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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 [...].

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**Subject : State aid N 613/2008 – Republic of France
Capital-injection scheme for banks**

Sir,

1. PROCEDURE

- (1) On 3 December 2008, the French authorities notified the Commission of an aid scheme for injecting capital into banking groups. The legal basis for this scheme is Article 6 (III) of the Finance Amendment Act for financing the economy, No 2008-1061 of 16 October 2008.

2. DESCRIPTION OF THE SCHEME

A. *Société de Prise de Participation de l'État* (SPPE)

- (2) In the framework of the notified scheme, the French State set up the *Société de Prise de Participation de l'État* (hereinafter SPPE) in which it is the sole shareholder and through which it will participate in operations to inject capital into sound financial institutions, or to rescue operations for financial institutions in difficulty¹, with a view to maintaining financial stability and avoiding any serious disturbance to the French economy. SPPE measures will therefore concern only institutions which play a key role in this respect by virtue of maintaining sufficient lending activity.

¹ Possible measures of this kind are not dealt with in this decision.

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- (3) The SPPE will intervene by raising funds guaranteed by the State. For each guaranteed financing operation, a decision by the Minister for the Economy will specify *inter alia* the duration and the limit on the guarantee provided. The SPPE will subscribe to securities, constituting regulatory own funds issued by the financial institutions concerned. When market conditions so permit, the SPPE will seek reimbursement of these securities or will re-sell them on the market.

B. Description of the scheme

1) Beneficiaries of the scheme

- (4) Any credit institution, including the subsidiaries of foreign groups, will be able to benefit from capital injection by the SPPE provided it meets the following criteria which, according to the French authorities, are in line with the objectives and the purpose of Article 87(3)(b) of the EC Treaty, namely to remedy a serious disturbance in the economy of a Member State:
- it must be authorised in France and supervised under the conditions defined in the French Monetary and Financial Code (hereinafter CMF);
 - it must comply with the own funds requirements as defined by the CMF;
 - it must be in a financial position to be able to guarantee its long term viability and to present a positive economic situation in accordance with the criteria normally used in the banking sector. In this connection, the French authorities have attached a note from the French Banking Commission (SGCB - *Sécretariat Général de la Commission Bancaire*) testifying to the financial soundness of the beneficiaries of the scheme;
 - it must have previously concluded an agreement with the State fixing the consideration provided for by law
- (5) In addition to this first set of criteria, another key criterion is that the measure shall apply only to institutions where a severe and sudden reduction in their activity would have a serious impact on the French economy.
- (6) There are three possible scenarios in this respect:
- general banking networks accounting for a substantial part of the French banking market;
 - smaller institutions understood to represent a very significant or essential part of a particular sector of bank financing activity, which cannot be replaced in the short term by another institution;
 - smaller institutions seen, however, to represent a significant presence in a particular economic region, which cannot be replaced in the short term by another institution.
- (7) All requests received from credit institutions will be examined according to the same criteria. So far, the six main French banking groups (*Société générale, BNP Paribas, Groupe Crédit Agricole, Groupe Crédit Mutuel, Groupe Caisses d'Epargne, Groupe Banques Populaires*) have communicated their intention to benefit from the scheme

and they meet the first criterion set out above². Although HSBC France has declined to benefit from the scheme, as a general banking network of significant weight, it is eligible to do so.

2) *Need for the scheme*

- (8) According to the French authorities, although the economic and financial situation of the banking groups which will benefit must be sound, this recapitalisation is necessary in order to restore market confidence. The markets are putting the banking groups under severe pressure, which could lead them to reduce their lending, placing the entire French economy at the risk of significant damage.
- (9) With its funds, the SPPE will subscribe to deeply subordinated debt securities (hereinafter TSS), qualifying for original own funds (Tier 1), issued by the beneficiary banking groups.

3) *Duration of the scheme and budget*

- (10) The eligible groups will be offered the possibility to request capital injection for a period of six months.
- (11) The total amount of the first operation should be EUR 10.5 billion, broken down as follows:

Banking Groups	Amount (EUR billion)
BNP Paribas	2.55
Société générale	1.70
Groupe Crédit Agricole	3.00
Groupe Crédit Mutuel	1.20
Groupe Caisse d'Épargne	1.10
Groupes Banques Populaires	0.95

- (12) This first operation will enable the Tier 1 capital ratio of each of these banking groups to be increased by around 0.5%.
- (13) The French authorities have pointed out that in the case of BNP Paribas, this reflects the impact on the ratio prior to acquisition of FORTIS bank. The French authorities have also indicated that the impact is less if account is taken of the group's new structure. [...]*

² The six groups which have indicated that they are interested in the scheme represent, together account for over 80 % of France's net banking income.

* Confidential information

(14) The State might subscribe to a second instalment of an equivalent amount under the same conditions in 2009 should current market conditions continue. This would thus bring the total budget notified for the scheme to EUR 21 billion, which is the subject of this decision.

4) *Characteristics of the securities subscribed to*

(15) The instruments envisaged, TSS, are hybrid debt securities, similar to those issued by the French banks before the crisis. This is in line with frequent practice on the French market, while other instruments in the same category, such as preference shares, are used far less.

(16) In order to qualify for the banks' original own funds (Tier 1), these securities will have to meet the following criteria laid down by the Basle Committee on Banking Supervision: permanent type, subordination ranking placing the bearers just before shareholders (all types of shares, including preference shares), able to absorb losses.

(17) In accordance with the decision taken by the Banking Commission on 3 November 2008, these non-innovative TSS will be subject to a ceiling of 35 % of original own funds.

(18) The TSS to be acquired by the SPPE have the following characteristics:

Maturity

(19) These TSS have a maturity of 99 years or are perpetual, in line with the same kind of instruments normally issued by French banks.

Rates:

(20) The TSS will be remunerated in two phases:

- fixed-rate remuneration during the first five-year phase;
- remuneration based on a variable rate after the first phase.

Subordination clause:

(21) The amounts owed in terms of principal and interest under the TSS are:

- deeply subordinated bonds issued by the issuer³;
- *pari passu* among themselves and all other present or future deeply subordinated securities issued by the issuer;
- senior in relation to other instruments qualifying as Tier 1 (hybrids qualifying as core Tier 1 and capital instruments);
- subordinated to present or future equity loans granted to the issuer, to profit participation certificates issued by the latter and to other bonds of the issuer, whether subordinated or not.

³ Pursuant to Article L. 228-97 of the French Commercial Code.

- (22) In the event of liquidation of the issuer, payments on TSS will take priority over payments to shareholders and to holders of the issuer's equity securities.

Payment of interest

- (23) Interest will be paid at the end of each interest period. Payment of interest accrued on the TSS is obligatory whenever the issuer has remunerated bearers of securities representing capital (dividends or other). If there has been no such remuneration, the issuer has the option of suspending payment of interest on the TSS but this suspension of interest is only possible provided it is applied to all securities issued *pari passu*. Payment of interest must be suspended in the event of own funds being insufficient⁴. Once the insufficiency of own funds has been remedied, the issuer will have the possibility of paying, at the next interest payment date, the interest in respect of which payment had been suspended.

Absorption of losses and reestablishment of nominal value

- (24) In the event of own funds being insufficient, the issuer will first of all have to increase its capital or adopt any other measure deemed necessary or useful in order to remedy the insufficiency.
- (25) Failing this, or if own funds continue to be insufficient, the amount of interest earned and then, if necessary, the nominal amount of the TSS, may be reduced by an amount equal to the difference between (i) the amount of original own funds needed to remedy the inadequacy of own funds and (ii) the amount of the increase in capital or any other measure adopted to remedy the capital insufficiency. The nominal amount of the TSS may be reduced to one cent. If other subordinated securities constituting original own funds are subject to such a reduction, it will apply pro rata to TSS and other bonds. The interest which is mandatorily payable is not subject to reduction.
- (26) The TSS bearer's right is equivalent to the initial nominal capital subscribed since it is a debt instrument, regardless of any reduction in the nominal amount which may have arisen to absorb losses in advance.
- (27) In the event of a return to profitability, defined as the recording of a positive consolidated net result during at least two consecutive years from the end of a case of insufficiency of own funds, the nominal amount of the TSS will be re-established at the highest possible amount insofar as this does not result in a new case of insufficiency of own funds.
- (28) At all events, whether or not profitability is restored, the issuer will have to increase the nominal amount of the TSS up to the original nominal amount before any of the following events occurs:
- the issuer decides to distribute or has distributed dividends or, more generally, make a payment of any sum of any kind on an instrument representing the issuer's capital, or on account of deeply subordinated bonds or deeply subordinated securities issued and guaranteed by the issuer;

⁴ Own funds will be declared insufficient where the issuer's consolidated capital adequacy ratio falls below the minimum percentage required by the relevant banking legislation or where the issuer receives a notification from the General Secretariat of the Banking Commission indicating that it has estimated, at its sole discretion, that this ratio would soon reach a level below the minimum required.

- a subsidiary of the issuer decides to distribute or has distributed dividends on deeply subordinated securities or preference shares (the products of which are considered to be original consolidated own funds for the issuer);
- reimbursement of the TSS in the event of liquidation.

Reimbursement conditions

(29) Deeply subordinated securities can be reimbursed⁵ at any time:

- should it no longer be possible to classify the TSS securities as Tier 1 capital in the light of an amendment to applicable legislation;
- in the event of an amendment to applicable legislation with the following consequences: (1) the issuer would no longer be able to benefit from the deductibility of interest paid for corporation tax purposes; (2) the issuer was obliged to pay additional amounts; (3) the issuer would be prevented from paying TSS bearers all amounts owing on TSS;
- in the event of activation of the review clause of a contract and subject to the agreement of the Banking Commission, the issuer can reimburse the TSS to the subscriber provided the TSS are replaced by equivalent securities.
- in the event of liquidation, if a judicial winding-up order is issued against the issuer or if the issuer goes into liquidation for any other reason, the TSS will become payable immediately. The rights of the TSS bearers will be calculated on the basis of the initial nominal amount of the TSS, including all other amounts due (including interest).

(30) The TSS may also be reimbursed in their initial nominal amount plus any other amount due⁶ (including interest earned) on the first day of the second period (variable rate) then on every date on which interest is paid.

Conditions for repurchase and sale

- (31) The issuer has the possibility of repurchasing the TSS at any time on the market or by any other means following approval by the Banking Commission.
- (32) The subscriber may at any time sell the TSS on the secondary market. The TSS market is not an organised market but an over-the-counter (OTC) market.
- (33) A mechanism for the payment of a premium on the nominal amount (add-on) is also provided for (cf. point 44 below).

Review Clause

(34) The TSS contracts issued by the French banks usually include a review clause covering the possibility of reimbursement of the TSS subject to the agreement of the Banking Commission and substitution of the TSS by equivalent securities.

⁵ Subject to notification of the debt security bearers and the approval of the Banking Commission (SGCB).

⁶ These might be early redemption fees, other related costs and amounts owing due to the mechanism for the payment of a premium on the nominal amount described below.

(35) The TSS acquired by the SPPE will include a clause of this type, which will enable the issuer, under certain conditions and subject to the agreement of the Banking Commission, to reimburse the securities before the end of the first period. The mechanism for the payment of a premium on the nominal amount (add-on) will apply to the institutions at the time of reimbursement. This mechanism is intended to promote reimbursement to the State as swiftly as possible.

5) *Remuneration*

(36) To establish the level of remuneration applicable to the TSS subscribed to by the SPPE, the French authorities have relied on a methodology in line with the recommendations of the ECB and Eurosystem⁷.

(37) As indicated above, the TSS will be remunerated in two phases:

- fixed rate remuneration during the first five-year phase;
- remuneration based on a variable rate after the first phase.

(38) The fixed rate applicable during the first five-year period will be calculated as follows: BTAN five years + 300bps + 5 x CDS (senior five years)

(39) The variable rate applicable⁸ after the first five-year period will be calculated as follows: EURIBOR + 250bps + 5 x CDS (senior five years).

(40) The French authorities submitted the following arguments in support of the coherence of the above formulae:

- i. in order for the TSS to be considered as non-innovative securities qualifying as Tier 1, the Banking Commission cannot accept that using the formulae at the time of issuing, results in a leap in rates with reference to conditions at that time.
- ii. since the reference to Euribor during the second period is market practice, the French authorities consider its use to be necessary in order not to limit the liquidity of these securities on the secondary market.
- iii. whatever formula is applied, the French authorities consider that the formulae result in significantly high rates compared with current market practice for these instruments.

(41) In these formulae:

- *BTAN* is the average rate on 5-year government bonds during the 20 days preceding the issue;
- CDS (senior 5 years) is: (i) if the beneficiary institution has an available CDS (credit-default swap), the average value of the 5-year CDS spreads over the period from 1 January 2007 to 31 August 2008; (ii) if the beneficiary institution has no representative CDS (credit-default swap) but does have a credit rating, the average

⁷ 'The pricing of recapitalisations' - Confidential ECB-Eurosystem document, 20 November 2008.

⁸ This variable rate is defined so that remuneration will be equivalent in the first and second periods. It takes account of the risk premium included in the EURIBOR rate.

five-year CDS in the beneficiary institution's rating category, over the period from 1 January 2007 to 31 August 2008.

- (42) Assuming the 5-year BTAN 20 days before the issue is 3%, applying these formulae gives a rate between [around 8%], depending on the bank, given market conditions at the beginning of December 2008.
- (43) These formulae enable the following to be taken into account:
- the risk profile of each institution by virtue of the reference to 5-year senior CDS. To take account of the subordinated nature of the securities, a multiplication factor of 5 is applied. It should be noted in this connection that this method was preferred over using subordinated 5-year CDS, which are generally simply double senior CDS for the banking groups in question but which are not liquid enough to be used as a reliable benchmark.
 - a margin to guarantee that the cost borne by the beneficiary banks will represent a significant premium to what they will be able to find on the market when conditions start to improve significantly.

6) *Terms and incentives for withdrawing from the scheme*

- (44) The scheme provides a number of incentives for the groups to withdraw as soon as market conditions return to normal:
- the high level of remuneration for the TSS, *inter alia* in relation to the recommendations of the ECB;
 - behavioural commitments and the constraints arising from the existence of the Credit Mediator also provide a strong incentive to withdraw as quickly as possible from the scheme given the high management costs involved for the banks.
- (45) In addition, a mechanism for the payment of a premium on the nominal amount (add-on) was introduced in order to create an additional incentive to repay the securities quickly. In the event of the review clause being invoked, the securities will be redeemed on the basis of the nominal amount plus an increasing percentage from the date of issue.
- (46) The rate of increase of the nominal amount to be redeemed will be 1 % the second year, 3% the third year, then an additional 2% each year until the seventh year, i.e. a maximum of 111 % of the original nominal amount. This results in an effective cost for the beneficiary institutions of between [around 8%] in year 1, increasing to between [around 9%] in year 7.
- (47) On the basis of the above, the French authorities carried out a simulation in order to estimate the average annual remuneration for each of the beneficiaries already identified, on the basis of the year of withdrawal: [...]

7) *Behavioural commitments*

- (48) All the groups benefitting from the capital-injection mechanism undertake in advance in an agreement signed with the State to adopt ethical rules consistent with the general interest, entailing *inter alia* restrictions on directors' remuneration. The rules also limit

severance payments to senior executives and ban all severance payments where a senior executive or enterprise has failed or where a senior executive leaves of his own volition. The beneficiary groups will also have to submit a remuneration policy for market operators (including traders).

- (49) Banks which want to benefit from the refinancing will have to sign an agreement with the State in advance. This agreement will include a number of behavioural commitments in order to ensure that the funds the banks obtain from the SPPE will be used to finance the ‘real economy’ and to avoid distortions in competition between beneficiary institutions and others.
- (50) These commitments will, in particular, have to apply for each institution with regard to:
- the objective of maintaining an annual growth rate of 3-4 % of overall lending to the French economy throughout the period between the date on which the agreement was signed and 31 December 2009;
 - monthly presentation of a report on lending volume and trends: to private individuals, distinguishing between consumer loans and mortgages; to enterprises, distinguishing between loans to different categories of companies; to local authorities;
 - seeking on a case-by-case basis solutions for clients experiencing difficulties in repaying their bridging loans. In particular, for clients who have not signed a preliminary sale agreement, and at the latest three months before the repayment date for the bridging loan, the credit institution will review in detail with its clients their property and financial situation;
 - making every effort to finance the investment requirements of local authorities. The banks will undertake to participate in a committee monitoring loans to local authorities, which will meet every quarter under the aegis of the State. This group will identify aspects that can be improved in terms of practices and relations between banks and local authorities.
- (51) Supervision and mediation mechanisms have been set up requiring the banks to comply with their commitments towards companies encountering credit difficulties.
- (52) Companies experiencing credit difficulties with regard either to renegotiating conditions for their commitments, or to refusals to provide loans or open cash lines, can *inter alia* apply to the national Credit Mediator to take up their case immediately. Alternatively, they can also address their request for mediation to the *Banque de France*.
- (53) For examination of the cases, the national mediator will be guided by the *département* heads of the *Banque de France*, acting in the capacity of ‘*département* mediators’. The mediator will prioritise mediation for companies which have been in financial difficulties for less than six months, i.e. those which are specifically affected by the general financial situation. If mediation is unsuccessful, the *département* mediator may refer to the national mediator or a representative of the same. If the *département* mediator proposes a solution which the company does not accept, the latter may ask for the case to be reviewed, which will be decided by the national mediator.

- (54) In return for the funds mobilised by the State, the banks have undertaken to increase the volume of loans to companies. The *Préfets* [the State's representatives in each *département*], the General Payment Agencies (hereinafter TPG) and the *département* mediators must therefore ensure locally that the mobilised funds are available for the companies and that the national commitments are observed. This will be checked by the operational monitoring unit - assembled by the *Préfet* and comprising the TPG and the *département* mediator – and by the *département* committee for financing the economy (CDFE). The members of this committee are representatives of the banking networks operating in each *département* and OSEO [a French public body which finances and supports small and medium-sized enterprises], the *Banque de France*, and representatives of local economic operators (MEDEF, CGPME and UPA); it may involve the main factoring and credit insurance companies in its work.
- (55) The CDFE serves three purposes:
- to inform the economic operators of the measures adopted at national level and their aims;
 - to analyse the situation in the *département* and in particular to restore the normal functioning of the business lending market;
 - regular and meticulous monitoring at local level of the commitments made by the banks at national level.
- (56) These credit monitoring and mediation mechanisms are not accompanied by sanctions since that would imply the introduction of an entitlement to credit which would be detrimental to the functioning of the French economy and of the internal market. These mechanisms do nevertheless seriously commit the beneficiary institutions, which would moreover suffer reputational damage if they did not comply.
- (57) Moreover, the French authorities will ensure that the beneficiary banking groups do not engage in aggressive or unfair commercial practices (such as a publicity campaign in which an institution invoked the capital-injection scheme).
- (58) Lastly, the groups which will benefit from capital injection will find that they are prohibited from repurchasing their own shares, with the exception of purchases enabling employee shareholding schemes to be honoured, and the group's day-to-day management operations to be covered, as long as the TSS have not been reimbursed to the SPPE or sold by it on the market.

8) *Commitments on the part of the French authorities*

- (59) Should eligible institutions other than those which have to date declared their intention to benefit from the scheme submit a request to do so, the French authorities undertake to notify the Commission of the increase in the budget required for these new measures. They also undertake to provide, after six months of implementation of the scheme, the information that will make it possible to verify that the financial situation of the beneficiary banks continues to be healthy and viable.
- (60) The French authorities undertake to carry out a study on the implementation of the scheme after six months in order to assess whether it should be continued as is or adapted to developments on the financial markets and changes in the banks'

circumstances. They undertake to report to the Commission on the findings of this study and to notify, if appropriate, an extension of the scheme.

- (61) Lastly, the French authorities undertake to inform the Commission regularly as to the growth in lending by the beneficiary banks and their compliance with lending commitments.

3. POSITION OF THE FRENCH AUTHORITIES

- (62) The French authorities consider that the state intervention under the notified scheme will not constitute state aid. According to the French authorities, the investments made by the SPPE will be in strict compliance with the principle of the prudent private investor in the market economy. The French authorities have thus ensured that:

- the price of securities acquired by the SPPE entails no advantage for the issuing banks, in particular compared to appropriate benchmarks or market practices for this type of investment;
- if necessary, intervention by the SPPE is possible alongside other investments, in particular from private investors;
- the financial situation of the banks issuing securities acquired by the SPPE is such that it can guarantee their long-term viability, and their economic situation is of a quality that satisfies the criteria generally applied (quality of image and brand, market share, expertise).

- (63) If the Commission were not to accept the absence of aid in its legal assessment despite the evidence set out above, the French authorities consider that the scheme meets all the conditions laid down by the Commission in its Communication of 13 October 2008⁹ and in its draft Communication of 24 November 2008¹⁰. In this case, they take the view that the capital-injection scheme could be considered by the Commission to be an aid scheme which is compatible with the EC Treaty, in particular Article 87(3)(b) thereof. The French authorities would base their assessment on the following factors.

- (64) Although the economic and financial situations of the beneficiary banking groups are sound, they have suffered for several weeks from the distrust of the financial market. This is seen *inter alia* in the increased demands on the part of all market operators (financial analysts, rating agencies ...) regarding own funds. Although the banking groups benefitting from the measure have, at the moment, a level of Tier 1 own funds which is compatible with regulatory requirements, they are under severe pressure to increase these funds swiftly. All these factors taken together prompted the French authorities to contribute to a capital-injection measure, which must enable market confidence in these banking groups to be restored and the financing of households and companies to be maintained. It is therefore a complementary measure to the scheme for

⁹ Communication by the Commission – (2008/C270/02) - Application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, published in the Official Journal of the European Union of 25 October 2008.

¹⁰ Draft Commission Communication of 24 November 2008 - The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortion of competition".

refinancing credit institutions. A letter from the Governing Board of the *Banque de France* confirms the need for this measure.

- (65) According to the French authorities, eligibility for capital injection by the SPPE is based on objective and non-discriminatory criteria, in line with the objectives pursued by the French authorities and the purpose of Article 87(3)(b) of the EC Treaty, which is to remedy a serious disturbance in the economy of a Member State:
- any credit institution, including the subsidiaries of foreign groups, established and authorised in France may be eligible for the scheme, subject to objective and justified eligibility rules regarding own funds;
 - each beneficiary credit institution must be in a financial position which guarantees its long-term viability and present a positive economic situation in terms of the criteria usually applied in the banking sector;
 - each beneficiary credit institution must have previously concluded an agreement with the State stipulating the consideration provided for by law;
 - the measure will apply only to institutions where a severe and sudden reduction in their activity would have a serious impact on the French economy.
- (66) Regarding the proportionality of the measure, the French authorities put forward that the amount of the recapitalisation measure was determined in order to enable the beneficiary banks' Tier 1 own funds ratio to be increased initially by around 0.5 %. This is the level which the French authorities, in consultation with the supervisory authorities, deem to be strictly necessary and sufficient to restore market confidence. Prior to this measure, the average level of the beneficiary banks' original own funds was 8 %. Following this measure, their average ratio will rise to 8.5 %. The letter from the Board of the *Banque de France* attached to the notification confirms that the level chosen for this recapitalisation is sufficient under current circumstances.
- (67) According to the French authorities, the measure means significant costs for the beneficiary banks since it involves high pricing and a mechanism for payment of a premium on the nominal amount (add-on) depending on the time of repayment. Moreover, the groups which will benefit from capital injection will be prohibited from repurchasing their own shares, with the exception of purchases to honour employee shareholding schemes and to cover the group's day-to-day management operations, provided the securities have not been reimbursed to the SPPE or sold by the same on the market. Again according to the French authorities, these factors will prevent windfall gains and will encourage the beneficiaries to withdraw from the scheme as soon as market conditions return to normal.
- (68) Furthermore, banks wishing to benefit from the capital injection will have to undertake to ensure that the liquidity provided under the notified scheme will be used for financing the 'real economy', and to prevent distortions in competition between the beneficiary institutions and other institutions. In particular, the objective was set to maintain an annual growth rate of 3-4 % of overall lending to the French economy throughout the period between the date the agreement was signed and 31 December 2009;

- (69) Moreover, the beneficiary groups would have to undertake to comply with a number of behavioural commitments and to apply the control and mediation mechanisms set up by the French authorities.
- (70) Lastly, the French authorities will ensure that the beneficiary banking groups do not engage in aggressive or unfair commercial practices (such as a publicity campaign in which an institution vaunts the capital-injection scheme).

4. ASSESSMENT OF THE SCHEME

A. Existence of state aid

- (71) According to Article 87(1) of the Treaty, ‘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, insofar as it affects trade between Member States, be incompatible with the common market’.
- (72) The classification of a measure as state aid presupposes that the following cumulative conditions are met: (1) the measure in question confers an advantage through state resources; (2) the advantage is selective; and (3) the measure distorts or threatens to distort competition and is capable of affecting trade between Member States.
- (73) France rejects the classification of the notified scheme as state aid and the Commission must therefore analyse this classification in detail.
- (74) First, the Commission notes the intention of the French authorities to carry out certain recapitalisation measures under the aegis of the SPPE, in conjunction with private operators.
- (75) However, since the French authorities have neither indicated nor defined the terms and conditions for possible participation of private operators, the Commission cannot exclude the possibility that interventions within the framework of the notified scheme constitute state aid. This analysis is supported by the following factors.
- (76) Firstly, given current market tensions, it is difficult, or impossible to raise capital. The interventions of the SPPE thus represent an appreciable financial advantage for the beneficiary banks, which would be difficult for them to obtain from private investors under current conditions.
- (77) Secondly, since eligibility for the notified scheme is confined to credit institutions where a severe and sudden reduction in their activity would have a serious impact on the French economy, the measure is clearly selective.
- (78) Thirdly, the scheme is financed out of public resources. The SPPE of which the French State is the sole shareholder, is a public enterprise carrying out a public-authority task defined by law . This structure, whose actions are therefore attributable to the State, is financed through issues guaranteed by the State, and therefore involves public resources.
- (79) Fourthly, since the beneficiary institutions are active on the highly competitive market of banking operations, the financial advantages resulting from capital injection are likely to distort competition and trade between Member States.

(80) Therefore, in the light of these factors, the Commission considers that the notified scheme constitutes state aid pursuant to Article 87(1) of the EC Treaty.

B. Compatibility of the aid with the common market

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

(81) If the Commission were to retain the classification as state aid, the French authorities would argue that the notified scheme is compatible pursuant to Article 87(3)(b) of the EC Treaty.

(82) 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 to the economy of a Member State.'

(83) The Commission does not dispute the conclusions of the French authorities regarding the critical situation encountered by credit institutions, which need to increase their own funds owing to growing market mistrust. Although the institutions have the level of capital required by the regulations, these measures seem necessary in order to restore confidence in the financial system. The Commission agrees with the French authorities' analysis that until confidence in the financial system has been restored, the potential impact of this crisis cannot be contained solely within the banking sector. Given the sector's key role in the economic system and the scale of the current financial crisis, there is now a sufficiently evident and real systemic risk that could have an impact on the entire French economy. The Commission therefore considers that the notified scheme is intended to remedy a serious disturbance in the French economy.

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

(84) The compatibility of the aid must be assessed with regard 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 crisis¹¹ (hereinafter Financial Communication) and the Communication from the Commission on the recapitalisation of financial institutions in the current financial crisis¹² (hereinafter Recapitalisation Communication).

(85) According to the Financial Communication, if a measure is to be deemed compatible with Article 87(3)(b) of the EC Treaty, it must meet all three of the following criteria:

(1) The aid must be well targeted. The measures implemented must be appropriate for the aim pursued, i.e., in the case in point, to remedy a serious disturbance in the economy of a Member State;

(2) The aid must be necessary, i.e. the amount of aid must be limited to the minimum necessary to achieve the aim pursued and to the most appropriate means to remedy the disturbance to the economy; In other words, if a different aid measure of a lower amount or entailing less distortion of competition (for example a temporary

¹¹ OJ C 270, 25.10.2008, p.8

¹² http://ec.europa.eu/competition/state_aid/legislation/specific_rules.html

and limited guarantee rather than a capital-injection) would be sufficient to remedy the disturbance to the economy, the measure cannot be deemed to be necessary.

(3) Lastly, the aid must be proportionate in the sense that any actual or likely distortion of competition must be outweighed by its positive impact. Any distortion of competition must therefore be limited to the minimum required to achieve the desired effect.

(86) The Recapitalisation Communication describes in more detail the principles which must govern the recapitalisation of financial institutions in order to ensure that they are compatible with community rules on state aid. It specifies the criteria for setting remuneration of recapitalisations and mechanisms to prevent undue distortions of competition.

3) *Compatibility of the notified scheme pursuant to Article 87(3(b) of the EC Treaty*

Appropriateness of the measure to achieve the desired objectives

(87) The purpose of the notified scheme is, *inter alia*, to prevent the financial crisis from having serious repercussions on the French economy. To this end, the Commission agrees with the French authorities that, without state intervention, the probable reaction of economic operators to the increased market pressures regarding own funds would naturally be for credit institutions to be tempted to keep new lending to a minimum. In order to prevent this kind of reaction, which given its scale and suddenness would result in financial turmoil being passed on to the entire real economy, the French authorities are seeking to minimise this effect by providing additional capital in conjunction with commitments by the beneficiaries to maintain increased lending. In return for granting the capital-injection measure, the French authorities have asked all beneficiaries to maintain annual growth of 3-4 % in their overall lending to the French economy. The measure should therefore have the effect of reducing the impact of the financial crisis in a consistent manner across all sectors of the French economy. The Commission points out moreover that there is no differentiation in the treatment of the various sectors of the economy affected by this commitment. Indeed, the French authorities require a commitment with regard to the growth of overall lending, not just any one sectoral indicator.

(88) In addition, the nature of the monitoring and mediation mechanisms set up by the French authorities will ensure that the banks comply with their commitments in terms of financing the real economy. The scoreboard established by consolidating the information provided by the *département* committees for the financing of the economy, and the pressure which the mediator will be able to exert, provide significant guarantees which could jeopardise the reputation of beneficiary banks not meeting their obligations under the notified scheme.

(89) Finally, the Commission points out that eligibility for this scheme is not possible for credit institutions in difficulty at the time the measures are granted. The French authorities have confirmed that, in order to be eligible in the framework of this scheme, a credit institution is obliged to comply with the regulatory requirements before each capital-injection measure. The Commission also notes that the measure will apply only to institutions where a severe and sudden reduction in their activity would have a serious impact on the French economy. The scheme therefore seems to be well targeted in this sense. In accordance with the commitment by the French authorities to notify

the financial situation of the eligible institutions, the French authorities have provided a note from the Banking Commission attesting to the financial soundness of the beneficiary banks within the six banking groups set out in paragraph 11 above.

- (90) For all these reasons, and in line with the recent decisions on similar schemes¹³, the Commission considers that the scheme addresses the relevant aspects of the current financial crisis and that it is well targeted to facilitate the financing of the French economy and to restore confidence, and therefore in line with the objectives defined in the Recapitalisation Communication. The measures implemented are appropriate to the desired objectives.

Need for the measure

- (91) In paragraph 34 of the Communication, the Commission acknowledged that ‘[...] a second systemic measure in response to the ongoing financial crisis would be the institution of a recapitalisation scheme which would be used to support financial institutions that are fundamentally sound but may experience distress because of extreme conditions in financial markets. The objective would be to provide public funds so as to strengthen the capital base of the financial institutions directly or to facilitate the injection of private capital by other means, so as to prevent negative systemic spillovers.’
- (92) Moreover, in its Recapitalisation Communication, the Commission recognised that preserving financial stability and access to credit for traders in the real economy were objectives which could justify intervention by the Member States.
- (93) The Commission further takes note of the letter from the Governing Board of the *Banque de France* of 3 December 2008 confirming the need for this scheme in order to restore confidence. The Commission also takes note of the statement made by the euro zone countries on 12 October 2008 that Member States remained committed ‘to avoid the failure of relevant financial institutions, through appropriate means including recapitalization. In doing so, we will be watchful regarding the interests of taxpayers and ensure that existing shareholders and management bear the due consequences of the intervention. Emergency recapitalisations of a given institution shall be followed by an appropriate restructuring plan.’
- (94) In this context, the Commission considers implementation of a recapitalisation mechanism to be necessary. The capital injection which this scheme will provide will directly facilitate access to credit for all traders in the real economy. Moreover, the Commission agrees that a mechanism of this kind will be able to boost the confidence necessary for the financial system to operate effectively.
- (95) Regarding the scope of the measure, the Commission supports the limits defined by the scheme. The injection of capital will amount to a maximum increase of 1% in the Tier 1 ratio. In addition, the planned interventions will be graduated and thus restricted to what is strictly necessary. While the first intervention under the scheme is planned and

¹³ NN533/08 Support measures for the banking industry in Sweden, NN51/08 Guarantee scheme for banks in Denmark, N507/08 Financial support measures to the Banking Industry in UK, NN48/08 Guarantee scheme for banks in Ireland, N512/08 Rescue package for the financial institutions in Germany, NN60/08 Guarantee scheme for credit institutions in Portugal.

will increase the Tier 1 ratio of the beneficiaries by 0.5%, the second intervention of 0.5% is not automatic and will take place only if warranted given market conditions.

- (96) Furthermore, the French authorities' commitment to notify an extension of the scheme, if considered necessary, ensures that any intervention after six months of application of the scheme will be looked at again in the light of market developments. Limiting the window for intervention to six months, and the overall budget for the scheme to EUR 21 billion, provides additional safeguards against excessive intervention by the State.
- (97) On the basis of these findings, the Commission considers that this scheme is well targeted so that the objective of remedying a serious market disturbance can be achieved effectively.
- (98) However, the Commission must verify whether the measure is not disproportionate with regard to the distortion of competition which it will cause.

Proportionality of the measure

- (99) In order to evaluate the proportionality of the measure, the Commission must check that distortion of competition resulting from this kind of intervention is kept to a minimum, having regard to the risk of serious disturbance to the economy. According to the Recapitalisation Communication, for aid to be compatible with the common market, a good balance must be achieved between the pursuit of common objectives and the distortion of competition between Member States and between the banks. The recapitalisation schemes must also ensure that normal market operating conditions are restored.
- (100) In this context, the Commission considers that the closeness of pricing to market pricing is the best guarantee to limit distortions in competition¹⁴. 'Overall remuneration needs to adequately factor in the following elements:
- (a) current risk profile of each beneficiary;
 - (b) characteristics of the chosen instruments, including the level of subordination, risk and all payment arrangements;
 - (c) built-in incentives for exit (such as step-up and redemption clauses),
 - (d) appropriate risk-free rate of interest.'

- (101) Firstly, the Commission points out, with reference to the Recapitalisation Communication¹⁵, that the French authorities have relied on a methodology in accordance with the recommendations of the ECB and Eurosystem. The notified formula has an appropriate structure in that it takes account of a risk-free interest rate and the risk profile of each beneficiary through the credit default swap component supplemented by an add-on fee. This add-on is a premium which encourages the beneficiaries to return to the markets as soon as conditions improve and minimises the financial advantage that intervention represents.

¹⁴ Paragraph 19 of the Recapitalisation Communication.

¹⁵ Paragraph 28 of the Recapitalisation Communication.

- (102) Pursuant to the recommendations of the Recapitalisation Communication¹⁶, the provisions regarding the add-on fee provide an incentive for the credit institutions to repurchase TSS held by the French authorities as swiftly as possible. Indeed, because of this mechanism, the nominal amount to be reimbursed increases with time, which is an incentive for the credit institutions to proceed with reimbursement at the earliest opportunity. On top of that, given the remuneration formulae used, the Commission considers that the transition to variable rates after five years will probably keep the remuneration high. Over a five-year period, the average annual remuneration received by the French authorities will vary between [around 9%]. The five-year time span is justified by market practice, which will encourage the issuing banks to repurchase the TSS before the transition to the variable rate, as described by the French authorities.
- (103) The Commission moreover notes that the instrument selected by the French authorities is a subordinated debt instrument, which, while qualifying as Tier 1, offers the subscriber more security than shares in the event of the issuer defaulting. According to the Recapitalisation Communication¹⁷, this therefore justifies lower remuneration compared to holdings in the form of ordinary shares or preference shares, which rank higher in terms of subordination and are classified as core Tier 1 (while the TSS are classified as non core Tier 1). Similarly, the maximum impact of the scheme is limited to a maximum increase of 1% in the Tier 1 ratio. In this way, given the method of remuneration chosen, the exit mechanisms, the choice of the instrument and the constraints imposed on beneficiaries with regard to financing of the real economy, any distortion resulting from this scheme is kept to a minimum.
- (104) In addition, the Commission points out that the credit institutions will be subject to monitoring to prevent unfair or aggressive commercial practices. These conditions will by their very nature reduce the impact of the measures on competition.
- (105) Finally, the Commission notes the commitment of the French authorities to review the scheme as described in paragraphs 59 *et seq.* above.
- (106) For all these reasons, the Commission considers the measure to be proportionate, having regard to the risks of serious disturbance to the French economy.
- (107) The Commission notes that any intervention for the benefit of a financial institution in difficulty is not covered by the notified scheme. Furthermore, any intervention pursuant to the conditions of the scheme for the benefit of eligible institutions other than those mentioned in paragraph 11 above will have to be notified.

¹⁶ Paragraph 31 of the Recapitalisation Communication.

¹⁷ Paragraph 28 of the Recapitalisation Communication.

5. CONCLUSION

(108) The Commission has therefore decided that the notified scheme is compatible with the common market under the exemption laid down in Article 87(3)(b) of the EC Treaty.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen 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:

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Directorate-General for Competition
State Aid Registry
SPA3, 6/5
B-1049 BRUSSELS
Fax : +32 2 296 12 42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission