State Aid in the Banking Sector: A Viable Solution to the 'Too big To Fail' Problem?

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The expression 'too big to fail' refers to situations where a financial institution is so big that its failing would be catastrophic for the economy and society and for this reason, it is necessary to keep it afloat. A prevalent way of doing so is through State aid. Indeed, during the recent financial crisis financial institutions with assets over $100 billion received 90 percent of the government bailouts. The aim of this article is to explain how the coordinated use of State aid bailouts and the Single Resolution Mechanism (SRM) may provide a solution for the 'too big to fail' problem. The article demonstrates that if only one financial institution is failing, the State aid controls have been proved efficient to mitigate moral hazard, imposing a shared burden on shareholders and junior creditors. However, if several banks are failing, the SRM which was created as a response to the problems encountered during the 2007 crisis should prevail.

I. Introduction

Crises have been a recurrent feature of the financial history, century after century.[1] Whereas a solid banking system is essential for economic stability, some risks are inherent in the commercial banking model.[2] More precisely, most banks' liabilities are liquid: the depositors have the right to withdraw their money immediately, contrary, for instance, to mutual funds that guarantee payment at maturity.[3] However, the banks' main assets, i.e. the loans, are illiquid: banks cannot demand

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[1] Charles P Kindleberger, *Manias, Panics and Crashes. A History of Financial Crises* (3rd, John Wiley & Dons 1996)
[2] Rosa M Lastra, *Legal Foundations of International Monetary Stability* (1st ed, OUP 2006) p 110.
[3] Paul Davies, 'Liquidity Safety Net for Banks' [2013] 3 Journal of Corporate Law Studies 287.

the debtor to repay them immediately or in short notice.[4] By charging their assets more than paying out their liabilities, this mechanism is a source of revenue for commercial banks.[5] At the same time, however, it is exposed to two main risks. The first one is that the loan will not be repaid.[6] The second consists of an 'unanticipated and substantial level of withdrawal of short-term findings';[7]this causes liquidity issues, similar to those that worsened the 2007 crisis.

Nevertheless, one has to keep in mind two aspects. First of all, banks do mitigate their risks, notably by using collaterals and close-out netting.[8] Secondly, a lot of institutions that failed or were close to bankruptcy were not commercial banks.[9] For instance, the emblematic Bear Stearns and Lehman Brothers were investment banks. This crisis, qualified by professors Kokkoris and Olivares-Caminal as 'the biggest crisis since the Great Depression',[10] started as a mortgage lending crisis in the United States. It then spread to become a financial crisis that evolved into recession, shrinking the wider economy and affecting households, businesses and jobs.[11]

Against this backdrop, it is necessary to provide a brief explanation of this phenomenon. The 2007 crisis started with a housing bubble and a financial innovation in the United States: subprime mortgages. The latest consisted in residential loans created for borrowers with a history of late payments or even in situation of bankruptcy.[12]Thus, many mortgage holders were only able to reimburse their credits if the housing pricing continued to rise.[13] However between 2004 and 2006, the value of houses started to diminish as the result of the rise of interest rates rose from 1% to 5.35%.[14] This lead to an exponential number of subprime mortgage defaults and thus triggered the fall of the securities based on

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[4] Ibid.
[5] Ibid.
[6] Ibid.
[7] Ibid.
[8] Philipp Paech, 'Cross-border Effects of Banking Resolution' [2014] BIICL.
[9] Daniel Pimlott, 'Retreat on need to split big lenders' (*Financial Times* ,17 December 2009) <http://www.ft.com/cms/s/0/656ce7a8-eb3b-11de-bc99-00144feab49a.html#axzz36nYPhAXY> accessed 07 July 2014
[10] Ioannis Kokkoris and Rodrigo Olivares-Caminal, *Antitrust Law Amidst Financial Crises* (1st, CUP 2010) 90.
[11] Communication from the Commission (EU) on the Temporary Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis [2009] OJ C83/01.
[12] 'Definition of subprime' (*Financial Times Lexicon*) <http://lexicon.ft.com/term?term=subprime> accessed 3 July 2014
[13] Jorgen Elmeskov, 'The General Economic Background of the Crisis' (OCDE 2009) <http://www.oecd.org/eco/42843570.pdf> accessed 3 July 2014.
[14] 'Timeline: Credit crunch to downturn' (*BBC News,* 7 August 2009) <http://news.bbc.co.uk/1/hi/7521250.stm#table> accessed 03 July 2014.

these loans.[15] Financial institutions started to accumulate losses, which were uncertain in their extent and their distribution, due to the complexity of the securitized assets.[16] The banking sector reacted to these losses by freezing securities, rising prices on insurance for default, and reducing inter-bank lending.[17] This also led to notable bank runs. The collapses of major institutions worsen the panic: Lehman Brothers was first major bank to file for bankruptcy the 15th of September 2007.[18] Then this financial crisis started to affect the real economy.[19] Investors earned high returns by placing their capital at risk. When they bore losses, the amount of capital to be invested directly reduced, which diminished their ability to invest. Thus, loans became hard to obtain, thereby threatening even healthy companies. This lead to job losses: as an example, 35,000 people were let go over three years in Bank of America.[20] Consumers reduced their expenses, which led to the drop of international trade and eventually recession.[21]

Governments did try to limit the effects of the crisis by providing financial institutions that were 'too big to fail' with State aids to avoid the catastrophic consequences of their failure. Moreover, large banks benefited from the political pressure to keep banks afloat in order to save jobs. The solution proposed by the European Union is to set aside national policies for the benefit of a supranational authority: the Single Resolution Mechanism. The latter is presented as a rising alternative to public bailout and nationalisation. However, State aid bailouts suffer from hazard and systemic risks, whereas the SRM is not a perfect answer to the problem either. With this in mind, the aim of this article is to demonstrate that the proper solution to the 'Too Big to Fail' problem is a coordinated use of both State aids and the SRM.

II. The evolution of State aid in the banking sector

The financial crisis has forced Member States to provide aids at an unprecedented scale.[22] In 2007 the total amount of State Aids represented less than 0.5 per cent of the Growth Domestic Product (GDP). It increased to 2.2 per cent of GDP in 2008

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[15] Ioannis Kokkoris and R Olivares-Caminal (2010).
[16] Ibid.
[17] J Elmeskov (2009) op cit.
[18] Ibid.
[19] Stephen Figlewski, 'Viewing the Financial Crisis from 20,000 Feet Up' (2009) 16 Journal of Derivatives 56.
[20] 'Timeline: Credit crunch to downturn' (2009) op cit
[21] I Kokkoris and R Olivares-Caminal (2010) op cit p 91
[22] Emiliano Tornese, 'A Single Resolution Mechanism For the Banking Union' (2014) London Financial Regulation Seminar
< http://www.lse.ac.uk/fmg/events/financialRegulation/LFR-2014-TorneseSlides-A-Single-Resolution-Mechanism.pdf>

(granted almost exclusively to the financial sector).[23] State aid control was the only way for European Commission to prevent unnecessary distortion to competition in the Internal Market and thus protect macro financial stability. This policy from 2007 to today has had four objectives: to impose a co-ordinated policy, avoid discrimination, recapitalize on an equitable basis and avoid undue distortion of competition.[24] Furthermore, it should be borne in mind that State aids are a temporary measure and thus are limited in time.

1. The principles of State aid control in EU competition law

Since the *Züchner* case European Competition law is applicable to the banking sector.[25] Thus the principle of prohibition of State Aids applies here as well.[26] More precisely and according to article 107(1) TFEU, any aid which affects trade and distorts competition between Member states is unlawful, unless it falls within one of the exceptions provided in articles 107(2) and (3) TFEU. The *ratio legis* is straightforward. Article 3 (1)(b) of the Treaty of the functioning of the European Union refers to the competition rules which are necessary for the establishment of the internal market. In particular, former article 3 (g) Treaty on European Union stressed the necessity of 'a system ensuring the competition in the internal market is not distorted'. Thus, although State intervention favours some undertakings over other, thereby distorting competition in the market, it may be allowed when such distortion is not 'excessive'. In assessing the compatibility of State aids with the internal market, the European Commission has exclusive jurisdiction.[27]

Not all public support from Member States is to be qualified as State aid according to EU competition law. Article 107(1) is silent on definitions, but the Court of Justice stressed in 1961 that State aids must be defined by reference to their effects.[28] More precisely, the Treaty along with the relevant jurisprudence lays down five cumulative conditions for State aid to be classified as such. First, the aid is to be granted 'by a Member State or through any state resources'.[29] 'Member States' refers to the central or local government (such as municipalities).[30] 'State resources' are public but also private bodies designated by the State that use

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[23] Phedon Nicolaides in *Antitrust Law admidst Financial Crises* (2010) at p 350.
[24] Ibid at p 351.
[25] Case C-172/80 *Gerhard Züchner v Bayerische Vereinsbank AG* [1981] ERC 2021.
[26] art 107(1) TFEU.
[27] art 108(3) TFEU.
[28] Case C-30/59 *Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* [1961] ECR 1, p 19.
[29] art 107(1) TFEU.
[30] Phaedon Nicolaides in *Antitrust Law admidst Financial Crises* (2010) at p 353.

funding controlled or directly belonging to the State.[31] This means that regulatory or administrative measures fall outside article 107(1) even where they affect competition or trade.[32] Second, the aid must give an advantage to its recipient. The concept of 'aid' encompasses any monetary advantage, which the recipient would not have benefited from 'in normal conditions' without the intervention of the State.[33] This covers grants, loans at below-market interest rates, tax reductions, etc.[34] Third, the advantage must favour certain undertakings or economic activities. The recipient is an 'undertaking', which covers any entity (private or public) engaged in an economic activity.[35] 'Economic activity' refers to 'any activity consisting in offering goods and services on a given market'.[36] Thus, activities are non-economic when they are not present on the market or they belong to the exclusive competence of the State.[37] Fourth, the aid must affect trade between Member States. *A contrario,* an aid does not affect trade when it is *de minimis* (in other terms, of a very small amount), the market affected is only national or the situation is wholly external to the Internal Market (when there is no indirect impact on the EU).[38] Fifth, the aid must distort competition in the internal market. For instance, there is distortion when the aid strengthens the position of an undertaking compared to its competitors.[39] This result can occur even when the aid is relatively small.[40] Moreover, the Court refused to accept that a State aid was justified based on the fact that undertakings in another Member State were in a more favourable condition.[41]

To sum-up, 107(1) applies when the effect on trade is direct, indirect, actual or potential, and focuses on the effect of the aid rather than on the goal pursued by the State. It results that many aids are caught by the Treaty, and thus should be prohibited. But there are exceptions to this prohibition. Article 107(1) provides an exception to the principle of prohibition: State aids are prohibited 'save as otherwise provided in this Treaty'. The four exceptions provided by the Treaty relate to the Common Agricultural Policy,[42] public transports,[43] Services of General

[31] Case C-72-73/91 *Firma Sloman Neptun Schiffahrts AG v Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG* [1993] ECR I-887, para 19. Case C-290/83 *Commission v France* [1985] ECR 439, para 14.
[32] Case C-379/98 *PreussenElektra AG v Schleswag AG* [2001] 2001 I-02099.
[33] Case C-39/94 *SFEI v La Poste* [1996] ECR I-3547, para 60.
[34] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010) ibid pp 355-356.
[35] Case C-41/90 *Höfner and Elser v. Macrotron GmbH* [1991] ECR I-1979, para 21.
[36] Case C-35/96, *Commission v Italy* [1998] ECR I-03851, para 36.
[37] Commission, *Credit Union Provision of Access to Basic Financial Services - Scotland* April 2005, N 244/2003.
[38] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010) op cit p 360.
[39] Case 234/84, *Belgium v Commission* [1986] ECR I-2263, para 22.
[40] Case T-214/95, *Vlaams Gewest v Commission* [1998] ECR II-717, para 49.
[41] Case C-11/69, *Commission v France* [1969] ECR 523, para 20.
[42] art 42 TFEU.

Economic Interest[44] and armament.[45] Therefore, they are not relevant to our analysis.

On the other hand, article 107(2) provides that certain types of aids are automatically compatible with the common market. In this category fall aids with a social character,[46] aids granted in order to face a natural disaster of exceptional occurrences,[47] or aids in relation to the division of Germany.[48] It should be emphasized that 'exceptional occurrences' do not include financial crisis since it is 'the expression of the market forces which must be faced by any business'.[49] Article 107(3) refers to the aids that 'may be' compatible with the internal market. This article was the basis of the authorization of state aids during the Economic crisis.

It should be noted that the Commission has exclusive responsibility to assess this compatibility and enjoys for that purpose a wide margin of discretion.[50] Indeed, the Commission can reject or approve the aid but it may also demand changes. There is, in theory, a limit to this wide discretion: the aid can only be authorized if it falls within at least one of the categories provided in article 107(3) TFEU.[51] Indeed, the Court forbade Member States to 'make payments which would improve the situation of the recipient undertaking although they were not necessary for the attainment of the objectives specified in Article 107(3)'.[52] Among these objectives, the Commission would normally assess State aid given to undertakings facing difficulties under article 107(3)(c) TFEU regarding aids to facilitate the development of certain economic activities or of certain economic areas and under the Rescue and Restructuring Guidelines (also called R&R guidelines).[53] However, one category is of particular importance for our subject matter: 'remedy a serious disturbance in the economy of a Member State'.[54] It is interesting to observe that before the financial crisis this provision was only used once.[55] By contrast, most

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[43] art 92 TFEU.
[44] art 106(2).
[45] art 346 TFEU.
[46] art 107(2)(a) TFEU
[47] art 107(2)(b) TFEU
[48] art 107(2)(c) TFEU
[49] Case C-346/03, *Atzeni and Others* [2006] ECR I-1875, para 80
[50] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010) op cit p 366
[51] Ibid
[52] Case C-730/79, *Philip Morris v Commission* [1980] ECR 267, para 17
[53] Commission, Community Guidelines on State aid for rescuing and restructuring firms in difficulty, OJ 2004 C 224/2
[54] art 107(3)(b) TFEU
[55] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010) op cit p 368

measures taken after 2007 have been approved on the basis of article 107(3)(b) TFEU.[56]

2. The coordinated approach chosen by the Commission: banking communications and temporary frameworks

The 'Banking Communication' of 2008[57]

The aim of this communication was for banks to return to 'long-term viability rather than liquidation', having taken into consideration that some financial institutions were sound before the crisis and now are in difficulty because of the restricted access to liquidity.[58] The Commission would approve aids with an accelerated procedure: within twenty-four hours or during the weekend.[59] The Communication also requires that they are well targeted, proportionate, and that the State provides safeguard to minimise unnecessary distortion of competition.[60] The Commission was well aware that if the circumstances are exceptional, capital injection is an irreversible act that can affect deeply competitors in other sectors or in other Member States.[61]

The reasoning was the following. The principle of prohibition of state aid still applies, and an exemption is possible under article 107(3)(b).[62] This exemption was exceptional and cannot apply to other sectors that do not present a risk of immediately impacting on the economy of the State as a whole.[63] The aid must be limited in time, more precisely as long as the crisis persists,[64] and a review will be carried out every six month.[65] The Communication only applied to sound institutions that were suffering from the liquidity crisis. Other financial institutions, which suffered from issues coming from their structures themselves,[66] fit in the normal framework of rescue aid.[67] The measures were divided in two categories: guarantees covering the liabilities and recapitalization.

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[56] Ibid p 368
[57] Communication on the application of State aid rules to measures taken inrelation to financial institutions in the context of the current global financial crisis, 2008/C 270/02
[58] Ibid para 2.
[59] Ibid para 53.
[60] Ibid para 15.
[61] Ibid para 35.
[62] Ibid para 10.
[63] Ibid para 11.
[64] Ibid para 12.
[65] Ibid para 13.
[66] 'Inefficiencies, poor asset-liability management or risky strategies', ibid para 14
[67] Ibid para 14.

Regarding the guarantee scheme, it must be non-discriminatory and there should be objective criteria to determine which institutions would benefit from this aid.[68] In the context of systemic risks, protecting retail deposits was considered as a legitimate public policy.[69] For guarantee schemes going beyond this purpose, such as wholesales deposits and short and medium debt instruments, additional requirements were necessary to avoid moral hazard.[70] In principle, the scheme should not include subordinated debts (tier 2 capital) or an indiscriminate coverage of all liabilities.[71] These schemes going beyond retail deposits must be limited in time,[72] with a review every six months with the Commission, to assess the need of the aid itself and of potential adjustments.[73] The Communication also gave guidelines on how keeping aids to a minimum, such as taking into account credit profiles and risks.[74] Eventually, undue distortion of competition has to be avoided, and Member States must include behavioural constrains or appropriate provisions to ensure that the recipient of the aid did not abuse of its situation, notably engaging in aggressive expansion.[75] Adjustment measures could also be taken for that aim.[76] For the recapitalization schemes, in principle the same considerations applied as well *mutatis mutandis.*[77] In case of a liquidation, creditors or shareholder should not benefit from the aid to avoid moral hazard.[78] Also, no aid should be granted to the buyer of the financial institutions.[79]

This Communication was used in recapitalization schemes in three Member states as well as in individual recapitalization.[80] However it has proven insufficient with the credit situation of autumn 2008: these schemes were not primarily intended to rescue financial institutions but to secure lending into the real economy. This is the reason for the adoption of the Communication of the 5th of December 2008 on the recapitalization of the financial institutions during the crisis.[81]

The 'Recapitalization Communication'

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[68] Ibid para 18.
[69] Ibid para 19.
[70] Ibid para 20 to 22.
[71] Ibid para 23.
[72] Two years maximum, except if the crisis persists longer. Ibid para 24
[73] Ibid para 24
[74] Ibid para 25
[75] Ibid para 27
[76] Ibid para 28 & 29
[77] Ibid para 35
[78] Ibid para 46
[79] Ibid para 49
[80] For instance see Case N 507/08 *Financial Support Measures to the banking Industry in the UK* (OJ C 290, 13.11.2008, p. 4)
[81] Communication on the recapitalization of he financial institutions during the crisis, OJ C 16, 2009

This time competition concerns are balanced with three objectives: restore financial stability, ensure lending to the real economy and rescue SIFIs.[82] Distortion of competition following recapitalization can arise in three situations. First, recapitalisation could result in a subsidy race among Member States and could create difficulties for countries which had not introduced such schemes.[83] This is why aids must be proportionate and temporary.[84] Second, if schemes were open to all banks, this would give an advantage to distress and low performing banks, thereby increasing moral hazard.[85] Thus, Member States have to distinguish between these banks and sound banks.[86] The risk profile of institutions will be determined on the basis of the remuneration rates, compliance with regulatory solvency requirements, prospective capital adequacy and pre-crisis ratings.[87] Third, recapitalization should not put at a significant disadvantage banks that seek funds from the private sector.[88]

The Commission will not investigate the remuneration of banks where the participation of the State is accompanied by a significant participation (30% or more) from the private sector.[89] For fundamentally sound banks, the average required return rate is of 7% for preferential shares and 9% for ordinary shares.[90] This is based on the methodology adopted of the Governing Council of the European Central Bank on November 2008.[91] Aids to non-fundamentally sound banks are subject to stricter requirements.[92]There are also exit incentives: there is a need clear mechanism for capital redemption especially when the bank has a high profile risk or the recapitalization is substantial.[93] Regarding distortion of competition already mentioned in the Banking Communication,[94] the Commission provided safeguard to avoid aggressive commercial expansion, notably via mergers. [95] Just as in the Banking Communication there is a biannual review.[96] To respond to the necessity of a structural reform of individual instructions, the

[82] Ibid para 4 to 6
[83] Ibid para 8
[84] Ibid para 11
[85] Ibid para 9
[86] Ibid para 12.
[87] Ibid para 14.
[88] Ibid para 10.
[89] Ibid para 21.
[90] Ibid para 27 & 28.
[91] Ibid para 16.
[92] Ibid para 43.
[93] Ibid para 31(f).
[94] Ibid para 35.
[95] Ibid para 37.
[96] Ibid para 40.

Commission issued the Communication of the 25th of February 2009 on the treatment of impaired assets.[97]

The 'Impaired Assets Communication'

Banks had to clean up impaired assets and this Communication provided Member States with guidance on the application of state aid rules to asset-relief. The purpose is to ensure financial stability, supply of credit into the real economy, quality of balance sheets and confidence into the market.[98] As the crisis continues, not only immediate objectives are taken into account but also long-term considerations.[99] The key issues are transparency, burden-sharing, eligibility and valuation of assets, and aligning financial institution's behaviour with public-policy objectives.[100]To respond to these issues, the Communication considers as State aid every measure that 'frees the beneficiary from registering a loss or a reserve for a possible loss on its impaired assets and/or regulatory capital for other use'.[101] The principles of necessity, proportionality and minimisation of distortion of competition are reminded.[102] Member States must make the aid conditional on full transparency and disclosure of impaired assets and must ensure that the costs of these assets are shared among itself, the shareholders and the creditors of the financial institution.[103]Incentives are put into place for banks to participate in this public policy, such as an enrolment limited to six month after the launch of the scheme.[104] This would prevent financial institutions from delaying necessary disclosure.[105] Participation in this program can be mandatory or voluntary with additional incentives.[106] Banks have themselves to take steps to ensure long-term profitability.[107]

The 'Restructuring Communication'[108]

This complementary communication has as its central aim the restoration of long-term financial stability.[109] It explains the conditions under which financial

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[97] OJ C 72.
[98] Ibid para 7.
[99] Ibid para 8.
[100] Ibid para 4
[101] Ibid para 15
[102] Ibid para 16
[103] Ibid para 20 & 21
[104] Ibid para 26
[105] Ibid
[106] Ibid para 28
[107] Ibid para 48
[108] Communication from the Commission 'The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 2009

institutions have to submit their restructuring plans. If the criteria of restructuring have been set down in the previous communications, this Communication details how the Commission will assess the restructuring plans of Member states.[110] The restructuring plans must be comprehensive, detailed and coherent, and must restore long-term viability without State aids. [111] In other terms, there should be a return on equity, taking into account the risk profile the institution.[112] When this purpose cannot be attained, then the restructuring plan must indicate how to wind up in an orderly fashion, auction off or create a 'good bank'.[113] The requirements for long-term viability are internal to the banks that have to withdraw from activities that are structurally loss-making.[114] The efficiency of the plan is tested under 'stress' and worse case scenarios.[115] Long-term viability requires that the aid received is either redeemed over time or is remunerated according to normal market conditions.[116] The Commission does take into consideration the crisis: structural measure can take a longer time than is usually the case when it would avoid depressing markets through fire sales.[117] However if a further aid is necessary, it should be notified *ex ante.*[118]

Regarding the return to viability through the sale of the bank, the purchaser must be found through transparent, objective, unconditional and non-discriminatory procedures.[119] Considerations about competition do still apply.[120] State aids to the buyer are in principle excluded.[121] When a long-term viability is not possible, there will be an orderly winding-up according to the principles of the Banking Communication.[122] The rationale behind burden sharing is to avoid moral hazard. State aids should be limited to what is strictly limited to the minimum necessary to cover the costs necessary for the restoration of viability.[123] Also the banks' own contribution should be significant.[124]

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[109] Ibid para 2
[110] Ibid para 5
[111] Ibid para 9
[112] Ibid para 13
[113] Ibid para 21
[114] Ibid para 12
[115] Ibid para 7
[116] Ibid para 14
[117] Ibid para 15
[118] Ibid para 16
[119] Ibid para 18
[120] Ibid para 19
[121] Ibid para 20
[122] Ibid para 21
[123] Ibid para 23
[124] Ibid para 24(f)

The Communication is very clear about the risks of distortion of competition. State aid creates moral hazard to the aid recipients and reduces incentives to compete for the non-aid recipients.[125] They also endanger internal market when they are used to the advantage domestic undertakings.[126] The Commission will assess the need of State aids taking into consideration these distortions.[127] Thus, remuneration the entry is at a level significantly below the market should be justified by financial stability.[128] Banks may have to take structural measures, such as divesting subsidiaries.[129] State aid cannot be used for anti-competitive behaviour, such as acquisition of competing business.[130]

The 'Temporary Framework'

The first communications adopted by the Commission, as it has been described, targeted financial institutions. By contrast, the first Temporary Framework of 2008, as amended in 2009,[131] was a measure applied horizontally to all sectors of the economy to be followed until 2010.[132] The purpose was to improve bank lending into the real economy and encourage companies to invest in the future, creating growth.[133] Indeed, the credit squeeze affected the private sector, by threatening to affect healthy companies and by hitting households and jobs.[134] Similarly to the Banking Communications, the temporary framework applies to the use of article 107(3)(b) TFEU: aids '*to remedy a serious disturbance in the economy'*.[135] Small and Medium sized Enterprises (SME) of all sectors that were in difficulty before the financial crisis were excluded.[136] These firms would use the Rescue and Restructuring Guidelines instead. Among the new aid measures, there 'Compatible limited amount of aid' (the 500k measure) allowed to grant €500,000 per undertaking in a form of a scheme,[137] if the whole territory of the State concerned is disturbed.[138]

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[125] Ibid para 28
[126] Ibid
[127] Ibid para 31
[128] Ibid para 34
[129] Ibid para 35
[130] Ibid para 40
[131] Temporary Framework for State aid measures to support access to finance in the current financial and economic crisis, OJ C 16/01/2009.
[132] However it was applied until 2010.
[133] Mercedes Campo, 'Prolongation of the State aid temporary framework' (europa.eu 2011) <http://ec.europa.eu/competition/publications/cpn/2011_1_8_en.pdf> accessed 13 November 2014.
[134] I Kokkoris and R Olivares-Caminal (2010) op cit p 481.
[135] Temporary Framework 2009.
[136] Ibid.
[137] Ibid.
[138] Case C-50/06 *BAWAG* OJ L 83.

The phasing out of the framework was planned for the 31st of December 2010. However the Commission assessed the risk for financial stability if it was ended abruptly, while taking into account the damages of the level playing field if it was prolonged longer. [139] Indeed, in 2010 the financial crisis was not as dramatic as in 2008/2009, but it transitioned into an economic crisis then a sovereign debt crisis.[140] The Commission decided to prolonged the framework until the 1st January 2012 under tighter conditions, in order to attain the normal State aid regime and avoid distortion to competition[141] Among the new measures figured the exclusion of firms in difficulty that were subject to the Rescue and Restructuring guidelines instead. Moreover, the 500k measure was eliminated to improve efficient way of spending public money.[142] The normal *de minimis* rule of €200,000 applied.

***The new 'Banking Communication'*[143]**

Applicable from the 1st August of 2013, the new Banking Communication replaces the one of 2008.[144]Its necessity is justified by the fragile recovery of the Member States' economy.[145] Indeed, there is still a stress on the sovereign debt market which leads to the volatility of the financial market and risks of contagion.[146] Among State aids, recapitalization and impaired assets measures are irreversible and may entail serious fiscal implications.[147] For these reasons, Member States now have an obligation to submit a capital raising plan as well as a restructuring plan.[148] These plans must contain burden-sharing measures on shareholders and junior creditors.[149] Regarding guarantees and liquidation support, these schemes are no longer available for banks with a capital shortfall.[150] However, the minimum remuneration level of the State is still calculated on the basis of the Prolongation

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[139] M Campo (2011) op cit.
[140] N.J. Philipsen et al, 'An Assessment of the 'Exit Strategy' of the Temporary Framework of State Aid Rules for Financial Institutions in the Light of the Financial and Economic Crisis' (State Aid & Public Procurement 2012) <http://www.maastrichtuniversity.nl/web/file?uuid=6dfe4395-0dbb-4abe-bb7d-39e1dc6524e8&owner=56637b04-0eaa-40f5-93ad-913ae64722ec> accessed 13 November 2014.

[141] M Campo (2011) op cit
[142] Ibid.
[143] Communication from the Commission on the application, from 1 August 2013 , of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), 0J C 2016 30/07/2013.
[144] Ibid para 89.
[145] Ibid para 5.
[146] Ibid.
[147] Ibid para 29.
[148] Ibid para 30.
[149] Ibid para 29.
[150] Ibid para 60.

communication.[151] Eventually, liquidation aids should comply with the burden-sharing requirements of the new Communication.[152]

III. The consequences of the crisis on State aid policy in the banking sector

Beck argued that when the financial system is stable, the closure of a bank might be beneficial to the market as a whole. Indeed, the reason of its failure might be aggressive pricing, risky and reckless behaviours, which would undermine the ability of other banks to operate in a profitable way on the market.[153] Fingleton goes further by saying that in the long-term crises are beneficial for competition in the sense that they force inefficient operators to exit the market, thereby facilitating the entry into the market of better competitors.[154] These approaches were, without doubt, ignored during the crisis. In fact, the 'Too Big to Fail' doctrine began gaining prominence with the controversial back-up of the sale of Bear Stearns by the US Federal Reserve to JPMorgan at a very low price and the much criticized decision to let Lehman Brothers fail.[155]

1. The explosion of State aids during the crisis

Before the financial crisis, State aids have been rarely granted to financial institutions.[156] However, after 2007, State aid bailouts became necessary to prevent a financial meltdown. Thus, State aids were intended to prevent the liquidation of financial institutions and help them return to long-term viability, instead.[157] During the crisis, most governments acted with a view to protecting their institutions that they considered as 'too big to fail' without taking into account competition policy considerations.[158] For example, three weeks after the collapse of Lehman Brothers the Irish Dáil[159] approved a €480 billion aid in a two-year guarantee scheme to save the major institution owned by the country.[160] This measure was intended to protect

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[151] Ibid para 59.
[152] Ibid para 72.
[153] Thorsten Beck et al, [2013] ibid.
[154] OCDE, 'Competition and Financial Markets' (2009) <http://www.oecd.org/daf/competition/sectors/43046091.pdf> accessed 10 july 2014.
[155] Morris Goldstein & Nicholas Veron, 'Too Big Too Fail: The Tranatlantic Debate' [2011] Peterson Institute for International Economics Working Paper Series 11-2
[156] Commission Decision of 26 July 1995 giving conditional approval to the aid granted by France to the bank Crédit Lyonnais 95/547/EC [1995] OJ L 308/92–119
[157] Ioannis Kokkoris and Rodrigo Olivares-Caminal (2010) ibid 473
[158] Ioannis Kokkoris, 'State Aid Law v Single Resolution Mechanism: David v Goliath or vice versa' [2013] International Corporate rescue
[159] In other words, the lower house of the Oireachtas (Irish parliamanet)
[160] European Commission, State Aid NN 48/2008 – Ireland C(2008)6059

national banks only[161] and gave rise to a risk of distortion in the single market.[162] The Eurogroup took into account this event by holding an emergency summit on 12 October 2008. It was decided that under these exceptional circumstances, State aid rules should be relaxed and cooperation between Member States enhanced.[163] Notably, governments were allowed to purchase banks' high quality assets, only if unnecessary distortions to competition are avoided.[164] One day after, the Commission reacted by issuing the first of the seven communications regarding State aids in the financial sector.[165] This resulted in the European Union approving by the end of 2009 a total amount of State aids of €3,630 billion.[166]

A first problem with the explosion of State aid in the banking sector is that it increases moral hazard.[167] Indeed, it has been shown that large banks have greater write-downs of assets than smaller ones, showing that savings induced by their diversifications of assets are used on risky operations.[168] As a result, sometimes they may put a substantial pressure on the Government at the expense of its own substantial stability.[169] Thus, this phenomenon also reinforces systemic risk which is often compared to the domino effect: the failure of an institution leads to a chain of negative consequences on the financial market and on the real economy.[170] That is why these institutions are also referred as Systemic Important Financial Institutions (or SIFIs).

Another concern with the 'too big to fail' doctrine is that it decreases public trust in the fairness of the system: although potential gains are enjoyed by the private sector, any losses are nevertheless endured by the public sector.[171] From a competition policy perspective, large banks have an advantage over smaller banks in three ways. First, they have an advantage compared to smaller banks, in relation

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[161] Thomas Doleys, 'Managing State Aid in a Time of Crisis: Commission Crisis Communications and the Financial Sector Bailout' [2012] 34 European Integration 6, pp 549-554
[162] Sarah Schoenmaekers & Niels Philipsen, 'State Aid and the Financial Crisis - An Assessment under State Aid Rules for the Banking Sector ' (2013) < FinalPaperStateAid-Kim-Filos-corrected_version.pdf> accessed 30 July 2014
[163] Summit of the Euro Area Countries, 'Declaration on a Concerted European Action Plan of the Euro Area Coutries', 12 October 2008
[164] Ibid
[165] Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, 13 October 2008, IP/08/1495
[166] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010) op cit p 485
[167] Ibid.
[168] Ibid.
[169] Ibid.
[170] Steven L. Schwarcz, 'Systemic Risk ' [2008] 97 Geo. L.J. 193 193, 198.
[171] M Goldstein & N Veron [2011] op cit.

to their credit ratings.[172] Second, they have the ability to fund themselves at a much cheaper price.[173] Last, during the crisis banks with assets over $100 billion received 90 percent of the government bailouts.[174]

According to Professor Kokkoris, 'competition policy was relegated to being a bystander in the proceedings'.[175] However, this affirmation needs to be nuanced with Professor Nicolaides' claim that some distortions of competition have been avoided.[176] Indeed, Member States were forbidden to discriminate in favour of their financial institutions, they were not allowed to grant amounts of aid in an unlimited fashion.[177] Moreover, they had to present restructuring plans, which sometimes led to closures.[178] Indeed, since 2008 the Commission did put into place seven communications for the assessment of State aid in the financial sector.[179] The purpose of this framework was to take into account the 'persistent threat to financial stability'.[180] This approach created some serious issues, notably the 'too big to fail' issue.

At the end of 2009 the European Commission had approved unconditionally 85% of the aids notified by the national authorities, the remaining part being approved conditionally.[181] This shows that during the crisis, State aid control was very (to say the least) permissive regarding the financial sector.[182] They are some interrogations regarding as whether the distortion to competition has 'been kept to a minimum'.[183] There has not been a cost-benefit analysis yet, thus this question cannot be answered with absolute certainty.[184] The European Union has to be seen in an international context: around it, countries were giving to their financial institutions sometimes even greater amounts of State aid. This was explained by the 'unprecedented magnitude of the crisis'.[185] It is submitted that the amount of State aid granted was not excessive.

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[172] Ibid.
[173] Ibid.
[174] Ibid.
[175] Ioannis Kokkoris, (2013) n 28.
[176] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010) op cit p 370.
[177] Ibid.
[178] Phedon Nicolaides takes the example of the liquidation of Roskilde Bank in Denmark (NN 39/2008), ibid p 370.
[179] European Parliament, 'Banking Union : The Single Resolution Mechanism' IP/A/ECON/NT/2013-01.
[180] Ibid.
[181] Ibid.
[182] Ibid.
[183] Ibid p 370.
[184] Ibid p 370.
[185] P Nicolaides in *Antitrust Law admidst Financial Crises* (2010)op cit p 370.

2. The limits of the State aid policy regarding financial institutions

A first problem arose when the stability of the Member States' economy became jeopardized. According to the Chairman of the Office of Fair Trading Philip Collins competition policy cannot be disregarded because of the recession, but needs to adapt.[186] Thus, competition law has to be pragmatic and ensure that competition is not damaged in the long-term.[187] For Professor Ito, on the contrary, competition rules should be set-aside during a crisis.[188] The reason is that stability is of greater importance in troubled times. This analysis could be completed by the one of Professor Vives.[189] He argues that the aim of competition law is long-term focused. Thus systemic risks override competition policy and banking is different from other sectors. Professor Peltzman goes further by writing that measures for stability are inherently anticompetitive.[190] The European Commission has been pragmatic in its approach. In our view, competition policy has as its final purpose consumer welfare. Thus short-term anticompetitive measures are acceptable, when they are in the benefit of stability.

Clearly stated in the Banking Communication, the problem of level playing field was exacerbated during the crisis. In all fairness, one must point out the major obstacles faced by the players. Regarding the Member States, the issue was raising awareness of the rules regarding State aids: the new entrants were not familiar with EU bureaucracy.[191] The needs of the banks were different: some were better structured and some needed greater help.[192] However, despite what was advised in the different communications, there was no coordination between Member States neither in the granting of aids nor in the guarantees provided.[193] The uneven level playing field eventually arose mainly because of the management banks themselves.[194] This issue cannot be dealt directly with State aids: the Commission can only limit the amount of State aid regarding restructuring scheme. There is thus

[186] Summary Record of the Discussion on Competition and Financial Markets, DAF/COMP/M(2009)1/ANN4, 10 April 2009, Roundtable 3 on Real Economy and Competition Policy un a Period of Retrenchment
[187] Ibid
[188] Takatoshi Ito, 'Global Financial Crisis of 2008 : Crisis Management and Competition Policy', OECD, 17 February 2009
[189] Xavier Vives, 'Competition and Stability in Banking : A new World of Competition Policy?', OECD, 17 February 2009
[190] Presentation to OECD Competition Committee, Competition and the Financial Markets
[191] Karel Lannoo & Chris Napoli, ' Bank State Aid in the Financial Crisis – Fragmentation or Level Playing Field?', CEPS Task Force Report, Centre for European Policy Studies, Brussels, October 2010.
[192] S Schoenmaekers & N Philipsen (2013) op cit.
[193] Karel Lannoo & Chris Napoli (2010) op cit.
[194] Ibid.

a need for coordination with other policy areas.[195] This issue cannot be solved through State aid policy only.

Regarding moral hazard, it is widely accepted that it might generate inefficiencies and can lead to market failures.[196] In theory, inefficient undertakings exit the market, thus rescue aid and restructuring aid distort competition the most by weakening the firms' incentives to improve efficiencies. It thus bears the question of the strictness of the State aids control. Another way to put it is did the Commission approve too much State aids provided by taxpayer money? In spite of the €11 billion given to WestLB in Germany,[197] the bank went into bankruptcy.[198] This raises the question whether stricter rules on State aid could have saved the taxpayers' money. A part of the issue is that it is difficult for governments to design appropriate measures. Thus, it is difficult for the Commission to assess them as well. The Commission relaxed existing rules to give more leeway to the Member States and beneficiaries to State Aids. For instance, it did not oblige the banks to make large contribution to their own restructuring plans nor to sell their assets immediately as that would further suppress their prices. Moreover, according to the 'one time, last time' principle, State aid should be granted only once in ten years to each undertaking unless 'restructuring aid follows the granting of rescue aid as part of a single restructuring operation'.[199] This principle has been ignored and some banks have benefited from several aids during the crisis.[200]

A criticism levelled against the current competition policy was that if beneficiaries were faced with withdrawal from other Member States, this would be damaging for the integrity of the internal market.[201] There are four arguments against this statement. First, recipients were already required in the R&R Guidelines to compensate its competitors. Thus, the new Temporary Framework does not differ on that point. Second, rules are about removing barriers (prohibition) and do not dictate companies to move into other Member States. Third, getting rid of loss making assets actually promotes competition. Fourth, the Commission does not

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[195] Ibid.

[196] http://www.oecd.org/competition/sectors/48070736.pdf.

[197] European Commission Press Release, ' European Commission - Press release State aid: Commission approves split-up of WestLB' (europa.eu 20 December 2011) <http://europa.eu/rapid/press-release_IP-11-1576_en.htm> accessed 30 July 2014.

[198] Matthias Inverardi, 'Germany waves goodbye to WestLB as bank broken up' (Reuters 1 July 2012) <http://www.reuters.com/article/2012/07/01/westlb-breakup-idUSL6E8I15SR20120701> accessed 30 July 2014.

[199] Community Guidelines on State Aid for Rescue and Restructuring Firms in Difficulty, OJ 2004 C 244/02

[200] See for instance the case of SachsenLB at European Commission Press Release, 'State aid: Commission approves restructuring of Sachsen LB' (europa.eu 4 June 2008) <http://europa.eu/rapid/press-release_IP-08-849_en.htm> accessed 30 July 2014

[201] Phedon Nicolaides in *Antitrust Law admidst Financial Crises* (2010), op cit p 491

expect undertakings to leave certain Member States but to get rid of unprofitable assets. In 2013, in the Union 59 banks have been restructured and among them 19 have been orderly liquidated.[202] If the goal was not to save every bank but only the fundamentally sound ones,[203] these numbers do only represent 25% of the European financial sector.[204] The success of the work of the European Commission was recognized as well by the International Monetary fund.[205]

However, this goal has not been achieved yet. Germany for instance, 'the last important well-performing Eurozone crisis' still fears a recession.[206] More generally, the sovereign debt crisis is still to be one of the greatest risks to financial stability.[207] There is a need for a new tool to provide stability.

IV. The benefits of a coordinated action between the Single Resolution Mechanism and State aids bailouts

During the crisis, when a large bank was about to fail, it was almost immediately bailed out.[208]When a financial institution actually went into insolvency, hundreds of thousands creditors pursued that took years of litigation.[209] The European Commission has proposed the Single Resolution Mechanism (SRM) for the Banking Union on the 10th of July 2013 as an alternative option to both bailouts and disorderly liquidation.[210] This mechanism is a response to the financial crisis. The resolution tools already in place were not sufficient, as it was shown by the Cyprus crisis. This is an interesting example showing that a country with a small economy (0.2 % of the Eurozone output)[211] can have a systemic impact on the

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[202] S Schoenmaekers & N Philipsen (2013)

[203] 'The Recapitalisation Communicatio2n' op cit

[204] Europa Press Release, 'Speech of Joaquin Almunia 'Banking crisis, financial stability and State aid: The experience so far', (europa.eu 8 March 2013) < http://europa.eu/rapid/press-release_SPEECH-13-223_en.htm.> accessed 30 July 2014

[205] IMF Press Release, 'Assessment of Financial Stability in Europe: Much Achieved to Address the Crisis but Vulnerabilities Remain and Intensified Efforts Needed' (No. 13/79 of March 15, 2013) <http://www.imf.org/external/np/sec/pr/2013/pr1379.htm> accessed 30 July 2014

[206] Harald Sander, 'The Euro crisis has arrived in Germany: but is a recession scenario plausible?' (The Conversation 23 January 2013) <http://theconversation.com/the-euro-crisis-has-arrived-in-germany-but-is-a-recession-scenario-plausible-11695> accessed 30 July 2014

[207] S Schoenmaekers & N Philipsen (2013)

[208] Thorsten Beck et al, 'On the Design of a Single Resolution Mechanism' [February 2013] PE 492.473

[209] Ibid

[210] European Commission Press Release, 'Commission proposes Single Resolution Mechanism for the Banking Union' (europa.eu 13 July 2013) <http://europa.eu/rapid/press-release_IP-13-674_en.htm?locale=en> accessed 4 June 2014

[211] George C. Georgiou, 'Cyprus's Financial Crisis and the Threat to the Euro' [2013] 24 Mediterranean Quarterly 3 56, 60

internal market. However, the SRM is not without disadvantages in rescuing financial institutions.

1. The advantages and limits of the two systems

The SRM is part of the Banking Union and was presented by the European Commission in June 2012 as a 'building block' of the Economic and Monetary Union.[212] The purpose of this further integration is tripartite: to put an end to 'too systemic to fail' problem, restore confidence in the financial market and put an end to the link between banks and sovereignty. In its communication 'A roadmap toward banking Union', [213] the institution introduced the SRM, as well as a Single Rulebook and the Single Supervisory Mechanism (SSM). On the 30th of November 2012 the main characteristics of the SRM were presented.[214] The European Council agreed on the adoption of three successive steps for the completion of the Economic and monetary Union. The first one consists of the implementation of the SSM where the European Central Bank (ECB) will play a crucial part, followed by new rules on Recovery and Resolution and Deposit Guarantee Schemes in the Bank Recovery and Resolution Directive (BRRD), and then the attainment of the SRM.[215] There is also an implicit fourth step that would consist of creating a European insolvency regime, a European resolution regime and amendments regarding fiscal and deposit insurance.[216] The rationale behind this order is as followed: if Europe is moving toward a single supervisory mechanism, this creates a need for appropriate resolution tools for failing banks in the participating Member States. The SRM shall 'safeguard financial stability' with a 'fiscal neutral' financial backstop.[217]

President Draghi stated that one of the objectives of the European Central Bank is to complete the financial Union through the implementation of the SRM.[218] It will allow banks to close down in an orderly way while maintaining financial stability.[219] It should be noted that the SRM is a necessary step after the

[212] European Commission Press Release, 'Update - The banking union' (europa.eu 22 June 2012) <http://europa.eu/rapid/press-release_MEMO-12-478_en.htm> accessed 23 June 2014
[213] Commission, 'A roadmap toward banking Union' COM (2012) final
[214] Commission, 'A blueprint for a deep and genuine economic and monetary union – Launching a European Debate' COM (2012) 777 final/2, Section 3.3.1 A
[215] Council, 'Roadmap for the completion of the European Monetary Union' EUCO 205/12
[216] European Parliament, 'Banking Union : The Single Resolution Mechanism' op cit
[217] Council, 205/12 op cit
[218] Mario Draghi, 'Introductory statement at the hearing of the Committee on Economic and Monetary Affairs of the European Parliament' (ecb.europa.eu 17 December 2012) <http://www.ecb.europa.eu/press/key/date/2012/html/sp121217.en.html> accessed 23 June 2014
[219] Ibid

implementation of the SSM. Indeed, it puts into place a single supervisor for participating States.[220] Thus, national authorities should not bailout banks that have failed under the prudential supervision of the ECB.[221] The SSM grants it wide powers regarding the banks it supervises, from licencing to supervision *stricto sensu,* except resolution.[222] This is why resolution should also be supervised at EU level.[223]The role of the Commission in the SRM is to assess if the fund would distort competition under article 107 TFEU.[224] For that purpose, any undertaking that could be affected by the use of the Fund can transmit its comments to the Board.[225] State Aid regulation is still applied in order to protect the integrity of the Internal market. With the case of Lehman Brothers the world witnessed how an uncoordinated bankruptcy procedure could widespread a panic.[226] The SRM will tackle this issue because it that gives rise to competitive disadvantage.[227] Moreover, it has been showed when assessing the compatibility of a State aid, the Commission takes into account the viability of the financial institution and macro-economic consideration: the effects on the real economy.[228] The objectives of the SRM and the State aid regulation are thus aligned. It goes even further by tackling issues that State aid control could not solve by itself.

The SRM is the application of the principle of burden-sharing, which provides sustainability. It is in the view of the Commission that shareholders and creditors will fund most resolutions.[229] It's only in exceptional circumstances that the fund would be used.[230] Moreover it will only be used to finance the resolution and not to recapitalize banks nor absorb losses.[231] Also, the find is financed by *ex-ante*

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[220] Eilís Ferran & Valia Babis, 'The European Single Supervisatory Mechanism' [2013] UC 10/2013
[221] Thorsten Beck et al, 'On the Design of a Single Resolution Mechanism' [2013] PE 492.473
[222] ECB Regulation, art 4(1)(a)-(k)
[223] Thorsten Beck et al, [2013] ibid
[224] Ibid art 19
[225] Ibid
[226] T Beck et al [2013] ibid
[227] European Commission Press Release, 'The SRM- essential for a stronger single market & EMU and to avoid bank bail-outs' (europa.eu September 2013) <https://www.google.fr/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0CDEQFjAB&url=http%3A%2F%2Fec.europa.eu%2Finternal_market%2Ffinances%2Fdocs%2Fbanking-union%2Fdg-markt-factsheets-srm_en.pdf&ei=QDbaU5aAEIrE0QXryIDwAw&usg=AFQjCNFpGmoG_IX0ZP8m14LHtUTlqJ9nAw&sig2=12c-PcTCoY5Zf6qZffVt0A&bvm=bv.72185853,d.d2k> accessed 30 July 2014
[228]I Kokkoris [2013] op cit
[229] European Commission Press Release, op cit
[230] Ibid
[231] Ibid

contributions for undertakings in the financial sector.[232]Also, if there is an enforceable resolution regime that imposes losses on equity and junior creditors, and if the banks cannot argue that this mechanism will damage the economy, then it will become an incentive for banks to avoid excessively risky operations.[233] The SRM will thus impose a discipline on banks.[234] Also, contributions to the Fund are calculated taking into account the risks of banks and their business model.[235] No contribution will be based charged on deposit, thus banks that are financed for the major part by savings would have a low contribution.[236] This compatibility of objectives between State aid rationale and the SRM is important since the Fund will not receive its total funding until 2022 and State aids will remain lawful.

The Fund is estimated at €55 Billion[237] with a possibility for the Board to borrow from the market (even if this hypothesis seems unlikely).[238] This target will be achieved in 2022.[239] In the meantime, in the first 10 years the Fund will have national compartments.[240] Then, funding will be gradually mutualized: in the first year, it will represent 40% of the Fund.[241]

Against this backdrop, a failure of two banks could be resolved in two ways, namely, through the Fund or through State aid. This situation could also arise after 2016: it is conceivable that State aid could support the resolution scheme proposed by the Board, such as deposit guarantee funds.[242] In this regard, the question that arises is whether the use of State aid by a Member State will defeat the objectives of the SRM (such as burden-sharing or level-playing field). To this, the response is clearly negative. In its assessments during the crisis, the Commission has taken into consideration these objectives. The Commission, as well as the Board, ensures financial stability, which allows a coherent approach for the purposes of the internal Market. Moreover, according to recital 44 of the 'SRM Regulation', for

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[232] 'SRM Regulation' op cit, recital 19
[233] T Beck et al [2013] ibid
[234] Ibid
[235] 'SRM regulation' recital 109
[236] European Commission Press Release, 'The SRM- essential for a stronger single market & EMU and to avoid bank bail-outs' (europa.eu September 2013) Ibid
[237] European Commission Press Release, 'Finalising the Banking Union: European Parliament backs Commission's proposals (Single Resolution Mechanism, Bank Recovery and Resolution Directive, and Deposit Guarantee Schemes Directive)' (europa.eu 15 April 2014) <http://europa.eu/rapid/press-release_STATEMENT-14-119_en.htm?locale=en> accessed 30 July 2014
[238] 'Regulation SRM' art 72
[239] European Commission Press Release, 'Finalising the Banking Union: European Parliament backs Commission's proposals (Single Resolution Mechanism, Bank Recovery and Resolution Directive, and Deposit Guarantee Schemes Directive)'
[240] Ibid
[241] Ibid
[242] I Kokkoris (2013) op cit

other resolution tools, such as bail-in, Member States are required to demand replacement of management, as required in the Recapitalization Communication.[243] Also, the sale of an institution requires that State aid rules be taken into consideration, notably for the marketing,[244] as well as the creation of a bridge institution.[245] In this regard, a concern raised by Professor Beck et al. relates to the 'post Lehman' abhorrence of bank insolvency' or 'post Lehman syndrome''.[246] The decision not to bailout Lehman Brothers was taken unilaterally by the US Government without taking into account the global consequences, which is exactly what Europe is trying to avoid.[247] Thus, it has led to a policy where banks, if they are large enough, are guaranteed to be saved.[248] This policy would result in putting aside the SRM or only use it as a support for banks in difficulties.[249] Moreover, the question remains: is bailout necessarily bad for the taxpayer? These questions raise the issue how SRM and State aid can be coordinated.

2. When to use State aid bailouts and the future SRM

Bailouts are loans to financial institutions or countries when they are illiquid (as opposed to insolvent). This loan can be provided by the private sector, when an investor buys stocks at a low price.[250] The controversy arises when the bailout is State-sponsored. In that case, the Government receives preferred stocks after providing public funds.[251] The controversy regarding bailouts is difficult to explain in theory, since the money collected from the dividends derived from the banks' stocks are used for the protection of taxpayer's money.[252] The common stocks equity is cancelled at the loss of the shareholders but depositors' and debtors' claims are protected.[253] Bailouts can be even beneficial for the taxpayers: in the case of AIG the US Government has realized a profit of $23 billion.[254] Moreover, some bail-ins have been more costly than some temporary ownership for the taxpayer: this was the case for Lloyds and RBS.[255] The aversion of public intervention would be explain first by the bad experience left by some credit bail-

[243] 'Recapitalisation communication' op cit para 44
[244] 'SRM Regulation' op cit art 21
[245] Ibid art 22
[246] T Beck et al, [2013] op cit
[247] Ibid
[248] Ibid
[249] Ibid
[250] Ibid.
[251] Ibid.
[252] Ibid.
[253] Ibid.
[254] Avinash Persaud, 'Bail-ins are no better than fool's gold' (FT.com 21 October 2013) <http://www.ft.com/cms/s/0/686dfa94-27a7-11e3-8feb-00144feab7de.html#axzz3689juR2s> accessed 30 June 2014.
[255] Ibid.

ins like those of Lehman Brothers or Bank of Cyprus, as it has been developed earlier in this dissertation. The real problem that arises in practice with bailouts is the one of moral hazard: this resolution tool is a safety net for financial institutions.[256] Moreover, bailouts can be costly and disproportionate for some Member States.[257] However, Governments had to bailout banks through state aids because there was no other option.[258]

During the crisis, when the banking system was overall weak, there was a tendency to avoid bail-ins: this is due to the 'post Leman syndrome' that we described earlier.[259] This behaviour should not be automatically justified when only one or a few banks are in trouble and the financial system is stable.[260] When the market is stable, it might even be preferable to let a bank fail, especially when it is the result of aggressive tactics that have for purpose to exclude other viable operators from the market. However, banks rarely become insolvent when the market is sound.[261] Therefore, in the future there should be a distinction between quiet and troubled times to use either the SRM or State aids.

If the SRM regulation takes into account the possibility of using State aids, there is no doubt that one system, either public aids or the Fund, will prevail. According to Tornese, as the fund is being built up and mutualized, there will be a decrease of State aids in resolution.[262] This vision might be too idealistic. Goodhart and Schoenmaker take the view that State aids should only be used when the cost on the taxpayer is lower than the 'social benefits' that the bailout will bring, such as containing a banking crisis.[263] It is submitted that there should be a distinction between times of crisis and non-troubled times.[264] During the pick of the crisis the Commission adopted a pragmatic approach, taking into account the urgency of the measures to be taken to avoid systemic risk.[265] It cannot be denied that the objective of ensuring the financial institutions' viability prevailed over competition policy.[266] Thus, during a crisis it can be expected that the Commission will adopt a similar approach while assessing resolution schemes presented by the Board.[267]

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[256] S Gleeson [2012] op cit.
[257] Constantin Gurdgiev, 'State Aid in EU27 & Ireland' (True Economics 2012) <http://trueeconomics.blogspot.fr/2012/12/23122012-state-aid-in-eu27-ireland.html> accessed 20 June 2014.
[258] Ibid.
[259] T Beck et al [2013] op cit.
[260] Ibid.
[261] Ibid.
[262] E Tornese (2014) op cit
[263] C A E Goodhart & D Schoenmaker (2006) op cit
[264] I Kokkoris [2013] ibid
[265] Ibid.
[266] Ibid.
[267] Ibid.

From this perspective, the SRM should prevail during troubled times.[268] Indeed, it is a response to the issues encountered during the 2007 crisis and it would be illogical to put it aside. However, if only one institution is failing, State aid control has proved efficient and should not be abandoned.

V. Conclusion

The 2007 crisis which started as a mortgage crisis spread to become a financial crisis that evolved into recession, impacting on the wider economy and affecting households, businesses and jobs.[269] In order to save banks and solve the credit-crunch with a view to ensuring stability, governments used the only tool that was available at the time: state aids. However, the extensive use of State aids deepened the 'too big to fail' problem. In the absence of a fully harmonized regulatory framework, the Commission put into place five communications and a temporary framework for the use of State aids in order to minimise unnecessary distortions to competition. However, the explosion of State aids during the financial crisis generated inefficiencies and uneven level-playing fields, which ultimately had an adverse effect on the integrity of the internal market.

To solve this issue, on the 10th of July 2013 the European Commission proposed the Single Resolution Mechanism (SRM) for the Banking Union as an alternative option both to bailouts and disorderly liquidation. This is composed of a fund that is financed by *ex ante* contributions for undertakings in the financial sector. It will only be used to finance the resolution and not to recapitalize banks nor absorb losses. However, the instaurations of special bank resolution legislations do not guarantee that taxpayers' funds will not be used in case of a crisis. In fact, most of the Member States' new regimes are still untested. Moreover, coordination between Member States is fairly recent.[270]

To sum up, speed is essential: 'whatever the mechanism for resolving a bank, the sooner that is done, the less burden that will have to be subsequently met'.[271] It is submitted that the SRM should prevail during financial crises times. However, if only one institution is failing, State aid control has proven efficient and should be

[268] Ibid.

[269] Communication from the Commission (EU) on the Temporary Framework for State Aid Measures to Support Access to Finance in the Current Financial and Economic Crisis [2009] OJ C83/01

[270] Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (FSB October 2011) <http://www.financialstabilityboard.org/publications/r_111104cc.pdf> accessed 25 June 2014

[271] Charles A.E. Goodhart, 'Funding arrangements and burden sharing in banking resolution ' (Vox 16 October 2012) <http://www.voxeu.org/article/funding-arrangements-and-burden-sharing-banking-resolution> accessed 25 June 2014

preferred. Moreover, there should also be a strict policy towards unviable institutions in order to stabilize the market. Indeed, if banks retain their 'too big to fail' leverage, there will be no real competition in the market. A similar approach should transcend the SRM as well.