

# Agenda

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## Passing judgment on crisis state aid control: the ING MEIP case

In a landmark judgment, the General Court ruled in March 2012 that the European Commission had overstated the state aid received by Dutch bank, ING Groep NV, during the financial crisis by up to €2 billion, and, as such, ING may be relieved from certain remedies imposed by the Commission. What was the Court's reasoning, and does it have a bearing on the support given to other banks in recent years?

The ING judgment is the first time the General Court has scrutinised one of the many banking state aid Decisions taken by the European Commission during the financial crisis.<sup>1</sup> The Court is critical of the Commission's analysis, and has declared that part of the 'aid' might not actually be aid, since the market economy investor principle (MEIP) test was not applied by the Commission, although it could and should have been. The MEIP test helps to determine the existence of state aid by comparing the terms offered by the state to the terms that a private investor would offer. As such, the Court has annulled part of the finding of state aid, and annulled the second annex to the Commission Decision, which required a series of commitments from ING, including a reduction of 45% in its balance sheet and a price leadership ban. The General Court's judgment in *ING* may still be reviewed by the European Court of Justice.

The essential facts of the ING case are the following.

- On November 11th 2008, ING Groep received a capital injection of €10 billion from the Dutch state via the creation of one billion ING securities at a price of €10 each. Under the terms agreed between ING and the state, the securities were, on ING's initiative, either to be repurchased at €15 (50% premium), or, after three years, to be converted into ordinary shares.<sup>2</sup>
- On October 24th 2009, the state and ING amended their deal. The new terms provided that ING could now repurchase up to half of the securities at the issue price €10, rather than €15. If it exercised this option, ING would have to pay accrued interest plus an early-redemption penalty of up to €705m.<sup>3</sup>
- On November 18th 2009, the Commission adopted a Decision which said that the amendment itself constituted additional state aid on top of the capital

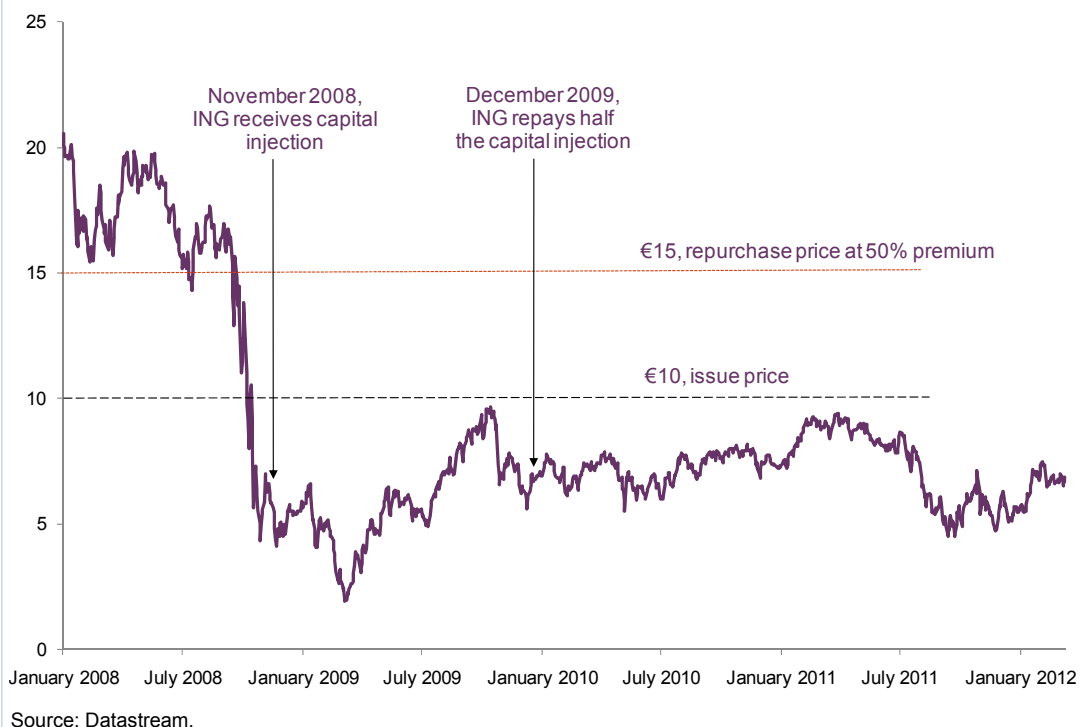
injection, and that this new aid could be valued at €2 billion.<sup>4</sup>

- On December 21st 2009, ING exercised the option available under the amended deal, repaying half of the capital injection by redeeming half of the state's securities at a price of €10, plus the interest and early-redemption premium. The state had earned approximately a 15% internal rate of return on its investment in one year.
- On January 28th 2010, ING and the Dutch government appealed the Commission Decision, saying that the amendment to repayment terms did not result in an additional €2 billion of aid, and that, on this basis, the Decision should be annulled.
- On March 2nd 2012, the General Court ruled in favour of ING and the Dutch government.

The share price of ING during these events is shown in Figure 1 below.

The Commission had perceived the amended deal as granting an advantage to ING because it introduced a lower redemption premium than established in the original terms. Why would a private investor choose to swap a promised 50% redemption premium for a much lower amount? The Commission also objected to the application of the MEIP to circumstances where an existing restructuring aid was being amended.

However, viewing the deal from the Dutch government's perspective, the state had agreed an amended deal with an attractive return and swiftly thereafter was repaid half of the original capital injection by ING, plus a premium. How could there possibly be €2 billion of new aid granted when ING was merely repaying existing aid ahead of time? These were the economic questions of this case.

**Figure 1 Share price of ING Groep NV, January 1st 2008 to March 9th 2012, €**

## The arguments for and against

The Court's focus was on the amendment to the repayment terms and whether the amendment resulted in additional aid to ING of €2 billion. The appellants argued that, while a redemption premium of 50% was made possible under the original terms, there was nothing to encourage ING to repay early while the ING share price remained significantly below €15 (which it did throughout the period, as shown in Figure 1). The possibility of the state receiving the 50% premium was remote and uncertain. According to the appellants, the Commission had therefore erred in considering that repurchase of the securities at €15 in the course of the first three years would be a realistic option. It followed that the state had behaved in the manner of a private investor, making an amendment that exchanged a speculative return of 50% for a certain return of between 15% and 21.5%.<sup>5</sup>

In contrast, according to the Commission, the MEIP test should not apply, and, even if it did, the amendment would fail the test.<sup>6</sup> The Commission pointed out that ING's share price had already risen from a low of around €2.50 to over €11, and that in 2001 ING shares had traded at €43. It was therefore certainly possible that the share price could rise to €15, the price at which ING said it would redeem the securities under the original repayment terms. As such, a private investor would not accept the lower return of the amended repayment option (which allowed ING to redeem half the securities at the issue price).

The Dutch state presented two financial reports which stated that, in the circumstances, it would have been more attractive for a private investor to obtain early repayment of half of their investment with an attractive return than to hope for a theoretical return of 50%. The Commission considered that these reports were irrelevant, having been prepared after the amendment of the payments terms and for the purposes of the General Court appeal.<sup>7</sup>

## Was it aid?

Clearly, markets had changed between November 2008 and November 2009—for example, in summer 2009 the *Financial Times* was reporting improvements to the market for European subordinated bank debt, noting the sale of subordinated debt with an 11% coupon by Dutch institution, Rabobank, as a sign of markets opening up.<sup>8</sup> Such market data could have been accessed by the Commission when examining the ING amendment, and therefore an MEIP assessment was not impossible.

In its judgment, the Court found that the comparison of the behaviour of the state with that of a private investor 'must be carried out taking into consideration the information available and foreseeable developments'.<sup>9</sup> It criticised the Commission for not examining the economic rationality of the amendment to the repayment terms, saying that the MEIP test could, and should, have been applied in light of the developments in market conditions.<sup>10</sup>

The Court went on to say that the Commission was bound to analyse the data available in order to judge whether a private investor would have agreed to the amended repayment terms: the Commission could 'not therefore adopt the contested decision without taking such information into consideration and examining its effect on its assessment of the aid'.<sup>11</sup> This included the data on which the Dutch government's financial reports had been prepared. The Court found that the Commission had not carried out the requisite MEIP analysis—it complained of 'the absence of any examination in the contested decision of the economic rationality of the amendment to the repayment terms from the perspective of a private investor'.<sup>12</sup>

Finally, the Court itself assessed whether the amount of aid in the amendment could have been €2 billion, as the Commission found in its Decision. It noted that part of the amended terms removed the condition that payment of interest to the Dutch state would be contingent on the payment of a dividend to ordinary shareholders. As no dividend was paid by ING for 2009, the state received €258.5m in interest, incremental to the amendment, which the state would not have received under the original repayment terms. On this basis, the Court ruled that the amount of aid could not be as high as €2 billion, since the Commission had missed out this interest payment when it assessed the incremental effect of the amendment.<sup>13</sup>

Beyond the Court's assessment, it can be seen that standard financial option pricing techniques could have been used to assess the existence and quantum of aid. The interest component of the amendment had a negative value to ING, whereas the reduction in the strike price of the option had a positive value to ING. The net effect of these two components can be valued. For example, it is straightforward to value the

difference between two call options on ING equity with exercise prices of €15 and €10, by applying the Black–Scholes option pricing formula.<sup>14</sup> A quick calculation using this formula suggests that the benefit to ING of the amendment to the repurchase price could be considerably lower than the cost of interest (€258.5m) due to the Dutch state. On this basis, it might be concluded that the ING amendment should have passed the MEIP test, since the amended repayment terms appear to have constituted a positive financial development for the Dutch state.

## Implications for the MEIP and for other aid recipients

The judgment is a reminder that the MEIP is truly at the heart of the assessment of state aid under the EU rules. It also shows that the General Court can engage in economic analysis of the facts. The Court notes that, although the Commission has a broad discretion regarding economic assessment, this 'does not imply that the European judicature must refrain from reviewing the Commission's interpretation of economic data'.<sup>15</sup>

The judgment demonstrates that the aid granted to financial institutions at different moments of the global financial crisis should not be painted with a broad brush. The Court notes the differences between the market conditions in November 2008 and November 2009: investors could 'have been interested in [ING] securities in November 2009, when the financial crisis was less strongly felt and it was possible to believe that the market return could have been lower'.<sup>16</sup> This indicates that the state aid assessment should always be sensitive to market conditions—and to the availability of private capital at the relevant point in time. Further assistance provided to banks, perhaps in response to losses on sovereign debt, ought to be assessed on this basis.

<sup>1</sup> General Court of the European Union (2012), 'Judgment in Joined Cases T-29/10 Netherlands v Commission and T-33/10 ING Groep NV v Commission', Luxembourg, March 2nd. European Commission (2010), 'Commission Decision of 18 November 2009 on State aid C 10/09 (ex N 138/09) implemented by the Netherlands for ING's Illiquid Assets Back Facility and Restructuring Plan', OJ 2010 L 274, p. 139.

<sup>2</sup> If ING chose the conversion option, the state would have the option of redeeming its securities at €10, plus accrued interest. A coupon on the debt would be paid only if ING were paying a dividend on its ordinary shares.

<sup>3</sup> A condition was that ING's share price traded above €10. The interest was to be based on an annual coupon of 8.5%, and an interest payment was no longer conditional on whether ING paid a dividend on its ordinary shares.

<sup>4</sup> Since in the original deal ING would have paid a 50% premium on early redemption, the state would have received €2.5 billion if half of the shares were redeemed at €15. As such, the amendment was said to give ING an advantage worth around €2 billion after the early-redemption penalty.

<sup>5</sup> General Court of the European Union (2012), op. cit., para 84.

<sup>6</sup> Specifically, the Commission said that the MEIP should not apply to an additional measure in favour of the recipient of state aid that is being restructured. It also argued that the amendment to repayment terms cannot be separated from the initial capital injection, and therefore the amendment cannot be scrutinised separately under the MEIP.

<sup>7</sup> General Court of the European Union (2012), op. cit., para 90. Additionally, the Commission thought the reports were not sufficiently substantiated or based on a clear methodology.

<sup>8</sup> *Financial Times* (2009), 'Hybrid Tier One Market Wakes Up', June 1st.

<sup>9</sup> General Court of the European Union (2012), op. cit., para 98.

<sup>10</sup> *Ibid.*, paras 118 and 119.

<sup>11</sup> *Ibid.*, para 123.

<sup>12</sup> *Ibid.*, para 119.

<sup>13</sup> *Ibid.*, para 140. The Court said that the amount of aid 'must necessarily be lower than [€2 billion], reduced in proportion to the interest accrued when the repayment was made.'

<sup>14</sup> A model used to calculate the value of an option, by considering the stock price, strike price and expiration date, risk-free return, and the standard deviation of the stock's return.

<sup>15</sup> General Court of the European Union (2012), op. cit., para 102.

<sup>16</sup> *Ibid.*, para 121.

If you have any questions regarding the issues raised in this article, please contact the editor, Leonardo Mautino: tel +44 (0) 1865 253 000 or email [l\\_mautino@oxera.com](mailto:l_mautino@oxera.com)

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