EUROPEAN COMMISSION

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

PUBLIC VERSION

WORKING LANGUAGE

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Subject: **State aid N 615/2008, Germany**
State aid to BayernLB

Sir,

1. PROCEDURE

(1) On 4 December 2008 the German authorities notified the Commission of measures to support BayernLB, Germany. On 8, 11 and 15 December 2008 the Commission requested further information from the German authorities, which was provided on 11, 12, 15, 16 and 17 December 2008. In addition, an exchange of information relating to this matter took place in the course of two telephone conferences, held on 12 and 13 December 2008.

2. DESCRIPTION OF THE AID

2.1. The beneficiary

(2) The beneficiary is BayernLB, a publicly owned credit institution operating in the form of a public institution. It is – indirectly through the holding company BayernLB Holding AG – owned by the Free State of Bavaria (50%) and the Association of Bavarian Savings Banks (50%). BayernLB Holding AG is the sole shareholder in BayernLB and is not itself a credit institution.

(3) BayernLB is a commercial bank with an international presence. It has a home market in Bavaria with selective representation in other parts of Germany, neighbouring European countries, Central and South-Eastern Europe, North America and Asia. BayernLB also has a presence in selected financial centres around the world. BayernLB's customers comprise sovereign States and municipal authorities, financial institutions, large and medium-sized companies and real-estate developers. BayernLB's business activities

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consist of retail and corporate banking, capital market and securities activities as well as leasing.

(4) Outside Germany, BayernLB's business is concentrated in the fields of retail and corporate banking and leasing, especially in Central and South-Eastern Europe. Given its ownership structure, BayernLB also functions as the principal bank of the Free State of Bavaria and as the central clearing institution of the Bavarian savings banks.

(5) In 2007, the BayernLB group's balance sheet total amounted to EUR 416 billion, and the bank recorded a pre-tax profit of EUR 255 million. The BayernLB Group employed over 19 000 people. BayernLB is therefore one of Germany's biggest banks and, based upon its balance sheet total, the second-biggest Landesbank in Germany.

2.2. The events leading up to the provision of aid

(6) In the aftermath of the insolvency of Lehman Brothers and the crisis affecting the Icelandic financial system, a sharp deterioration in the state of financial markets occurred in October 2008. As a result of significant and rapidly spreading uncertainty in the macro-economic environment, numerous rating downgrades had to be sustained in BayernLB's credit operations and in compliance with the rules of Basel II, these had to be offset by substantially increased equity coverage. Moreover, the basis of calculation for the amounts required, where denominated in US dollars, increased as a result of foreign exchange movements. Substantial rating downgrades and write-downs occurred in BayernLB's ABS portfolio, which resulted in a significant reduction in the bank's equity ratio.

(7) These events, together with the announcement by BayernLB that it would claim aid on the basis of the German Financial Markets Stabilisation Law, resulted in a deterioration in the financing possibilities of BayernLB. This can be seen most clearly in the increase of the CDS (Credit Default Swap) spreads. On 8 December 2008 BayernLB had a CDS spread of 130 basis points, compared to 50 basis points at the beginning of 2008.

(8) According to current estimates, without stabilisation measures BayernLB will report a net loss of EUR [(4–7)][*] billion under German Accounting Standards (HGB) and, as a result, will record an accumulated loss on its balance sheet. In such a scenario, profit-sharing capital, silent investments and, potentially, hybrid capital may not be serviced, and moreover the holders of silent investments and profit-sharing capital would be proportionately affected by the balance sheet loss. According to the German authorities, in such a scenario, the bank could lose its access to capital markets. In particular, BayernLB's credit rating and potential for refinancing could be severely impaired.

(9) Based on the last reporting date, the core capital ratio on 30 September 2008 (taking into account market risk positions) was [(5–7)]%. Allowing for BayernLB's expected post-tax loss, in the absence of stabilisation measures, of EUR [(4–7)] billion in the financial year 2008, the core capital ratio would fall to [(<4)]% (taking account of market risk positions, or [(<4)]%) disregarding market risk positions.

[*] Subject to commercial confidentiality.

(10) On 10 December 2008 a capital increase in the amount of EUR 700 million was implemented by BayernLB at one of its foreign participations, namely the Austrian Bank Hypo Group Alpe Adria (HGAA), which is based in Klagenfurt. This capital increase was funded out of BayernLB's own liquidity.

(11) BayernLB currently has a long-term, non-guaranteed rating from Standard & Poor's of A, with negative outlook, and from Moody's a long-term, non-guaranteed rating of Aa2. On 2 December 2008 Moody's placed the bank's long-term issuer rating on 'review for possible downgrade'.

2.3. The measures

(12) The intended stabilisation of BayernLB consists of two measures: a reinforcement of capital in the amount of EUR 10 billion, and a risk shield on the ABS portfolio of up to EUR 4.8 billion. Both measures are to be implemented by the Free State of Bavaria outside the framework of the aid scheme approved by the Commission on 12 December 2008 for a rescue package for financial institutions in Germany.[1] However, as can be seen in the following explanations, the conditions follow the German aid scheme.

Reinforcement of capital

(13) The reinforcement of the capital by a total amount of EUR 10 billion is implemented in three instalments. In the first, BayernLB will receive EUR 3 billion (of which part on 19 December 2008 and the remainder on 30 December 2008). The second and third instalments, in the amount of EUR 3 billion (silent participation) and EUR 4 billion (capital increase) respectively, are to take place in the first quarter of 2009. The capital received in all three instalments constitutes core capital within the meaning of the Gesetz über das Kreditwesen (KWG) (Law relating to Credit Institutions).

(14) The first instalment of the capital increase is to be implemented in several steps. First, the general assembly of BayernLB Holding AG will decide to increase the registered capital by around EUR [(1 000–1 500)] million through the issuance of around [(1 000–1 500)] million new shares (resulting in a share of EUR 1 per share in the registered capital). The issue price is to be set at around EUR [(2–3)], i.e. with a premium for each share of around EUR [(1–2)]. This results in a total capital injection of EUR 3 billion. The premium is calculated on the basis of the current valuation of BayernLB Holding AG of EUR [(500–1 500)] million, which has been determined on the basis of a preliminary, indicative valuation exercise established by an audit firm.

(15) The new shares will be exclusively taken over by the Free State of Bavaria. The Association of Bavarian Savings Banks, which prior to the capital increase holds a stake of 50% in BayernLB Holding AG, will not participate in the capital increase. Following completion of the third instalment, the stake held by the Association of Bavarian Savings Banks will be reduced to around [(3–10)]%.

[1] Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany, not yet published.

(16) The new shares are endowed with voting rights and a non-cumulative preferential entitlement to participate in earnings. This dividend distribution applies until the completion of BayernLB's process of restructuring. These vote-carrying preference shares will receive a share of EUR 300 million out of the balance sheet profits before other shares receive dividend payments (a return of [(20–30)]% on the nominal value of the new shares). In economic terms, this is equivalent to a preferred dividend of 10% on the total capital injected.

(17) In the next step, the holding company transfers the funds to BayernLB. This is to be carried out through payment into the capital reserves of BayernLB. On the level of the bank itself, therefore, no capital increase will take place in the legal sense, but rather a payment into reserves. A formal capital increase is not necessary, as the holding company already holds a stake of 100% in BayernLB. Payment into the (utilisable) reserves is necessary, in order potentially to avoid a balance sheet loss through the utilisation of these reserves. A balance sheet loss has the consequence, in addition to the non-servicing of hybrid instruments such as silent investments and profit-sharing rights, that these instruments participate in losses.

(18) The second instalment is to take the form of an open-ended silent participation of EUR 3 billion, which is to be carried out on 30 January 2009. A rate of 10% of the nominal value is set as a preferential, non-cumulative return on this silent participation.

(19) The third instalment of the capital increase, in an amount of EUR 4 billion, is to be implemented in the same way and under identical conditions as the first instalment. In particular, the same corporate valuation and, in consequence, the same issue price for the new shares will be used as the basis for the capital increase. The newly created preference shares will be entitled to the same preferential dividend earnings as in the case of the 2008 capital increase.

Risk shield for the ABS portfolio

(20) The Free State of Bavaria will provide a risk shield for losses in BayernLB's ABS portfolio. The nominal value of the total ABS portfolio can currently be calculated to be around EUR 21 billion. The risk shield relates to a maximum amount of EUR 6 billion. The Free State of Bavaria will give a declaration of guarantee in this respect of EUR 4.8 billion, which can however only be taken into account once and to the extent that a loss of EUR1.2 billion is exceeded (at the risk of BayernLB).

(21) The objective of the risk shield for the ABS portfolio is to avoid further write-downs on the ABS portfolio and so to reduce BayernLB's annual loss for 2008 and to avoid a decrease in the bank's capital. The current market value of the ABS portfolio is estimated at approximately [(50–70)]% of the nominal value of EUR 21 billion. In a base case scenario, the expected and unexpected losses will amount to EUR 2.825 billion. In a worst case scenario, the expected and unexpected losses will amount to EUR [(4–5)] billion.

(22) In return for its declaration of guarantee, the Free State of Bavaria will receive a return of [(0.4–0.7)]% per annum, based on the amount of EUR 4.8 billion. The basis for this calculation is reduced by amounts taken up and increased by amounts repaid, which are charged or distributed to the guarantor.

(23) The duration of the risk shield in theory depends on the final maturity of the securities that are part of the ABS portfolio. However, the current portfolio of EUR 21 billion should be reduced to EUR [(4–6)] billion over six years through repayments. Moreover, the remaining portfolio is subsequently to be sold in agreement with the guarantor, so that a phase out of the risk shield can be expected in six years.

Guarantee of liquidity by the Special Fund for Stabilisation of Financial Markets

(24) In addition to the measures by the Free State of Bavaria, BayernLB will receive a guarantee of EUR 15 billion for liquidity loans from the Sonderfonds Finanzmarktstabilisierung (SoFFin) (Special Fund for Stabilisation of Financial Markets), in accordance with Article 6 of the Gesetz zur Errichtung eines Finanzmarktstabilisierungsfonds (Law establishing a Financial Markets Stabilisation Fund 'FMStFG'), of 17 October 2008. However, this measure does not form part of the notification at issue here, but should be covered by the Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany.

Aim of the measures

(25) The reinforcement of capital and the risk shield for the ABS portfolio are necessary to demonstrate appropriate equity ratios. Through the risk shield for the ABS portfolio and the first instalment of the recapitalisation, in an amount of EUR 3 billion, BayernLB will probably reach in the first step a core capital ratio of [(4–5)]%, in the second step [(6–7)]% and ultimately, after the third step in the recapitalisation, a core capital ratio of [(7.5–8.5)]%.

(26) According to the German authorities, this target of a core capital ratio of [(7.5–8.5)]% meets international requirements for a minimum core capital ratio, which in comparison with the levels demanded by regulatory bodies have increased substantially.

(27) The reinforcement of capital which has been notified in an amount of EUR 10 billion equates to [(4–6)]% of total risk positions (risk-weighted assets).

(28) The capital strengthening also aims indirectly (see above, paragraph 17) to avoid a participation in losses on the part of the bank's hybrid equity instruments (in particular, silent investments and profit-sharing rights). Such a participation in losses is to be avoided, as this would severely damage BayernLB's ability to access capital markets and its possibilities for refinancing.

3. OBSERVATIONS OF THE GERMAN AUTHORITIES

(29) The German authorities have notified these measures as constituting State aid. Germany is of the opinion that this aid is permissible under Article 87(3)(b) EC, as it is necessary to remedy a serious disturbance in the economy of a Member State.

(30) German points out that these measures are necessary to maintain BayernLB's ability to access capital markets and the minimum level of capitalisation required of market participants [….].

(31) The German Bundesbank and the Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Institute for the Supervision of Financial Services) have confirmed that BayernLB is of systemic importance for the German banking system, on account of its close integration into the functioning of this system. Should the measures fail, it is to be assumed that BayernLB [….] will no longer be able to perform its important role within the German financial system.

(32) In the opinion of the German authorities, the Free State of Bavaria will receive a market rate of return on its participation in these capital measures, which is in accordance with the German rescue package for credit institutions. The measures are necessary to maintain BayernLB's ability to function and do not exceed the scope that is required.

(33) The German authorities claim that potential distortions to competition are mitigated through the conditions which have been set out and that the conditions and assurances contained within the Commission's approval of the German rescue package apply to the measures at issue here.

(34) Furthermore, the point is made that the Free State of Bavaria intends to privatise BayernLB.

(35) With respect to the capital increase which BayernLB has implemented at its Austrian participation, HGAA, the German authorities state that this capital measure was necessary on account of the clean-up of HGAA's loan portfolio and the effects of the financial crisis on HGAA, in order that HGAA should be recapitalised to an extent (to a minimum capital ratio of [(5–7)]%) allowing it to participate in the Austrian State aid system for banks [….].

4. COMMITMENTS MADE BY THE GERMAN AUTHORITIES AND BAYERNLB

(36) The Commission takes into account the following commitments made by the German authorities and BayernLB, which are limited to the period in which the aid measures will be in effect:

- The BayernLB Holding AG will pay out no dividends on existing shares; for the current business year, in the absence of earnings, BayernLB will pay out no interest or coupon on existing capital instruments, unless legally obliged to do so despite an accumulated loss on its balance sheet.

- The remuneration of board members and employees of BayernLB will be restricted to a reasonable level and the payment of bonuses will be suspended. In this context, it is explicitly stated that BayernLB will comply with the stabilisation conditions of Article 5 of the Finanzmarktstabilisierungsverordnung (Financial Market Stabilisation Decree, 'FMStFV').

- BayernLB undertakes to take sufficient account of the requirements for credit in the domestic economy, in particular with respect to small and medium-sized companies. Here also, reference can be made to Article 5 of the FMStFV.

- Growth in BayernLB's balance sheet will be restricted as follows: BayernLB is committed not to exceed the level of balance sheet growth recorded in previous years and not to exceed whichever is the highest of the following: the growth in nominal GDP of the previous year, the average growth of the banking sector over the 20 years 1987-2007 and the average growth in the Eurozone banking sector over the last six months.

(37) The German authorities assure the Commission of ongoing review of these capital measures.

(38) The German authorities undertake to present to the Commission within six months a restructuring plan that embraces the whole BayernLB group. Cornerstones of this plan are to be a concentration on core business areas and a focus upon selected European regions. In addition, a substantial reduction in the balance sheet total is anticipated.

(39) Moreover, Germany agrees that BayernLB will present to the Commission the restructuring plan within the next four months, ahead of its final adoption by the bank's ownership bodies.

5. ASSESSMENT

4.1 Existence of aid

(40) First, the Commission recognises, in agreement with the German authorities, that the measures of which it has been notified constitute State aid for BayernLB Holding AG and its 100%-owned subsidiary BayernLB, in accordance with Article 87(1) EC.[2]

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

(42) As BayernLB operates in the financial sector, which is characterised by intense international competition, any advantage provided to BayernLB by State funds would carry the hidden potential to damage trade within the Community and distort competition. Moreover, State funds are at issue and the measures which will be implemented by the Free State of Bavaria are to be attributed to the State.

(43) The Commission is of the opinion that the measures grant BayernLB a selective advantage.

[2] The Commission currently has no indication of indirect aid to the bank's shareholders, which could arise through the retention of a stake of around [(3–10)]% by the Association of Savings Banks after the capital increase. However, such an assessment could be made only after careful scrutiny of the provisional, indicative valuation of the group, which the Commission can perform at best in the context of assessing the restructuring plan, and which the Commission therefore reserves the right to carry out.

(44) The capital increase measures permit BayernLB to receive sufficient equity capital, which, in the light of the bank's difficult position and the current constraints upon financial markets, it would not have been able to receive to such an extent and under such terms.[3] This creates an economic advantage for BayernLB and strengthens its position with respect to competitors in Germany and other Member States. This advantage is selective, as only one bank benefits.

(45) Likewise, in the case of the risk shield for the ABS portfolio, the Commission assumes that against the background of the current financial crisis, no commercially-motivated provider of capital would have been willing to provide such a shield. In any case, the Commission is of the view that the risk shield for the ABS portfolio is not to be compared with a guarantee, but rather with a capital injection, as it serves to compensate for significant losses which have already been substantiated. In particular, with respect to the worst case losses, the Commission is of the view that, in line with its previous practice, the element of aid present in the risk shield can be construed as 100% of the amount covered by the shield, i.e. EUR 4.8 billion.[4] However, the Commission is also of the view that it is not required precisely to quantify the element of aid present in the risk shield, so long as this aid can be considered as rescue aid which is compatible with the common market.

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3 Cf. Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany, not yet published, paragraph 44, as well as the Commission's report on the recapitalisation of financial institutions against the background of the current financial crisis: *The limitation of aid to the minimum necessary and safety precautions for the avoidance of undue distortion of competition*, of 5 December 2008, paragraph 24.
See http://ec.europa.eu/comm/competition/state_aid/legislation/recapitalisation_communication.pdf

4 Cf. Commission Decision of 30 April 2008 in Case NN 25/2008, Rescue aid for WestLB (OJ C 189 26.07.2008, p.3), paragraph 36, where it is stated: 'The Commission understands that an appropriate alternative to a risk shield would have been an equity injection. The required capital due to *mark-to-market* losses would have amounted in March 2008 to an amount of EUR [(2.5-5)] billion. Moreover, the Commission notes that the EUR 5 billion are the result of a stress test and could be considered as the maximum default risks. This is so despite the fact that the expected losses in the portfolio were much lower, given that the Commission doubted the validity of the retained loss scenarios before the background of the current subprime crises and in the light of the huge difference between any possible loss scenarios and the worst case of using the full guarantee. Thus, the Commission assumes that the risk to which the owners of WestLB and in particular the Land exposed itself was in fact much higher than expressed in a normal scenario and would not exclude in the circumstances described above that the aid element would be up to 100% of the nominal value. However, as long as the aid can be considered as compatible rescue aid, the Commission considers that it does not need to quantify the aid involved in the guarantee precisely. In any event, the Commission also notes that the State of NRW obtained a commission of [(0.2-1)] % in return which reduces the aid element in the guarantee nominally by roughly EUR [(100-500)] million assuming that the guarantee will be in place for a period of 10 years.'

4.2 Compatibility of the financial support measures

4.2.1. Application of Article 87(3)(b) EC

(46) Germany intends to grant a capital increase and a guarantee measure to BayernLB, which from the German perspective is regarded as a bank with systemic importance for the German financial market. Under current circumstances in financial markets, the Commission has already agreed to examine such measures directly under Article 87(3)(b) EC.[5]

(47) Article 87(3)(b) EC empowers the Commission to declare aid compatible with the common market if it is intended 'to remedy a serious disturbance in the economy of a Member State'. The Commission would point out that the Court of First Instance has expressly stated that Article 87(3)(b) EC needs to be applied restrictively so that the aid may not benefit only one firm or one sector of the economy, but must serve to remedy a disturbance in the whole economy of a Member State.[6]

4.2.2. Compatibility under Article 87(3)(b) EC

(48) According to the Commission Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis [7] it must be stressed in the context of the application of Article 87(3)(b) EC that an aid measure or scheme may be declared compatible with the common market only if it satisfies the general criteria for compatibility under Article 87(3) EC viewed in the light of its general objectives and in particular Articles 3(1)(g) and 4(2), which imply compliance by such measures with the following conditions:[8]

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

b. *Necessity:* The aid measure must, in its amount and form, be essential to achieve the objective. This means that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g. a temporary and limited guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measure in question

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5 Cf. paragraph 47 of the Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany, not yet published.

6 Cf. Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG v Commission* [1999] ECR II-3663, paragraph 167. Confirmed in the Commission Decisions in Cases C 47/1996 *Crédit Lyonnais* (OJ L 221, 8.8.1998, p. 28, paragraph 10.1), C 28/2002 *Bankgesellschaft Berlin* (OJ L 116, 4.5.2005, p. 1, paragraphs 153 *et seq.*) and C 50/2006 *BAWAG*, not yet published, paragraph 166. See the Commission Decision of 5 December 2007 in Case NN 70/2007 *Northern Rock* (OJ C 43, 16.2.2008, p. 1), the Commission Decision of 30 April 2008 in Case NN 25/2008 *Rescue aid for WestLB* (OJ C 189, 26.7.2008, p. 3), and the Commission Decision of 4 June 2008 in Case C 9/2008 *Sachsen LB*, not yet published.

7 Communication from the Commission: *The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*, OJ C 270, 25.10.2008, p. 8.

8 Cf. Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany, not yet published.

would not be necessary. This is confirmed by settled case-law of the European Court of Justice.[9]

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

(49) In the Banking Communication, general conditions are drawn up for measures of support, including capital increases, during the financial crisis. These conditions apply not just to the rules governing aid but, *mutatis mutandis*, to individual cases. The conditions have been expanded and more tightly defined in the Communication from the Commission on the recapitalisation of financial institutions in current financial crisis (the 'Recapitalisation Communication') of 5 December 2008.[10]

(50) On 12 December 2008 the Commission approved the German aid rules relating to the rescue package for financial institutions in Germany.[11] These are based fundamentally on the provisions contained within the FMStFG and the FMStFV. Insofar as the measures at issue here conform with the conditions underlying the aid rules, although these measures themselves are to be implemented outside the scope of the aid rules, the Commission can assume that the measures are compatible with the common market.

a) Firms in difficulty

(51) The Recapitalisation Communication expands upon the Banking Communication, in that it sets out proposals for a necessary differentiated treatment of two groups of banks: on the one hand, fundamentally healthy banks that are only temporarily being supported in order to stabilise financial markets and enable unrestricted access to credit for private individuals and companies, and on the other, banks which have run into difficulties as a result of their business model, or for any other reason, and which are threatened with insolvency. Since there is a great danger of distortion of competition in the case of State aid to banks in a state of bankruptcy, unlike the case of fundamentally healthy firms, the application of State funds is permissible only if the fees paid for that aid, and further conditions on any injection of capital, take into account the distressed status of the bank

[9] See judgment in Case 730/79 *Philip Morris* [1980] ECR 2671. This judgment was recently reaffirmed by the European Court of Justice in its judgment of 15 April 2008 in Case C-390/06 *Nuova Agricast v Ministero delle Attività Produttive*, where the Court held that: 'As is clear from the judgment of 17 September 1980 in Case 730/79, *Philip Morris/Commission* [1980] ECR 2671, paragraph 17, aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market.'

[10] Communication from the Commission on *The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition.*
See also http://ec.europa.eu/comm/competition/state_aid/legislation/recapitalisation_communication.pdf

[11] Commission Decision of 12 December 2008 in Case N 625/2008 Rescue package for financial institutions in Germany, not yet published.

in question. At the same time, wide-ranging restructuring measures must be undertaken to restore long-term profitability. An appropriate restructuring plan is to be assessed on the basis of the *Community guidelines on State aid for rescuing and restructuring firms in difficulty* (the 'Rescue and Restructuring Guidelines').[12] [13]

(52) The Commission notes the assertion by the German authorities that BayernLB is a firm in difficulty. The Commission agrees in this assessment, as without the measures which have been notified, the bank's equity ratio would fall below the regulatory minimum level. To this extent, BayernLB satisfies the criteria for a firm in difficulty, laid down in section 2.1 of the Rescue and Restructuring Guidelines. The Commission will therefore assess compatibility with the conditions laid down in the Recapitalisation Communication for banks which have run into difficulties.

b) Capital injection

(53) Capital increases undertaken by banks are, in principle, a suitable means of enabling them to withstand the effects of the financial crisis and to continue their ongoing role as providers of credit.[14]

(54) However, injections of capital must always be carried out on the lowest scale possible and in a manner that is fair. This relates both to the scope of the measures undertaken and also, in principle, the fees that are charged.

(55) As far as the scope of the measure is concerned, the Commission notes that a capital injection of EUR 10 billion amounts to [(4–6)]% of BayernLB's risk-weighted assets (RWA). This lies above the figure of 2% of risk-weighted assets which the Commission considers as an indicator for fundamentally healthy banks in its Recapitalisation Communication. This measure will therefore have a very considerable scope. Nonetheless, a capital strengthening in the amount foreseen, together with the risk shield for BayernLB's ABS portfolio, is necessary for the bank to demonstrate an appropriate equity ratio. This capital strengthening, together with the risk shield for the ABS portfolio, will make it possible to bring BayernLB's equity ratio up to a target level of [(7.5–8.5)]% in three stages. The Commission has already approved measures to strengthen equity on this scale in various decisions.[15] This increased core capital ratio is to be maintained on an ongoing basis, at least for as long as BayernLB receives the aid measures which are at issue here.

(56) Moreover, the capital measures in total do not exceed the maximum of EUR 10 billion for a single company and are therefore in accordance with the constraints contained in the rescue package for financial institutions in Germany, as approved by the Commission.

(57) Above all, the German authorities undertake to limit the capital measures in the form of rescue measures to a period of six months, and then to continue these in the form of

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[12] OJ C 244, 1 December 2002, p. 2 [*sic*].

[13] Recapitalisation Communication of 5 December 2008, paragraph 44.

[14] Recapitalisation Communication of 5 December 2008, paragraph 3. Commission Decision of 13 October in Case N 507/2008, Rules governing guarantees for UK banks, OJ C 290, 13.11.2008, p. 4.

[15] Commission Decision of 13 October in Case N 507/2008, Rules governing guarantees for UK banks, OJ C 290, 13.11.2008, p. 4, and Commission Decision of 19 November 2008 in Case N 560/2008, Support Measures for the Credit Institutions in Greece, paragraph 9, not yet published.

restructuring measures, for which a wide-ranging and all-embracing restructuring plan is to be put forward.[16]

(58) Fairness is principally a function of a sufficient rate of return on capital provided and wide-ranging rules of conduct.

(59) As far as the rate of return is concerned, the preference shares which are to be issued in the first and third instalments of the capital increase enjoy a preferential entitlement to earnings of EUR 300 million, which equates to a return of 10% on the capital invested. The silent participation will likewise enjoy a return of 10% and is to be serviced prior to any dividends to shareholders and any transfer to reserves. These entitlements are not cumulative in the event of omission.

(60) The rate of return of 10% is in principle in accordance with German rules governing aid, which envisage an annual return of at least 10% in the case of banks which are not fundamentally sound.[17] However, this represents only an average figure, which can also be higher according to the individual risk profile of the bank in question. Since the risk profile of BayernLB lies towards the upper end of the spectrum, a higher rate of return should in principle be expected. However, in the case of banks which are in difficulty, a market-oriented rate of return can be dispensed with, provided there is certainty that the rate applied does not lie below the corresponding figure for fundamentally sound banks.[18] This is clearly the case with respect to the anticipated rate of return of 10%.

(61) The Commission also notes as positive the fact that BayernLB Holding has undertaken to suspend dividend payments.

(62) Moreover, the funds raised in the current financial year are not to be deployed in financing coupons paid to holders of hybrid capital (i.e. holders of silent investments, profit-sharing rights and other hybrid capital holders) in that financial year. With respect to holders of hybrid capital, the capital raised will be used solely to avoid a participation in losses on the part of these holders. This appears to be necessary so as not to jeopardise BayernLB's possibilities of refinancing, as explained above.

(63) Finally, Germany and BayernLB have made numerous commitments with respect to conduct, in order to avoid undue distortion of competition (see paragraph 36), which are in accordance with the considerations contained within the Recapitalisation Communication relating to distressed banks.

(64) On this basis, the Commission concludes that the envisaged measures for the strengthening of capital are, at the current time, to be viewed as suitable, necessary and proportional to the situation.

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16 Likewise, in the case of capital measures at HGAA, the Commission assumes that the restructuring of BayernLB will encompass the entire group, and therefore also HGAA. The Commission assumes that measures undertaken by BayernLB in this respect, and the future development of HGAA, will be subject to examination as an element of BayernLB's restructuring plan when this is published.

17 Cf. paragraph 16 of the Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany, not yet published.

18 Recapitalisation Communication from the Commission of 5 December 2008, paragraph 44.

c) Risk shield for the ABS portfolio by a guarantee declaration

(65) The objective of the risk shield for the ABS portfolio is to avoid further write-downs on the ABS portfolio and so to reduce BayernLB's loss in 2008 and avoid a decrease in the bank's own capital.

(66) The Commission has already established in other cases that the valuation of securities in the current turbulence affecting financial markets can have significant effects on equity, and a risk shield is a suitable means of preventing this.[19] In fact, the risk shield granted to BayernLB will prevent a reduction in equity of around EUR [(1–2)] billion under German Accounting Standards (HGB) and around EUR [(2–3)] billion under International Financial Reporting Standards (IFRS). In addition, the risk shield will reduce the current tying-up of equity and will also prevent such a tying-up in future, in the event of a deterioration in ratings in the ABS portfolio, in an amount of around EUR [(0.2–0.8)] billion. In this way, the risk shield will lead to a necessary stabilisation in the bank's equity, with a positive impact upon regulatory equity capital of EUR [(1.2–2.8)] billion. The risk shield is therefore also suitable for strengthening BayernLB in order to carry out its function in the real economy.

(67) Furthermore, the Commission is of the view that this measure is to be reduced to the minimum necessary level. The Commission notes, in this respect, that the risk shield envisages a first loss on the part of BayernLB in an amount of EUR 1.2 billion. BayernLB can benefit from the loss shield only once and to the extent that a loss of EUR 1.2 billion is exceeded.

(68) However, the Commission realises that the duration of the risk shield could be up to six years.[20] On this point, the German authorities have explained that the desired effect of the risk shield, i.e. the prevention of a reduction in equity resulting from the ABS portfolio, can be achieved only if the risk shield runs for as long as the respective positions which it covers in the ABS portfolio. However, the risk shield is also to be limited to six months as a rescue measure and can then potentially be continued as restructuring aid and assessed on this basis. Under this proviso, the longer duration can be accepted.

(69) As far as the rate of return of [(0.4–0.7)]% on the risk shield is concerned, the Commission is of the opinion that this rate cannot in principle be appropriate for a risk shield, as it lies below the rates set for guarantees in the German rules governing aid,[21] and on account of its quasi-equity nature it should have a higher rate of return. However, because this aid is to be assessed in the context of a restructuring plan, an appropriate rate of return during the rescue phase of a bank which is not fundamentally sound is not absolutely mandatory.[22]

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19 Cf. Commission Decision of 30 April 2008 in Case NN 25/2008, Rescue aid for WestLB, OJ C 189 26.07.2008, p. 3.

20 The Commission notes that the portfolio will be reduced through repayments to below EUR [(4–6)] billion in six years and that the remaining portfolio is to be disposed of in agreement with the guarantor, therefore it can be assumed that the risk shield will expire after six years at the latest.

21 Cf. Commission Decision of 12 December 2008 in Case N 625/2008, Rescue package for financial institutions in Germany, not yet published.

22 To the same effect: Commission Decision of 30 April 2008 in Case NN 25/2008, Rescue aid for WestLB, OJ C 189 26.07.2008, p. 3.

(70) In addition, the commitments with respect to conduct which have been cited above (see paragraph 35) are also valid for the risk shield. On this basis, the Commission concludes that the proposed measure of a risk shield for the ABS portfolio is, at the present time, to be seen as suitable, necessary and proportional to the situation.

6. DECISION

The Commission concludes that the measures at issue constitute State aid pursuant to Article 87(1) EC.

The Commission takes the view that these measures fulfil the criteria for compatibility with the common market under Article 87(3)(b) EC. As a consequence, the Commission raises no objection against the measures.

The Commission expects the German authorities to respect their commitment to communicate to the Commission, within six months, a credible and substantiated restructuring plan or proof of the complete termination of the aid.

The Commission authorises the specified measures for a period of six months. In accordance with paragraph 26 of the Rescue and Restructuring Guidelines, this period is automatically extended upon the presentation of a restructuring plan for BayernLB until such time as the Commission has reached a decision upon the plan.[23]

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt, setting out reasons. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter in the authentic language on the Internet site:

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

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

- European Commission
  Directorate-General for Competition
  State Aid Greffe
  Rue de la Loi/Wetstraat, 200
  B-1049 Brussels
  Fax No: +32-2-296 12 42

Yours faithfully

For the Commission

Neelie KROES
Member of the Commission

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[23] Cf. also the Commission Decision of 19 November 2008 in Case NN 49/2008, Dexia, not yet published.