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The European Commission issues a communication announcing that restoration of competition in the banking sector is an EU priority

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European Commission, 22 July 2009, The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules

Tom Bainbridge, Matt Evans, Vincent Brophy, e-Competitions, N° 33768, www.concurrences.com

The global financial crisis has seen competition authorities come under pressure to relax their interpretation of competition laws in order to help companies weather the current financial storm. In general, competition authorities have been reluctant to do so, on the basis that in such circumstances it is more important than ever that companies do not engage in anticompetitive conduct.

Nevertheless, to support banks facing record losses, exceptions have been made in a number of respects. For example, the European Commission (the Commission) adapted the State aid rules to facilitate and simplify the grant of aid by EU Member States to banks. In the UK, the Government decided to allow the Lloyds TSB / HBOS merger, to avert HBOS' collapse, despite the UK Office of Fair Trading (OFT) having identified clear competition concerns [1]. The German government enacted the Financial Markets Stabilization Act, which states that merger control does not apply if the government fund SoFFin recapitalizes a bank through the acquisition of shares; a prominent example for this is the acquisition by SoFFin of approximately 25% of the capital of Commerzbank.

Recent statements by European competition authorities and Governments make it clear that maintaining and restoring effective competition in the banking sector will be a key priority. For example, the German competition authority has indicated its desire to see the restoration of merger control rules to the recapitalisation of banks through share acquisitions as soon as possible.

Conditions attached to the receipt of State aid by banks

Under EC competition laws, it is illegal for a Member State to grant aid in any form that favours certain companies or the production of certain goods, if that aid may distort competition and affect inter-State trade. EU Member States wishing to grant State aid must comply with certain criteria developed by the Commission, and in many cases they must apply in advance to the Commission for authorisation.

Companies receiving rescue and restructuring aid generally are required to restructure to offset the competitive

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advantages that may stem from that support. The Commission's recent Communication of 23 July 2009 (the July Communication) - which follows three other recent Commission communications addressing the financial crisis - builds on this principle and demonstrates the Commission's determination to restore long term stability and effective competition to the banking sector. It follows a number of recent high-profile speeches by Competition Commissioner Neelie Kroes, in which she emphasised that banks such as Lloyds TSB and RBS, which have benefited from vast amounts of Government support, should not expect to gain a competitive advantage as a result of such support.

The July Communication addresses three key points.

Long term viability of banks: EU Member States granting aid to banks must submit a restructuring plan that demonstrates how the bank will restore long-term viability to its business so that it can operate without State aid in future and compete in the marketplace for capital on its own merits. The plan must demonstrate how the bank would perform in normal and in "stress" scenarios, which may require disposals of certain businesses or assets. The plan must be implemented as soon as possible and must take no longer than five years. The Communication also highlights the concept of "burden sharing," which means that the bank and its shareholders should fund the restructuring plan as much as possible with their own resources. Distortions of competition within the banking sector must be limited: Member States granting aid to banks must limit any resultant distortions to competition. This could be by way of ordering banks that benefit from State aid, independently of any restructuring plan, to divest subsidiaries or branches, portfolios of customers or business units. Measures could also include placing limits on a bank's ability to expand in certain business or geographical areas. State aid must not fund anticompetitive conduct: Banks receiving State aid must continue to lend money on commercial terms and should not use the aid as a means of undercutting competitors. They conceivably could also be prohibited from acquiring competitors, or where prohibition or divestitures are not appropriate, the acquisition of competitors could be made subject to a claw-back mechanism, in order to recover parts of the State aid.

The July Communication highlights the Commission's determination to ensure that the billions of Euros of aid, given by EU Member States to national banks in the last 12 months, does not unduly distort competition in the banking sector.

[1] See Harshita Mathur, The UK OFT waives competition law in the interest of "maintaining the stability of the UK financial system" and clears a major concentration in the banking sector (Lloyds-HBOS), 24 October 2008, e-Competitions n° [illegible] and Ciara McSorley, David Shaharudin, The British Government is reported to have assured a bank that is set to create the UK's largest retail bank would not be subject to competition scrutiny (Lloyds/HBOS), 17 September 2008, e-Competitions n° [illegible].

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