Financial crisis & State Aid

DAVID SZAFRAN*

*All views are personal to the author and should not be attributed to any organisation or institution.
Agenda

- Economic & Budgetary context
- EU Enforcement Policy on State aid
- Financial Sector
- Tax Ruling
- Conclusion
1. Introduction

ECONOMIC & BUDGETARY CONTEXT
Financial Crisis & Budgetary Control

- Financial crisis 2007-2008
- Sovereign debt crisis
- EU Directive 2011/85/EU (implementation by 31/12/2013)
  - Financial statements of EU Member States
  - Accrual Accounting (IPAS; EPSAS)
  - Independent Audit
- Eurostat
  - ESR 2010
  - Scope (municipalities; police zones; etc.)
- US SEC – protection of investors in municipalities bonds
  - Individual investors
  - Financial institutions
2. Policy

EU ENFORCEMENT POLICY ON STATE AID
## State Aid Policy

<table>
<thead>
<tr>
<th>Definition</th>
<th>Main features:</th>
<th>European Commission</th>
<th>Examples:</th>
<th>Recent cases:</th>
</tr>
</thead>
</table>
| • Public support granted to companies by a EU Member State which provides a **selective economic advantage** over the others  
• Not prohibited: subsidies granted to **individuals** or **general measures** open to all enterprises (examples include general taxation measures or employment legislation) | • Intervention by the State or through **State resources**  
• The intervention gives the recipient an **advantage on a selective basis**, for example to specific companies or industry sectors, or to companies located in specific regions  
• **Competition** has been or may be distorted  
• The intervention is likely to affect **trade between Member States** | • DG Competition  
• DG Fisheries  
• DG Agriculture | • Direct grants  
• Tax exemptions  
• Loans granted at low or no interest rates  
• Government holdings of all or part of a company  
• Providing goods and services on preferential terms  
• Etc. | • Financial Sector  
• Tax rulings |
3. Financial Sector

STATE AID
EU Banking Union

1. Basel III Framework (CRDIV and CRR)

2. Single Resolution Mechanism (SRM)
   - Bank Resolution & Recovery Directive (BRRD)
   - Single Resolution Fund (SRF)
   - Deposit Guarantee Scheme (DGS)

3. Single Supervisory Mechanism (SSM)
## Banking Structural Reform

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</thead>
<tbody>
<tr>
<td><strong>Broad Approach</strong></td>
<td>Subsidiarisation: proprietary and higher risk trading activity in separate legal entities</td>
<td>Subsidiarisation: proprietary activity in separate legal entity</td>
<td>Subsidiarisation: proprietary activity in separate legal entity</td>
<td>Ring-fencing: structural separation of activities via a ring fence for retail banks</td>
<td>Institutional separation of commercial banking and certain investment activities</td>
<td>Subsidiarisation: proprietary activity in separate legal entities (above certain threshold)</td>
</tr>
<tr>
<td><strong>Proprietary trading</strong></td>
<td>Separate legal entities (even within same group)</td>
<td>Separate legal entity of large banks</td>
<td>Separate legal entity</td>
<td>Retail ring fencing</td>
<td>Structural separation (not within same group)</td>
<td>Separate legal entity for proprietary trading (with capital surcharge) if above thresholds of own funds of deposit-taking banks</td>
</tr>
<tr>
<td><strong>Market-making</strong></td>
<td>Separate legal entities (even within same group)</td>
<td>Allowed under certain conditions</td>
<td>Allowed under certain conditions</td>
<td>Separate legal entity (even within same group)</td>
<td>Allowed (underwriting in response to client/counterparty demand)</td>
<td>Allowed under certain conditions</td>
</tr>
<tr>
<td><strong>Retail Ring-fencing</strong></td>
<td>Yes (under certain conditions)</td>
<td>Yes (under certain conditions)</td>
<td>Yes (under certain conditions)</td>
<td>Yes (US Fed's Regulation W; S.608 Dodd Frank Act)</td>
<td>Yes (under certain conditions)</td>
<td>Yes (under certain conditions)</td>
</tr>
</tbody>
</table>
Economic Impact (Belgium)

Table 4: Macroeconomic impacts of regulations under Scenarios 1 and 2, 30-year averages

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Requirement</th>
<th>Scenario 1</th>
<th>Scenario 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Requirements Directive and Regulation (CRD IV)</td>
<td>Minimum capital requirement (CET1 as % of RWAs)</td>
<td>(0.45)</td>
<td>(0.72)</td>
</tr>
<tr>
<td></td>
<td>Short-term liquidity coverage ratio (LCR)</td>
<td>(0.17)</td>
<td>(0.28)</td>
</tr>
<tr>
<td></td>
<td>Long-term net stable funding ratio (NSFR)</td>
<td>N/A</td>
<td>(0.09)</td>
</tr>
<tr>
<td>Bank resolution (RRD and SRM)</td>
<td>Bail-in liabilities (% of total liabilities)</td>
<td>(0.05)</td>
<td>(0.08)</td>
</tr>
<tr>
<td></td>
<td>Bank contribution to Resolution Fund</td>
<td>(0.01)</td>
<td>(0.02)</td>
</tr>
<tr>
<td>Structural reform</td>
<td>Separation</td>
<td>N/A</td>
<td>(0.00)</td>
</tr>
<tr>
<td>FTT</td>
<td>FTT</td>
<td>N/A</td>
<td>(0.17)</td>
</tr>
<tr>
<td>Bank taxes</td>
<td>Deposit Guarantee Fund contribution</td>
<td>(0.01)</td>
<td>(0.01)</td>
</tr>
<tr>
<td></td>
<td>Financial stability contribution</td>
<td>(0.00)</td>
<td>(0.04)</td>
</tr>
<tr>
<td></td>
<td>Annual bank levy and loan-to-deposit tax</td>
<td>(0.05)</td>
<td>(0.03)</td>
</tr>
<tr>
<td>Combined effects of regulations</td>
<td>(% deviation from baseline level of real GDP)</td>
<td>(0.74)</td>
<td>(1.51)</td>
</tr>
</tbody>
</table>

Source: PwC analysis
# Capital Requirements - Liquidity

## Requirements

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<tbody>
<tr>
<td>Minimum total capital</td>
<td>4%</td>
<td>4.5%</td>
<td>5.125%</td>
<td>5.75%</td>
<td>6.375%</td>
<td>7%</td>
</tr>
<tr>
<td>CET1</td>
<td>4%</td>
<td>4.5%</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Additional Tier 1</td>
<td></td>
<td></td>
<td>1.5%</td>
<td></td>
<td></td>
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<tr>
<td>Tier 2</td>
<td>2.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Capital conservation buffer</td>
<td></td>
<td></td>
<td>0.625%</td>
<td>1.25%</td>
<td>1.875%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Countercyclical buffer</td>
<td></td>
<td></td>
<td>0-0.625%</td>
<td>0-1.25%</td>
<td>0-1.875%</td>
<td>0-2.5%</td>
</tr>
</tbody>
</table>

- Systemic risk buffer: 1%-3% of all exposures up to 5% for domestic and third party exposures
- Leverage ratio: Test minimum 3% requirement. Parallel run 1 Jan 2013- 1 Jan 2017. Disclosure starts 1 Jan 2015. 3% (migration to pillar 1, decision on binding status)

## Liquidity

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<tbody>
<tr>
<td>LCR</td>
<td>60%</td>
<td>70%</td>
<td>80%</td>
<td>90%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>NSFR</td>
<td></td>
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</table>

- Introduce minimum standard
Deposit Guarantee Scheme

Directive 2014/49/EU (OJUE, 12.06.2014)

1. A universal guarantee of deposits up to € 100K
2. Priority right
3. Easier and faster access to repayment
4. A robust financing regime
5. Communication duty towards depositors
6. Borrowing between DGSs on a voluntary basis
7. DGSs will have to perform stress tests
8. DGSs may use their own risk-based methods for determining and calculating the risk-based contributions by their members.

Implementation deadline for MS: 1 year
EC Crisis Communications (art. 107 TFEU)

**EC Banking Communication (2013):**

- Recapitalisation and Impaired Asset Measures, in relation with:
  - capital raising measures by the bank
  - strict executive remuneration policy
  - burden-sharing by the shareholders and the subordinated creditors
  - preventing the outflow of funds prior to a restructuring decision and
  - schemes for recapitalisation and restructuring of small institutions

- Guarantees and Liquidity support outside the provision of Central Bank liquidity

- Provision of liquidity by Central Banks and intervention of deposit guarantee schemes and resolution funds

- Specific considerations in relation to liquidation aid
Corporate Governance

• Board Composition (individuals)

• Board Missions
  - Strategy and objectives of the institution and the risks policy
  - Governance Memorandum
  - Resolution and recovery plans

• Prior approval by Banking Regulator
  - Strategic decisions
  - Merger, splitting, disposal of segment business
  - Significant acquisition (non financial sector)

- Management committee
- Availability of directors and members of management
- Chairman of the Board ≠ Chairman of the management committee
- Independent control functions (compliance, risk management, internal audit)
Corporate Governance

- Executive Directors (Management Committee)
- Independent (non executive) directors
- Non executive directors
Corporate Governance (art. 107 TFUE)

- Potential conflicts of interests

- Impact on governance
  - **Financial Holding**
    - Board of directors (majority proposed upon public shareholder)
    - Management Committee (proposed upon public shareholder)
    & independent of the management of the financial institution
  - **Financial Institution**
    - Board of directors
    - Management committee
4. Tax Ruling

STATE AID INVESTIGATIONS
Tax Incentives – Foreign Investment

First, we are committed to making this the most open, welcoming, business-friendly country in the world. We've cut our corporation tax to a record low - it stands at 20 percent from April 2015, the lowest rate in the G7 and the G20. For those developing intellectual property here, we are lowering corporation tax further; to those investing in research and development, we are giving tax relief. What's more,
Parliamentary Hearings on Tax
OECD

Action Plan on Base Erosion and Profit Shifting

EU

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on tax transparency to fight tax evasion and avoidance

UNCTAD
Tax Ruling

EC Investigations (2014) – Corporate income tax
- Apple (Ireland)
- Starbucks (The Netherlands)
- Fiat Finance (Luxemburg)
- Amazon (Luxemburg)
Tax Ruling

- Tax ruling does not constitute *as such* a State Aid prohibited under the European legislation.

- However, tax rulings may involve State aid if they are used to provide selective advantages to a specific company or group of companies.

- It should be analysed, on a *case by case* basis, if an advance ruling is obtained based on a profit made on *market terms*, reflecting normal conditions of competition.

- If, after review, the EC has concerns that ruling decisions underestimate the taxable profit and thereby grant an advantage to the respective companies by allowing them to pay less tax, this may lead to an in-depth investigation by the EC.
5. Conclusion

IMPACT OF FINANCIAL CRISIS ON STATE AID POLICY
Conclusion

- Financial Crisis and Sovereign Debt Crisis
- Budgetary control
- EU Enforcement Policy on State aid
- Financial Sector
  - Banking Union
  - EC Communications
  - State Aid Decisions
- Tax Ruling