The current financial crisis and EU Competition Policies

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(*) Disclaimer: the views expressed in this presentation are those of the author and are not necessarily those of the European Commission.

Outline

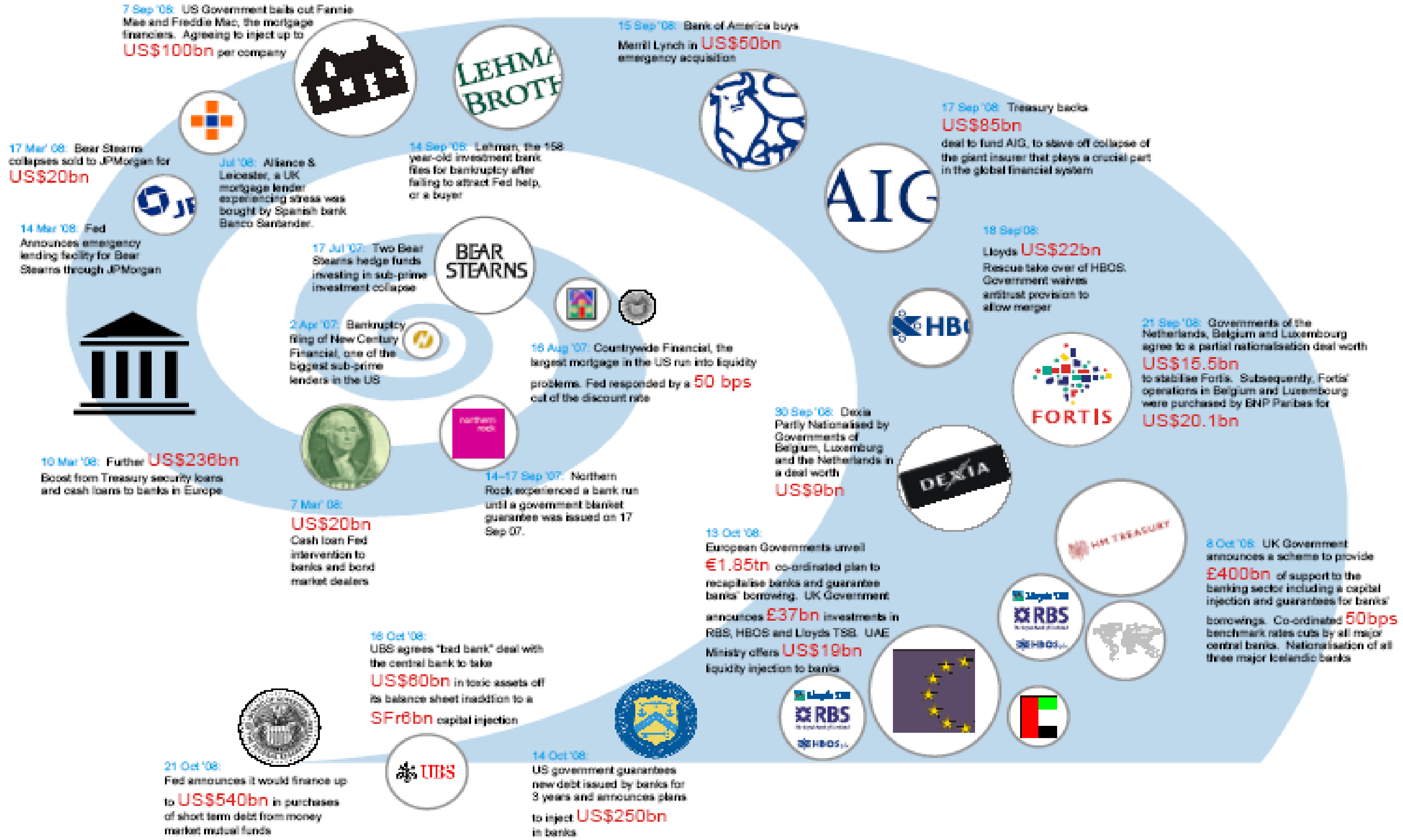
- Objective of competition enforcement
- Taking stock of developments
  - Ex ante guidance
  - Cases
- Current challenge: validate restructuring
  - Ex-ante and ex-post intervention
  - Business models
  - Regulatory framework

Some perspective

- First series of cases: Summer 2007
  - Northern Rock (UK), Sachsen LB(G), IKB (G), WestLB (G), Roskilde (DK)
- Stepping up of response from Mid-September 2008
  - Lehman Brothers failure
  - Gridlock of interbank market – explicit guarantees
- Consequences:
  - Retail deposit insurance (Council: up to EUR 100 000 per account)
  - Calls for a new legal basis : Article 87 3b): systemic crisis
  - Exemption from the classical legal framework, Rescue/Restructuring assessment
  - New forms of State intervention: Nationwide rescue packages (Denmark/Ireland)

European Commission
Competition

Tsunami of SA cases



Competition enforcement

- Balancing
  - Market failure
  - Distortions of competition
- Market failure
  - Systemic effects from bank failures –an externality such the social cost much exceeds the private cost
  - Crisis of confidence - a coordination failure
- Distortions of competition
  - For the recipient: moral hazard
  - For its competitors: incentives to compete are affected because rents are allocated ex post by the state

Competition enforcement

- Distortions of competition
  - In the product market (one-off versus repeat recaps)
  - In the input market (access to funds)
- Across member states
  - Banks compete across national jurisdictions
  - Member states do not internalise effects beyond their own jurisdictions
  - Different ability and willingness to support banks
- Instruments
  - Ex ante guidance
  - Assessment of schemes and individual cases

Ex ante guidance

- Banking communication (October 2008)
  - General principles
  - Pricing of guarantees (ECB)
- Recapitalisation (December 5 2008)
  - Distinction between banks in distress because of contagion and banks that are not fundamentally sound
  - Ex ante indicators
  - Pricing of recapitalisation that reflect the instruments, the risk profile, exit incentives
  - Sliding scale for restructuring and reporting requirements

Ex ante guidance

- Impaired asset (February 25 2009)
  - Asset purchase or guarantees
  - Transparency
  - Incentives to participate
  - Asset valuation by independent experts
  - Market value, book value and real economic value
  - Remuneration in accordance with guidance on recapitalisation
- Restructuring paper in the pipeline
- EU-wide stress testing using common criteria

State aid for the financial sector –decisions

- 57 decisions so far (does not count amendments as a separate decision)
  - – 32 individual measures, for 26 different banks
  - – 24 schemes
- 6 on-going in-depth investigations

Decisions: Individual cases

- Pending cases with in-depth investigations
  - Northern Rock (UK, Restructuring) – 2 April 2008, extension on May 7 2009, Hypo Real Estate (DE, Aid) - 2 October 2008, May 7, Dexia (BE, FR, LUX, restructuring) March 13 2009, Bayern LB/Hypo Group Alpe Adria (DE, AU, Aid) May 12, ING (Illiquid asset facility) March 31, Fortis Bank Nederland (NE), April 8 2009
- Recent approved cases outside of schemes
  - ING (NL) - 13 November 2008 / March 31 2009
  - Roskilde (DK) – July 31 2008 / November 5 2008
  - Fionia (DK) – May 20 2009
  - Dexia (BE, FR, LUX) – 19 November 2008 / 13 March 2009
  - Fortis (BE, LUX, NL) – 19 November / 3 December 2008
  - Fortis (BE, LUX) -12 May 2009
  - Caisse d'Epargne & Banque Populaire (FR) May 8 2009
  - Aegon (NL) – 27 November 2008
  - SNS Real (NL) – 10 December 2008
  - Bradford and Bingley (UK) - 1 October 2008
  - Carnegy Investment Bank (SW) – 15 December 2008

Decisions: Individual cases

- Recent approved cases outside of schemes (continued)
  - KBC (BE) – 18 December 2008
  - Bayern LB (DE) – 18 December
  - Nord LB (DE) - 22 December
  - IKB (DE) – October 21 2008 / 22 December 2008 Conditional decision following formal procedure
  - Anglo Irish Bank (IE) – 14 January 2009 / 17 February 2009
  - Kaupthing Bank – (FI) – 21 January 2009
  - Parex Banka Latvia (LAT) – 24 November 2008 / 11 May 2009
  - Ethias Group (BE) – 12 February 2009
  - Sachsen LB (DE) – June 4 2008 Conditional decision following formal procedure
  - Commerzbank (DE) – May 7 2009
  - West LB (DE) – May 12 2009
  - Bank of Ireland (IR) – March 26 2009
  - Allied Irish Bank (IR) - May 12 2009
  - Banco Privado Português (PO) – March 13 2009

Decisions: Schemes

- Denmark (Guarantee) - 10 October 2008 / February 3 2009 (Recap. + amend. Gtee)
- Ireland (Guarantee) - 13 October 2008
- United Kingdom (Guarantee + Recap) - 13 October 2008 (amendment 22 December) / April 15 2009 (extension)
- United Kingdom (Working capital guarantee scheme) – March 29 2009
- Germany (Recap) - 27 October 2008 (amendment 19 December)
- Germany (Guarantee) – January 22 2009
- Portugal (Guarantee) - 29 October 2008
- Sweden (Guarantee) - 29 October 2008 / January 28 – April 28 (amendments + extension)
- France (Guarantee) - 30 October 2008 / May 12 2009 (extension)
- Netherlands (Guarantee) - 30 October 2008

Decisions: Schemes (continued)

- Spain (Assets) - 4 November 2008
- Spain (Guarantee) – December 22 2008
- Italy (Guarantee/Recap) - 13 November 2008 / 23 December 2008
- Finland (Guarantee) - 14 November / April 30 2009 (amendment / extension)
- Greece (Recap + Guarantee) – 19 November 2008
- Hungary (Recap + Guarantee) – 12 February 2009
- Latvia (Guarantee) – 22 December
- France (Recap) - 30 October /8 December / 29 January / March 23 (amendments)
- Austria (Recap) – 9 December
- Slovenia (Guarantee) – 12 December
- France (Recap 2) – end of January
- Denmark (Recap) – 3 February
- Sweden (Recap) – 11 February 2009
- Portugal (Recap) – May 20 2009
- Slovenia (Liquidity) – March 20 2009

Special resolution regimes

- At the time of Lehman's demise, Member States had no special regime for dealing with distressed financial institutions
- Since then, Special Resolution Regimes (SRR) and Prompt Corrective Action (PCA) have been created, but so far, little used.
- SSR and PCA potentially avoid the dilema between fully fledged bankruptcy à la Lehman and a bail-out at taxpayers' expense
- Properly implemented, proto-insolvency allows for dealing with systemically important institutions without endangering financial stability. It also prevents minority stakeholders from impeding prompt and orderly restructuring of the distressed institution

Implementation

- In principle, the Commission could veto bail-outs but has not done because of financial stability concerns
- The implementation of a restructuring plan for fundamentally unsound banks that received State support is a second best as compared to SRR comprising PCA.
- At the same time, the design of the restructuring plans could potentially address many of the root causes of the current turmoil, and in particular, issues of moral hazard.

Restructuring plans

- These plans are based on three pillars:
  - private (“own”) contribution to the coverage of the restructuring costs (aid to the minimum)
  - compensatory measures
  - and ensuring long-term viability

Own contribution/burden sharing: financial restructuring (liabilities)

- In principle, the first requirement could ensure restructuring costs are borne by the owners, creditors, and managers of the entity receiving support
- Potentially, this allows for an ex-post implementation of standard feature of SSR/PCA, namely the conversion of unsecured debt/hybrid capital into common equity and/or the write-down of (part of) the unsecured debt.

Compensatory measures (assets)

- Compensatory measures aimed at reducing competition distortions.
- For non-financial institutions, compensatory measures typically consist of asset disposals and/or capacity reductions that “compensate” competitors for the survival of the distressed firm
- For financial institutions, the disappearance or downsizing of a bank may actually hurt competitors
- Added dimension during a systemic crisis: many sellers, few buyers
- For that reason, compensatory measures have to be tailored to the specificities of the industry (home country bias?)

Return to viability

- The third pillar seeks to ensure that State intervention has a lasting positive effect on the aided firm and the sector in which it operates (State aid is not “wasted”)
- Return to viability should also ensure that the firm will not require additional State support in the future. Repeated use of schemes/ad-hoc intervention?
- Orderly liquidation may constitute a realistic alternative to restructuring.

Regulatory changes and evolving business models

- Sources of bank funding?
- Business lines operating on a stand alone basis (including regulatory capital requirements)?
- Counter-cyclical provisioning?
- Counter-cyclical capital requirements?
- Reduce the incentive to become TBTF/TITF/TBTS
- Implementation of the De Larosière recommendations

Conclusion

- Rescue and restructuring
  - Simultaneous – rather than staggered
  - Political versus regulatory process
- Missed opportunity ?
- In the mean time, expanding credit squeeze.
- Prospect for zombie banks and zombie borrowers