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In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].

PUBLIC VERSION

WORKING LANGUAGE

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Subject: **State aid N 164/2009 – France**

Amendment to the capital-injection scheme for banks

Sir,

1. PROCEDURE

(1) On 8 December 2008 the European Commission approved[1] the French capital–injection scheme for banks deemed essential for financing the economy. That decision approved capital injections of up to EUR 21 billion in favour of six banks.

(2) On 28 January 2009 the European Commission authorised France[2] to amend the capital–injection scheme for banks in order to allow them to make a choice, for the second tranche, between deeply subordinated securities (TSS – *titres super subordonnés*) and preference shares, both of them eligible for the banks' Tier 1 ratio.

(3) On 16 March 2009 the French authorities notified to the Commission a new amendment to the scheme. Additional information was received on 19 March 2009.

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[1] Decision C(2008) 8278 of 8 December 2008, not yet published.

[2] Decision C(2008) 597 of 28 January 2009, not yet published.

His Excellency Mr Bernard Kouchner
Minister for Foreign Affairs
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2. DESCRIPTION OF THE SCHEME AND THE NOTIFIED AMENDMENTS

A) The scheme approved by the decision of 8 December 2008

(4) As a reminder, the French authorities have established a state-owned investment company (SPPE – *Société de Prise de Participation de l'État*), whose sole shareholder is the French State. They used hybrid debt securities, the TSS, qualifying as Tier 1 capital. The first tranche reinforced the Tier 1 capital ratio of each of the beneficiary banks by around 0.5%.

(5) The main features of the TSS subscribed by the SPPE, described in more detail in the decision of 8 December 2008, are as follows:

(6) The remuneration for the TSS takes place in two phases:

i. a remuneration based on a fixed entry rate during the first phase of five years;

ii. a remuneration based on a variable rate after the first phase.

(7) The fixed entry rate for the first five-year phase is based on the following formula: the five-year BTAN + 300bps + 5xCDS (five-year seniority).

(8) The variable rate applicable[3] after the first five-year phase is based on the following formula: EURIBOR + 250bps + 5xCDS (five-year seniority).

(9) In these formulae:

i. the five-year BTAN (*bon à taux annuel normalisé*) is the average rate of the five-year government bonds over the twenty days preceding the issuance;

ii. CDS (five-year seniority) is: (i) the average value of the beneficiary's five-year CDS (credit default swap) over the period between 1 January 2007 and 31 August 2008, if the beneficiary has a CDS; (ii) the average five-year CDS for the beneficiary's rating category over the period between 1 January 2007 and 31 August 2008, if the beneficiary does not have a representative CDS but has a rating.

B) The first amendment approved by the decision of 28 January 2009

(10) For the second tranche of the recapitalisation, the French authorities have allowed eligible banks to choose, before 30 August 2009, between the following two instruments:

i. TSS on the terms approved by the decision of 8 December 2008;

ii. preference shares on the terms approved by the decision of 28 January 2009. These are the terms that France wishes to amend.

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[3] The definition of this variable rate ensures the same level of remuneration for both phases. It takes into account the risk premium included in the EURIBOR rate.

a) Intervention based on preference shares

Terms of the preference shares

(11) The preference shares are ranked *pari passu* among themselves and with ordinary shares in both the event of continuity of business and that of liquidation. From a prudential point of view, they represent core capital that is eligible without limit as core Tier 1 capital. The preference shares[4] cannot be converted into ordinary shares. They cannot account for more than 50% of a non-listed company's capital or 25% of a listed company's capital.[5]

Remuneration

(12) Under the scheme approved on 28 January 2009, the issuer must pay an annual coupon equal, within the limit of the double of the TSS entry rate, to the highest of the following two rates:

i. The TSS entry rate increased every year by 25 basis points – the first increase in 2010 – added to the current value[6] of the preference shares, so that beginning with the seventh exercise the rate will be the TSS rate + 150 basis points;

ii. The rate equal to 105% of the dividend per share paid to ordinary shareholders for 2009 divided by the unit issue price of preference shares, 110% for 2010, 115% for 2011-2017 and 125% for 2018 and subsequent exercises.

(13) It is mandatory to suspend the remuneration if (i) the sums available for distribution are insufficient, (ii) dividend payments to ordinary shareholders are suspended or (iii) a prudential event occurs.

(14) In the event of a distribution of dividends, payments to preference shareholders have priority. The remaining amount available for distribution after the dividend payments to preference shareholders will be paid to ordinary shareholders.[7]

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4 Holders have the same rights as the holders of ordinary shares with the exception of voting rights and the preferential subscription right in the event of a capital increase. However, in the event of changes in the issuer's capital (particularly an increase), the terms of remuneration for preferential shareholders must remain unchanged.

5 Under section L. 228-11 of the Commercial Code.

6 Current value: the subscription price of the preference shares (i) reduced by the total losses suffered by the subscription price (ii) increased by the share of reconstituted capital.

7 It is necessary to recall that in order to be recognised as part of the banks' core Tier 1 capital, preference shares have to be ranked *pari passu* with ordinary shares in both the case of continuity of business and that of liquidation. The result is the suspension of remuneration for preference shares in the event of a suspension of remuneration for ordinary shares.

Repurchase

(15) Subject to prior approval by the Secretariat-General of the Banking Commission, the issuer can repurchase the preference shares at a price equal to the highest of the following two values:

i. 110% of the current value increased by the reconstitutable capital;

ii. the average price of underlying shares over the 30 days preceding the repurchase date.

(16) In any event, the repurchase price cannot be higher than 120% of the preference share's subscription price if the repurchase occurs before 30 June 2013; 130% if the repurchase occurs between 1 July 2013 and 30 June 2016; 140% if the repurchase occurs between 1 July 2016 and 30 June 2019; 150% if the repurchase occurs between 1 July 2013 and 30 June 2022; 160% if the repurchase occurs after 1 July 2022.

b) Budget

(17) The French authorities wanted to adjust the amount of the second tranche to take into account the merger of the central bodies of the Caisses d'Épargne and the Banques Populaires within the limit of 50 basis points of the Tier 1 ratio of the new entity, representing a maximum of EUR 500 million. The maximum amount earmarked for the second tranche is therefore EUR 11 billion (instead of the EUR 10.5 billion initially earmarked by the decision of 8 December 2008).[8]

c) Window of intervention

(18) Given the uncertainties weighing on the financing of the economy in 2009 and the time needed to issue preference shares[9], the French authorities wished to give banks the possibility to choose the form of the second tranche, TSS or preference shares subscribed by the State, at the latest by 30 August 2009. The French authorities also wished to allow the banks that had benefitted from the first tranche of capital injection to reimburse it and issue in its stead and in similar amounts preference shares based on the terms outlined below.

(19) The behavioural commitments agreed between the beneficiary banks and the State, approved by and outlined in the decision of 8 December 2008, are equally applicable to the second tranche.

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[8] See paragraphs 23 and 24 of the decision of 28 January 2009.

[9] The issuance of preference shares by a bank requires the approval of an extraordinary general meeting of the shareholders, which cannot be convened in less than 35 days. The earliest possible meeting date, after the publishing of the results for the fiscal year 2008, was the second half of February.

C) The new amendment notified on 16 March 2009

(20) According to the French authorities, the banks do not have sufficient incentives to repurchase preference shares during the early years of the scheme, because of the features of their repurchase price.[10] France would therefore like to introduce new repurchase terms that would provide banks with more incentives to repurchase preference shares.

a) The new remuneration for preference shares proposed by France

(21) France has proposed a system of remuneration for preference shares under which the issuer must pay[11] an annual coupon, within the limit of the double of the TSS entry rate, equal to the highest of the following two values:

- i. the fixed TSS entry rate increased every year by 25 basis points beginning with the first year – the year 2009 instead of the year 2010 as initially envisaged under the scheme approved by the Commission in January 2009 – applied to the current value of the preference shares, so that beginning with the sixth exercise the rate will be the TSS rate + 150 basis points; or
- ii. the rate indicated in the decision of 28 January 2009[12], namely a progressive rate indexed to the dividend per share paid to ordinary shareholders.

(22) Under current market conditions, applying the fixed TSS rate formula, as approved by the Commission in January 2009, would create rate floors for the preference shares issued by the six eligible banks during the first exercise [of about 8%][*].

b) The new repurchase terms for preference shares proposed by France

(23) France has proposed that the issuing bank be allowed to repurchase preference shares, with prior approval by the Secretariat-General of the Banking Commission, on the following terms:

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[10] To date, no bank has issued preference shares under the scheme approved by the Commission in December 2008 and January 2009.

[11] As under the scheme in the form approved in January 2009, suspending the remuneration is mandatory if (i) the sums available for distribution are insufficient, (ii) dividend payments to ordinary shareholders are suspended or (iii) a prudential event occurs, and any dividend distribution by the issuer during a particular exercise must give priority to preference shareholders (the remaining amount available for distribution after paying the preference shareholders will be paid to ordinary shareholders). See paragraphs 17 and 18 of the decision of 28 January 2009.

[12] See paragraph 12(ii) of the present decision, repeating paragraph 16(ii) of the decision of 28 January 2009.

[*] Confidential information.

Terms applicable until 30 June 2013:

(24) Repurchase at a price equal to the highest of the following two values:

i. the current value increased by the accrued coupon; or

ii. the average stock market price over the 30 days preceding the repurchase.

(25) In any event, under the new amendment proposed by France the repurchase price cannot be higher than 103% of the unit issue price of preference shares until 30 June 2010, 105% until 30 June 2011, 110% until 30 June 2012, 115% until 30 June 2013.

Terms applicable after 30 June 2013:

(26) Repurchase at a price equal to the highest of the following two values:

iii. 110% of the current value increased by the accrued coupon; or

iv. the average stock market price over the 30 days preceding the repurchase.

(27) In any event, under the new amendment proposed by France the repurchase price cannot be higher than 120% of the unit issue price of preference shares until 30 June 2014, 125% until 30 June 2015, 130% until 30 June 2017 and increasing after that up to 160% in 2022.

c) Additional monitoring measures

(28) Moreover, the French authorities have committed to send the Secretariat-General of the Banking Commission, for each bank and on the day when the notified operation occurs, a letter: (i) containing an analysis of the evolution of the bank's financial situation and prospects since the initial notification of the capital-injection scheme; (ii) confirming that the bank can still be considered fundamentally sound; (iii) and especially that to date there is no reason to believe that the bank would need a total amount of aid exceeding 2% of its risk-weighted assets (including already received recapitalisation but excluding financial aid under the Commission-approved scheme N548/08).

3. ASSESSMENT

A. State aid character of the assessed measures

(29) The notified amendments do not call into question the aid character acknowledged by the decision of 28 January 2009.

B. Compatibility of the scheme with the common market

1) Applicability of Article 87(3)(b) of the EC Treaty

(30) Article 87(3)(b) of the EC Treaty states that: '3. The following may be considered to be compatible with the common market: (b) aid ... to remedy a serious disturbance in the economy of a Member State.'

(31) The Commission notes that the market conditions that provided the basis for its decisions of

8 December 2008 and 28 January 2009 persist and that the notified measure is limited to a modification of the remuneration for and redemption of preference shares and does not involve any other changes in the terms of the scheme approved on 8 December 2008 and 28 January 2009. The Commission therefore considers that the notified measure is indeed designed to remedy a serious disturbance in the French economy.

2) Conditions for compatibility under Article 87(3)(b) of the EC Treaty

(32) The compatibility study must take into account the Commission Communication of 13 October 2008 on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis[13] (hereinafter 'the Banking Communication') as well as the Commission Communication of 5 December 2008 on the recapitalisation of financial institutions in the current financial crisis[14] (hereinafter 'the Recapitalisation Communication').

(33) According to the Banking Communication, in order to be compatible with Article 87(3)(b) of the EC Treaty, the measure must cumulatively fulfil the following three requirements:

i. The aid must first of all be well-targeted. The means must be appropriate for the objective, in this case to remedy a serious disturbance in the economy of a Member State;

ii. The aid must also be necessary, meaning that its value must be limited to the minimum necessary for achieving the objective and to the most appropriate means for remedying the disturbance in the economy. In other words, if another aid measure of a lower value or inducing less distortion of competition (for example, a temporary and limited guarantee instead of a capital injection) is sufficient to remedy the disturbance in the economy, the proposed measure cannot be considered necessary;

iii. Finally, the aid must be proportionate, in the sense that the distortion of competition that it causes or threatens to cause must be balanced against its positive effects. The distortion of competition must therefore be limited to the minimum necessary to achieve the desired effect.

(34) The Recapitalisation Communication provides a more detailed description of the principles that have to be applied to recapitalisations of financial institutions in order to make them compatible with the Community rules on state aid. In the case of temporary recapitalisations of fundamentally sound banks, the Commission can accept a minimum remuneration based on the methodology adopted by Eurosystem on 20 November 2008. The methodology includes the calculation of a price corridor with a risk premium of 200 basis points plus the bank's CDS spread for preference shares similar to subordinated debt and a risk premium of 600 basis points for the ordinary shares of euro area banks.

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13 OJ C 270, 25.10.2008, p. 8.

14 http://ec.europa.eu/competition/state_aid/legislation/specific_rules.html

Moreover, the Commission also demands sufficient incentives to encourage the redemption of the state participation when the market allows it.

3) Compatibility of the notified scheme with Article 87(3)(b) of the EC Treaty

Appropriateness

(35) As indicated above, the notified measure does not change the conclusions reached in the decisions of 8 December 2008 and 28 January 2009 on the context of state intervention, the compensatory measures asked from the banks and the monitoring and mediation mechanisms put in place. The Commission's assessment remains therefore unchanged by comparison with the two decisions mentioned above.

(36) Moreover, the Commission welcomes the French authorities' commitment to communicate to the Commission information that confirms the financial situation and long-term viability of the beneficiary banks at the moment of the recapitalisation. This information constitutes an additional guarantee that the scheme is reserved for fundamentally sound banks.

Necessity

(37) To assess the necessity of the measure, the Commission would refer again to its decisions of 8 December 2008 and 28 January 2009. The proposed modifications do not change in any way the Commission's conclusion that the amount of the measure is limited firstly to the minimum necessary to achieve the objective and secondly to the most appropriate means for remedying the disturbance in the economy.

Proportionality

(38) To assess the proportionality of the measure, the Commission must check that the distortion of competition caused by this kind of state intervention is limited to the lowest level possible given the risks of serious disturbance in the economy. According to the Recapitalisation Communication, to ensure that the aid is compatible with the common market, it is necessary to achieve a balance between the pursuit of common goals and the distortion of competition between Member States and between banks. Recapitalisation schemes must also ensure a return to normal market conditions.

(39) In this context, the Commission considers that the closeness of remuneration to the market level is the best guarantee to limit the distortion of competition.[15] 'Total remuneration must appropriately factor in the following elements:

i. the current risk profile of each beneficiary;

ii. the characteristics of the chosen instruments, including the level of subordination, risk and all modalities of payment;

[15] Cf. paragraph 19 of the Recapitalisation Communication.

iii. the built-in exit incentives facilitating the retreat of the State from the beneficiary's capital (such as step-up or early redemption clauses);

iv. an appropriate benchmark risk-free interest rate.'

(40) As in the decision of 28 January 2009, the Commission notes, with reference to the Recapitalisation Communication[16], that the methodology used by the French authorities is in line with the recommendations of the ECB and Eurosystem. The structure of the notified formula is appropriate because it includes a risk-free interest rate and the risk profile of each beneficiary through the credit-default swap (CDS) component, plus an additional cost. On the other hand, according to the Recapitalisation Communication, the proposed mechanism must include exit conditions encouraging financial institutions to repurchase the securities as soon as possible. The amendments proposed by the French authorities aim precisely at enhancing the incentives for redemption during the first years of the scheme by (i) lowering the redemption floor for preference shares from 110% to 100% of the par value for the period before 30 June 2013 and (ii) increasing the coupon risk premium by 25 basis points beginning with the first year. The two amendments – especially the first one – reinforce the conclusion reached in the decision of 28 January 2008, according to which the terms of remuneration (particularly the increase in the shares' coupon and repurchase price over time) constitute exit incentives that ensure the beneficiaries' return to the capital markets as soon as the situation improves and at the same time encourage the beneficiary banks to shorten the presence of preference shares subscribed by the State.

(41) It is also necessary to ensure that after the two notified amendments the absolute level of remuneration continues to be sufficient. The Commission notes first that the preference shares' entry rate is based on the TSS formula. This formula has already been validated by the Commission's decision of 8 December 2008.[17] Concerning the coupon, the amendments introduced by the French authorities lead to an entry rate that is 25 basis points higher than the TSS rate. The Commission notes that in the first year the risk premium paid to the State through the coupon amounts to 325 basis points plus five times the CDS of the bank concerned. This corresponds to a risk premium ranging in the first year from 490 basis points for the least risky bank to 565 basis points for the most risky bank. The risk premium increases then by 25 additional basis points every year. Moreover, this is a floor level, the actual levels of the coupon and the risk premium being higher in the event of a dividend increase. Furthermore, the Commission notes that the risk premium does not take into account the possibility of remuneration based on the redemption of the principal at a price higher than the par value, in the event of an increase in the share's market price. Overall, the risk premium is therefore compatible with the recommendations of Eurosystem. The Commission therefore concludes that after the two notified modifications the level of remuneration continues to be sufficient in the context of the Recapitalisation Communication.

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[16] Cf. paragraph 28 of the Recapitalisation Communication.

[17] Cf. paragraphs 101 to 103 of the decision of 8 December 2008.

(42) On the basis of the above, the Commission's opinion is that the amended scheme is proportionate with the serious risks of disturbance in the economy.

4. CONCLUSION

(43) The Commission therefore considers that the amendment to the capital-injection scheme is compatible with the common market under the derogation provided for in Article 87(3)(b) of the EC Treaty.

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http://ec.europa.eu/community_law/state_aids/index.htm

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

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Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission