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Details and Differences of banks rescue packages France

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Outline

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I – The French Scheme

The Guarantee Scheme

- Creation of a *Société de Financement de l'Economie Française* (SFEF)
  - Purpose: Issuing debt securities with State guarantee to grant loans to credit institutions.
  - Shareholding: Limited liability company with a Board of Directors. State ownership of 34%, with blocking minority and veto right. Remaining 66% owned by French banks.
- Eligibility: Credit institutions licensed and supervised in accordance with the French Monetary and Financial Code and which comply with capital adequacy requirements in accordance with the provisions of the Code
- Loans with a maturity of up to 5 years and interest rate to be agreed on a case-by-case basis but equal to the refinancing rate of the SFEF, plus an additional remuneration corresponding to the premium charged by the French State in consideration of its guarantee.
- Obligation for the beneficiary to post collateral (ie mortgages, real estate leasing, loans to local authorities, corporate loans with sufficient ratings and loans to individuals).
- Price of the guarantee: the financing costs of each Credit institution will be market prices.
- Compensations: beneficiaries must observe ethical rules and commit to provide credit to SMEs and households.

The Guarantee Scheme - Implementation

- On October 2008, the Caisse des Dépôts et Consignations (CDC) granted a € 5 bn loan to the SFEF, reimbursed by an issue of bonds.

- 3 tranches have already been issued, all of which were subscribed:
  - The 1st issue of notes was completed by the SFEF in November 2008 (€5 bn 3-years bonds). Orders for the bonds were in excess of € 7 billion.
  - The 2d issue was completed in December 2008 (€ 6 bn 2-year bonds) Orders for the bonds were in excess of € 3 bn.
  - The 3d issue was completed on January 2009 (€ 5 bn, 5-years bonds).

- In total, French banks benefited of € 21 bn contributions in liquidity.

The Recapitalization Scheme

- Article 6-III of the Finance Act Amendment provides for 2 options:
  - Recapitalization of a Financial Institution to restore confidence: The State can subscribe to Tier 1 Subordinated Securities and/or Preferred shares from Financial Institution;
  - Aid to a financial institution in difficulty: The State commits to intervene, where necessary, in the capital of Financial institutions in difficulties and whose failure would create a risk for the entire financial system
- The Ministry of Finance will use an *ad hoc* vehicle Société de prises de participations de l'Etat (SPPE) for those recapitalizations.
- The French State will guarantee securities issued by the SPPE.
- The type of guarantee, its maturity and the amount guaranteed are subject to a decision from the Minister of the Economy.
- Eligible Institutions: French institutions referred to in article L.562-1 of the French Monetary and Financial Code, (broad category)
- Financial institutions must commit to respect undertakings.

The Recapitalization Scheme - Implementation: First Tranche

- On December 11, 2008, 6 French banks issued an aggregate amount of €10.5 bn of Tier 1 Subordinated Securities to the SPPE.
  - The securities are interest bearing (5-year OAT yield + approximately 400 bp), non voting, perpetual subordinated instruments with a call option at the request of the issuer after 5 years.
  - Credit Agricole received €3 bn; BNPP €2,55 bn; Société Générale €1,7 bn; Crédit Mutuel €1,2 bn; Caisses d'Epargne €1,1 bn and Banques Populaires €950 million.
  - Obligations for the beneficiary:
    - Adopt the MEDEF/AFEP Code of Conduct (review of their remuneration policy);
    - Commitment to increase the amount of outstanding loans by 3 or 4% annually;
    - No share buybacks while securities are outstanding, other than to cover employee shareholding schemes and ongoing management operations;
    - No restriction on dividend distribution.

The Recapitalization Scheme - Implementation: 2d Tranche

- The French government has announced its intention to subscribe for a second tranche of €10,5bn of Tier1 securities (Preferred Shares without voting rights and/or Tier 1 Subordinated Securities) by August 31, 2009.

- Each of the 6 banks that participated in the 1st tranche will be entitled to receive an identical share in the second tranche.

- Obligations for the beneficiary:
  - Adoption of the MEDEF/AFEP Code of Conduct by May 31, 2009,
  - Priority must be given to the reinforcement of capital base when allocating 2008 earnings
  - Top executives have foregone their bonuses for 2008
  - Undertaking to enter into an agreement with the government relating to the financing of €7 bn in export contracts.

- The amount of the second tranche have been increased of €500 million to take account of the merger of the central bodies of the Caisses d'Epargnes and the Banques Populaires, within the limit of 50 bp of the Tier 1 ratio of the new entity.

II- Commission Assessment of the Scheme

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Previous Commission decisions on French banks

- <u>Rescue and restructuring aid to credit institutions in difficulty</u>
  - *Crédit Lyonnais* (1995 and 1998)
    - The Commission refuses to apply 87(3)(b).
    - But the aid can be compatible with the common market if it (i) restore the viability of the firm, (ii)is proportionate to the restructuring costs and benefits and doesn't exceed what is strictly necessary; (iii) has the least distortion of competition possible and significant contribution of the firm; and (iv) if measures are taken to compensate competitors.
  - *Transfer of Assets of the Société Banque Occidentale to Crédit lyonnais* (1998): aid incompatible with the R&R Guidelinnes because it had not restored the viabilitity of the firm.
  - *Crédit Foncier de France* (1999): approval of the aid on condition tyhat CFF implemented the recovery plan in full.
  - *GAN Group* (1996 and 1997): aid compatible with the common market.
  - *Société Marseillaise de Crédit* (1998): aid compatible with the common market.
- <u>State Guarantees in favour of public banks</u>
    - State Guarantee by the *Caisse des Dépôts et Consignations* (2003): existing aid to be abolished.

Authorization Of The Scheme For Refinancing Credit Institutions (1)

- Commission Decision of October 30, 2008, authorising the French scheme for refinancing institutions.
- The Scheme constitutes State Aid:
  - State imputability
    - SFEF set up by a legislative Act + State conrol over its activity;
    - Financial risks rest *in fine* on the State;
    - Administrative sanctions if the benficiaries do not respect obligations.
  - The State guarantee is a State ressource;
  - There is an advantage as equivalent financing is not available on the market.

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Authorization Of The Scheme For Refinancing Credit Institutions (2)

- The Scheme is compatible with the Common market, as an appropriate means of restoring confidence on the financial markets.
  - Legal basis: article 87(3)(b) + Commission Commmunication of October 13, 2008
  - Appropriateness:
    - Non-discriminatory access for banks authorised in France, including subsidiaries of foreign groups;
    - Obligation for the beneficiary banks with regard to financing the real economy;
    - Limitation to the discretionary power of the French authorities;
    - The refinancing scheme does not lead to a capital release.
  - Necessity
    - Aid limited in time: essentially less than 3 years. Not more than 5 years.
    - Aid limited in scope.

Authorization Of The Scheme For Refinancing Credit Institutions (3)

- Proportionality
  - Pricing mechanism covers the funding costs of the scheme and ensures a fair contribution by the beneficiary banks;
  - Incentive to minimize use of the scheme;
  - Appropriate safeguards against abuse of the scheme, including restrictions on certain commercial practices and a cap on the increase in the balance sheets of the beneficiary banks.
  - Commitments taken by the French authorities:
    - Re-notification of the scheme in the event that the total amount of loans granted or of securities subscribed, to or acquired by, the SFEF with a maturity of more than 3 years exceeds a certain percentage of the total amount outstanding.
    - Notification of individual aid decisions if the total amount to be received by a bank exceeds certain pre-defined limits
    - Re-notification of the scheme in 6 months’ time

Authorisation Of The Recapitalization Plan

- Commission decision of December 8, 2008, authorising the French scheme to inject capital into certain banks.

- The Commission noted that the scheme is intended for « fundamentally sound » banks which are under sever pressure to increase their capital owing to the financial crisis and that this pressure could lead the banks to cut lending to the detriment of the entire French economy.

- The Commission concluded that the scheme was compatible with EU state aid principles (article 87(3)b) in that it provides in particular for:
  - An obligation for the beneficiary banks with regard to financing the real economy;
  - An undertaking by the beneficiary banks to adopt measures concerning the remuneration of senior management and market operators and to observe certain governance rules;
  - minimum level of remuneration on the securities and a step-up mechanism to ensure that the State’s involvement in the banks’ capital will be as brief as possible.

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II- Action Plan To Save Dexia

Action Plan to Save Dexia - Recapitalization

- Agreement of September 30, 2008 between the French, Belgian and Luxembourg governments: capital increase of €6,4 bn.

- The French state invested €3bn in new shares (joint investment including €2 bn from the French State-controlled Caisse des Dépôts et Consignations).

- Following that operation the French State owns more than 25% of Dexia SA.

Action Plan to Save Dexia - Guarantee

- Agreement of October 9, 2008 between the French, Belgian and Luxembourg governments on a joint guarantee mechanism – covered 60,5% by Belgium, 36,5% by France and 3% by Luxembourg.

- The Finance Act Amendment authorises the Minster of Economy to grant the guarantee of the French State to the debt capital markets funding programs set up by certain entities of the Dexia Group.

- Conditions
  - The programs must have been set up and implemented between October 9, 2008 and October 31, 2009
  - The guarantees issued by the Belgian and the Luxembourg States must be jointly called upon
  - The guarantee is caped to up to 36,5% of the funds raised by the Dexia group.

- The Finance Act Amendment n°2008-1443 of December 2008 adds that the State guarantee can be granted in respect of certain liabilities incurred by Dexia in connection with its monoline insurer FSA in the U.S.

Commission Authorisation Of The Guarantee

- Commission Decision of October 19, 2008, authorising the guarantee granted by the Belgium, France and Luxembourg States to Dexia.

- The Commission notes that the collapse of the bank would have had a snowball effect on the Belgian banking sector and, consequently, on the entire Belgian economy.

- The Commission concludes that this measure is proportionate, appropriate and necesary in order to remedy the group's difficulties, in so far as:
  - it is intended to facilitate Dexia's access to means of financing in order to restore investor confidence and encourage inter-banking lending;
  - It is limited in time;
  - It will be repaid by Dexia at low rates based on the recommendation of the ECB.

- The authorization is limited to a period of 6 months. In order to benefit from an extension, the Member States must submit a restructuring or liquidation plan.

- The decision covers neither the capital increase nor the guarantee in the context of the sale of FSA.

IV- New Developments and Comments

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The French Paradox

- France has a long experience of State Aid in the banking sector and governments have traditionnally expressed very interventionist (even protectionist) views.

- However, French interventions were neither the first nor the more massive
  - First States to notify a scheme: Ireland, Denmark and UK (Commission auhorisation on October 8). France waited until the Eurozone summit of October 12.
  - French biggest recapitalization: BNP (€5 bn). To be compared with Guarantee of ING's Alt-A Securitized Mortgage Portfolio by the Dutch State (€35.1 bn) or Recapitalization of RBS by UK (£20 bn).
  - French Recapitalization: €40 bn. To be compared with German scheme: €80 bn

Unresolved Issues

- How will the beneficiaries' commitments be monitored?
- What must be the content of the restructuring plans?
- How are impaired assets going to be dealt with? (cf *Communication From the Commission on the treatment of Impaired Assets in the Community Banking Sector*, February 25, 2008)
- How can ask for assets disposals when everybody sales?
- Is the distinctinction between fundamentally sound banks and banks in difficulty appropriate? (what if a sound bank situation deteriorates?)

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