MONETARY PANEL
Amsterdam - 5 March 2009
Minutes of the meeting

Present

Wim BOONSTRA, President of the Monetary Panel

Austria	Marianne KAGER
Belgium	Alain CAMU Paul GOLDSCHMIDT Bernard SNOY
France	André ICARD
Germany	Rainer BODEN Ottokar HAHN Ralph ODENDALL
Netherlands	Bouke de VRIES
Spain	Rosa Maria GELPI
Un. Kingdom	Graham BISHOP

Speaker

Nicola PESARESI - Head of Unit, State Aid - DG COMP - European Commission

ELEC Secretariat

Jerry van WATERSCHOOT, Secretary General

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Introduction

Prior to ELEC's Monetary Commission on banking supervision, held at the ING House in Amsterdam on March 5th and 6th 2009, a meeting of ELEC's Monetary Panel was organized. The gathering was a follow-up on the previous Monetary Panel held in Madrid on January 30th 2009. There, the members of the Monetary Panel wondered whether the level playing field between banks can be maintained, because the different forms of state aid given to banks since the outbreak of the financial crisis, may have led to distortions in competition between banks.
To answer this question, the Monetary Panel invited an expert in the field to give his view. Mr. Nicola Pesaresi, Head of the Unit State Aid of the DG Competition of the European Commission, kindly accepted the Panel's invitation.

1. Adoption of the agenda

The agenda was adopted.

2. Approval of the minutes of the last meeting

The minutes of the meeting held in Madrid (Jan. 30, 2009) were approved.

3. How to maintain the level playing field amidst the banking crisis, a EU-view

Mr. Pesaresi gave an overview of state aid control in the European Union. In principle, state aid is prohibited if it provides a selective advantage, distorts competition or if it can affect trade between member states. However, state aid may be accepted in certain cases, e.g. to remedy a disturbance. In that case, it has to be notified and approved.

The way DG Comp reacted during the financial crisis, can be divided into four stages:

- In the early days of the crisis, DG Comp. based its approach on **art 87 (3)(c) on guidelines for rescue and restructuring**. State aid to banks with a weak business model such as WestLB and Northern Rock was approved on the basis of this article.

- But after the default of Leman Brothers, there was a risk of a financial meltdown and DG Comp used **art 87 (3)(b) on aid to remedy a serious disturbance in the economy**, to approve rescue programs rapidly. The aim was to prevent unwarranted damages due to distortions of competition, spill-over effects on banks in other member states, subsidy races and discrimination on grounds of nationality. DG Comp published a banking communication on October 13th 2009 in which the guiding principles were laid down.

- The drying up of credit during the following moth was a threat to the real economy. Recapitalizations of banks were necessary, but threatened to create even more competitive distortions. So DG Comp published a new **recapitalization communication on December 5th 2008**. It outlines a framework for national measures in order to maintain a level playing field. It makes a clear distinction between fundamentally sound banks and distressed banks. For fundamentally sound banks, it is not up to the commission to judge on capital adequacy, size of recap, current CDS spreads, rating or outlook. Member states should judge via their supervisor. DG Comp will only monitor ex post after 6 months. For distressed banks, there are stricter safeguards (as on bonuses), and the restructuring will be judged by DC Comp on the rescue and restructuring guidelines. The remuneration can't be close to the market since there is a higher risk.

- In the present state, the aim of DG Comp is to prevent a "Japan II". The existing measures need to be complemented with a more structural action on impaired assets so as to maintain confidence and the flow of credit to the real economy. So, on **February 25th**, DG Comp published a **communication** saying how to take **asset relief measures** from impaired bank without harming competition. Lessons were learned form the way bad banks took over bad assets at Banco di Napoli and Crédit Lyonnais in 1998. DG Comp advocates a consistent approach, so as to avoid a "race to the top", arbitrage for cross border banks and protectionism. The asset relief can take the form of asset purchase ("bad bank"), asset insurance, asset swaps or hybrid solutions, but equivalent treatment is a condition. A whole set of principles governing asset relief has been elaborated, e.g. on asset eligibility, asset valuation and cost burden sharing. As far as the remuneration is concerned, it should at least be equivalent to remuneration of state capital.

Up to now, the European commission has taken 50 decisions on state aid for the financial sector, of which 24 individual measures (for 20 different banks) and 26 schemes. There are still 4 on-going in-depth investigations and 12 pending cases.

In April, the **first reviews on guaranties and recaps** will take place. Also, the first wave of restructuring cases will be reviewed soon. The asset relief guidelines have just been published and now DG Comp is working **on guidance on restructuring and competition** to pave the way for a return to normal market functioning. The next step is how to deal with **"to big to fail" institutions**.

The rules that DG Comp has established on state aid are part of the solution, they not the problem. DG Comp has to be firm on its principles. But it is flexible on procedures. To maintain the level playing

field, it rejects all subsidy races and protectionism. DG Comp cares for the long term perspective, which is a return to normal market, so Mr. Pesaresi concluded.

DISCUSSION

"You give me hope that it can be done, but it will be difficult", was the reaction of Wim Boonstra.

Mr. Pesaresi's presentation was followed by a lively debate - be it without final conclusions - on a wide range of topics. Some of the many questions asked:

Shouldn't we already prepare an **exit strategy**, because stopping the rescue measures could create serious disturbances?

Will overall guidelines instead of a case by case policy not lead to a **contraction of credit**? When a bank needs capital or liquidity because it has not enough equity, can it be allowed that they use that money for **lending**? Can we request a bank to increase lending as a condition for state aid? If so, won't it create distortions? Once you start helping systemic banks, how can you avoid free riders?

If there is a distortion of competition because of state aid, where do we have to **complain**? At the European Court? And if we have to wait to complain until a bank closes down, won't that be too late?

Transparency is alright, but isn't the problem with bad assets that we do not know how toxic they are? How can we ask banks to disclose their bad assets as a precondition for aid if they don't know their impaired assets themselves?

Isn't a **bad bank** which takes over the bad assets a better solution? Is a **European** bad bank a realistic option? Or a **national** bad bank? Shouldn't a bad bank as a split off of an **individual** bank in difficulty, be isolated completely in another vehicle of the group or even be sold entirely? Isn't a bad bank very difficult to manage? Can Sweden be a model for the way to treat impaired assets, since the "Sweden" was not uniform case?

Shouldn't we make a **good bank** instead? But wouldn't a good bank become a bad bank quickly because there are not many good assets to buy? Why don't we recapitalize one bank, and as we know that its assets are not as toxic as we fear, this could revive the whole market?

Isn't there a danger that government support will lead to **zombie banks**?

Shouldn't we break the last taboo and admit that by **closing down** some banks, others might get stronger? Shouldn't one country do a bold clean up, so that other countries will follow?

Since in the present circumstances equity is not given by the private sector, it must come from the state. Even if the final aim is that banks must stay private, it may mean that we have to go though this other taboo first: **nationalization**.

4. Date and place of the next meeting

No invitation received so far for the Autumn meeting.

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