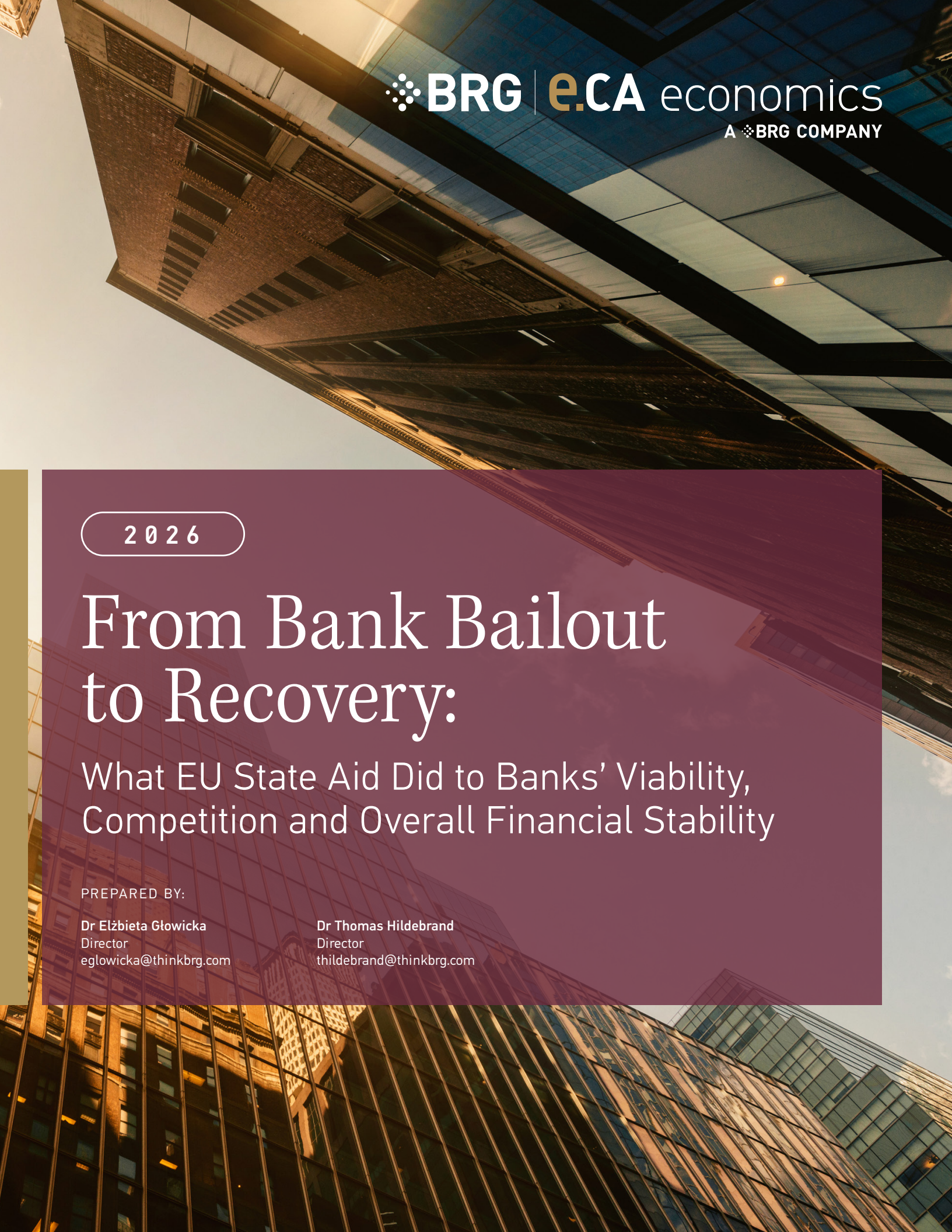


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From Bank Bailout to Recovery:

What EU State Aid Did to Banks' Viability, Competition and Overall Financial Stability

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Introduction

E.CA Economics (a BRG company since May 2026) and a team of academic partners provided a study for the European Commission, DG Competition. The study assessed State aid for banks in difficulty along five objectives:

- financial stability of the banking sector
- banks' return to viability
- limiting competition distortions
- preserving market discipline and preventing moral hazard
- efficiency of the State aid control framework

For more information, visit the European Commission's webpage of the study.

Key takeaways

- State aid contributed to stabilising the European banking sector during the financial crisis.
- Aided banks typically return to viability or exit the market within five years of receiving support.
- Commitments attached to individual aid decisions help mitigate competition distortions.
- Market discipline and burden-sharing mechanisms remain important safeguards in bank rescue policies.
- A mix of individual procedures and aid schemes can balance effectiveness and administrative efficiency.

Rescuing banks without weakening competition

Can European Union (EU) State aid rules balance stability, competition and efficiency in the banking sector?

Benefits

State aid can generate significant benefits for banks in distress, the financial system and the wider economy.

1. By preventing bank failures, State aid can help preserve confidence in the banking sector and avoid destabilising events such as bank runs. It can also limit contagion effects, whereby difficulties at one institution spread to other banks and threaten the stability of the financial system as a whole.

2. More broadly, State aid can contribute to maintaining financial stability and ensuring the continued provision of essential banking services to households and businesses, thereby supporting the functioning of the real economy.

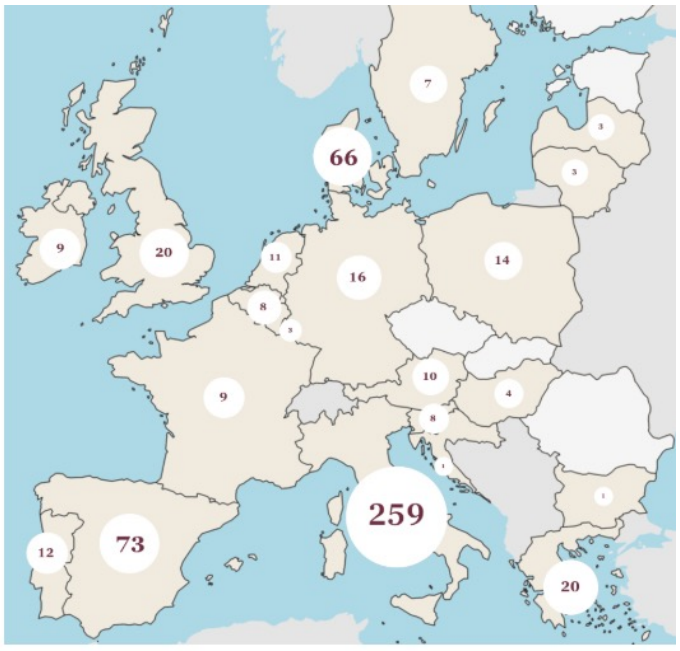


Figure 1: The number of subsidised banks per country

Drawbacks

A drawback is that State aid can result in harmful side effects for the banking sector.

1. By benefiting selected institutions, it can distort competition within the sector. Aided banks may gain an artificial competitive advantage, enabling them to undercut competitors, expand their market share, reduce incentives to improve service quality or delay the introduction of innovative products and services.

2. State aid may weaken market discipline. Expectations of public support can encourage excessive risk-taking by banks while reducing investors and creditors' incentives to monitor banks' risk profiles. As a result, the perceived riskiness of aided institutions may no longer accurately reflect their underlying financial condition.

3. In addition, State aid entails administrative and compliance costs for aid beneficiaries, granting authorities and the European Commission. Public resources used to support banks also carry an opportunity cost, as funds allocated to State aid cannot be used for other public policy objectives.

4. Starting from the outbreak of the global financial crisis in 2008, Italy has recorded the largest number of banks receiving State aid. By contrast, six countries—Czech Republic, Estonia, Finland, Malta, Romania and Slovakia—did not grant State aid to banks during the period under review.

State Aid control in the European Union

State aid is prohibited within the European Single Market because it can distort competition and affect trade between Member States. However, aid may be declared compatible with the internal market if it satisfies six cumulative criteria:

01

Necessity

State aid must address a problem that markets cannot resolve on their own (e.g. market failure, equity and cohesion concern). In the banking sector, relevant market failures include:

- Negative externalities: Individual banks do not fully internalise the social costs of excessive risk-taking.
- Coordination failures: If depositors remain confident, a bank may remain solvent. However, if depositors simultaneously withdraw their funds, the bank may collapse.
- Too big to fail: The failure of a large bank may generate significant spillover effects across the wider economy. Expectations of public support can create moral hazard, weaken market discipline and encourage excessive risk-taking.
- Public-good characteristics of financial stability: Financial stability benefits society as a whole, yet no individual bank has sufficient incentives to provide it. This may lead to underinvestment in prudent behaviour and risk management.

02

Incentive effect

State aid must induce beneficiaries to change their behaviour in a manner that contributes to the policy objective pursued. In other words, the aid should lead to outcomes that would not occur in its absence.

03

Appropriateness

State aid must be an appropriate policy instrument for achieving the intended objective. The measure should be more effective than alternative instruments (e.g. regulation, market-based solutions).

04

Proportionality

The amount of aid must be limited to the minimum necessary to achieve the objective. Beneficiaries should not receive support exceeding what is required to address the identified problem.

05

Avoidance of undue negative effects on competition and trade

Positive effects of the aid must outweigh any negative effects on competition and trade. In the banking sector, distortions may arise when support is granted only to selected institutions, including:

- static distortions between banks, where aided banks gain an advantage over competitors
- distortions of dynamic incentives, reducing incentives for prudent risk management
- distortions of trade between Member States, affecting the level playing field within the Single Market

Potential distortions can be mitigated through commitments imposed on beneficiaries and burden-sharing measures involving shareholders and creditors.

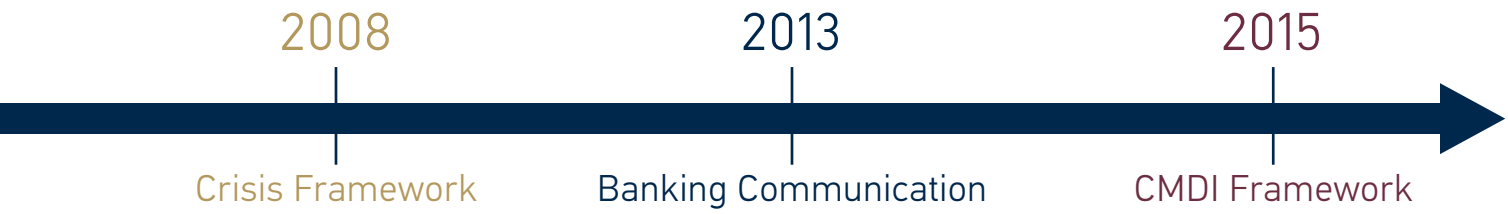
06

Transparency

Information on the legal basis, beneficiaries and amounts of aid granted must be publicly available. The European Commission maintains a State Aid Transparency Database containing information reported by Member States. Poland, Romania and Spain operate separate national transparency databases.

These six criteria form the foundation of EU State aid control. They are designed to ensure that public support can achieve legitimate policy objectives while minimising distortions to competition and preserving the integrity of the Single Market.

How the rulebook changed



Crisis Communications

The EU framework evolved in three main stages. In response to the financial crisis, the first package was built in 2008–2009 around three principles: minimising competition distortions, restoring the long-term viability of aided banks (or encouraging the exit of nonviable institutions) and ensuring that shareholders and selected creditors bore part of the losses. These principles were set out in crisis communications beginning with the 2008 Banking Communication and followed in 2009 by the Recapitalisation Communication, Impaired Assets Communication and Restructuring Communication.

Banking Communication

The 2013 Banking Communication marked a turning point. It replaced the 2008 framework and complemented its rules, making recapitalisation and impaired asset measures more conditional by linking them more clearly to an approved restructuring plan. It placed greater emphasis on burden-sharing, requiring shareholders and subordinated creditors to contribute before public recapitalisation or impaired asset aid could be granted (except in exceptional cases justified by financial stability).

CMDI Framework

A third stage began with the 2015 Crisis Management and Deposit Insurance (CMDI) framework which moved the EU toward a broader framework of resolution, bail-in and stronger prudential supervision. CMDI architecture was built around reforms which have strengthened the expectation that losses should increasingly be absorbed by investors rather than taxpayers, while making crisis management more structured and more credible across the banking system.

Two administrative procedures at the heart of the analysis

State aid scheme

standardised framework used for multiple banks, typically quicker and less burdensome to deploy

444 banks
20% of aid

- Mostly smaller beneficiaries and usually less distressed
- Mainly recipients of liquidity-like aid (guarantees and loans)
- **Main benefit:** lower administrative effort
- **Main risk:** temporary increases in markups and profitability

Individual procedure

tailored to the needs of a bank, with a detailed review of bank's situation and bank-specific design of commitments and burden-sharing measures

122 banks
80% of aid

- Larger and more distressed banks with significantly higher aid per bank
- A mix of instruments, including most capital-like aid
- **Main benefit:** no evidence of competition distortion
- **Main risk:** higher administrative effort per case

Figure 2: Aid value peaked in 2008 in terms of inflows, 2010 in terms of stock

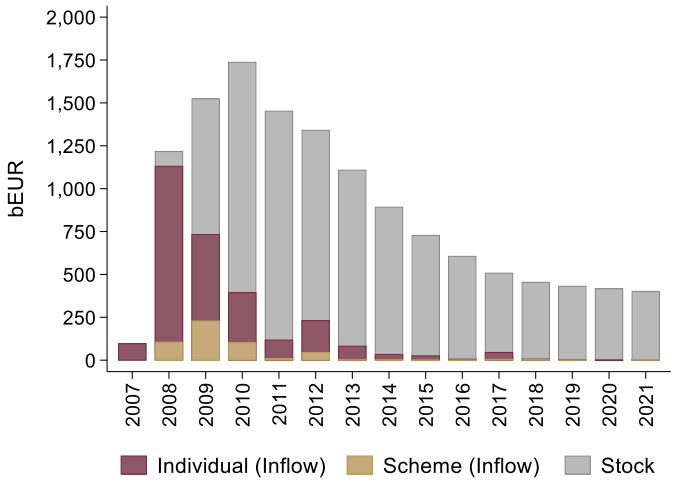
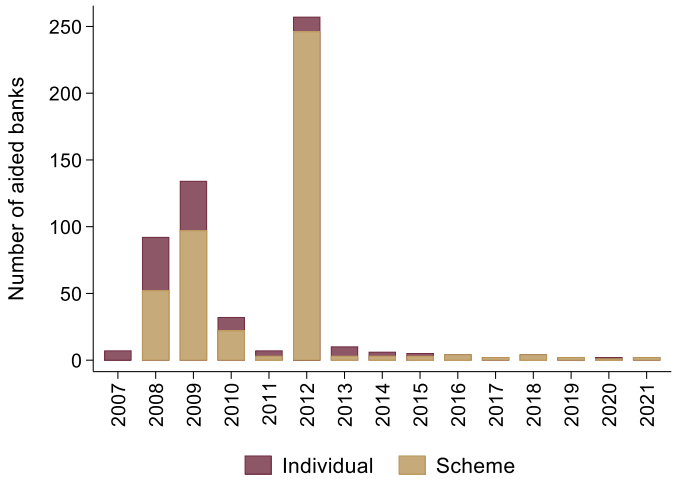


Figure 3: Number of aided banks peaked in 2012



From crisis to stability

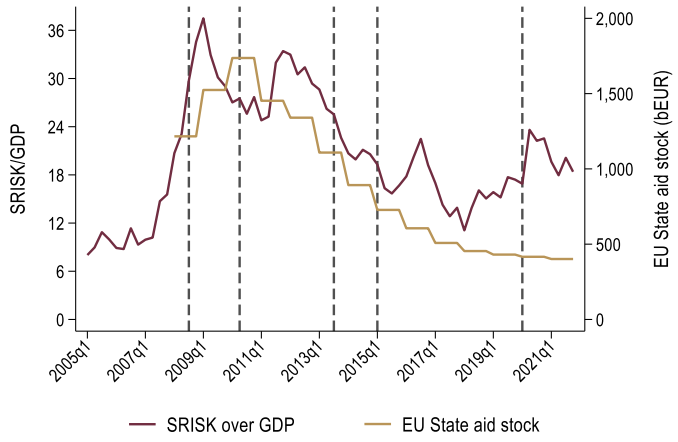
The financial stability of the EU banking sector deteriorated sharply during the global financial crisis. Several indicators of banks' contributions to systemic risk increased sharply in 2008, signalling severe financial distress and heightened risks to the stability of the financial system. Elevated levels of systemic risk persisted until mid-2013.

To address these challenges, Member States granted State aid to banks experiencing financial difficulties. Evidence suggests that such interventions reduced the default risk of significant institutions. Measured by credit default swap (CDS) spreads, the perceived risk of bank failure declined by approximately 20 basis points in the thirty days following individual State aid decisions by the European Commission. While bank stock returns fell around the time of State aid announcements, the effect was temporary and share prices returned to normal levels shortly thereafter.

Measures of financial stability

- **SRISK**
  conditional capital shortfall measure of systemic risk
- **CLIFS**
  country-level index of financial stress
- **CISS**
  composite indicator of systemic stress
- **CDS spreads**
  banks' credit default swap spreads

Figure 4: SRISK and stock of State aid at the EU level



From mid-2013 onwards, indicators of systemic risk declined steadily. The figure below illustrates a lagged relationship between the stock of State aid and developments in SRISK, a measure of banks' contributions to systemic risk. Higher levels of State aid are associated with lower systemic risk in the banking sector and lower financial market distress around three years later.

A more granular analysis indicates that stocks of capital-like aid have an even faster effect. Increases in such aid are associated with reductions in financial distress within one year, suggesting that recapitalisation measures can play an important role in restoring confidence and strengthening the resilience of the banking sector.

Nuanced effects on competition

State aid can potentially distort competition by giving an advantage to certain banks. To assess these effects, the study compares aided banks with similar banks that did not receive aid. The results show that banks supported through State aid schemes temporarily increase their markups, suggesting short-term distortions of competition. In contrast, banks receiving aid through individual decisions—typically subject to stricter conditions and commitments—do not exhibit such effects.

The figure below shows raw markups of aid beneficiaries after receiving aid, relative to similar nonbeneficiaries. A statistically significant increase is visible for scheme aid but not for individual aid.

Figure 5: Scheme aided banks – dynamic effects (markups)

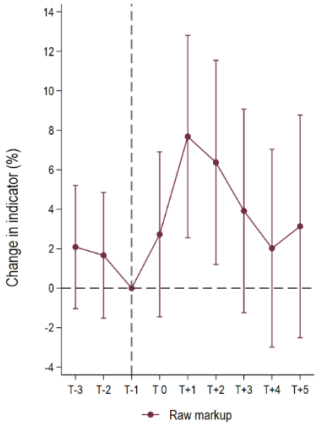
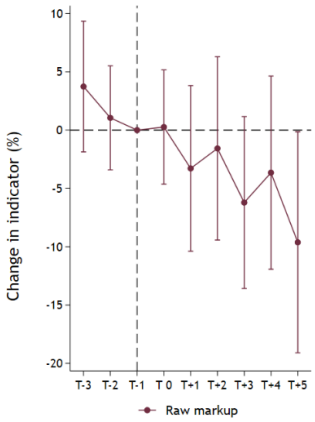


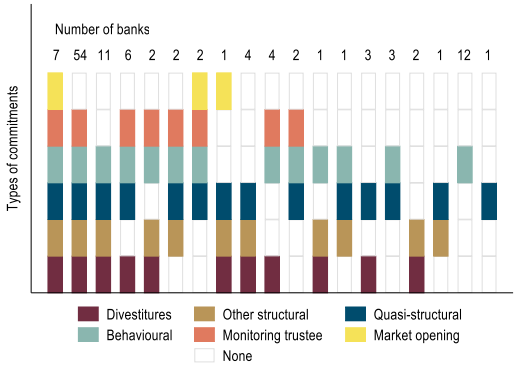
Figure 6: Individually aided banks – dynamic effects (markups)



Commitments for individually aided banks

1. Nearly all banks have commitments attached to aid.
2. Many banks face multiple types of commitments simultaneously: structural, quasi-structural, behavioural, supervision by monitoring trustee and market opening.

Figure 7: Commitment mix for individually aided banks

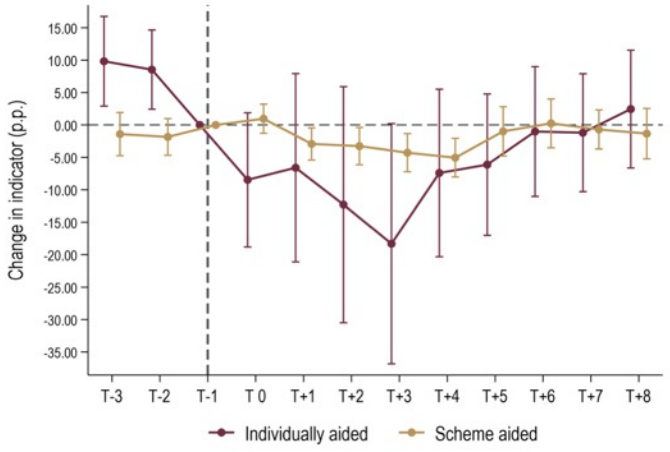


3. Commitment intensity correlates positively with bank size and aid volume, especially for capital-like aid.

Conclusion: Commitments were successful in limiting distortions of competition.

Return to viability for aided banks

Figure 8: Dynamic effects on ROAE



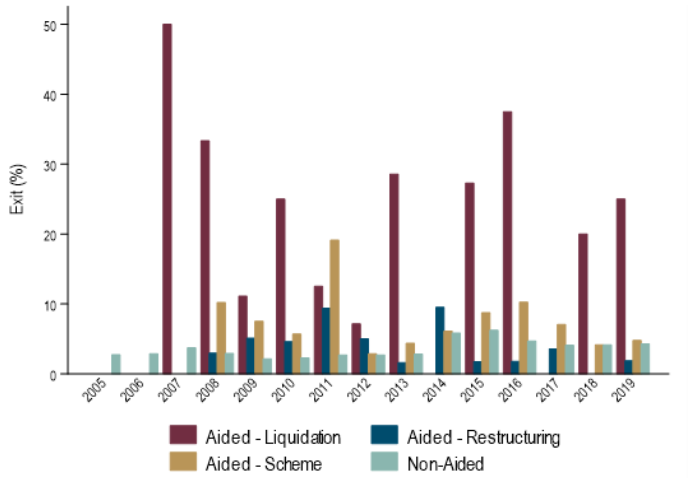
Return on average equity (change in percentage points)

State aid for the banking sector has the objective of enabling banks to return to viability within a reasonable period of time or ensuring that institutions unable to restore long-term viability exit the market.

The evidence shows that after receiving State aid, average performance indicators of aided banks (e.g. return on average equity) align with similar, nonaided banks after five years.

This result applies to both scheme aid and individual aid. It means that regardless of the type of procedure, beneficiaries of State aid returned to long-term viability as expected.

Figure 9: Annual exit rates, by aid type



Liquidation aid vs. restructuring aid

- 86% of banks that received liquidation aid exited the market by 2020.
    - Banks took on average four years to exit (conditional on exiting).
- 35% of banks defaulted having received restructuring aid.
    - These banks exited the market after three years.

Moreover, banks that received restructuring aid are more likely to require additional aid than banks that received liquidation aid.

Market discipline and moral hazard

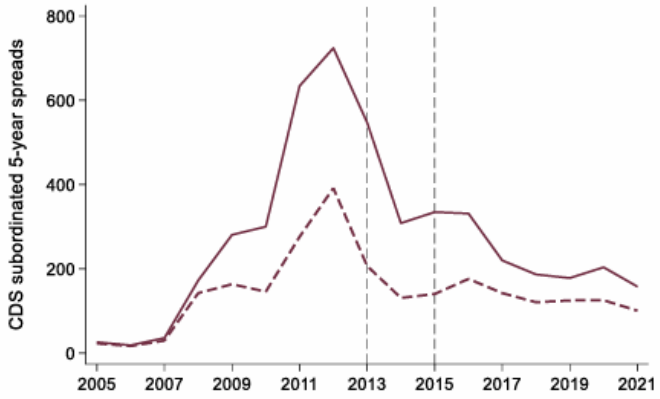
State aid, as a form of safety net for banks, must not encourage moral hazard (excessive risk-taking behaviour) nor distort market discipline. The study found:

- No evidence of increased **moral hazard**: Individually aided banks have higher risk, both in terms of default risk and credit risk, than comparable non-aided banks. However, this is not a causal impact of State aid, as aided banks already exhibited increasing levels of risk in the pre-aid period. **Burden-sharing measures** did not lead to less risk after receiving State aid.
- Market discipline means that riskier banks need to pay more for capital from the market. **There is no evidence that market discipline** was weakened by State aid or burden-sharing.
- Implicit subsidies are measured by the funding costs of liabilities in large, systemic banks. These banks could benefit from lower costs of funds than other banks due to a higher probability of being bailed out. The findings show that **implicit subsidies decreased** under the 2013 Banking Communication and even more markedly after the entry into force of the 2015 CMDI framework. This likely reflects the reduced expectations of the bank funding providers regarding the scope and benefits related to State aid.

The results suggest that while State aid rules do not immediately remedy the high risk of aided banks, market discipline is not distorted and banks with higher risk face funding disadvantages compared to banks with lower risk.

The following figure depicts a well-functioning market discipline, showing the development of pricing for five-year CDS for subordinated debt (a proxy for the cost of funding) over time for all European banks.

Figure 10: Development of CDS subordinated 5-year spreads for European banks

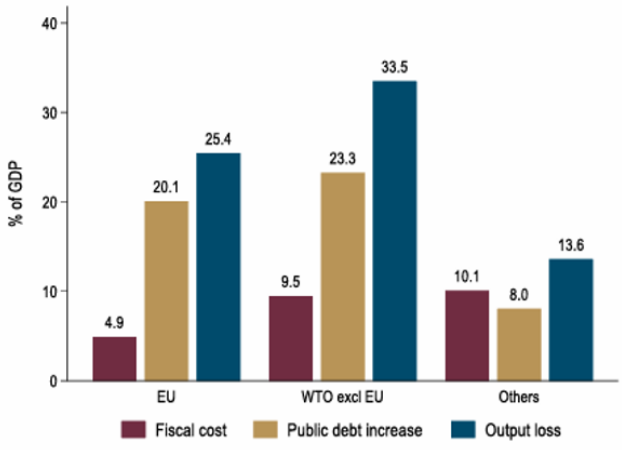


From 2007 to 2021, banks that received aid consistently had higher CDS spreads than banks that did not—meaning investors saw them as riskier. This was especially true in 2008–2009 and again in 2010, when banks' perceived risk spiked and the cost of funding surged.

Efficiency of State aid rules for banks in difficulty

EU Member States were more efficient than other countries in the World Trade Organization (WTO) when addressing the financial crisis.

Figure 11: Benchmarking results, by groups, weighted by 2020 GDP



EU Member States spent less on restructuring the financial sector during the crisis than the WTO and other countries, both in terms of fiscal cost (4.9 vs. 9.5% of GDP) and public debt (20.1 vs. 23.3% of GDP). EU Member States also suffered lower output losses than the WTO (25.4 vs. 33.5% of GDP) and other countries.

Data source: Laeven, L., and F. Valencia, "Systemic Banking Crises Database II", IMF Economic Review 68 (2020): 307–361; seventy systemic financial crisis episodes from fifty-nine countries.

Further results on costs of State aid include:

- State aid schemes are associated with a lower administrative burden per bank than individual aid procedures, largely because a single scheme can support multiple banks through a simplified approval process.
- By contrast, individual aid procedures typically involve higher aid amounts and more administrative effort per beneficiary.
- Regardless of the type of procedure, the administrative effort required per bank has increased over time.

The analysis further suggests that, for banks potentially eligible under both individual aid procedures and schemes, the use of schemes could generate efficiency gains by reducing both the amount of State aid required and the associated administrative burden.

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