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On 26 February 2010, the Commission took a final, conditional decision ([2]) approving the State aid package to, and the restructuring of, Dexia SA ('Dexia'), which benefited from a large State aid package. This conditional decision follows an in-depth investigation opened in March 2009 ([3]). In this article we briefly describe the situation of the bank (1), the measures involved (2), the procedural context (3) and the assessment of the restructuring measures (4), before drawing some concise conclusions (5).

1. Dexia and the need for State aid

Dexia is a European financial services group created by a merger, in 1996, between the Crédit Communal de Belgique and the Crédit Local de France, both of which specialised in lending to local authorities. Since the merger, Dexia has grown rapidly: Its total assets increased by 152% between 2000 (258 billion euros) and 2008 (651 billion euros), an average growth rate of 12.3% per annum. The balance sheet growth stemmed mainly from the accumulation of a very large bond portfolio and the development of public finance lending outside its traditional markets, especially through the acquisition or creation of new subsidiaries in Italy (Dexia Crediop), Spain (Dexia Banco Sabadell), Germany (Dexia Kommunalbank Deutschland), Japan, the United Kingdom and the United States (where the bank acquired, in 2000, the monoline FSA — Financial Security Assurance). Hence, Dexia had to rely heavily on wholesale markets to fund its growing public finance activities, as a material increase in its customer deposit-taking activities was not possible.

This business model, consisting to a large extent of short-term funding raised on wholesale markets to finance long-term and low-margin loans to the public sector, worked well while liquidity was flooding at very low cost in wholesale markets. However, in September 2008, in the aftermath of the collapse of Lehman Brothers, liquidity in the interbank and capital markets dried up, leaving Dexia with a material short-term liquidity gap. The bank's situation was made worse by impairments on a large portfolio of structured credit assets, either held directly or insured by FSA, by its large exposure to banking and sovereign counterparties in difficulty (e.g. US, Irish, and Icelandic banks), and by the equity market downfall. Total losses and impairments recorded by Dexia as a result of the financial crisis amounted to 6.6 billion euros in December 2009 (of which 5.9 billion euros were booked in 2008).

These major difficulties led the three Member States where Dexia's main legal entities are incorporated, namely Belgium, France and Luxembourg, to agree on a rescue package which would enable the bank to withstand the crisis and pursue its activity.

2. Description of the State aid measures

2.1. Capital injection

On 30 September 2008, the Governments of Belgium, France and Luxembourg publicly announced a capital increase of 6.4 billion euros for Dexia. Of this total amount, 3 billion euros of newly issued shares were subscribed by the French state (1 billion euros) and the Belgian federal and regional states (2 billion euros). In all 3 billion euros were subscribed by the bank's key shareholders, most of them closely linked to the public sector: Caisse des Dépôts et Consignation and CNP Assurances in France; Holding Communal SA, Arcofin SCRL, and Ethias, in Belgium. An additional 376 million euros of hybrid capital to be issued by Dexia BIL in Luxembourg were to be subscribed by the State of Luxembourg.

2.2. The State guarantee on funding

Beyond recapitalisation, Dexia also urgently needed to regain access to wholesale funding in order to pursue its activities. Hence, the same three Member States announced on 9 October 2008 that they would jointly guarantee all new funding raised by Dexia with an initial maturity of up to 3 years and for a maximum amount of 150 billion euros. This guarantee, split into 60.5% for Belgium, 36.5% for France, and 3% for Luxembourg, was mainly targeted at wholesale deposits, commercial papers and bonds. One year later, in October 2009, the maximum guaranteed amount was reduced to 100 billion euros and maximum maturity was extended to 31 October 2014 (up to 5 years). Financings with

([1]) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

([2]) Commission Decision of 26 February 2010 in State aid case No C9/2009 (ex NN45/2008, NN49/2008 and NN50/2008) implemented by Belgium, France and Luxembourg in favour of Dexia SA, not yet published.

([3]) OJ C 181, 4.8.2009, p. 42.

a maturity lower than one month were excluded from the scope of the guarantee.

During the last quarter of 2008, in order to meet its commitments, Dexia was also able to rely on emergency liquidity assistance (ELA) granted jointly by the National Bank of Belgium and the Bank of France. The facility granted by the National Bank of Belgium was explicitly guaranteed by the Belgian State ([4]).

2.3. The impaired assets measure

The rescue package was finally topped up in November 2008 by an additional guarantee granted by the Belgian and French States (for 62.4 % and 37.6 % respectively) on a sub-portfolio of structured credit assets (covered assets) totalling 12.48 billion US dollars in nominal value, part of a total portfolio of 16.98 billion US dollars held by Dexia's loss-making US monoline subsidiary FSA (the 'FSA measure'). The FSA measure was granted to facilitate the sale of FSA, which closed on 1 July 2009. The portfolio was primarily made up of US residential mortgage-backed securities (RMBS) and collateralised debt obligations (CDO)/collateralised loan obligations (CLO) that were ring-fenced from the scope of assets to be sold, and counter-guaranteed by the Belgian and French States.

3. Procedural issues

In the light of Dexia's overall situation in September and October 2008, the Commission concluded on 19 November 2008 that the bank was in difficulties and authorised the capital injection and the State guarantee on Dexia's funding as a rescue measure to avoid a serious disruption of the economy of the Member States concerned, provided that a restructuring plan for the bank was submitted to the Commission within a six-month period. In its decision the Commission considered that the recapitalisation and the guarantee amounted to State aid, pursuant to Article 107 of the Treaty on the Functioning of the European Union (TFEU), since they were granted from State resources and created an advantage for Dexia, which would not have had access to wholesale and capital markets without them, thereby distorting competition across Member States.

In February 2009, the three Member States submitted to the Commission an initial restructuring plan for Dexia. One of the main measures of the plan was the sale of FSA to Assured Guarantee, which would reduce the group's risk profile. Closure of the deal was, however, conditional on implementation of the FSA measure by the Belgian and French governments. On 13 March 2009, the Commission concluded in this respect that the FSA measure was in line with the principles set out in its communication on the treatment of impaired assets in the Community banking sector ([5]), except for the asset valuation aspects, which needed a more detailed assessment. In its decision of 13 March 2009, however, the Commission expressed some doubts as to the ability of the proposed restructuring measures to restore the long-term viability of the bank, to share the cost of restructuring among stakeholders, and to compensate for the distortions of competition caused by the aid. As a result, while declaring the FSA measure compatible with the internal market, the Commission opened in-depth investigations on the restructuring plan.

4. Dexia's restructuring plan

Intensive discussions took place between the Commission, the authorities of the Member States, and Dexia from April 2009 to February 2010. During this period the Member States clarified and completed Dexia's restructuring plan. Additional restructuring measures were notified to the Commission on 9 February 2010.

In its decision of 26 February 2010 closing the in-depth investigation, the Commission: (i) confirmed the State aid elements of the Belgian State's guarantee on the liquidity assistance provided by the National Bank of Belgium; (ii) established the amount of State aid involved in the recapitalisation measure ([6]) and in the FSA measure; and (iii) confirmed that the bank's restructuring plan, as notified on 9 February 2010, was in line with the principles set out in the Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules ([7]).

As the March 2009 decision was not comprehensive with respect to the assessment of the FSA measure, the Commission also reviewed the valuation of the portfolio with the assistance of external experts and concluded that the level of the first tranche of losses finally borne by Dexia (in cash) and amounting to 4.5 billion US dollars was satisfactory, given the real economic value of the portfolio, and that the remuneration paid to the States was appropriate.

In total, the Commission assessed the amount of aid received by Dexia at 8.4 billion euros for the recapitalisation and the FSA measure, and up to 135 billion euros for the State guarantees on Dexia's

([4]) See Moniteur belge of 17.10.2008, 2nd edition, p. 55637.

([5]) OJ C 72, 26.3.2009, p. 1-22.

([6]) This corresponds to the total recapitalisation amount excluding equity shares subscribed by Arcofin SCRL, Ethias, and CNP Assurance, all considered as private shareholders.

([7]) OJ C 195, 19.8.2009, p. 9-20.

liabilities and on the ELA. The Commission also assessed Dexia's complete restructuring plan and concluded that it was appropriate to restore the long-term viability of the bank, share the cost of restructuring across the bank, and compensate for the distortions of competition, as explained below.

4.1. Measures to restore long-term viability

In its assessment of the bank's business model, the Commission identified major issues regarding viability. In the first place, despite recent improvements Dexia still relies to a large extent on wholesale funding, especially short-term funding. This makes the group vulnerable to market disruptions and credit spread variations. This is particularly the case for Dexia Crédit Local (France), while the funding sources for Dexia Bank Belgium and Dexia BIL (Luxembourg) are more stable. Secondly, Dexia has to cope with a very large and slowly amortising stock of assets (mostly bonds and public finance loans), making it harder to deleverage and to pass through the increased cost of funding, thus putting pressure on refinancing needs. Thirdly, margins ([8]) on such assets are very low and potentially not high enough to absorb sustained increases in funding costs and provisions. In the fourth place, Dexia's funding cost, especially for capital markets financing (e.g. covered bonds and senior unsecured bonds), has increased significantly and is still materially higher than pre-crisis levels, despite the sharp improvement in market conditions over 2009. Fifth, Dexia has developed quickly and in geographical regions outside its core markets, taking in non-traditional and riskier activities, such as monoline insurance services in the US. Finally, Dexia keeps a certain amount of exposure to a portfolio of structured credit securities mainly made up of US RMBS and CDO/CLO, and is overexposed to sovereign and sub-sovereign risks, through both its bond and loan portfolios.

In order to address these viability issues, the main elements of Dexia's restructuring plan were (i) to focus on its core markets and business segments and engage in profitable lending only; (ii) to reduce its risk profile by deleveraging and improving its liquidity profile; and (iii) to improve its cost structure.

The restructuring plan achieves this goal through commitments of the Member States to ensure that Dexia will implement the following measures: (i) refocusing activities in public and wholesale banking (PWB), as well as retail and commercial banking (RCB), mainly on the group's core markets (Belgium, France and Luxembourg) and putting into run-off several non-strategic loan and bond portfolios; (ii) reducing the balance sheet size by 35 % over the restructuring period (until the end of 2014), including organic growth; (iii) accelerating the deleveraging through the selective (and realistic) sale of bonds in the run-off portfolio; (iv) reducing the proportion of short-term funding, increasing the proportion of more stable funding sources and increasing the average duration of liabilities gradually over the restructuring period according to a pre-agreed schedule; (v) engaging in lending to PWB customers only if a minimum risk-adjusted return on capital (RAROC) of 10 % can be achieved; (vi) reducing its cost base by 15 %; and (vii) stopping proprietary trading activities. All these measures will be subject to periodic monitoring by the Commission over the restructuring period, with the support of a monitoring trustee.

To assess whether the planned measures are sufficient to restore the long-term viability of the group at the end of the restructuring period, the Commission has reviewed Dexia's business plan, together with the results of different stress tests performed by the bank. Such tests are aimed at assessing: (i) the resistance of the group to severe macro-economic shocks; (ii) the vulnerability of the group to material increases in the cost of wholesale funding; and (iii) the liquidity of the group under severe assumptions. The Commission also relied on the expertise of the regulatory authorities.

The various stress testing exercises were used to identify the group's weaknesses and formulate measures to address them. Dexia demonstrated that at the end of the restructuring period, its level of regulatory capital should be sufficient to withstand a severe recession and that its liquidity should gradually improve to make the group more resilient to external shocks in the future. Therefore, the Commission's assessment concluded that the measures contained in the restructuring plan were sufficient to restore the long-term viability of Dexia at the end of the restructuring period.

4.2. Measures to share the restructuring costs (burden sharing)

First, Dexia will sell a significant amount of ownership stakes, including Dexia Crediop in Italy, Dexia Banco Sabadell in Spain, Dexia Banka Slovensko in Slovakia, and Dexia Epargne Pension in France. Second, Dexia's historical shareholders have taken on a part of the burden, because their share in the bank's capital has been diluted by the recapitalisation subscribed by the Belgian and French Governments. Shareholders and holders of hybrid capital instruments further participate in the cost of restructuring through a partial ban on dividend and coupon

([8]) Above interbank rates.

payments. Third, the total fees paid by the bank to the Member States for the guarantee granted on its liabilities and on impaired assets (through the FSA measure) are appropriate and amount to significant burden sharing for Dexia.

Therefore, the Commission considered that the large-scale divestments, the fees paid for the State guarantees and the asset relief measure, the dilution effect of the recapitalisation, and the partial suspension of payments of dividends and interests provided for in the plan limit the aid to the minimum necessary and ensure an adequate contribution by the bank and its owners to the restructuring.

4.3. Measures to limit distortions of competition

As already mentioned, the restructuring plan includes divestment measures in certain activities and the sale by Dexia of certain subsidiaries, which de facto limit the distortions of competition. In addition, in its core markets, certain limitations on new volumes of PWB loans will be applied each year throughout the entire restructuring period. These measures address the Commission's concerns regarding possible undue distortions of competition due to the extent of the aid granted.

In addition to divestments, the bank will also be subject to a general two-year acquisition ban. However, because of the specific nature of public finance lending practices, often based on public tendering, the Commission did not impose a price leadership ban on Dexia but, instead, required that a minimum profitability of PWB loans (measured through RAROC) is ensured and that the French and Belgian Governments increase the transparency of public finance tenders.

On this basis, the Commission considered that Dexia had sufficiently mitigated the distortions of competition triggered by the State aid it had received.

5. Conclusion

Dexia being one of the most severely hit banks following Lehman's filing for bankruptcy, the decision provides an illustration of how the Commission is dealing with banks whose business models were completely challenged by the crisis. The handling of the Dexia case by the Commission is therefore interesting for two specific reasons:

- On the one hand, the Commission undertook a detailed assessment of the bank's viability issues and reviewed the results of three types of stress tests performed by the bank. The set of measures to achieve the bank's return to long-term viability were designed in order to address the most important weaknesses of the bank and were translated into periodic, pragmatic and realistic milestones for the bank to reach.

- On the other hand, the Commission has again demonstrated that it is helping to overcome the financial crisis by not blocking large-scale rescue measures undertaken by Member States. However, the Commission needs to ensure that such measures take place in an adequate framework which provides for a return to the long-term viability of the bank, a sharing of restructuring costs among stakeholders, and measures to limit the distortions of competition created by the aid.