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The changing role of the state in finance: some observations from DG COMP's case practice during the crisis

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2 October 2012

MS' responses to the financial crisis in the EU: bank rescues

Recapitalisation by the State

State-guaranteed funding

Impaired assets measures

- Guarantees of impaired assets
- Purchase of impaired assets
- Hybrid schemes

In few cases: resolution

Potentially triggering need for in-depth **restructuring**

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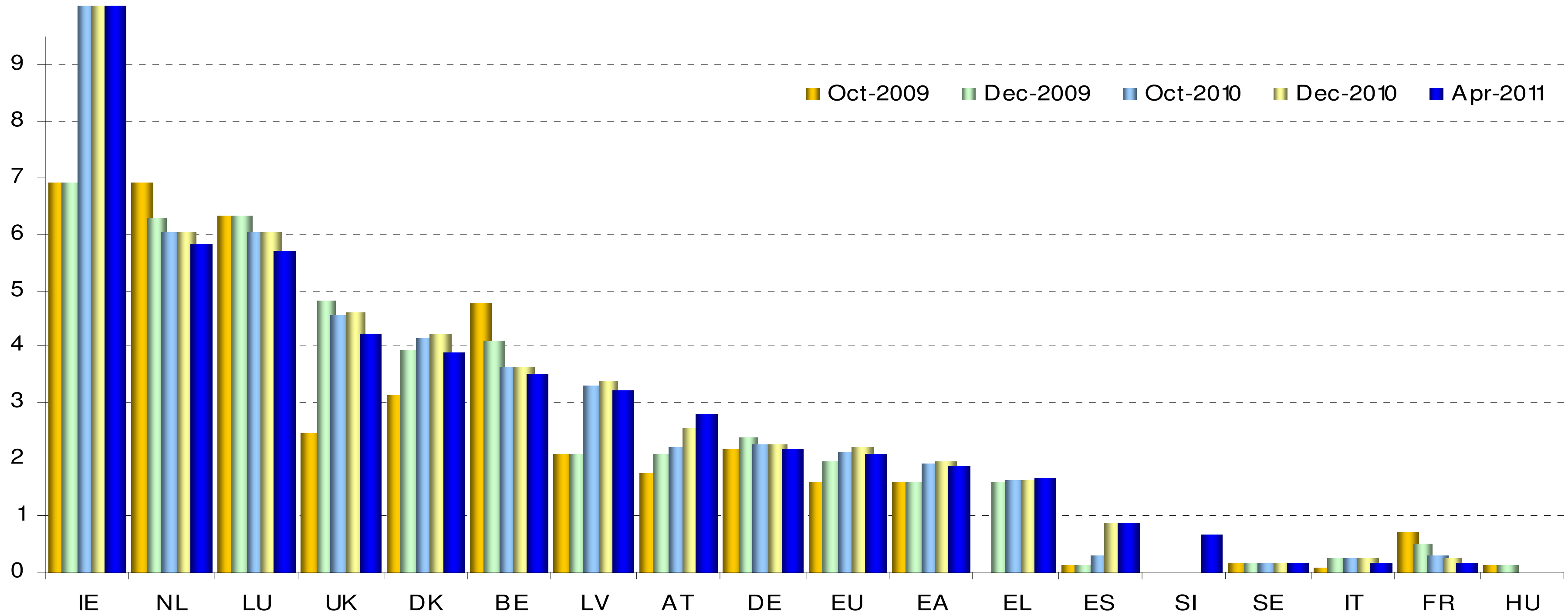
Rescue of Banks has been massive

Capital injections, as a percentage of GDP



Source: European Commission; as of 31 April 2011

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EU State aid control in the financial crisis: Instruments, based on 107.3.b

13 October 2008	**Banking Communication**: General principles, guarantee pricing, recapitalisation, winding-up, liquidity assistance, procedural aspects.
5 December 2008	**Recapitalisation Communication**: refines approach to recapitalisations.
25 February 2009	**Impaired assets Communication**: guidance on asset purchase / insurance / hybrid schemes.
14 August 2009	**Bank restructuring Communication**: guidance on how to restore long term viability of banks in difficulty while ensuring burden sharing and minimising competition distortions.
1 December 2010	**"Exit"-Communcation:** update on conditions for guarantees to incentivise exit from state support;
1 December 2011	**Prolongation Communication:** extension of crisis rules beyond end 2011; account taken of valuation of government bonds

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Member States' response to the financial crisis – a bird's eye perspective

Effective amounts*

	In EUR bn	% of GDP
Capital injections	287,8	2,3%
Guarantees on bank liabilities	1111,8	9,1%
Relief of impaired assets	121,2	1,0%
Liquidity and bank funding	87,2	0,7%
Total	**1.608,0**	**13,1%**

Committed /approved amounts **

	In EUR bn	% of GDP
Capital injections	598,1	4,9%
Guarantees on bank liabilities	3.289,6	26,8%
Relief of impaired assets	421,1	3,4%
Liquidity and bank funding	197,7	1,6%
Total	**4.506,5**	**36,7%**

Period 2008 – 2010

***** Period 1/10/2008 – 1/10/2011***

Source : European Commission; State Aid Scoreboard Dec. 2011
http://ec.europa.eu/competition/state_aid/studies_reports/2011_autumn_en.pdf

ILLUSTRATIVE

Difficulties of banks irrespective of the level of concentration in MS or of resilience of sovereign

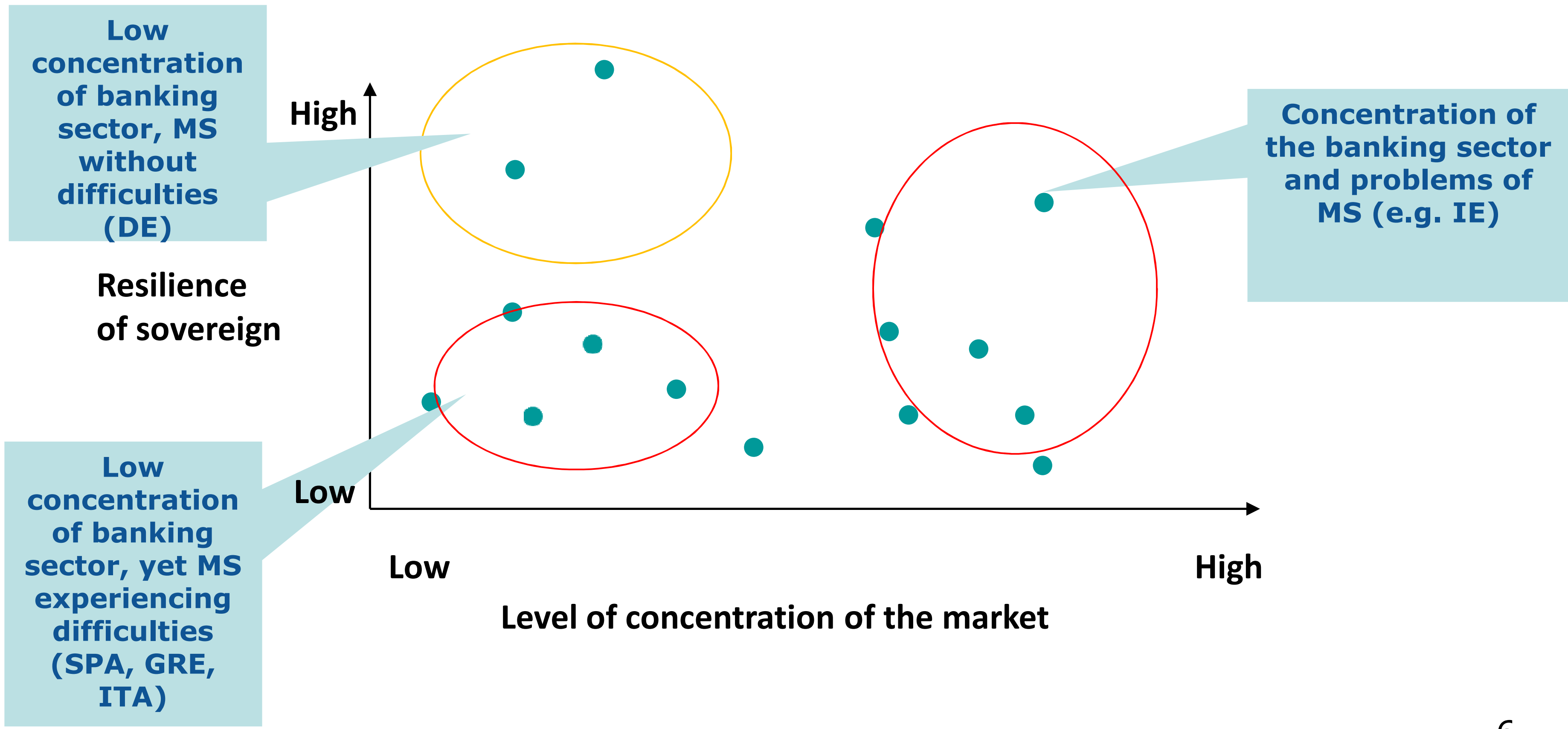

Table 1: Causes difficulties vs. business models (not exhaustive)

Business model/causes difficulties	Excessive reliance on wholesale funding/ liquidity issues	Exposure to (US) sub-prime/ABS/ CDOs	Exposure to bad loans	Deficient (risk) management
Retail	Northern Rock, (i.e. CAM, Unnim, Catalunya Caixa, Bankia), SNS	Northern Rock, BAWAG	Northern Rock, Spanish cajas (i.e. CAM, Unnim, Cataluny Caixa, Bankia), NLB	
Monoliner retail	INBS, B&B	Dunfermline, B&B, INBS	INBS, EBS, B&B	INBS
Universal	RBS, Dexia, Parex, BPN	ING, KBC, RBS, CoBa, Parex	RBS, Dexia, Lloyds, Fionia, AIB, BOI, ILP, ATE, Parex, BPN	RBS, Dexia, Parex
Investment banking		Dexia (FSA)		
Wholesale (solely corporate, commercial real estate, public finance, etc)	Anglo Irish, HRE	Anglo Irish, Kommunalkredit, WestLb	Anglo Irish	Anglo Irish

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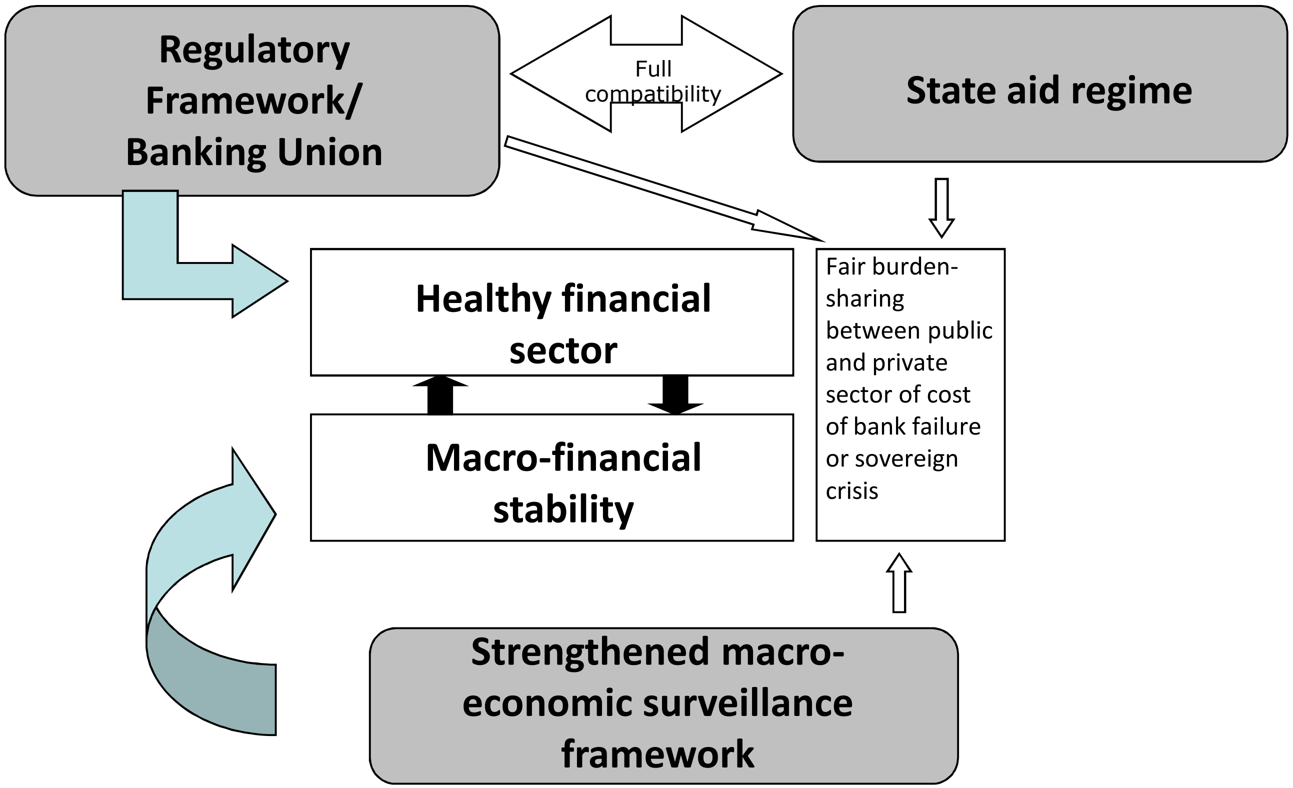
State aid control in the crisis: Lessons learned

- Importance of State aid control as a coordination tool
  - At the time, crisis management and resolution tools were mainly national: EU SA only de facto EU level co-ordination tool for bank restructuring
- Reconcile objective of financial stability with limitation of market distortions: no trade-off
- State aid control has endeavoured to impose burden sharing and address moral hazard but can only go so far in the absence of a robust resolution mechanism
  - Importance of regulatory framework to prevent financial crises and reduce need for state aid to financial institutions as a solution

Complementarities SA control, banking regulation and macroeconomic policies



Source: Commission services

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Lessons learned (1/4)

- **Business model does not matter, funding does**:
  - From the outside, not possible to tell which bank will be safe in the long-term, regardless of the type of activity;
  - Retail focussed banks have failed to a similar degree as universal and wholesale banks (see Table 1);
  - Both too much specialisation (monoliners) and too much diversification (RBS) can increase risk;
  - (Risk) Management is more important than precise business model – balance sheet transparency, properly managed diversification, stability of funding each contribute to resilience
  - **What has always failed, irrespective of the business model : dependence on short-term / wholesale funding and important ALM mismatch**

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Lessons learned (2/4)

- **Ensure that risk management takes account of need to:**
    - Anticipate marco-economic developments
    - Detect early on asset bubbles (real estate, technology etc)
    - Properly value sovereign and para-sovereign risk
  - Distortions in the banking sector also disrupt the real economy

- **Sovereign situation impacts on banks:**
  - The macro-economic situation matters when defining a systemically important bank: when the sovereign is weak, smaller banks are systemic

- **Governance is essential: need professional and independent supervisory boards and risk committees**

Lessons learned (3/4)

- **Management and supervision matter, structure does not**:
  - Success or failure of a bank predominantly determined by way the bank is managed and supervised;
- **Smart and proactive supervision is key, with powers**:
  - Supervisors need to become more pro-active in understanding the banks they are supervising;
  - Availability of resolution frameworks gives additional leverage to intervene and impose restructuring on ailing banks;
- **Regulators need to rapidly implement new tools**:
  - Implement rapidly a pan-European resolution framework is key to address TBTF (cf. proposals by Commission)
  - Living wills (Recovery and resolution plans) is very promising approach – more tailored solution than upfront structural separation.

Lessons learned (4/4)

- **State aid control is key to ensure level playing field for competition**:
  - Systemically relevant banks need comparatively more aid and cause the most distortion of competition as they cannot be allowed to fail;
  - MS more likely to liquidate smaller banks or even allow them to fail (UK, DK, NL);
  - The TBTF problem: Banks which cannot be put into effective resolution benefit from an implicit state guarantee which:
    - Lowers their cost of capital relative to competitors, and
    - Induces moral hazard

- **Degree of concentration on the market does not matter:**
  - Both banks in concentrated markets (BE, NL, UK, IE) and less concentrated markets (GE, SP, GR, ITA) experienced difficulties;
  - More concentration does not lead to a more resilient banking sector, but can create moral hazard from "too-big-to-fail" (TBTF) banks;

Decision taken during crisis

- ~300 decisions since 1/10/2008 (as of May 2012)

  ~135 individual decisions (rescue, restructuring, monitoring)

  ~165 decisions regarding (schemes)

- Involving:
  - 46 banks
  - 42 rescue/support schemes
  - 22 Member States