Subject: State aid scheme No N 512/2008 – Germany
Rescue package for credit institutions in Germany

Sir,

I. PROCEDURE

(1) On 14 October 2008 Germany notified the above-mentioned aid scheme to the Commission. On 27 October 2008 Germany transmitted an extensive set of commitments to be fulfilled when the package of measures is implemented.

II. DESCRIPTION OF THE AID SCHEME

1. Legal basis

(2) In order to stabilise the financial market the Federal Republic of Germany passed the Financial Market Stabilisation Act (Finanzmarktstabilisierungsgesetz – “FMSStG”) on 18 October 2008. To finance the measures a Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfonds – “Fund”) was established, backed by Germany. Borrowing by the Fund will be financed by issuing debt up to a maximum amount of EUR 100 billion. Further details regarding the administration of the Fund and the corresponding framework conditions are set out in an accompanying statutory order, the Financial Market Stabilisation Fund Order (Finanzmarktstabilisierungsfonds-Verordnung – “FMSStFV”), which entered into force on 20 October 2008.

2. Object of the aid scheme

(3) The object of the FMSStG is to stabilise the financial market. It seeks to create a sustainable mechanism for overcoming financial institutions’ current cash-flow

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difficulties and strengthening the stability of the German financial market. The aid scheme consists of three elements:

A. **Recapitalisation of enterprises**: Participation in enterprises in the financial sector. Acquisition of shares, silent participations or other items constituting own resources up to a maximum of EUR 80 billion.

B. **Asset swap (“risk assumption”)**: Within the limits of the joint ceiling referred to at A of a total of EUR 80 billion, temporary assumption, whether by acquisition or otherwise, of the risk associated with the risk positions acquired by financial sector enterprises before 13 October 2008, including in particular receivables, transferable securities, derivative financial instruments, rights and obligations under loan commitments or warranties and participations, in each case including the related collateral.

C. **Guaranteeing of liabilities**: Provision, in return for an appropriate remuneration, of a guarantee up to an amount of EUR 400 billion for financial sector enterprises’ newly issued debt instruments with a term of up to 36 months.

(4) The FMStG was adopted against the background of a dramatic worsening of the existing tensions in the financial markets and of the resulting global turbulence. Germany has not been immune to these international developments. The direct effects of the crisis and the difficult market environment are leading to a tight liquidity situation for financial institutions. The viability of the German financial system, which makes an important contribution to the functioning of the entire economy and hence to growth and employment in Germany, is suffering under the impact of the current financial crisis. The central task of the FMStG is therefore to ensure temporary support for the financial system and to restore confidence among market players.

3. **The beneficiaries**

(5) Access to the aid scheme is reserved for enterprises in the financial sector, i.e. essentially banks and insurance companies¹. Besides German financial institutions, German subsidiaries of foreign institutions can also take part.

(6) There is, however, no legal right to benefit from the planned measures. Instead, under Section 4 FMStG, the Federal Ministry for Finance takes a decision at the request of an enterprise, according to its best judgment and in the light of how important the enterprise covered by the stabilisation measure is to financial market stability, the urgency of the situation and the principle of the most effective and most economical possible use of the Fund’s resources. The German authorities have given a commitment that the importance of financial sector enterprises to financial market stability within the area of validity of the Act will be assessed in particular in the light of their balance sheet total, their level of deposits, the part they play in the nation’s payments system, and their general importance to maintaining confidence in the stability of the financial market.

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¹ Business secret

Pursuant to Section 2 FMStG, such enterprises comprise institutions within the meaning of Section 1(1)(b) of the Banking Act, insurance companies and pension funds within the meaning of Section 1(1) Nos 1 and 2 of the Insurance Supervision Act, investment companies within the meaning of the Investment Act and the operators of stock or futures exchanges and their respective parent companies, in so far as these are financial holding companies, mixed financial holding companies or supervised financial conglomerate companies having their registered office in Germany. Financial sector enterprises also include private bodies vested with authority over public Landesbanken, even where such bodies are not financial holding companies.
(7) Under Sections 2 and 4 FMStFV, the guarantee provision and the risk assumption will be directed only at solvent financial sector enterprises, which in principle presupposes that beneficiary enterprises will be adequately capitalised. The German authorities have given a commitment that only credit institutions with a Tier 1 ratio of at least \( \geq 6 \)* will be able to avail themselves of a guarantee or an asset swap – even allowing for a recapitalisation pursuant to Section 3 FMStFV. This commitment applies *mutatis mutandis* to financial sector enterprises which are not credit institutions.

(8) With regard to enterprises which seek recapitalisation pursuant to Section 3 FMStFV, the German authorities have given a commitment that as a rule only enterprises which undertake to bring their capital base into line with the above-mentioned requirements will be recapitalised. Beneficiary credit institutions will also have to ensure as part of the review of their commercial policy under Section 5(2) No 1 FMStFV that they do not fall short of the minimum regulatory capital under Basel II plus \( \geq 1\% \), a requirement which will be regularly reviewed as part of the reporting obligations.

4. **Description of the measure**

A. **Recapitalisation of enterprises**

(9) Under Section 7 FMStG, the Fund can participate in the recapitalisation of enterprises in the financial sector in any suitable form. In particular, it can in return for a capital contribution acquire shares or silent participations and other items constituting the own resources of such enterprises, including those created by *Land* legislation.

(10) Under Section 9 FMStG, the ceiling for participation in own resources items is set at a total of EUR 80 billion. Under Section 3(2) No 3 FMStFV, the ceiling for participation in respect of individual financial sector enterprises is set in principle at EUR 10 billion. If the ceiling for participation in respect of individual enterprises is exceeded, a restructuring plan will be presented to the Commission.

(11) Under Section 3(2) No 1 FMStFV, the Fund is to receive a normal market remuneration. As a rule, a form of remuneration will be sought which takes precedence over the profit-sharing rights of the other shareholders in the beneficiary enterprise, e.g. in particular a preference dividend or an interest payment.

(12) In this connection the German authorities have given a commitment that only shares which have not been acquired by existing shareholders or placed on the market will be acquired. In the case of ordinary shares, the Federal Government will demand \([… a]\) discount on the price prevailing before the capital increase was announced.

(13) The German authorities have given a further commitment that in the case of preferred shares a normal market remuneration will be assured which will be not less than 10% a year, unless the Federal Government makes the capital injection with significant private sector involvement\(^2\) (at least \( \geq 25\% \)) on the same terms.

(14) Under Section 5(2) No 5 FMStFV, enterprises which are supported by a recapitalisation measure must first sell the Fund’s shares to a third party or repurchase them before they may once more distribute dividends to their shareholders. The German authorities have

given a commitment that any exceptions to this principle will be notified to the Commission.

(15) The stabilisation measures are, moreover, combined with various behavioural safeguards designed in particular to increase the accountability of the present owners and management. Thus, under Section 5(2) FMStFV, financial institutions participating in the recapitalisation will be required:

a) to review their commercial policy and its sustainability. In this connection the Fund may seek to ensure that especially risky lines of business are reduced or abandoned.

b) to take account of the borrowing requirements of domestic industry, and in particular of small and medium-sized enterprises.

c) to limit the remuneration of their executives and shareholders to that which is reasonable; “reasonable” implies in principle a cash remuneration of EUR 500 000 a year.

d) not to pay any bonuses as long as the enterprise is benefiting from stabilisation measures.

(16) The German authorities have also given a commitment that, as provided for in Section 5(5) FMStFV, beneficiary enterprises will have to fulfil further appropriate conditions with respect to their activities in order to avoid distortions of competition due to the stabilisation measures.

(17) In particular, the German authorities have committed to ensure within the framework of all three measures that financial institutions participating in the stabilisation measures do not, either individually or together, exceed a certain balance sheet growth rate based on previous years. This is limited to either the nominal gross national product growth rate of the past year, the average banking sector growth rate of the 20 years from 1987 to 2007, or the average Eurozone banking sector growth rate of the last six months, whichever is the highest. Should the limit be exceeded, the German authorities commit to take every step to remain within it unless they can prove that it was exceeded for reasons unconnected with the FMStG.

(18) Lastly, the German authorities have given a commitment with respect to enterprises supported by a recapitalisation measure to present a restructuring plan six months after the recapitalisation if the enterprise does not undertake to buy back the shares within six months.

B. Guaranteeing of liabilities

(19) Under Section 6 of the FMStG, the Fund may provide certain guarantees for liabilities of financial sector enterprises up to an amount of EUR 400 billion.

(20) Guarantees may be provided for new debt instruments issued or other liabilities (i.e. debt capital and non-Tier 1 and -Tier 2 capital) created by financial sector enterprises between the entry into force of the FMStG and 31 December 2009 and having a term of up to 36 months.

(21) The German authorities have given a commitment that the above-mentioned date of 31 December 2009 will apply only on condition that the crisis lasts until then and that they
will notify the Commission of any extension within six months of the Act’s entry into force.

(22) A remuneration of an appropriate amount per year is to be charged for the provision of guarantees. In accordance with Section 2 FMStFV, the German authorities have given a commitment that such remuneration will be regarded as a normal market remuneration if it includes a margin consisting as a rule of a provision premium of 0.5%, plus in all cases of debt instruments and other liabilities with a term of more than one year a risk premium corresponding to the individual financial institution’s credit default swap spread, being not less than the median of the financial institution’s five-year credit default swap spread between 1 January 2007 and 31 August 2008. According to the German authorities’ commitments, the minimum amount of the premium will be not less than the amount described by the European Central Bank in points 3-8 of its recommendations of 20 October 2008.

(23) The German authorities have also given a commitment that, as provided for in Section 5(5) FMStFV, financial institutions will avoid restrictions of competition as part of their activities by refraining in particular from advertising to the public using references to the provision of the guarantee. Financial institutions will also have to review their commercial policy and its sustainability. The Fund may seek to ensure that especially risky lines of business are reduced or abandoned (Section 5(3) FMStFV).

(24) Lastly, the German authorities have given a commitment that, in the event of the guarantee being called (Section 2 FMStFV) by an enterprise, the latter will present a restructuring or liquidation plan within six months.

C. Asset swap (“risk assumption”)

(25) Finally, under Section 8 FMStG, the Fund may acquire or otherwise secure risk positions acquired by financial sector enterprises before 13 October 2008, including in particular receivables, transferable securities, derivative financial instruments, rights and obligations under loan commitments or warranties and participations, in each case including the related collateral. The same applies to special purpose vehicles which have assumed the risk positions of a financial sector enterprise.

(26) Under Section 9 FMStG, a joint ceiling totalling EUR 80 billion is to apply to the risk assumption and to the participation in own resources items. Under Section 4(6) FMStFV, the ceiling for participation in respect of individual financial sector enterprises is set in principle at EUR 5 billion. Where the ceiling for participation in respect of individual enterprises is exceeded, the German authorities have committed to present a restructuring plan to the Commission in so far as no such plan has yet been presented. The German authorities have also committed to present a restructuring plan where the risk assumption exceeds 2% of an enterprise’s balance sheet total.

(27) The risk assumption by the State may take place until 31 December 2009. The German authorities have given a commitment that the above-mentioned date of 31 December 2009 will apply only on condition that the crisis lasts until then and that they will notify the Commission of any extension within six months of the Act’s entry into force. The German authorities have also given a commitment that the repurchase will take place at the latest 36 months after the risk assumption.
(28) In the context of Section 4(2) No 2 FMStFV, it is made clear that the risk assumption will be effected at the value shown by the seller in the last interim report, annual report or annual accounts or at a lower value against transfer of the debt instrument. If, however, at the time of repurchase the price is lower than the purchase price, i.e. if any loss of market value occurs upon expiry of the agreed term, the enterprise must as a rule compensate for the loss of value. The German authorities have made clear in this connection that the discretion allowed by Section 4(2) second sentence FMStFV (“may be required”) does not imply any prior renunciation but refers to the subsequent impossibility of making a compensatory payment resulting in a restructuring plan.

(29) The German authorities have also given a commitment in the context of Section 4 FMStFV that an appropriate remuneration will be paid to the Fund for the liquidity made available through the risk assumption of at least 12 months Euribor plus 50 basis points on the amount made available plus a risk premium corresponding to the individual financial institution’s credit default swap spread (being not less than the median of the financial institution’s five-year credit default swap spread in the last 12 months). The income from the risk positions assumed is to flow to the Fund, but will count towards the remuneration.

(30) A commitment has also been given that, during the period of the assumption of risk, the enterprise will have adequate own funds, the duration of the risk assumption will not exceed that of the risk positions and that, should it prove impossible to make compensatory payments for losses of market value upon expiry of the agreed term, a restructuring plan will be presented within six months in so far as no such plan has yet been presented.

(31) Lastly, the extensive behavioural safeguards governing recapitalisation will apply mutatis mutandis to the risk assumption, with the exception of paragraph 15 b).

III. COMMENTS FROM GERMANY

(32) The German authorities acknowledge that the notified scheme is in the nature of an aid measure. They stress, however, that the Federal Government has sought to make the individual measures as market oriented as possible.

(33) The German authorities point out that the package of measures is urgently needed in order to shield the German and European financial markets from damage due to the financial market crisis that has been steadily brewing since the summer of 2007. The insolvency of financial institutions and the resulting systemic risk would have dramatic consequences. Initially there would be “very severe disturbances in the money markets” in Germany and the European Union”. This would be followed by “considerable disruption” of payment transactions, such as transactions involving foreign exchange, securities or derivatives.

(34) The German authorities consider the aid scheme to be compatible with the common market inasmuch as it helps to “remedy a serious disturbance in the economy of a Member State” within the meaning of Article 87(3)(b) of the EC Treaty.

(35) A letter from the German Bundesbank dated 14 October 2008 confirms that the aid scheme is necessary to avert damage to the German and European financial markets.
The German authorities take the view that the notified aid scheme does not involve any undue distortions of competition or any harmful side effects for other Member States. The aid scheme is open to all German financial institutions and German subsidiaries of foreign institutions in Germany and is therefore not discriminatory. Germany gives in particular the following individual commitments.

The German authorities commit that the date referred to in Section 13(1) FMStG, namely 31 December 2009, will apply only on condition that the crisis lasts until then and the German Government notifies to the Commission an extension within six months of the Act’s entry into force.

The German authorities commit to report to the Commission on the support measures every six months.

The German authorities also commit to enforce extensive behavioural safeguards (see paragraphs 17 and 18 above) and specify how an appropriate remuneration for the measures is to be calculated.

IV. ASSESSMENT

1. Existence of aid

Article 87(1) of the EC Treaty states that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

The Commission agrees with the German authorities that the recapitalisation of financial institutions, the guarantees and the risk assumption for financial institutions affected by the crisis constitute aid to those institutions within the meaning of Article 87(1) EC.

The recapitalisation, the guarantees for new liabilities and the risk assumption will enable beneficiaries to secure the necessary capital and liquidity on more favourable terms than would otherwise be possible in the light of the prevailing conditions in the financial markets. Since this confers an economic advantage on beneficiaries and strengthens their position vis-à-vis their competitors in Germany and in other Member States, these measures distort competition and affect trade between Member States. The advantage is selective since it benefits only beneficiaries under the scheme and is provided through state resources.

It should be noted in particular that no market economy investor would have undertaken the recapitalisation, carried out the asset swap or provided the guarantee. With regard to the recapitalisation, the Commission would point out that a market economy investor expects a reasonable return on his investment\(^3\). However, if a firm is in difficulty or is active in a sector of the economy which is stricken in the way that the banking sector currently is, it is normally not justified to assume a reasonable return\(^4\). For the current

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4. The Commission has set out this position in various communications, including the communication on the application of Articles 92 and 93 of the EEC Treaty to public authorities' holdings (Bulletin EC 9-1984) and the communication

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scheme this is confirmed by the fact that the State is only investing because no market economy operator was willing to invest on a comparable scale on similar terms. Regarding the guarantee, the Commission is convinced that in the current circumstances of financial crisis no private investor would have been willing to provide so significant a guarantee on the participating financial institutions’ debt instruments and other liabilities. The same applies to the risk assumption, as this relates to covered risk positions for which no private investor would likewise be willing to pay the price then obtaining.

2. Compatibility of the financial support measures

a) Application of Article 87(3)(b) of the EC Treaty

(44) Germany intends to provide under a scheme in favour of financial institutions fresh capital and operating aid in the form of guarantees. Given the present circumstances in the financial market, the Commission considers that this measure may be examined directly under the Treaty rules and in particular under Article 87(3)(b) EC.

(45) Article 87(3)(b) empowers the Commission to declare aid compatible with the common market if it is intended “to remedy a serious disturbance in the economy of a Member State”. The Commission would point out that the Court of First Instance has expressly stated that Article 87(3)(b) EC is to be applied restrictively so that the aid may not benefit only one firm or one sector of the economy, but must serve to remedy a disturbance in the whole economy of a Member State.

(46) The Commission considers that the present scheme concerns the entire German banking industry. It does not dispute the analysis of the German authorities that the current global financial crisis has made access to liquidity more difficult for financial institutions across the board and has also eroded confidence in financial institutions’ creditworthiness. If the issues of lack of liquidity and lack of confidence are not addressed, it will result not only in difficulties for the banking sector but, owing to that sector's pivotal role in providing financing to the rest of the economy, will also have a systemic effect on the German economy as a whole. The Commission does not dispute that the present scheme is designed to address the problems of the lack of liquidity and lack of confidence that are currently striking German financial institutions. Therefore it finds that the scheme aims at remedying a serious disturbance in the German economy.

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b) Conditions for the application of Article 87(3)(b) of the EC Treaty

According to the Commission communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, it must be stressed in the context of the application of Article 87(3)(b) EC that an aid measure or scheme may be declared compatible with the common market only if it satisfies the general criteria for compatibility under Article 87(3) EC viewed in the light of the general objectives of the Treaty and in particular Articles 3(1)(g) and 4(2) EC, which imply compliance with the following conditions:

a. Appropriateness: The aid measure must be precisely targeted at its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the measure is not appropriate to remedy the disturbance.

b. Necessity: The aid measure must, in its amount and form, be necessary to achieve the objective. This implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g. a temporary and limited guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.

c. Proportionality: The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure’s objectives. This follows from Article 3(1)(g) EC and Article 4(1) and (2) EC, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87(1) EC prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87(3)(b) EC which authorises state aid must ensure that such aid is limited to that which is necessary to achieve its stated objective, limiting to a minimum consequential distortions of competition.

c) Assessment of the recapitalisation scheme

The objective of the recapitalisation scheme is to ensure that financial institutions are sufficiently strongly capitalised so as to better withstand potential losses. The Commission has already observed in several cases that fair-value assessments of securities can in the ongoing financial turmoil have such detrimental effects on a bank’s balance sheet that its capital risks falling below the minimum levels required. This has given rise to fears about the creditworthiness of financial institutions. The German

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10 See judgment in Case 730/79 Philip Morris [1980] ECR 2671. This line of authority was recently reaffirmed by the Court of Justice in its judgment of 15 April 2008 in Case C-390/06 Nuova Agricast v Ministero delle Attività Produttive, where the Court held that "As is clear from Case 730/79 [...] aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market".
Government accordingly intends to undertake a public sector capital intervention. This is in principle an appropriate means to strengthen the financial institutions and thus to restore market confidence\(^{12}\).

(49) In addition, the Commission notes that the scheme is in principle not aimed at enterprises in difficulty but applies to enterprises whose capital base is only to be strengthened against possible losses. The provision of capital is thus intended to prevent enterprises which are fundamentally sound from falling into difficulties as a result of the existing ongoing crisis. The scope of the recapitalisation scheme therefore seems appropriate to strengthening the German banking sector and to contributing to the revival of interbank lending in Germany.

(50) The recapitalisation scheme is limited to the minimum necessary in scope and time.

(51) As regards scope, the Commission noted previously that several measures might be possible to restore confidence in the banking sector\(^{13}\). It concluded that for Denmark a guarantee scheme was essentially sufficient. However, this does not mean that in other situations other means are not necessary. Indeed not all financial institutions in the different Member States may at the moment experience the same distress because of extreme conditions in financial markets. While some might only suffer from a shortage of liquidity, others might be more exposed to fair-value losses. However, the problem of write-downs cannot be solved solely with a guarantee on debt but also requires confidence building measures aimed at restoring the trust of third parties in German financial institutions. In this respect the Commission considers that recapitalisation can be an appropriate measure\(^{14}\).

(52) With regard to the scope of the measure, the Commission notes positively that Germany has limited the size of the recapitalisation scheme and that the scheme initially applies for six months.

(53) Secondly, as regards proportionality, the irreversible nature of capital injections entails the need that the scheme must establish some clear ex ante behavioural safeguards which the Member State must monitor and enforce in order to ensure their observance and to take steps avoiding undue distortions of competition\(^{15}\).

(54) Adequate safeguards would ensure that the State must, despite the current market conditions, obtain an adequate minimum return on its investment\(^{16}\). This is presently achieved by the issuance of preferred shares with an annual interest rate to be paid that amounts to at least 10%, unless the Fund makes the capital injection with significant private sector involvement\(^{17}\) (at least \([> 25\%]\) on the same terms. The latter safeguard

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\(^{12}\) See Commission decision of 10 October 2008 in Case NN 51/2008 Guarantee scheme for banks in Denmark, not yet published, paragraph 42.


\(^{15}\) See in particular the Commission communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, point 27.


ensures that the rate of return is determined in accordance with a market-oriented valuation. The former corresponds to what the Commission currently considers acceptable.\footnote{Commission decision of 13 October 2008 in Case N 507/2008 Guarantee scheme for banks in the United Kingdom, not yet published, paragraph 49, where a figure of about 12% was taken as a basis.}

(55) The Commission bases the 10% return in particular on comparable market-oriented investments. It would recall that in September 2008 banks with a lower investment grade (from A to BBB) already paid from 10% to 12.5% interest for their borrowings. These interest rates have increased even further in recent weeks. Since preferred shares are more risky than equity, they must be placed at least\footnote{The fact that reference is made here to the lower limit of a 10% minimum return on the preferred shares must be viewed also against the background of the numerous constraints on the banks relying on the recapitalisation to which Germany has committed itself.} on the same level.

(56) The State must likewise, as regards its participation in the ordinary share capital through share purchases, align itself as much as possible on the behaviour of a market economy investor by providing that the issue price of the shares should be fixed on the basis of a market-oriented valuation (see paragraph (12) above).

(57) Moreover, the behavioural commitments indicated above in paragraphs (16) to (19), in particular the commitment by the financial institutions not to allow their balance sheets to grow faster than at agreed indicative rates, should ensure that the institutions do not engage in aggressive commercial strategies or expansion of their activities or other purposes that would imply undue distortions of competition\footnote{Commission decision of 13 October 2008 in Case N 507/2008 Guarantee scheme for banks in the United Kingdom, not yet published, paragraph 53.}. In that context, the fact that the law requires the financial institutions to review their operations and to limit to a certain extent the remuneration of their executives and shareholders is also viewed favourably.

(58) Finally, the Commission welcomes the fact that the German authorities have given a commitment that they will within six months of implementation of the measure present a restructuring plan\footnote{In order to facilitate the work of the Member States and the Commission, the Commission will be prepared to examine grouped notifications of similar restructuring cases. The Commission may also consider that there is no need to submit a plan relating to a pure liquidation of the institution, or where the size of the residual economic activity is negligible.}. Such plans are the cornerstone of the Community Guidelines on State aid for rescuing and restructuring firms in difficulty\footnote{OJ C 244, 1.10.2004, p. 2.} (hereinafter called "the R&R guidelines"), which articulate the Commission's understanding of Article 87(3)(c) EC for this type of aid. For any aid to a firm in difficulty, it is in the common interest that the firm returns to long-term viability and that this is sufficiently scrutinized by means of the restructuring plan. However, and also in line with the R&R guidelines, the Commission will not require such a plan where the beneficiary has redeemed the State's stake within six months or commits itself to doing so in the next six months, or where the stake has been sold on within six months\footnote{Commission decision of 13 October 2008 in Case N 507/2008 Guarantee scheme for banks in the United Kingdom, not yet published, paragraph 54.}. If the latter requirement is not fulfilled, however, a restructuring plan must be presented.

(59) On the basis of the above, the recapitalisation scheme can be considered compatible with the common market.
d) **Assessment of the guarantee scheme**

(60) The objective of the guarantee scheme is to provide a safety net for investors in newly issued debt of participating institutions in Germany, so that such institutions can have sufficient access to liquidity. This is a reaction to the international market conditions in which even healthy financial institutions are having trouble gaining access to liquidity. The Commission has established that such a guarantee scheme should help to overcome these difficulties by allowing a revival of interbank lending and considers it therefore to be an appropriate means.

(61) Moreover, the scheme is targeted at the appropriate beneficiaries as the eligibility of participating firms is limited to solvent enterprises. Thus, the Commission considers that the design of the present scheme is appropriate to address the problem of refinancing currently faced by German financial institutions.

(62) As regards necessity, the guarantee mechanism, whereby a safety net is established to cover all newly issued debt against institutions in Germany, is limited to the minimum necessary in scope and time.

(63) As regards scope, the Commission does not dispute that the guarantee scheme is needed to restore confidence among lenders. A guarantee on retail deposits would not be sufficient as it would only avoid bank runs but not restore confidence among institutional lenders. Moreover, the Commission notes positively that Germany is limiting the guarantee to the form of financing that is experiencing the greatest problems at the moment, namely short-to-medium-term interbank financing. Firstly, subordinated debt is not guaranteed. Secondly, existing debt is not covered but only newly issued debt and only such debt that is short- and medium-term. Thirdly, Germany has also limited the scope of the guarantee scheme so that financial institutions initially have only a window of six months to issue the new debt that will benefit from the guarantee.

(64) The fact that the Act does not exclude covered bonds, the guarantee applying instead to all debt instruments, is not problematic as the level of the remuneration ensures that the guarantee will only exceptionally be called for such debt instruments.

(65) The German guarantee will apply to newly issued debt for up to three years. However, the Commission normally considers that two years is the longest period necessary for such a scheme to safeguard financial stability by facilitating the resumption of interbank

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26 See Commission decision of 10 October 2008 in Case NN 51/2008 Guarantee scheme for banks in Denmark, not yet published, paragraph 47.

27 A different system governs the guarantee in Denmark (see Commission decision of 10 October 2008 in Case NN 51/2008 Guarantee scheme for banks in Denmark, not yet published), where the guarantee, had it been applicable to such debt instruments, would have automatically extended to them.
lending\textsuperscript{28}. Notwithstanding this, the Commission notes positively an additional safeguard in the present scheme in that it has a shorter issuance period (i.e. initially six months) than two years\textsuperscript{29}. This means that already after six months the guarantee will not be used any more for newly issued debt. In this way the overall amount of debt covered can actually be much lower than if the guarantee were given for newly issued debt over two years. The temporal scope is thus also justified.

(66) As regards proportionality, the distortion of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market-oriented premium. It can be estimated that in this way financial institutions will pay on average an adequate premium. The premium to be paid by financial institutions corresponds to at least the amount described by the European Central Bank in points 3-8 of its recommendations of 20 October 2008. The European Central Bank bases itself in its recommendation on a provision premium of as a rule 0.5\% and a risk premium corresponding to the credit default swap spread of the individual financial institution.

This premium can be considered proportionate as it corresponds in its broad lines to previous decision-making practice\textsuperscript{30}. The Commission notes, moreover, that the premium is based on the calculations in the European Central Bank’s recommendations, the objective of which is to propose a generally appropriate premium for all countries in the euro area.

(67) Finally, the scheme includes several strong behavioural constraints which help to ensure that participating financial institutions do not expand their activities under the scheme and thus do not receive more support than is necessary for re-establishing their long term viability\textsuperscript{31}. This concerns a limitation of the expansion of activities on an individual and an aggregate level of all participating financial institutions against clear benchmarks (see paragraph (16)).

e) Assessment of the asset swap

(68) As in the case of the guarantee scheme, the objective of the asset swap is to ensure that financial institutions have sufficient access to liquidity. At the same time, the temporary acquisition of assets should enable tied-up equity to be released.

(69) This is a reaction to the international market conditions which are making it difficult even for healthy financial institutions to gain access to liquidity, in particular because the market for certain secured debt instruments has dried up. The Commission has established not only that a guarantee scheme is appropriate to restoring interbank lending, but also that an asset swap can be an effective way of supporting ailing financial institutions\textsuperscript{32}. The asset swap is thus also an appropriate means of overcoming the current difficulties.

\textsuperscript{28} See Commission decision of 10 October 2008 in Case NN 51/2008 Guarantee scheme for banks in Denmark, not yet published, paragraph 47.


\textsuperscript{31} A similar principle is contained in point 44 of the R&R guidelines.

(70) The scheme is directed, moreover, at suitable recipients inasmuch as only solvent enterprises are eligible for support. The Commission therefore considers, as in the case of the guarantee, that the approach taken by the present scheme is appropriate to resolving the refinancing problem currently facing German financial institutions.

(71) As far as necessity is concerned, the mechanism consisting in a temporary acquisition of certain assets of financial institutions in Germany is limited to the minimum necessary in scope and time.

(72) Materially, the asset swap is designed as a de facto repo transaction. It is organised in such a way that the seller sells the asset for the same price as that for which the asset subsequently has to be de facto sold back to the seller or a third party, as in the event of any loss of value upon expiry of the agreed term the seller must offset the loss to the State or, exceptionally, present a restructuring plan. In this respect, it is not so much the risk underlying the debt instrument that is relevant, since the actual risk is the default of the debtor. This makes the asset swap comparable to a guarantee, the only difference being that it is not a third party but the State itself that is making liquidity available. It must therefore be ensured that the State is properly remunerated for the costs of the guarantee and of providing the liquidity33.

(73) The asset swap scheme will apply for a maximum of three years. As indicated above, the Commission considers that two years is the longest period necessary to ensure the stability of the financial system through a revival of interbank lending with the help of such a scheme. Notwithstanding this, the Commission notes positively an additional safeguard in the present scheme in that the time limit for the asset swap is shorter than two years (i.e. again six months initially).

(74) As regards proportionality, here too the distortion of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market-oriented premium. It can be estimated that in this way financial institutions will on average pay an adequate premium. They will thus have to pay at least 12 months Euribor plus 50 basis points plus the median of the 5-year CDS spread over the 12-month period ended on 23 October 2008 for each institution.

(75) Finally, the scheme includes the same safeguards as the recapitalisation which help to ensure that participating financial institutions do not expand their activities under the scheme and thus do not receive more support than is necessary for re-establishing their long-term viability.

f) General requirements for the compatibility of aid schemes under Article 87(3)(b)

(76) First, the Commission notes that the German authorities have given a commitment to report to the Commission on the support measures every six months.

(77) Secondly, the Commission notes that all the measures are temporary and hence are shaped in accordance with the European state aid rules, being limited initially to a period of six months with a possibility of extension should the crisis persist.

33 Commission communication on the application of state aid rules to measures taken in relation to financial institutions in the context of the current financial crisis, point 40.
DECISION

The Commission concludes that the measure constitutes a state aid scheme within the meaning of Article 87(1) of the EC Treaty.

Since the above-mentioned conditions for aid under Article 87(3)(b) of the EC Treaty are met, it is compatible with the common market, with the result that the Commission raises no objections to it.

The Commission would point out that, according to the commitment given by Germany, the measure is limited in duration to six months and that any extension needs to be notified to the Commission.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within five working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/community_law/state_aids/index.htm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Registry
Rue de la Loi/Wetstraat, 200
1049 Brussels,
Belgium
Fax: (32-2) 296 12 42

For the Commission

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