

## SoFFin Capital Injections (DE GFC)

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### Abstract

The insolvency of Lehman Brothers in 2008 and the subsequent liquidity crisis spurred the German state to pass the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz, “FMStFG”) establishing the Federal Agency for Financial Market Supervision (Bundesanstalt für Finanzmarktstabilisierung), henceforth FMSA. Created in October 2008, it provided government support to ailing financial institutions. The FMSA supported German banks and maintained the stability of the German banking system, in part by establishing a Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung), henceforth SoFFin. SoFFin could provide capital injections and risk shield measures of €80 billion, and also possessed a guarantee provision of up to €400 billion. The actual recapitalizations peaked at €29.4 billion in late 2010. Capital injections rescued undercapitalized banks, and assisted in the government takeover of and restructuring of HRE Gruppe (International Monetary Fund 2011, 4-5). SoFFin was supposed to accept applications until late 2009, but this was extended several times until 2010. (“Fund for the Stabilization of the Financial Market Starts Its Operations in Germany.”) SoFFin was later reopened in 2012, finally closing in 2015 (Bundesrepublik Deutschland). Germany has since passed a Restructuring Act which acts as a framework for winding down banks that are “too big to fail,” making systemic risk support operations a permanent pillar of German banking regulations (Pleister 2011, 5, 8). Though this law facilitates the resolution of systemically relevant banks, critics argue that it does not sufficiently clarify interagency coordination nor does it establish a resolution for other nonbank systemically important financial institutions. As of the end of 2018, SoFFin has €14.6 billion outstanding from capital injections.

**Keywords:** Capital Injections, SoFFin, Germany

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# SoFFin Capital Injections (Germany)

## At a Glance

European liquidity crises and exposure to the subprime mortgage market in the United States created pressure affecting the German banking sector. The failure of Lehman created interbank liquidity shortages throughout Europe. In a bid to restore confidence in the financial system, European leaders met on October 12, 2008 and decided on a comprehensive framework to preserve financial stability and support banks.

Consequently, the German Parliament passed the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz, "FMStFG") on October 17, 2008. It created a Federal Agency for Financial Market Stabilization (Bundesanstalt für Finanzmarktstabilisierung, "FMSA"), which created and administered the new Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung "SoFFin"). SoFFin contained provisions for guarantees, capital injections, asset purchases, and nationalization of distressed financial institutions in Germany.

The recapitalization program was limited to €80 billion, of which a maximum of €29.4 billion was outstanding at the end of 2010. Solvent financial institutions with Tier I capital over 7% and meeting Basel II regulatory capital requirements plus 2% were eligible if they agreed to limit risk and suspend dividends after recapitalization.

The European Commission approved SoFFin and its recapitalizations scheme in accordance with Article 87 (3)(b) of the Treaty Establishing the European Community (2002), exempting SoFFin from the state aid rules due to serious economic disturbances in Germany. As of December 2018, €14.6 billion are outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former WestLB) with no clear exit strategy. Applications for recapitalization aid under SoFFin were initially due in December 2009, later extended to December 2010. SoFFin was reopened in 2012, with a closure date in 2014, but ultimately extended until 2015 ([Bundesrepublik Deutschland](#)).

## Summary Evaluation

SoFFin is generally assessed positively. It was a necessity to maintain financial stability in Germany. It bolstered the capital structure of German financial institutions, easing some pressure from interbank liquidity shortages, and later, the sovereign debt crisis. It limited the vulnerability of German financial institutions to systemic risk. However, critics had concerns about the stigma associated with seeking aid, and the extensions of the eligibility window as potential issues limiting SoFFin's effectiveness ([Spiegel](#)).

### Summary of Key Terms

**Purpose:** Strengthen the capital of German financial institutions and restore confidence in German economy.

**Announcement Date** October 12, 2008

**Operational Date** October 17, 2008

**End of Issuance Window** Dec. 31, 2009 (initial)  
Dec. 31, 2010 (extended)  
Reopened in 2012 – closed Dec. 31 2015  
([Bundesrepublik Deutschland](#))

**Program Size** € 70 B with a possible extension of € 10 B

**Peak Utilization** € 29.4 B (2010)

**Eligibility** Any financial institution

**Participants** Aareal Bank, Commerzbank, Hypo Real Estate, Portigon (former WestLB)

**Administrators** Federal Agency for Financial Market Stabilization (Bundesanstalt für Finanzmarktstabilisierung)

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# I. Overview

## Background

The financial tensions in Germany stemming from the GFC were exacerbated dramatically in 2008, amidst global turbulence (Bleuel 7). Germany's financial market was globally integrated and suffered from exposure to the American subprime mortgage markets and the subsequent disruptions on international money, interbank lending, and capital markets. These created uncertainties in the market with respect to price developments, transparency of information and confidence amongst market participants. Market forces were unable to stabilize the financial system and restore confidence in the financial market.

Germany has a three-pillar banking system, consisting of private banks, provincially owned *Landesbanken* and regional savings bank networks (Behr p. 1). The private banks and *Landesbanken* were hit particularly hard, and registered almost a quarter of Europe's write-downs by the end of September 2008 (Woll 115). Early on, the government asked representatives of the financial industry to contribute to the rescue of individual banks (128). While aiming to rescue the first failing banks through the private sector, both IKB and HRE were nationalized primarily with public financing (129).

Eurozone countries assembled on October 12, 2008 and created a comprehensive plan of action to restore the confidence and proper functioning of European economies ([Summit of Euro Area Countries 2008](#)). A crucial part of this plan was "providing financial institutions with additional capital resources so as to continue to ensure the proper financing of the economy" and "allowing for an efficient recapitalization of distressed banks" ([Summit of Euro Area Countries 2008, 2](#)). It also involved credit lines and guarantees.

Germany shortly thereafter passed the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz "FMStFG") which established a Federal Agency for Financial Market Stabilization (Bundesanstalt für Finanzmarktstabilisierung "FMSA"). The FMSA administered the Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung "SoFFin" or the "Fund") ([FMStFG 2008, §3\(a\)](#)). In 2008, Commerzbank was undercapitalized, and was recapitalized by SoFFin ([FMSA 2019](#)). By 2009, HRE Gruppe, Aareal Bank, and Portigon (former WestLB) had also sought recapitalization. HRE Gruppe and WestLB were eventually nationalized by SoFFin.

## Program Description

The Financial Market Stabilization Fund, or SoFFin, was a German federal fund to stabilize the financial market, overcoming liquidity shortages and creating the framework conditions for a strengthening of the capital base of financial institutions. FMStFG had a tripartite strategy for stabilization using SoFFin including guarantees, recapitalization and risk shields ([European Commission October 2008, p. 2](#)). The FMStFG limited total guarantees to €400 billion, and total recapitalization and risk shield funds to €80 billion. The objective of this recapitalization scheme was to ensure that existing solvent German financial institutions

were sufficiently capitalized so that they could withstand potential losses and to restore confidence in the German economy (p. 1, 2).

The programme was initially voluntary and open to any financial institution, including insurance undertakings, pension funds, investment companies, operators of stock and futures exchanges and their parent companies, financial holding companies, insurance holding companies, and private-law entrusted owners of Landesbanken organized under public law. (FMStFG 2008, §2; Woll p. 119) Each individual institution needed to be solvent, with a Tier 1 ratio of at least 7%, or a commitment to reaching this ratio within three months (European Commission December 2008, p. 3). They must also adhere to the requirement of minimum regulatory capital in Basel II plus two percentage points (p. 4). Each institution could apply for a maximum of €10 billion of recapitalization aid before the deadline of December 31, 2009. (Petrovic and Tutsch 2009, 36)

The Federal Ministry of Finance decided on the participation of SoFFin in a recapitalization scheme when there is a substantial interest on the part of Germany and the purpose sought by the Federation cannot better and more economically be achieved by other means (FMStFG 2008, §7). SoFFin could participate in the recapitalization of a financial-sector enterprise by acquiring shares or silent participations against a contribution and assuming other components of the funds of these companies. Silent participation aid does not dilute shareholder control and gives the Federal Republic no direct influence on the operations of a bank (Mitchell 88). Institutions receiving capital injections from SoFFin must pay interest at a rate that averages from 7-9% annually, unless SoFFin recapitalizes with significant contributions from the private sector. (Petrovic and Tutsch 2009, 38) The Federal Government was able to issue ordinances with more detailed provisions of the conditions of the recapitalization, upper limits for the size and type of fund items, and any other conditions required to safeguard the purpose of the Act under the context of recapitalization (FMStFG 2008, §7).

Financial institutions seeking to utilize one of the stabilization measures in SoFFin guaranteed a sustainable business policy and reduce or abandon any risky activities (Petrovic and Tutsch 2009, 38). Recapitalized entities were not allowed to pay dividends unless there existed sufficient incentives to repay the State first, and compensation for individual management members was limited to annual salaries of €500,000. Bonuses were disallowed while state capital remained in use, and dividend were distributable only to the Government. Recapitalized institutions also provided loans to SMEs. The Federal Government was empowered to issue additional requirements to these organizations on business strategy, use of monies received and other conditions surrounding recapitalization funds (FMStFG 2008, §10).

The federal government provides funding for SoFFin, though there are also mandated contributions from individual German states and a possible issuance of debt securities up to a maximum of €100 billion (Belka p. 22; Mayer Brown 2009, p. 1). The Federal Ministry of Finance was empowered to issue up to €70 billion of total aid within SoFFin's risk acquisition and recapitalization provisions, with a possible extension of €10 billion with the consent of the Budget Committee of the Deutscher Bundestag. Applications for SoFFin's stabilization measures were initially due on December 31, 2009, at which time they were no longer accepted, though subsequent policies extended this deadline first to 2010, then it was

reopened in 2012 with a deadline in 2014, and finally extended to 2015 (European Commission 2010; [Bundesrepublik Deutschland](#)). As of December 2018, €14.6 billion were outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (formerly WestLB) ([FMSA 2019](#)). There were no clear exit strategies set in advance for these involvements.

The Financial Market Stabilization Amendment Act, Financial Market Stabilization Acceleration Act, and the Rescue Takeover Act, all of April 2009, modified and augmented the powers enumerated under FMStFG (FMSA “History”). Specifically, they prolonged the maturity limit for security issuances guaranteed by SoFFin from 30 to 60 months, modified the corporate and takeover laws, and allowed a special solution for the complete acquisition of ailing financial institutions by Germany. This latter provision was never utilized.

Though the European Committee Treaty Article 87(1) disallows State Aid to domestic businesses in a manner that affects competition in the EU, the EC approved SoFFin ([European Commission October 2008, p. 6-9](#)). This was justified by EC Treaty Article 87(3)(b), permitting the recapitalizations, guarantees, and risk assumptions because of economic disturbances in Germany. During the financial crisis, the European Commission made several such exceptions to ensure a return to normal market functioning. The December 2008 Temporary Framework for State Aid allowed Member States to aid the “real economy” to mitigate the effects of the crisis (Lowe p. 3).

## Outcomes

Of a maximum of €80 billion, actual recapitalizations peaked at €29.4 billion in late 2010 ([International Monetary Fund 2011, 4](#)). Capital injections occurred throughout 2009 and 2010, much of which was directed to Hypo Real Estate (HRE) Gruppe, which was nationalized (p. 8). The European Commission approved extensions of SoFFin deadlines that made this possible. ([European Commission HRE 2011](#)). The initial deadline was December 31, 2009, presuming the crisis lasted that long, but Germany successfully appealed to have it extended first to June 3, 2010 and later to December 31, 2010 ([European Commission 2010, p. 1, 2](#)).

As of December 31 2018, €14.6 billion remain outstanding from recapitalization under SoFFin ([FMSA 2019](#)). Substantial amounts of this funding went to HRE Gruppe, peaking at €9.8 billion in late 2011, Commerzbank, peaking at €18.2 billion in late 2010, Portigon (former WestLB) peaking at €3 billion in December 2010, and Aareal Bank, peaking at €500 million in 2009. Aareal Bank has repaid SoFFin’s contributions, while Commerzbank has €5.1 billion outstanding, HRE Gruppe has €7.6 billion outstanding, and Portigon has €2 billion outstanding.

In the event of SoFFin’s liquidation, the outstanding positions are to be distributed 65% to the federal government and 35% to the *Länder*, capped at €7.7 billion (Belka p. 22). Costs associated with the rescues of Landesbanken by SoFFin are to be borne in their entirety by the relevant *Länder*.



## II. Key Design Decisions

### **1. The SoFFin capital injections scheme was introduced as part of a package in FMStFG, which also included guarantee and risk shield provisions.**

The German government passed the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz “FMStFG”), a package of crisis response measures that created the Financial Market Stabilization Agency (FMSA) (FMStFG 2008, §3(a)). FMSA was responsible for managing the fund in SoFFin. FMStFG also established SoFFin, which was to be used for three financial stability strategies: capital injections, guarantees, and risk shields (European Commission October 2008, p. 2). Section 7 of the FMStFG authorized the recapitalization scheme in particular.

### **2. SoFFin was funded primarily through Federal funding and mandatory state contributions.**

The federal government provides funding for SoFFin (Belka p. 22). However, states are also mandated to contribute to the Fund, and SoFFin may issue up to €100 billion of debt securities (Mayer Brown 2009, p. 1). The Federal Ministry of Finance capped total risk acquisition and recapitalisations at €70 billion with a possible extension of €10 billion with the consent of the Budget Committee of the Deutscher Bundestag. When SoFFin is liquidated, the remaining positions are to be issued 65% to the federal government and 35% to the *Länder*, capped at €7.7 billion (Belka p. 22).

### **3. The legal basis of the recapitalization scheme was the passage of FMStFG, the act which created SoFFin. Supplementary acts followed in 2009.**

The Deutsche Bundesbank is responsible for the general jurisdiction of the Fund, which may act, sue and be sued in its own name (FMStFG 2008, §3). In April 2009, the Rescue Takeover Act allowed for the complete acquisition of stricken financial institution by the Federal Republic of Germany, though it was never applied (FMSA “History”).

SoFFin can take part in the recapitalization of eligible financial sector enterprises in any suitable form, such as acquisitions of shares or silent participations in return for a capital contribution (European Commission October 2008, p. 3). It can receive a market-determined remuneration that must be preferred over profit sharing rights of other shareholders in the recapitalized institution, like dividend or interest payments.

### **4. The European Commission approved the SoFFin capital injections scheme under Article 87(3)(b) of the EC Treaty.**

The European Commission bans “state aid,” or government interventions that privilege a specific company, industry or region in a way that distorts trade or competition (European Commission 2019). Capital injections would normally be subject to a great deal of scrutiny under this rule. However, the European Commission (EC) permitted capital injections from SoFFin due to Article 87(3)(b) of the EC Treaty, which permits state aid to “remedy a serious disturbance in the economy of a Member State” (European Commission October 2008, p. 6).



The EC made these exceptions frequently for European countries in 2008 to help mitigate the effects of the financial crisis (Lowe p. 3).

**5. SoFFin and its capital injections schemes were managed by the FMSA, initially under the purview of the Bundesbank, but later assigned to the Federal Ministry of Finance in July 2009.**

The Federal Ministry of Finance controls FMSA, a public-law federal agency. The FMSA is managed by a three-member Management Committee appointed by the Ministry of Finance in consultation with the Bundesbank (FMStFG 2008, §3(a)). An inter-ministerial Steering Committee decides on agency proposals, though the Federal Ministry of Finance is responsible for the actual administration of the Fund (§4). The Steering Committee is composed of one member each from the Federal Chancellery, Ministry of Finance, Ministry of Justice, Ministry of Economics and Technology, and one member proposed by the Länder (provincial governments).<sup>2</sup> The Federal Government has the capacity to create guidelines that govern administration of the SoFFin fund, and does not required consent of the Bundesrat to do so. As of January 1, 2018, SoFFin has been managed by the Federal Ministry of Finance, which has been funding it since its inception in 2008 (Bundesrepublik Deutschland).

**6. Individual capital injections were capped at €10 billion, and total funding for SoFFin’s capital injections and risk shield strategies was capped at €80 billion.**

The Federal Ministry of Finance may take loans of up to €70 billion in order to fund SoFFin and the three strategies for which it is responsible (FMStFG Section 9 2008, §9). There is a possible extension of 10 billion additional Euros with the consent of the Budget Committee of the Deutscher Bundestag. Each individual institution was eligible for a maximum of €10 billion of recapitalization funds prior to the deadline of December 31, 2009.

**7. Participation in the plan was initially voluntary and open to any financial institution, but as the crisis worsened, SoFFin was given the power to nationalize banks and expropriate shares.**

The Federal Ministry of Finance decides on the participation of SoFFin in a recapitalization scheme when there is a substantial interest on the part of the Federation and the purpose sought by the Federation cannot better and more economically be achieved by other means (FMStFG 2008, §7). Each applicant to the recapitalization measure in SoFFin had to guarantee that their business activities were prudent and solid, and that their risky activities were limited or abandoned. (FMStFG 2008, §10; Petrovic and Tutsch 2009, 38) The Federal Government could also issue more detailed provisions on an institution’s business activities. The application volume for SoFFin stabilization in 2008 amounted to € 176.9 billion, of which €90 billion of guarantees and €8.2 billion of capital measures were granted (Bundesrepublik Deutschland). In April 2009, the Rescue Takeover Act allowed for the complete acquisition of stricken financial institution by the Federal Republic of Germany, though it was never applied (FMSA “History”).

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<sup>2</sup> The Länder are the states of Germany.

The institutions receiving recapitalization aid from SoFFin were Aareal Bank, Commerzbank, Hypo Real Estate Gruppe (HRE), and West Landesbank (FMSA 2019).

SoFFin was meant to strengthen the capital base of institutions “within the meaning of section 1(1b) of the Banking Act, of insurance undertakings and pension funds within the meaning of section 1(1) numbers 1 and 2 of the Insurance Supervision Act, of investment companies within the meaning of the Investment Act as well as of the operators of stock and futures exchanges and their respective parent enterprises, insofar as these are financial holding companies, mixed financial holding companies, insurance holding companies or mixed insurance holding companies and the abovementioned enterprises have their seat in Germany (financial-sector enterprises). Private-law entrusted owners of Landesbanken organized under public law, even where the owners are not financial holding companies, shall also be considered to be financial-sector enterprises within the meaning of the first sentence above.” (FMStFG 2008, §2)

These institutions needed to have a Tier 1 ratio of at least 7%, which was the threshold for solvency. If they did not meet this criterion, they were still eligible to apply for capital injections under SoFFin if they committed to reaching it within three months (European Commission December 2008, p. 3). This is in contrast to the Basel II Tier I ratio requirement then in force in Germany of 4% of risk-weighted assets.<sup>3</sup> There was also a requirement to hold minimum regulatory capital under Basel II (8%) plus 2 percentage points (European Commission December 2008, p. 4). This requirement indicates that SoFFin’s provision to inject capital was targeted towards solvent financial institutions. It was also an attempt to restore confidence in the German economy (European Commission October 2008, p. 2).

#### **8. SoFFin had discretion to determine the nature of its equity position in financial enterprises; in initially preferred nonvoting shares but ultimately nationalized two banks and acquired controlling common stakes.**

Section 7 of the FMStG act gave SoFFin discretion in determining the nature of its equity position in financial enterprises. It broadly authorized SoFFin to “acquire shares or silent [non-voting] participations and assume other components of the own funds [equity] of these companies, including such created by the legislation of the Lander [provincial governments].” (FMStFG 2008, §7) Additionally, under Section 3(2) No 1 FMStFV, SoFFin was entitled to receive a normal market remuneration. As a rule, SoFFin sought was to take a position senior to other shareholders in recapitalized institutions, e.g. in particular a preference dividend or an interest payment.

SoFFin ultimately invested in four banks. In three of those banks (Commerzbank, Aareal, and WestLB), it first took silent participations—a type of preferred share without voting rights,

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<sup>3</sup> While this is not explicitly described in Basel II, Part II Section I describes the calculation of minimum capital requirements as follows: “Part 2 presents the calculation of the total minimum capital requirements for credit, market and operational risk. The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. The total capital ratio must be no lower than 8%. Tier 2 capital is limited to 100% of Tier 1 capital.” With these requirements, the minimum acceptable amount of Tier 1 capital is 4%, with 4% of Tier 2 capital to adhere to the total capital ratio requirement of 8%. (Basel Committee on Banking Supervision)

that was senior to existing common and preferred shareholders. Aareal needed no further support and was able to pay back the government by 2014 (FMSA “Historical Overview of Financial Market Stabilization Fund FMS (SoFFin) Measures”). In other cases the initial capital injections proved insufficient. SoFFin later acquired a 25% stake in the common equity of Commerzbank and fully nationalized WestLB. SoFFin first extended credit to HRE in 2008 and fully nationalized the bank in 2009 (Reuters). WestLB and HRE were ultimately wound down by wind-down agencies that SoFFin created (Bundesrepublik Deutschland).

Capital injections to Commerzbank were announced on December 19, 2008 ([Commerzbank 2008 Press Release](#)). SoFFin made a silent participation of €8.2 billion in one tranche as of December 31, 2008 with annual interest of 9% paid on the silent participation (Mitchell 88). In case of insolvency and liquidation the debt is subordinate to all existing debt, pari passu with future hybrid offerings, and senior to shareholders ([Commerzbank 2008 Term Sheet, p. 1](#)). The silent participation is perpetual and can be terminated by Commerzbank with approval from the Ministry of Finance ([Commerzbank 2008 Press Release](#)). It will be redeemed at nominal value. There will not be a dividend for the first year, but in years with dividend payments, the interest rate applicable for the silent participation will increase. For each €4.4 million of dividend, 1 basis point is to be added ([Commerzbank 2008 Term Sheet, p. 1](#)). The first €4.1 billion of the contribution has an interest rate of 8.5% and the second €4.1 billion has an interest rate of 5.5% ([Levitin](#)). To avoid legal limits on state aid to individual banks, Commerzbank and Dresdner Bank separately sought additional aid in early 2009, prior to Commerzbank’s planned acquisition of Dresdner Bank (Mitchell 89). The state refused this request, but eventually acquiesced to a €10 billion contribution to Commerzbank after threats of abandoning the merger. Dresdner Bank was struggling due to its real estate investments and would have otherwise required nationalization to save it, which the German state sought to avoid. Of the €10 billion the state contributed, €8.2 billion was an additional silent participation, but €1.8 billion consisted of ordinary shares amounting to a 25% stake ([Clark](#)). This was the first time SoFFin had taken a direct position in a financial institution, and its contributions secured it veto power over decisions at Commerzbank (Mitchell 89). It also received three seats on the bank board, though it did not intend to influence any decision-making, or dilute ownership control by private shareholders. Commerzbank had a nine-member board in 2009 ([Commerzbank Annual Report 2009 p. 32](#)).

Aareal Bank had sufficient cash and capital base throughout the 2009 financial year, and sought SoFFin support to strengthen it against further turbulence in financial markets ([Aareal Annual Report 2009, p. 85](#)). SoFFin injections to Aareal bank in 2009 amounted to €525 million with 9% annual interest ([Aareal Q1 2009 Interim Report, p. 17](#)). To expedite the repayment of the silent participation, Aareal bank did not issue dividends in 2008 or 2009 ([Aareal Annual Report 2009, p. 71](#)). Aareal Bank refrained from paying its supervisory board any variable compensation.

In 2009, WestLB, a major Landesbank with €288.1 Billion of assets at year end 2008, was large enough to be considered a risk ([European Commission October 2009](#)). Its exposure to American subprime assets was a problem first realized in losses of €2.5 billion on its subprime portfolio (Mitchell 93). In November 2009, shareholders along with the German government agreed to establish a bad bank, Erste Abwicklungsanstalt. It took over a

portfolio of risk positions and risky assets that would have otherwise negatively impacted the performance of WestLB. The capital injection from SoFFin to WestLB amounted to €3 billion in three installments ([European Commission December 2011](#), §2(b)(i)). First, €672 million were injected on December 23, 2009, €1.5 billion were injected on January 4, 2010, and €828 million were injected on April 30, 2010. It was in the form of a non-callable silent participation, which was optionally convertible into ordinary shares after July 1, 2010. The terms dictate that SoFFin cannot become a majority shareholder of the company. If WestLB shows a sufficient year-end profit, the terms of the silent participation provide for a 10% remuneration per annum. In the case of loss, the silent participation will participate *pari passu* in the losses and will forgo remuneration.

Hypo Real Estate (HRE) was nationalized by SoFFin ([European Commission May 2009](#), p. 2). A credit line was extended to it in 2008, and SoFFin subsequently made a public takeover bid to acquire all shares in HRE. Though SoFFin could have nationalized HRE by law had its bid been unsuccessful, it acquired 38.65% of shares in the bid. This gave SoFFin 47.31% stake in HRE, and due to low shareholder attendance in the general assembly, SoFFin had *de facto* control of HRE. In April 2009, SoFFin submitted an offer to HRE shareholders to purchase shares at €1.39 per share:

“The Management Board and Supervisory Board of Hypo Real Estate Holding AG have resolved to propose an increase of the registered share capital against cash contributions, excluding shareholders' pre-emptive subscription rights, pursuant to sections 182 et seq. AktG in conjunction with section 7 FMStFG, to an Extraordinary General Meeting on 2 June, 2009. To strengthen the Company's capital base in a sustained manner, it was proposed to increase the Company's registered share capital (Grundkapital) of € 693,253,560 by cash contributions of up to € 5,639,282,040 to a total of up to € 6,332,535,600, through the issuance of up to 1,879,760,680 new non-par value bearer shares” ([HRE Press Release 2009](#)).

SoFFin will subscribe new shares at the lowest price to obtain a 90% stake in the company ([SoFFin 2009 Presse Release](#)). SoFFin intended to increase HRE equity from €700 million to around €6.3 billion, diluting the stake of existing shareholders ([DW 2009](#)). In October of 2009, SoFFin squeezed out remaining minority shareholders by forcing an offer of €1.30 a share, fully nationalizing HRE ([Reuters 2009](#)). Minority shareholder JC Flowers took legal action against the full nationalization of HRE Gruppe along with other shareholders, and filed a complaint with the European Union. However, they lost this challenge, and the 2011 decision of the Munich courts was that Germany had a legal basis for the forced nationalization of HRE Gruppe (Wilson).

As of December 2018, €14.6 billion are outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former WestLB) ([FMSA 2019](#)). SoFFin has no clear exit strategy for these involvements.

**9. In addition to existing limitations on dividend payments and compensation, the Federal Government may issue ordinances with more detailed provisions of the conditions of the recapitalization.**

These include the consideration of the recapitalization, upper limits for the participation in own fund items of individual organizations as well as particular types of fund items, the conditions under which the Fund may resell its participation in the own fund items, and any other conditions required to safeguard the purpose of the Act under the context of recapitalization (FMStFG 2008, §7). Financial enterprises seeking to utilize one of the stabilization measures in SoFFin have to guarantee a prudent business policy.

Participants were obligated to provide loans to small and medium-sized enterprises (SMEs) (Petrovic and Tutsch 2009, 38). They were not allowed to pay dividends to any shareholders before the State, and individuals managing each firm were limited to €500,000 in annual compensation. They were not allowed to receive bonuses.

The Federal Government was empowered to issue additional requirements to these organizations on business strategy, use of monies received, remuneration of their bodies and employees, the level of their own funds, distribution of dividends, the period within which to fulfill requirements, measures to avoid distortions of competition, the way in which account is to be rendered to the Fund, an undertaking on compliance with the above enumerated requirements to be given by the authorized representative body with the consent of the supervisory body and to be published, and any other conditions required to safeguard the purpose of the FMStFG (FMStFG 2008, §10).

**10. SoFFin's stabilization measures were initially available until December 31, 2009 but were subject to several extensions.**

The initial deadline for applications for recapitalization funds was December 31, 2009, provided the crisis lasted that long (European Commission December 2008, p. 1). However, with approval from the European Commission, Germany successfully appealed to have extended three times to December 31, 2010 (European Commission 2010, p. 2). SoFFin was reopened in 2012 with a final closure in 2015 (Bundesrepublik Deutschland)

**11. There were no clear exit strategies for SoFFin's recapitalization involvement.**

As of December 2018, €14.6 billion are outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former WestLB) (FMSA 2019). SoFFin has announced no clear plans to exit these capital injections, nor has FMStFG delineated any clear strategies. Firms may repurchase their shares from SoFFin or sell them to a third party to exit involvement with SoFFin, but there was no explicit timeline required for this exit (European Commission October 2008, p. 3). There was a commitment from German authorities to present restructuring plans to financial enterprises that had received capital injections but had not undertaken a buyback plan for their shares within six months (p. 4). This deadline was extended in six month increments if the crisis were to continue, and was not required if the financial institution was fundamentally sound (European Commission December 2008, p. 6). Though SoFFin has this mechanism for exiting recapitalizations, scholars criticize the fact that it did not delineate a timetable for doing so (Bleuel 20).



## **12. Germany has new legislation concerning government interventions in the case of financial crisis.**

Germany passed the Bank Restructuring Act in January 2011 ([Deutsche Bundesbank](#), p. 62). This act strengthened the coordination of various German federal agencies and European agencies in order to better deal with distressed systemically important banks. It creates procedures to recover struggling banks and reorganize insolvent ones by the Federal Financial Supervisory Authority (BaFin), the successor to FMSA (p. 61-63). These measures will be funded by a Restructuring Fund to which all banks are required to contribute (p. 72-74).

### **III. Evaluation**

Assessments of SoFFin's overall effectiveness from the IMF and academic scholars are generally positive in nature, and agree that it contributed to maintaining financial stability and limiting losses in Germany during the global financial crisis. It also created mechanisms for resolving problem banks and strengthens the broader crisis management framework in Germany ([International Monetary Fund 2011, 4](#)).

SoFFin was considered to have mechanisms to combat short-term issues of liquidity and confidence, but also helped achieve some long-term goals like encouraging executive responsibility by restricting compensation while using SoFFin funds ([Petrovic and Tutsch 2009, 38](#)). On the other hand, it was also criticized for not adequately addressing the issues of lack of transparency regarding bank assets and performance ([Bleuel 18](#)). In addition, it did not address long-term issues of bank concentration or liabilities for losses (p.19). The voluntary nature of the program was somewhat stigmatizing, in contrast to the forced recapitalizations of the United States or collective banking industry plan in France (Woll 128).

SoFFin also does not have a clear exit strategy, and this is particularly an issue for the recapitalization funds of which €14.6 billion remain outstanding ([International Monetary Fund 2011 p. 4](#)). In addition, the relationship between SoFFin's restructuring fund and the deposit insurance schemes and mutual protection schemes must be clarified. (p. 5) The IMF strongly recommends clarifying an exit strategy for current capital involvements and either raising private capital or modifying bank balance sheets in order to limit future demand for capital injections (p. 13).

SoFFin is not constructed to coordinate with other European and German institutions to comprehensively address failing banks ([International Monetary Fund 2011 p. 4](#)). SoFFin also dealt with some conflicts of interest, as the CEO of Commerzbank sat on the board of the Bundesbank, allowing banks to negotiate favorable terms for actual recapitalization aid (Mitchell 100). Germany has since passed a Restructuring Act that finances its recapitalization fund by collecting dues from systemically important banks. (p. 7) This Act also contains provisions to recover and restructure illiquid or insolvent banks in coordination with other German and European agencies, especially if the bank operates across borders. ([Deutsche Bundesbank 62-74](#) )

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## **V. Key Program Documents**

### **Summary of Program**

Act on the Establishment of a Financial-Market Stabilisation Fund – English translation of FMStFG, legislation authorizing SoFFin

### **Legal/Regulatory Guidance**

European Commission Decision October 27, 2008 (C(2008) 6422) – EC initial approval of SoFFin

European Commission Decision December 12, 2008 (C(2008) 8629 fin) – EC approval of amended SoFFin

European Commission Decision May 14, 2009 (C(2009) 3994 fin) – EC approval of HRE aid

European Commission Decision October 7, 2009 (IP/09/1434) – EC approval of aid to WestLB

European Commission Decision June 23, 2010 (C(2010)4261 final) – final EC approval of extension of SoFFin until December 31, 2010

European Commission Decision July 18, 2011 (C(2011) 5157 fin) – EC approval of HRE acquisition

European Commission Decision December 20, 2011 (C(2011) 245 fin) – EC approval of WestLB restructuring plan

### **Press Releases/Announcements**

SoFFin holds 47.31 percent of Hypo Real Estate Holding AG (HRE) after expiration of acceptance period – the takeover to stabilize HRE by the Federal Republic of Germany can be continued swiftly. - Press Release announcing HRE takeover

Archive of press releases related to SoFFin from 2008-2017  
<https://www.fmsa.de/en/press/>

### **Reports/Assessments**

The German banking system and the global financial crisis: causes, developments and policy responses (Bleuel 2009)– paper providing context for financial crisis in Germany and analyzing policy responses, including SoFFin <http://ssrn.com/abstract=1365813>

Fundamental Features of the German Bank Restructuring Act (Deutsche Bundesbank 2011) - paper describing the Restructuring Act and how it improves on FMStFG's flaws  
<https://www.bundesbank.de/resource/blob/707210/d60f5843069da07d666b02f2e8706c8f/mL/2011-06-fundamental-features-german-bank-restructuring-act-data.pdf>

## **VI. Appendix**

Financial Statements of SoFFin by year: (Bundesrepublik Deutschland)

### **Report FY 2008**

In the short financial year 2008, SoFFin generated net income of € 55.2 million. This was transferred in full to the equity of SoFFin.

The most important source of net income for the year was provisions for guarantees amounting to € 4.0 million and commissions from guarantees amounting to € 51.4 million. In addition, SoFFin generated interest income from its credit balances amounting to € 11.6 million. On the other hand, SoFFin's expenses of € 11.7 million stemmed from the borrowing to finance the silent participation in Commerzbank AG.

The application volume for SoFFin stabilization assistance amounted to € 176.9 billion as at 31.12.2008. Contracts amounting to € 90 billion were signed for the granting of guarantees. Capital measures of € 8.2 billion were granted. Risk assumptions were not carried out until the end of 2008.

The Finanzmarktstabilisierungsanstalt (FMSA) had 18 employees on December 31, 2008 (including the steering committee). FMSA's administration of SoFFin was fully covered by the flat-rate revenue generated by FMSA in the short financial year 2008, which FMSA invoiced to the applicant institutions.

### **Report on the 2009 financial year**

The Special Fund Financial Market Stabilization (SoFFin), which is managed by the German Federal Financial Market Stabilization Authority (FMSA), closes the year 2009 with a shortfall of 4.26 billion euros. This is the result of the valuation result, which squeezes operating surpluses amounting to € 497 million.

The participations of SoFFin in Hypo Real Estate Group AG and its subsidiary Deutsche Pfandbriefbank AG were reduced in value by 4.75 billion euros, 4.1 billion euros in equities and 0.65 billion euros in silent participations. The remaining participations of SoFFin were also accounted for unchanged according to the regulations of the HGB at the purchase price.

SoFFin's operating profit of € 497 million comprises € 690 million of commission income for providing guarantees to financial services institutions and corresponding drawdowns on guarantees, € 214 million of interest on deposits and a silent participation, less € 407 million. Euro for interest and interest-like expenses.

FMSA, which manages the fund, closed the year 2009 with net income of EUR 2.03 million. For the administration of the fund, it received remuneration packages from the applicant institutes amounting to 12.1 million euros. By contrast, operating expenses amounted to € 10.1 million. The consultancy costs charged to the applicant institutions were not taken into account. The costs of managing SoFFin were thus fully covered by revenue in the past financial year. On December 31, 2009, FMSA had 39 employees including the Executive Committee. It is subject to the ongoing review by the Federal Court of Audit, whereby the annual audit has been carried out by an auditor and must be audited.

As of December 31, 2009, the application volume for SoFFin stabilization aid amounted to € 230.9 billion. For the granting of guarantees, contracts worth 160.7 billion euros had been signed as of this date. Capital measures amounting to EUR 28.0 billion were granted. Current contracts for risk transfer did not exist at the end of 2009.

With the Act on the Further Development of Financial Market Stabilization of July 22, 2009, FMSA became an independent Federal Institution in the business area of the Federal Ministry of Finance. In addition, the instruments of the FMSA were extended to include "guarantees to special purpose entities" and "Federal Settlement Offices". The application deadline for Guarantees to Special Purpose Entities expired on January 22, 2010, without recourse to this instrument. The "Erste Abwicklungsanstalt" was established by the spin-off of a tranche of assets from WestLB in December 2009 and will cover a total volume of 77 billion euros after the end of the process in April 2010. Another application for the establishment of a winding-up institution was made by Hypo Real Estate Holding AG and is currently being examined by FMSA and the EU Commission. Provided that the EU Commission and the committees of SoFFin vote in favor, it is planned to conclude the corresponding spin-offs of the HRE Group by the end of September 2010.

## **Report on the 2010 financial year**

The Financial Market Stabilization Fund (SoFFin), which is managed by the German Federal Financial Market Stabilization Authority (FMSA), is closing 2010 with a deficit of € 4.80 billion. This essentially results from a scheduled provision in connection with the statutory loss-absorbing obligation of the Confederation vis-à-vis FMS Wertmanagement, the winding-up institution for former assets of the Hypo Real Estate Group (HRE) in the amount of EUR 3.87 billion and the valuation result of the fund.

As part of the spin-off of non-strategic business areas and risk positions from HRE to FMS Wertmanagement as of September 30, 2010, SoFFin has incurred a loss-absorbing obligation vis-à-vis FMS Wertmanagement. For this purpose, SoFFin has formed a provision in the amount of € 3.87 billion, from which the capital injection will be financed in 2011. This is already included in the total amount of capital grants for HRE totaling € 9.95 billion notified to the European Commission.

The valuation result reflects the value adjustments to the investments of the Fund according to the prudence principle. A final statement about the actual costs of the stabilization of the financial market will only be possible after the repayment of all investments and the liquidation of the liquidation institutions.

Payments for interest and similar expenses of the Fund of EUR 809 million were fully covered by income from commission income on guarantees provided to financial services institutions and guarantees taken up amounting to EUR 933 million. In addition, SoFFin generated interest income on balances as well as a silent participation in the amount of € 49 million and € 142 million in other operating income.

FMSA closed the year 2010 with a net loss of EUR 4.38 million. For the administration of the SoFFin it received from the applying institutes compensation flat rate in the amount of 4.39 million euro. FMSA generated interest income and other operating income of EUR 0.14 million. By contrast, operating expenses amounted to 8.91 million euros; These are essentially personnel and material costs. However, the shortfall is covered by surpluses from previous years, so that there was no allocation requirement from the federal budget for 2010.

On December 31, 2010, FMSA had 56 employees including the Executive Committee. Their annual accounts are audited by an auditor. It is also subject to the ongoing review by the Federal Court of Audit and the legal and technical supervision of the Federal Ministry of Finance.

As of December 31, 2010, there were liquidity guarantees of € 64 billion at nine institutions. In addition, SoFFin had granted capital measures worth EUR 29 billion. New support measures have not been granted by SoFFin since 31 December 2010. However, SoFFin continues to assume the responsibilities based on the existing stabilization measures, such as the controlling of the measures imposed by the measures and the legal supervision of the resolution institutions.

As of April 30, 2011, the volume of guaranteed guarantees has been reduced to € 36 billion. The latest due date is the beginning of 2015. According to the current state, no loss



can be expected. The recapitalisations are due to the repayment of SoFFin's investment announced by Commerzbank AG for the first half of the year to around EUR 18 billion. In connection with the repayment of the silent participations, SoFFin will receive from Commerzbank AG a fee of EUR 1.03 billion.

With the entry into force of the Restructuring Fund Act at the beginning of 2011, the legislator has also transferred the administration of the Restructuring Fund to FMSA. Thus, FMSA has become a permanent pillar of the architecture of the financial center Germany. For the first time in 2011, it will levy the bank levy that goes into the restructuring fund. He is thus financing the instruments available to him as part of the reorganization procedure for banks to stabilize the financial system. If it is not possible to cover the need for funds on time, including through special contributions, the restructuring fund may borrow. He was granted a guarantee of 100 billion euros and a credit authorization for recapitalization measures of 20 billion euros.

## **Report on the 2011 Financial Year**

### **A. Overview of Business Development**

The Financial Market Stabilization Fund (SoFFin), whose business is run by the Federal Institution for Financial Market Stabilization (FMSA), the year 2011 closes with a deficit of EUR 13.1 billion.

The net loss for 2011 mainly results from additions to provisions for the loss compensation obligation of SoFFin towards FMS Wertmanagement (FMS-WM) amounting to 11.4 billion euros. These are largely attributable to the sovereign debt crisis and the associated write-downs of the liquidation institution on its exposure to Greece. Further expenses of SoFFin are due to depreciation on participations in the amount of 4.13 billion euros and 0.42 billion euros incurred through interest expense.

Total expenses of € 15.95 billion include income of 2.85 billion euros.

The risk volumes transferred to the liquidation institutions decreased in the year 2011 compared to the end of the previous year significantly.

The volume of outstanding guarantees decreased by 49% to 28.2 billion euros.

The stock of recapitalization measures granted decreased by 32% or 19.8 billion euros.

## **Report on the 2012 financial year**

### **A. OVERVIEW OF BUSINESS DEVELOPMENT**

The Financial Market Stabilization Fund (SoFFin), whose business is run by the Financial Market Stabilization (FMSA) closes the year 2012 with a net income of EUR 580 million.

The 2012 net income mainly results from valuation effects. Thereby

Other operating income totaled EUR 1.43 billion. They relate to the partial release of the provision for the loss compensation obligation to the FMS Value Management (FMS-WM) in the amount of EUR 1.39 billion and the write-up on the silent investment in Deutsche Pfandbriefbank AG (pbb) in the amount of EUR 0.04 billion.



SoFFin's revenues amounted to EUR 0.13 billion and stemmed from commissions for granted guarantees and the provision of a loss-sharing framework to the First Resolution Institution (EAA). In addition, SoFFin has EUR 0.03 Billion income for the silent participation in Aareal Bank AG.

The total income of EUR 1.59 billion includes expenses totaling EUR 1.01 Billion, resulting from value adjustments to equity investments (totaling EUR 0.74 billion) and interest expenses of EUR 0.27 billion.

The volume of outstanding SoFFin guarantees decreased compared to 31 December 2011 by almost 87% to EUR 3.7 billion. The stock of granted recapitalization measures before value adjustments was 2012 by EUR 1.0 billion to EUR 18.8 billion by taking over part of the silent participation at WestLB AG through the state of NRW. In return, SoFFin took over one Subordinate loss compensation obligation of the same amount at the EAA.

Part of the claim of the FMS World Cup against SoFFin due to the loss compensation obligation was made in 2012 with a payment to the FMS World Cup in the amount of EUR 2.0 Billion. Further loss compensation payments to the FMS World Cup amounting to a total of EUR 7.3 billion were made after the balance sheet date. Reason for the early compensation is the reduction of the total cost to the taxpayer, adding the refinancing advantage used by the federal government. The repayment of the loss compensation obligation to the FMS-WM in 2012 will lead to increased refinancing costs for SoFFin.

In 2012, no new measures under the Financial Market Stabilization Act granted. The uncovered shortfall accrued to 31 December 2012 has been reduced down to approx. EUR 21.5 billion.