Aid Scheme for Financial Institutions in Germany

Kristina Haverkamp

Berliner Gesprächskreis zum EU-Beihilfenrecht e.V.
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Legal Framework

- Finanzmarktstabilisierungsgesetz – FMStG -
  Gesetz zur Umsetzung eines Maßnahmepakets zur Stabilisierung des Finanzmarktes (17.10.2008)

- Finanzmarktstabilisierungsfondsgesetz – FMStFG -
  Gesetz zur Errichtung eines Finanzmarktstabilisierungsfonds (17.10.2008)

- Finanzmarktstabilisierungsfondsverordnung – FMStFV -
  Verordnung zur Durchführung des Finanzmarktstabilisierungsfondsgesetzes (20.10.2008)

- **Case N 625/2008: Decision of the Commission not to raise objections** (12.12.2008, Corr. 5.2.09)

Objectives

Stabilisation of the financial markets

- ✓ Enhance interbank lending and
- ✓ facilitate access of financial institutions to liquidity from other sources
- ✓ by restoring confidence in the credit worthiness of financial institutions
- ✓ thus stimulating lending to the „real“ economy

Cornerstones I

- **Three instruments:**
    - Recapitalization
    - Debt guarantee
    - Asset relief

- **Scope:** Companies of the finance sector
  (irrespective of whether fundamentally sound or not)

- **Participation:** on a voluntary basis

- **No exclusivity**

Cornerstones II

- **Duration: 31.12.2009**

➢ Commission approval only for 6 months (12.06.2009); commitment to renotify; prolongation will be approved if crises continues

- **Administered by:** Finanzmarktstabilisierungsstabilisierungsanstalt (FMSA), acting in the name of the Finanzmarktstabilisierungsfonds (FMSF – „Soffin“)
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- **Financial Envelope: up to 480 billion €**
  - Guarantees: max. 400 billion €
  - Recapitalisation and temporary asset relief: together max. 80 billion €

Companies of the Finance Sector

In particular

- ✓ **Financial institutions (banks)**
- ✓ **Insurance companies, pension funds**
- ✓ **Capital investment companies**
- ✓ **Operators of stock exchanges and futures markets**
- ✓ **SPVs** *(guarantees and asset relief only)*

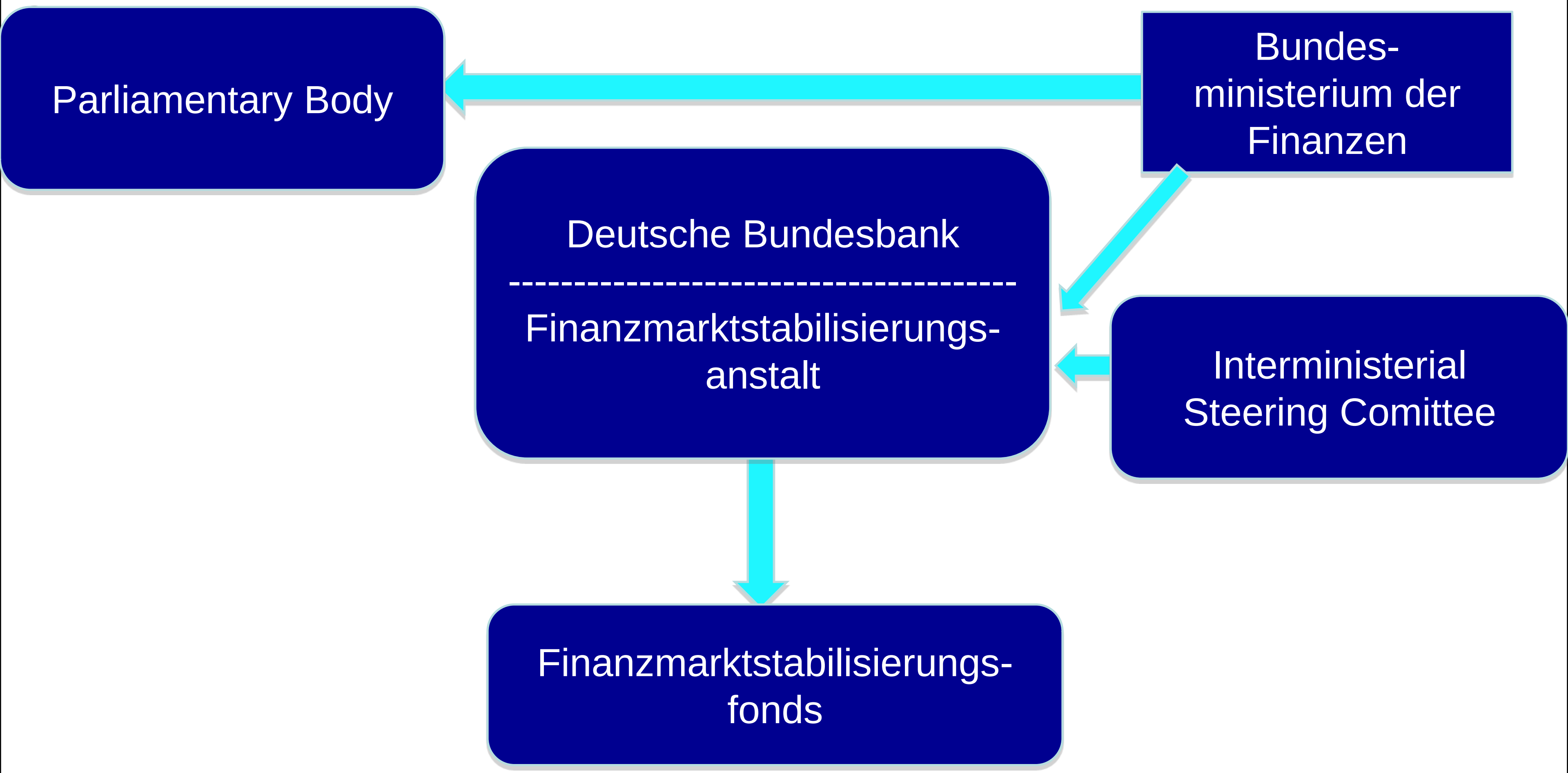
No Legal Title/No Discrimination

- **No legal title to stabilisation measures**
  - ➢ Company submits application
  - ➢ Fund exercises administrative discretion

    (critera: importance for the system, urgency...)

- **No discrimination:** All companies of the finance sector with a registered seat in Germany, including subsidiaries of foreign companies

Decision Structures



Recapitalisiation
Main Provisions

- **Objective:** strengthen balance sheet against losses due to, in particular a „fair value“ valuation of assets
- **Instrument:** Capital injection „in any appropriate way“ (capital contribution in exchange for ordinary shares, dormant equity, hybrid debts…)
- **Remuneration:** market oriented
- **Upper limit:** in principle 10 billion Euro per company
- **Behavioural commitments**

Recapitalisation: Remuneration

„Market oriented" : depends on risk profile of the company and the recapitalisation instrument chosen:

- **Fundamentally sound institutions**
  from minimum 7 % for subordinated dept to minimum 9.3 % for instruments like ordinary shares

- **Not fundamentally sound institutions**
  in average at least 10 %

- **Less** in case of a significant private participation under pari passu conditions

Exit Incentive

„Step up“ for fundamentally sound institutions:

- increase in the remuneration (0.5 % over next 5 years)

or

- dividend ban until shares are bought back or sold to a third party

Recapitalisation: Behavioural Commitmens

The Fund **shall** require the beneficiary e.g. to

- examine the sustainability of the business modell
- cater to the demand for credit of the real economy, in particular SME
- refrain from distortions of competition, in particular by advertising the recapitalisation
- limit managements remuneration (as a rule: 500,000 p.a.)
- refrain from paying bonfications, as well as dividends or other forms of profit distribution (as a general rule)
- check reward system for incentives to run inappropriate risks

The Fund **can** also require the benificiary to reduce or abandon particularly risky activities/markets

Recapitalisation: Restructuring Plan

The company **is not fundamentally sound** and

1. is recapitalized in excess of 10 billion Euro; or
2. does not buy back the shares within 6 months (or, if crises persits, within 6 months after the inititial 6 months); or
3. wants to distribute dividends

➢ Limitation on growth of such institutions

Debt Guarantees
Main Provisions

- **Objective:** support of solvent financial institutions that are unable to access interbank funding
- **Scope:**
  Bonds issued and liabilities entered into after 17 October 2008
- **Duration of the guarantees:**
  maximum 36 months / 31 December 2012
- **„Adequate Remuneration:**
  Premium of 0.5 %. If the bonds/liablities have a duration of more than 1 year: additional risk premium corres-ponding to the CDS spread of the institution

Guarantees: „Solvent“ Institutions

- Adequate equity capitalisation (**core capital ratio of 7%**) is prerequisite
- Owners may however enter into a commitment to achieve that core capital ratio **within 3 months after issuance** of the guarantee

Guarantees:
Behavioural Commitments

The Fund **shall** require the beneficiary to

- maintain an adequate solvency ratio
- examine the sustainability of the business modell
- refrain from distortions of competition, in particular by advertising the recapitalisation

The Fund **can** also require the benificiary to reduce or abandon particularly risky activities or markets

Guarantees: Restructuring Plan

- ✓ If guarantee is claimed (restructuring or liquidation plan)
- ✓ If owners do not honour the commitment to achieve a core capital ratio of minimum 7 % within 3 months after issuance of the guarantee

Asset Relief

- **Objective:**
  Relief for balance sheet, provision of liquidity
- **Instrument:**
  Hedge of risky assets (e.g. bonds, derivatives, loan commitments, participations) acquired before 13 October 2008 by acquisition or take over in any other form
- **Duration of the relief:** maximum 3 years
- **Beneficiaries:** solvent institutions/SPVs
- **Upper limit:** in principle 5 billion Euro per company
- **Behavioural commitments**

Asset Relief:
Buy Back, Remuneration

Two different options:

1. **Assets are bought back at essentially the initial sales price after max. 3 years**. Remuneration: minimum 12 months EURIBOR + 0.5 % + risk premium according the the CDS spread of the institution

or

2. **„risk adequate remuneration“** approved by the Commission in a **single notification procedure**

Asset Relief: Restructuring Plan

1. **Fundamentally sound companies:** liquidity exceeds 5 billion Euro and 2 % of risk weighted activa resp. 2 % of balance sheet
2. **Not fundamentally sound companies**: liquidity exceeds 5 billion Euro and 3 % of risk weighted activa resp. 3 % of balance sheet
3. Beneficiary is **unable to buy back the assets** after 36 months **or is unable to compensate the Fund for losses** of their value as compaired to initial sales price

Asset Relief:
Behavioural Commitments

The Fund **shall** require the beneficiary e.g. to

- examine the sustainability of the business modell
- refrain from distortions of competition, in particular by advertising the recapitalisation
- limit managements remuneration (as a rule: 500,000 p.a.)
- refrain from paying bonuses, as well as dividends or other forms of profit distribution (as a general rule)
- check reward system for incentives to run inappropriate risks

The Fund **can** also require the benificiary to reduce or abandon particularly risky activities/markets

Outlook

Gesetzentwurf zur weiteren Stabilisierung des Finanzmarktes (Finanzmarktstabilisierungs-ergänzungsgesetz – FMStErgG)

Draft approved by the Cabinet on 18 February 2009; approval of Parliament expected early April

Contents:

- New: **„Rettungsübernahmegesetz“** (Rescue Take Over Act)
- Minor changes of the existing „Finanzmarkt-stabilisierungsgesetz“

Draft „Rescue Take Over Act“ Main Contents

- Changes of the rules governing the take over of companies in order to make it easier for public authorities to gain control over ailing financial institutions

- „Ultima ratio“: option to nationalise institutions of systemic importance on a case by case basis until 30 June 2009 against adequate compensation, if no other legally and economically reasonable solutions to secure the stability of the financial market are available