovenia committed to write-down in full shareholders equity and outstanding subordinated debt

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82 Kotnik judgment, para. 101.

83 Commission Decision in Case SA.36598 - SNS REAAL, 19 December 2013, paras. 84 and 92.

84 Commission Decision in Case SA.36249 (2014/N-3) - Amendment of Restructuring of Banco CEISS through Integration with Unicaja Banco, 12 March 2014.

85 Commission Decision in Case SA.34825 - HFSF Recapitalization Commitment to EFG Eurobank, 29 April 2014, para. 400.

86 See, e.g., Commission Decision in Case SA.43363 (2015/N) - Additional Restructuring Aid to Eurobank, 26 November 2015, paras. 97 and 136.

before any State intervention. In this case, the principle of proportionality does not seem to have been invoked by the Slovenian authorities.[87] In the *Kotnik* judgment, the Court of Justice acknowledged that the Slovenian authorities were not compelled by the Revised Banking Communication to apply the burden-sharing principle, but ran the risk of a negative Commission decision if they proposed an exception to this principle.[88]

- In the case of Banco Espirito Santo, the bank was split between a "good" bank, which was capitalized by the State and due to be privatized within a few years, and a "bad" bank, where all shareholders and subordinated debt holders (as well as claims by related parties e.g. shareholders or Board members) were lodged. As a result, the chances of recovery by shareholders and subordinated debt holders were dramatically reduced.[89] As in the case of Slovenian banks, a number of creditors challenged the measures and the Commission decision before the courts. The challenge is still pending before the General Court. [90]

In sum, while the principle of proportionality has been acknowledged by the Commission and the Court of Justice as a limitation to the principles of burden-sharing and bail-in, the practical consequences of this recognition have yet to be defined in more detail. In particular, will the Commission accept to clearly deviate from its own Banking Communication rules, in line with the possibility offered to resolution authorities under the BRRD and therefore refrain from ordering requesting burden-sharing when financial stability is at stake, and will the Courts validate such approach? Or will derogations to the burden-sharing rules remain minor, as in the cases contemplated so far in the Commission's decisional practice? The answer to these questions may determine the speed and effectiveness of the European bank sector's recovery from the crisis.

c) *Expert assessments: banks' viability and valuation*

Expertise plays an important role in the assessments required for the Commission to determine the existence of State aid to banks and its compatibility with EU State aid rules. It also plays a part in the assessments to be made by the supervisory and resolution authorities within the Banking Union. The BRRD also refers to independent experts for one specific (and essential) task: the provision of a 'fair, prudent and realistic' valuation of the bank's assets and liabilities, which is required under Article 36 in case resolution is contemplated. *Ex ante* independent valuations pursuant to Article 36 (which may be provisional or definitive) are to form the basis for a number of decisions by the resolution authority, including among others (i) the placement of the bank into resolution; (ii) the use of the bail-in tool (i.e. the possible conversion or write-down of equity and liabilities); (iii) the use of the "bridge institution tool" (i.e. the break-up of the bank between a good and a bad bank); and (iv) the sale of business tool (i.e. the divestiture of all or parts of the bank) under market terms.

Some of these assessments may directly overlap (or collide with) the Commission's assessments under State aid rules. In its decisional practice, the Commission has sometimes

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87 Commission Decisions in Cases SA.33229 - Restructuring of Nova Ljubljanska Banka (NLB), SA.35709 - Restructuring of Nova Kreditna Banka Maribor (NKBM), and SA.37690 - Rescue aid in favour of Abanka (Abanka), 18 December 2013.

88 See Kotnik judgment.

89 See Resolution of Banco Espirito Santo precit.

90 Case T-814/14 *Banco Espirito Santo v Commission*, not yet decided.

used experts to perform some of these assessments, but has not hesitated to provide its own assessment or even contradict other assessments provided by experts appointed by Member States. By way of example:

- The assessment of the bank's viability has been an essential component of the restructuring plans imposed by the Commission. In a number of cases at the beginning of the crisis, the Commission tended to defer to the national regulators' assessment on the credibility of the restructuring measures. For instance, in Lloyds and RBS, the Commission noted that: '[T]he thorough analysis run by the supervisory authority and the degree of conservatism built in when assessing the capital needs of [the bank], give sufficient comfort to the Commission to assure that the implementation of the restructuring plan will lead to the restoration of the long-term viability of the bank.'[91] In other cases (involving in particular program countries) the Commission conducted its own assessment and imposed its own (usually tougher) conditions for restoring viability, based on a considerable amount of data and numerous scenarios including, for instance, projected capital/core tier 1 ratio as compared to minimum regulatory requirements, liquidity forecasts, revenue growth, operational costs and various scenarios regarding the quality of assets held by the bank.[92] More recently, the Commission seems to have placed less emphasis on quantified objectives and insisted more on behavioral measures, in particular the establishment of detailed credit risk management procedures.[93] A key question going forward is whether the Commission, as a guardian of State aid rules, will defer more to supervisory or resolution authorities in these viability assessments or whether it will continue to apply its own assessment on top of those of the relevant authorities.
- To determine whether an impaired asset measure contains State aid and quantify such State aid the Commission determines the difference between the transfer value of the assets (i.e. the value at which they are sold to or guaranteed by the State) and their market value. Assessing the market value typically requires expert valuations – a task that the Commission has sometimes delegated to experts, for instance in the *Fortis* and *Dexia* cases.[94] In the case of a number of German banks, by contrast, the Commission rejected the assessment provided by experts appointed by Member States and used its own assessment, which usually resulted in lower market values (and therefore a higher State aid component).[95] An open question is whether the Commission will agree to take into account the valuations required under Article 36 BRRD for the purpose of these assessments or whether it will continue to apply its own valuation methodology. At this stage, the *Banif*

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91 Commission Decision on State aid No. 428/2009 - Restructuring of Lloyds Banking Group, 18 November 2009, para. 148.

92 See, e.g., Commission Decision in Case SA.34724 - Restructuring of the Banco Comercial Português (BCP) Group, 30 August 2013.

93 See, e.g., Commission Decisions in Cases SA.43363 (2015/N) - Additional Restructuring Aid to Eurobank, 26 November 2015, and SA.38522 - Restructuring Aid for Banka Celje/Abanka, 16 December 2014.

94 Commission Decisions in Cases N274/2009 - Fortis Banque, 12 May 2009, paras. 42 and 112, and C9/2009 - Dexia, 26 February 2010, paras. 55 and 89-90.

95 See, e.g., Commission Decisions in Cases C29/2009 - HSH Nordbank, 22 October 2009, paras. 43 and 43, C40/2009 and C43/2008 - Restructuring of WestLB AG, 20 November 2011, paras. 43-44 and 148-9, and C17/2009 - Landesbank Baden-Württemberg (LBBW), 15 December 2009, paras. 41, 50, 53.

precedent seems to indicate that the Commission will not feel bound by the BRRD valuations for its State aid assessment.[96]

3. A tentative conclusion – how to handle many cooks in one kitchen

The Commission's decisional practice on State aid to banks in the crisis and the parallel, gradual implementation of the Banking Union have undoubtedly contributed to a more unified pan-European policy to address and prevent banking crises, and generally strengthen the stability of a still fragmented European banking system. But the parallel role of the Commission in its capacity of State aid controller, and European (and national) supervisory and resolution authorities, also raises coordination issues that have not yet been resolved through recent decisional practice. Part of the issue may lie with the fact that the level of centralization of the two frameworks is very different: while the Commission has exclusive competence to clear State aid (usually subject to commitments that reflect general policy positions on issues such as viability or burden-sharing), the regulatory landscape of the Banking Union remains much more decentralized and still relies to some extent on national authorities.

The inconsistencies between the two frameworks on critical points of flexibility (in particular regarding the bail-in or burden-sharing rules), as well as the lack of a definitive answer by the Court on the balance to be held between the principles of bail-in/burden-sharing and the principles of proportionality and the right to property further complicate the chances of swift clarification.

Against this background, possible actions to envisage could include (i) amending the Commission State aid communications in order to fully take account of the principles of the BRRD; (ii) deferring to supervisory and resolution authorities as much as possible under the legal discretion enjoyed by the Commission in its State aid assessment with respect to viability and burden-sharing principles; (iii) focusing State aid assessments on DG COMP's "core business" of protecting and developing competition and the Single market; and (iv) taking into account competition concerns in the action of supervisory and resolution authorities. At a time of enduring doubts on the European banking sector, regulators would probably do well to avoid a scenario of regulatory competition and parallelism and embrace deferral or close cooperation.

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96 See *Banif* precit., and Section I.C. above.

ANNEX

Table 2. Selected burden-sharing provisions in the Commission decisional practice under the 2013 Banking Communication

Case	Type of measure	Burden-sharing provisions impacting on private investors
Banco Espirito Santo (Portugal)[97] August 2014	Recapitalization of the "Bridge Bank" through ordinary shares.	Shareholders and subordinated creditors will be left in the "bad bank", while the Portuguese State will become the only shareholder of the "bridge bank". According to Portuguese banking resolution law, the burden-sharing is also extended to cover claims by related parties (e.g., shareholders or Board members) of a non-contractual nature (e.g., deposits of shareholders with more than 2% shareholding). Suspension of the payment of coupons and dividends unless those payments are legally due.
Eurobank (Greece)[98] April 2014	Recapitalization commitment letter by the Hellenic Financial Stability Fund.[99]	Greece's commitment to bail-in subordinated creditors before any capital support is actually paid out to Eurobank (see para. 135) was sufficient to ensure proper burden-sharing; mandatory conversion of subordinated debt and hybrid capital at the moment of the commitment could be disproportionate pursuant to Art. 45 of the 2013 Banking Communication (see para. 400).

97 Commission Decision in Case SA.39250 - Resolution of Banco Espírito Santo, 3 August 2014.

98 Commission Decision in Case SA.34825 - HFSF Recapitalization Commitment to EFG Eurobank, 29 April 2014.

99 This is only measure assessed under the 2013 Banking Communication in the Eurobank case.

Case	Type of measure	Burden-sharing provisions impacting on private investors
CEISS/Unicaja (Spain)[100] March 2014	Convertible preference shares, CoCos, guarantees (linked to arbitration and litigation costs). The Commission approved Banco CEISS's final restructuring plan on the basis of its takeover by Unicaja Banco.	The shareholders lost their equity stakes in Banco CEISS with no claim left over against the new Banco CEISS. Following a subordinated liability exercise (SLE) in July 2013,[101] the Spanish Deposit Guarantee Fund provided no liquidity mechanism to investors willing to sell the securities obtained though the SLE – 'in contrast with other exercised conducted by other State-owned banks in Spain' (para. 100). Thus, there were additional losses for the previous holders of the securities in Banco CEISS. In addition, holders of hybrid instruments have entirely assumed the negative economic value of Banco CEISS, as Fondo de Reestructuración Ordenada Bancaria (FROB)[102] did not become a shareholder in Banco CEISS. The Commission stressed that an exception to the burden-sharing requirements can be made, pursuant to Art. 45 of the 2013 Banking Communication, where the aid amount to be received is small in comparison to the bank's RWA and the

100 Commission Decision in Case SA.36249 (2014/N-3) - Amendment of Restructuring of Banco CEISS through Integration with Unicaja Banco, 12 March 2014.

101 'After the burden-sharing imposed on the original shareholders of Banco CEISS, in view of the significant losses posted by Banco CEISS for 2012, holders of preference shares and perpetual/dated subordinated debt instruments were asked to bear losses and contribute significantly to the recapitalisation of Banco CEISS that took place on 15 July 2013. They did so in the following way:

- First, those securities were bought back by Banco CEISS at their net present value, calculated in accordance with the methodology set out in the Term Sheet annexed to the December 2012 Decision, which implied deep discounts from their nominal value. That action generated immediate capital gains for Banco CEISS of EUR […] million net of tax effects, which significantly reduced its capital needs.
- Second, the proceeds from that buy-back were automatically reinvested in Banco CEISS in the form of ordinary shares and necessarily convertible instruments. The conversion of those securities into capital instruments further reduced the capital needs of Banco CEISS by EUR […] million.' (para. 23).

102 The FROB has been entrusted with the management of the restructuring and resolution proceedings of Spanish credit institutions. For that purpose, it may provide public support to distressed institutions. The FROB funds are contributed by the State Budget. Additionally, the FROB may obtain other funding (*via* issuance of securities, loans, credits or other debt transactions) up to the limit annually established in the State Budget.

Case	Type of measure	Burden-sharing provisions impacting on private investors
		capital shortfall has been reduced significantly in particular through capital raising measures (paras. 102-103). Banco CEISS also committed to an acquisition ban and a dividend-payment ban during the restructuring period.
NLB, NKBM, Abanka, and Banka Celje/Abanka (Slovenia)[103] December 2013 – December 2014	Recapitalizations through equity capital (in the form of cash or government securities), rights issue, CoCos.	Before any State aid was granted to the banks, Slovenia committed to write-down in full their shareholders' equity and outstanding subordinated debts. The State became (or will become) the sole shareholder of these banks. Further, Slovenia committed to a coupon ban, which would not apply to newly issued capital instruments provided that the payment of coupons on new instruments does not create a legal obligation to make any coupon payments on the banks' existing (at the moment of the decision's adoption) securities. In the case of Abanka, one of the commitments of its second recapitalization was to merge with Banka Celje once Slovenia had taken a majority stake in Banka Celje (as part of a general strategy to 'improve the sustainability of the Slovenian banking system'). It is noteworthy that, prior to its first recapitalization, Abanka had already written-down in full its shareholders' equity and the outstanding subordinated debt 'to ensure adequate participation of existing investors in the Bank' restructuring' – thus, the State became the sole shareholder of Abanka (see paras. 41, 140-141 of the second Abanka decision). The same applies for Banka Celje, which had written-down in full its equity holders and subordinated debt

103 NLB precit., NKBM precit., and Abanka precit.; Commission Decision in Case SA.38228 - Restructuring of Abanka Vipa Group, 13 August 2014 (2nd Abanka decision); and Commission Decision in Case SA.38522 - Restructuring Aid for Banka Celje/Abanka, 16 December 2014.

Case	Type of measure	Burden-sharing provisions impacting on private investors
		holders prior to its recapitalization. For this purpose, the Bank of Slovenia had frozen all subordinated debt issued by Banka Celje (see para. 168 of the *Celje/Abanka* decision).
SNS REAAL **(The Netherlands)**[104] December 2013	Transfer of SNS Bank's property finance activities into a bad bank.	SNS REAAL was a bank insurance holding company with separate banking (SNS Bank) and insurance (REAAL Insurance) subsidiaries. SNS REAAL and SNS Bank were nationalized in 2013, following a 2008 recapitalization and due to persistent problems with the property finance activities. Thus, with respect to burden-sharing requirements, the shareholders and hybrid debt-holders of SNS Bank and SNS REAAL were expropriated and will only receive a 'fair compensation' in line with Dutch law. As regards REAAL Insurance (the insurance subsidiary), which did not require State aid, the enhanced burden-sharing requirements of the 2013 Banking Communication did not apply to its hybrid debt-holders. However, there will be no capital transfer between SNS Bank and REAAL Insurance, and the Dutch State/SNS REAAL committed to divesting the insurance subsidiary. Last, the Dutch State committed to a coupon ban, which did not apply to newly issued capital instruments provided that the payment of coupons on new instruments did not create a legal obligation to make any coupon payments on the bank' existing (at the moment of the decision's adoption) securities.

[104] Commission Decision in Case SA.36598 - SNS REAAL, 19 December 2013.