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Summary of Government Interventions in Financial Markets
Germany

Overview

Europe's largest economy, which officially fell into recession in mid November 2008, is expected to contract by two per cent. or more in 2009 making it the worst economic performance since the second world war. For this and more data, please see the summary of the latest yearly and monthly economic projections for Germany by the Deutsche Bundesbank lined here: Economic Projections for 2009 and 2010 and monthly projections by the Bundesbank.

Germany's economic bailout measures have so far proceeded in two stages, with the enactment of the Financial Market Stabilization Act in October and November 2008 and of a stimulus plan in January/February 2009. Furthermore, on 20 March 2009, the lower house of the German Bundestag passed the 'Emergency Takeover Law' paving way, if accepted by the upper house in early April 2009, the nationalisation of some banks, such as that of Hypo Real Estate AG.

State Guarantees and Summary of Key Legislation

Financial Market Stabilization Act

The "*Finanzmarktstabilisierungsfonds*" (Financial Market Stabilization Fund) is managed by the "*Finanzmarktstabilisierungsanstalt*" (Financial Market Stabilization Agency). It is sometimes referred to as the "*Sonderfonds Finanzmarktstabilisierung (SoFFin)*" (Special Fund Financial Market Stabilization) given its special temporary purpose. The EU Commission has provided its support to this plan.

The German Financial Market Stabilization Act (*Finanzmarktstabilisierungsgesetz*) established the Fund on 17 October 2008 after being passed by the German Parliament and the Chamber of German States. The Federal Government enacted the regulation to the Act on the 20th October 2008 and it is effective until 31 December 2009.

SoFFin is to be used to secure newly-issued refinancing instruments (up to 36 months) for German banks until the end of 2009 and is to be established by issuing debt securities up to a maximum of EUR 100bn.

Total volume of the package of measures EUR 480bn:

- EUR 400bn in guarantees (in return for a fee);
- EUR 70bn (+ 10bn if necessary) in fresh capital and assumption of risk positions.

German federal states are required to contribute to the stabilisation fund and German subsidiaries of foreign banks with German Banking licenses are included in the package.

The rescue package consists of:

- A recapitalisation scheme, providing new capital to banks and insurance companies in exchange for shares.
- A guarantee scheme covering new issuances of short- and medium- term debt, in return for market-oriented remuneration, to support the banks which are unable to access interbank funding. Eligible institutions include German credit institutions, insurance, pension funds, financial service providers, investment management companies and security and commodity exchanges. State guarantees will be issued with a maximum term of 36 months for liabilities entered into by the recipient bank after 18 October 2008. This is to aid the recipient bank to overcome a temporary liquidity shortage and to gain access to inter-bank lending. Guarantees are available for banks until the end of 2009.
- A temporary acquisition of assets under the condition that these assets are bought back after 36 months maximum without the state making a loss.

Though several amendments have been made to the SoFFin fund plan, details on prerequisites, structure and conditions of the stabilisation measures are as follows:

Maximum limit per company for:

- grant of guarantees: depends on company's equity capital;
- recapitalisation measures: EUR 10bn; and
- risk assumption: EUR 5bn.

The authorities in charge of the stabilisation regulations may impose on the banks accepting stabilisation aid restrictions on their business activities depending on the type, amount and duration of the state aid as well as the economic situation of the bank, e.g.:

(i) re-examination of business policy; reduction or waiver of certain risky transactions in the future;

(ii) re-examination of compensation systems;

(iii) overall compensation of board members and managing directors to be reasonable; monetary compensation not to exceed EUR 500,000 per year;

(iv) no payout of compensation upon termination;

(v) no bonus payments that are not legally required; and

(vi) no dividend payments to shareholders other than the Fund; no re-purchase of shares; no reduction of capital except for reorganisation.

For the assumption of guarantees, the restrictions on the compensation system and dividends payments do not apply.

German states (*Bundesländer*) are to take a 35 per cent. share in the risks from the Fund (capped at EUR 7.7bn) while at the same time protecting the state-owned Landesbanks.

In case of recapitalisation measures strengthening of tier 1 capital is intended. Some German banks have tier 1 capital below 8 per cent., against the 9 per cent. that has become required by the UK and been urged in France. They include Commerzbank, Deutsche Postbank and various Landesbanks – Germany's regional, publicly owned wholesale lenders.

On 7 March 2009, it was reported in the press that SoFFin had made a sizeable profit by collecting EUR 125.7m in commissions from banks which had asked for state aid. After deducting EUR 62.5m in costs, the fund was left with a profit of EUR 62.9m.

In a statement released by SoFFin on 3 March 2009, SoFFin advised that since its start in October 2008, SoFFin has received filed requests from 18 credit institutions, including three new ones asking for EUR 31bn in February, for a grand total of EUR 294bn in aid. Of this total figure, EUR 197bn already has been allocated, EUR 178bn has been for loan guarantees and EUR 19bn was in cash. There has been no defaults on payments thus far. SoFFin has a total of EUR 400bn in guarantees and EUR 80bn in cash to support the banking sector.

According to BaFin, the German regulator, as much as EUR 300bn in toxic assets still lurk on banks' balance sheets as of 19 March 2009.

New Stimulus Package 2009

On 22 February 2009, Germany approved a new stimulus package worth EUR 50bn (USD 63bn) over two years, which is about 1.6 per cent. of gross domestic product. This package makes it the biggest economic injection in Europe. However, it is small compared to the US's plans for a 2-year stimulus program of about USD 775bn, or about 2.8 per cent. of GDP.

The new package envisages about EUR 18bn in new investments in infrastructure and education; EUR 1.5bn in aid for the domestic auto industry (e.g., Daimler and BMW) and a fund of EUR 100bn to provide credit guarantees to struggling businesses. Tax relief totalling EUR 2.9bn in 2009 and EUR 6.0bn from 2010.

Emergency Takeover Law – March 2009

On 20 March 2009, Germany's Bundestag lower house of parliament approved a law that could give the government power to take control of banks hit by the financial crisis. The legislation which still has to be passed by the upper house of parliament before it becomes law, is expected to be presented to the German Bundestag on 3 April 2009. Below are key facts about the new bill:

- It extends the financial markets stabilisation law agreed in 2008, giving the government powers to seize control of banks whose failure would pose a risk to the stability of the financial system;
- Allows for the expropriation of shareholders as a last resort. This would enable the nationalisation of Hypo Real Estate, which has received billions of euros worth of state guarantees;
- Any expropriations would have to take place by 31 October 2009, and requests must be submitted by the end of June 2009;
- In special cases, it extends the current guarantees the government has made to bank loans to five years from three; and
- In the event of a nationalisation, the bill purports to help compensate shareholders of nationalised by paying them a price per share calculated by the average value during the two weeks prior to the nationalisation, or an even shorter period if the share price falls rapidly.

Government loans

SoFFin provides capital injections into financial institutions in return for shares or other equity instruments to be issued in a simplified and accelerated form. The government may in the future sell the shares it receives, and it will have shareholders' subscription rights.

So far, SoFFin has approved government guarantees for EUR 90bn (USD 126bn) in loans. It has received requests for another EUR 100bn in liquidity assistance.

State aid loans sanctioned by the EU Commission

On 17 December 2008, the EU Commission adopted a Temporary Framework under state aid rules to help Member states tackle the effects of the credit squeeze on the real economy.

As a first measure, on 30 December 2008, the EU Commission approved a EUR 15bn German loan programme ("*KfW-Sonderprogramm 2009*") in accordance with the Temporary Framework. The loan programme provides for interest rate reductions on loans to finance investments and working capital of up to EUR 50m to be granted to undertakings with a turnover of less than EUR 500m. The programme will be administered by the *Kreditanstalt für Wiederaufbau (KfW)*, the main public development bank in Germany, in close cooperation with the undertakings' own bankers.

On 19 February 2009, as a second measure, the EU Commission authorised, under the temporary Federal framework scheme ("*Bundesregelung Kleinbeihilfen*"), to permit German authorities at federal, regional and local level to grant aid in the form of reduced interest rates on loans granted before 31 December 2010 and to provide subsidised guarantees for investment and working capital loans granted before 31 December 2010.

These are the first cases to be approved under the EU Commission's new temporary framework providing EU member states like Germany with additional economic tools to tackle the effects of the credit squeeze on the real economy.

Notable developments with commercial banks

Bailout of Commerzbank

On 3 November 2008, Commerzbank became Germany's first commercial lender to turn to the government for capital, taking EUR 8.2bn (USD 10.5bn) to prop up its flagging finances and a 25 per cent. stake in the company.

It was been reported on 18 March 2009 that the European Commission is looking into Germany's rescue of Commerzbank after Germany had added to the original rescue package of November 2008 with an additional EUR 10bn (USD 13bn), taking the grand total government capital injection to this bank to EUR 18bn. Commerzbank needs EU approval to tap into the extra funds so as to avoid distorting competition with any state aid.

Bailout of Hypo Real Estate

On 20 March 2009, the lower house of the German parliament passed a law, proposed by the current government, providing the finance minister with the power to nationalise the troubled lender Hypo Real Estate. The law, an extension of the German Financial Market Stabilization Act enacted in October 2008, permits the state to expropriate all the stock of the bank if no agreement can be reached with the current shareholders on the planned bailout steps. However, nationalisation can only be taken once all other means have been exhausted. The German upper parliament need to pass the bill before it officially becomes law, which is set for their approval in April 2009.

Discussions have been underway of a potential government stake of at least 75 per cent. or more, though a complete takeover is also under discussion. If it goes through, this will be the first nationalisation of a listed bank since World War II, though Germany has already agreed to take a 25 per cent. stake in the country's second-biggest lender Commerzbank. Private discussions were held on 15 March 2009 with Hypo's largest shareholder, JC Flowers, the private equity group holding 24 per cent. of Hypo, to find ways to stabilise the stricken property lender.

On 11 February 2009, Hypo Real Estate obtained EUR 10bn of guarantees from SoFFin, which the bank will use to collateralise debt securities to cover short- and medium-term liquidity. These guarantees are in addition to the EUR 10bn SoFFin provided Hypo with in January. This will bring the aggregate guarantee amount provided to the bank to EUR 87bn and the total amount of government support for the bank to EUR 102bn. Hypo's new guarantees are to be used to collateralise debt securities to be issued, which must be repaid at the latest by 12 June 2009. Hypo is to pay SoFFin a pro-rata commitment fee of 0.1 per cent. on the undrawn portion and a 0.5 per cent. p.a. fee on any drawn portion of the guarantee.

On 17 March 2009, the German government extended its guarantee for notes issued by Hypo Real Estate Group until 31 December 2009, which initially was set to expire on 31 March 2009. The guarantee collateralises EUR 15bn in notes issued by Hypo Real Estate Bank AG, which were subscribed by a consortium of German banks and insurance companies. The guaranteed notes form part of the EUR 50bn liquidity facility, which has been provided by the consortium and Deutsche Bundesbank since 13 November 2008. Back in October 2008, the German government and the German Central Bank agreed to provide Hypo the EUR 50bn bailout package with an extra EUR 15bn in aid under the Financial Market Stabilisation Act. The government provided EUR 26.6bn, in two tranches, with the consortium of the banks providing the remainder.

The extension of the term of the guarantee has also automatically extended the term of this additional EUR 15bn in notes. As per the takeover bill passed by the lower house of the German parliament on 20 March 2009, the German Federal Ministry of Finance has indicated that it is prepared, in principle, to extend the term of the guarantee to cover the remaining EUR 20bn of the liquidity facility.

Bailout of BayernLB

Bayerische Landesbank ("**BayernLB**") announced it would seek EUR 5.4bn from the Fund plus an additional EUR 1bn for a capital increase, making it the first lender to draw on the Fund after being hit by third-quarter losses. While the EUR 5.4bn payment will come straight from the rescue program, the additional EUR 1bn capital injection is being provided by BayernLB's public sector owners with the state of Bavaria contributing EUR 700m and the state's savings banks EUR 300m.

BayernLB has received a EUR 10bn recapitalisation injection from its main shareholder, the Bavarian regional authorities, and EUR 15bn euros in guarantees from the federal government's banking sector support fund, under the Financial Market Stabilisation Act. BayernLB had a EUR 5.0 bn (USD 6.4bn) operating loss for 2008.

On 13 February 2009, a German prosecutor announced that BayernLB may face a criminal probe over subprime-related losses. No decision has been taken yet

Bailout for IKB

The European Commission approved a EUR 9bn restructuring package for German bank IKB, caught up in the US-born financial crisis. The rescue package will allow for restructuring of the bank, while the significant scaling back of IKB's activities would, according to the Commission, limit the distortion of competition created by the state support.

SoFFin aid for WestLB

In November 2008, WestLB announced its intent to tap the SoFFin fund for an undisclosed amount of state guarantees. This comes after the bank received EUR 5bn in emergency aid back in April 2008. It also disclosed its intent to increase its current tier 1 capital of 6 per cent. WestLB's prediction is that markets will want to see banks have a tier 1 capital between 8 and 10 per cent.

SoFFin aid for HSH Nordbank AG

On 7 March 2009, SoFFin announced that HSH Nordbank AG can access EUR 30bn (USD 38bn) of government-backed aid as long as shareholders' approval is sought, including from the states of Hamburg and Schleswig-Holstein. After approval, HSH Nordbank, which is seeking EUR 3bn in capital and EUR 10bn to cover potential losses, can access SoFFin liquidity guarantees.

Deutsche Bundesbank

Despite all the economic downturn, the Deutsche Bundesbank posted on 10 March 2009 a profit of EUR 6.3bn in 2008, which is even higher than the EUR 4.3bn figure announced in 2007, largely as a result of the increase in interest income denominated in euro and no write-down of foreign exchange assets or securities. The distributable profit was paid to the Federal Government pursuant to section 27 number 2 of the Bundesbank Act.

The Bundesbank also announced from 1 May 2009 it will establish a new Financial Stability Department in order to leverage its expertise in the field of financial stability.

Swap facilities

SoFFin is permitted to acquire or secure special risk positions of financial institutions and to sell to third parties were possible.

The criteria for the temporary acquisition of assets are aligned on the rules of the guarantee scheme. See: Asset swap ("risk assumption").

In particular the state will take over the assets but not bear their risk, as the assets need to be bought back after 36 months maximum for essentially the initial sales price. Moreover, a minimum premium similar to that of the guarantee and the costs for the provision of liquidity must be paid by the beneficiary.

Further details for the risk assumption can be found here.

Interest rates

Base interest rates, which are changed in July and January each year pursuant to section 247 of the German Civil Code (*Bürgerliches Gesetzbuch*), have reduced on 1 January 2009 to 1.62 per cent., down from 3.19 per cent. in July 2008. The latest rates can be found here.

Other Developments

Short Selling Ban

The Federal Financial Supervisory Authority (BaFin) has extended the ban on uncovered/naked short selling. The ban was originally in place by Decrees set in place on 19 and 21 September 2008. The ban has now been extended to 31 March 2009.

On 10 November 2008, the German Finance Ministry announced it is considering banning the undisclosed accumulation of shares in listed companies through options trading, and wants to boost transparency on its financial markets.

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