STATE AIDS (BANKING): THE GERMAN BANKING CASE

Subject: State aids
Guarantees

Industry: Banking; credit institutions

Parties: Provincial Banks in Germany (special purpose and savings banks)
European Banking Federation (complainant)

Source: Commission Statement IP/01/119, dated 26 January 2001

(Note. For many years the Commission has rightly done its best to stop state aids to banks and other financial and credit institutions; but it has encountered some difficulty over the entrenched system of state guarantees to public credit institutions in Germany. The Commission Statement, reported below, does not mention Declaration 37 annexed to the Treaty amending the Treaty on European Union – declarations annexed to Treaties do not, in any case, have the force of law – but the declaration represented an attempt to preserve the status quo in Germany. Now that the European Banking Federation has formally complained about the practice of allowing guarantees to public credit institutions in Germany, the Commission has been given the opportunity to renew its attack, though as the report explains this is only the first move in the procedure. The terminology used in the report is not ideal; but the translations of the German words for the two types of guarantee which are the subject of the complaint are offered by the Commission and are accepted for the purposes of this commentary.)

The Commission has sent a letter to the German authorities stating that it considers the guarantees in favour of the country's public law credit institutions, to the extent that they affect the competitive position of the institutions and trade between Member States, to be State aid which is incompatible with Community law. The German Government is invited to submit its observations on the Commission's position within one month. The letter is the first step in the normal procedure for bringing existing aid schemes into line with EU rules. The Commission not only spelled out its general position on State aid in the form of guarantees in November 1999 but has also received, more than a year ago, a formal complaint directed specifically against maintenance obligations and guarantee obligations (*Anstaltslast* and *Gewährträgerhaftung*), the two guarantee instruments traditionally used in the German public banking sector. The letter was sent by the Directorate General for Competition.

The Commissioner responsible for competition policy emphasized that the Commission did not question the ownership structure of Germany's public banks. "What must be remedied, however, is the distortion of competition arising from State guarantees which are unlimited both in duration and amount and are provided free. Ultimately, such aid is not in the interest of the beneficiaries.

Shielding them from market pressures which other players have to cope with may, in the long run, weaken their structures and competitive positions."

The Commission had looked carefully at all aspects of this matter and had come to the preliminary conclusion that both forms of guarantee had to be considered as existing aid regimes within the meaning of the European Community's state aid rules. No action could therefore be taken for their application in the past. However, a solution had to be found for the future in all cases where such guarantees affected trade between Member States. The Commissioner called on Germany to cooperate in dismantling the distortion of competition. "It is always preferable for the Member State concerned to come up with an acceptable solution. In this case no such solution has yet been offered by the German authorities. The ball is now formally in their court. I am aware that discussions are going on in Germany on how to address this matter and I would hope that they will shortly lead to constructive proposals in Brussels. The Community's state aid rules leave the door wide open to solutions shaped by the interested parties themselves."

The maintenance obligation means that the public owners (such as the Federal State, the provinces and the municipalities) of the institution are responsible for securing the economic basis of the institution and its function for the entire duration of its existence. The guarantee obligation stipulates that the guarantor will meet all liabilities of the bank which cannot be satisfied from its assets. Both guarantees are unlimited in time or amount; and the credit institutions do not have to pay for them. The publicly owned German credit institutions which benefit from these guarantees comprise the provincial banks, a number of special purpose banks and around 580 savings banks of widely varying size.

The guarantees have an effect on the competitive situation of the financial institutions concerned. In particular they improve their creditworthiness and so normally the financing conditions, because creditors ask a lower risk premium. On the basis of a preliminary evaluation it can be assumed that the advantages arise in particular for activities on the (international) capital markets, such as issuing bonds or raising subordinated equity), in the derivative and over-the-counter (OTC) business and in the interbank business. Where there is distortion of competition, it can in general be considered to affect trade between Member States: in the financial services sector the single market has to a large extent been achieved and there is strong competition between institutions of different Member States.

The Commission has therefore arrived at the preliminary conclusion that the guarantees fulfil the conditions of Article 87(1) of the Treaty in that they involve a transfer of state resources, favour certain undertakings, distort competition and affect trade between Member States. The analysis looked at whether any of the exemptions possible under the State aid rules might apply. However, this was not the case.

Finally, it is doubtful whether the guarantees represent compensation for the provision of services of general economic interest. At present, there seem to be no

precise definitions of the services with which the public law credit institution in Germany may be entrusted. In addition, no costs of any such services are calculated, and the proportionality of any compensation facility can therefore not be verified.

According to the Procedural Regulation concerning State aid, Member States must provide the Commission with all necessary information for the review of existing aid schemes. The Commission can demand such information. If the Commission considers a scheme is not, or is no longer, compatible with the common market, it must inform the Member State of this preliminary view. This is usually done by way of a letter signed by the responsible Director. The Member State has the opportunity to comment on the letter within one month. If the Commission maintains its position that the scheme is not, or is no longer, compatible it must propose appropriate measures, suggesting amendments or an abolition of the scheme. These appropriate measures take the form of a formal Commission decision and constitute only a recommendation. If the Member State accepts the proposed measures no further Commission action is needed. The Commission will only monitor the implementation of the appropriate measures.

If, however, the Member State does not accept the proposed measures, the Commission can initiate a formal state aid investigation procedure under Article 88(2) of the Treaty. This procedure can then end with the adoption of a decision declaring the aid incompatible and requesting its amendment or abolition. From that moment on (or a later time stated in the Commission decision, as in the case of a transitional period granted by the Commission) the existing aid becomes illegal.

The procedure is different in the case of "new aid". Normally, when the Commission receives a complaint and does not immediately consider it unfounded, it asks the Member State concerned for information. Then it decides whether or not to open a formal state aid procedure under Article 88(2) of the Treaty. If this procedure ends with a negative decision and the aid has already been paid out, it has to be recovered from its beneficiary.

"Existing aid" is, according to the Procedural Regulation,

- aid which existed before the entry into force of the Treaty;
- aid authorised in the meantime;
- aid with regard to which the limitation period of ten years to recover unlawful aid has expired;
- aid which was no aid when put into effect and which became aid in the meantime because of the evolution of the market (unless the changes in the market are due to liberalisation acts by Community legislation; then it becomes "new aid").

On 24 November 1999, the Commission adopted a Notice summing up its approach to state aid in the form of state guarantees. The document explains conditions in which the Commission considers that a state guarantee includes elements of state aid and when it does not. The Notice also confirms that, if aid

is involved, this aid is already granted when a guarantee is given and not only when it is actually honoured. The Notice was intended to make the Commission's policy in this area as clear as possible. It covers all forms of guarantees in the commercial field except export credit guarantees, irrespective of their legal basis and the transaction covered.

The European Banking Federation had filed a complaint on 21 December 1999 about maintenance and guarantee obligations. The complaint referred, as examples, to the West German Provincial Bank (*Westdeutsche Landesbank*), the Cologne City Savings Bank (*Stadtsparkasse Köln*) and the West German Real Property Bank (*Westdeutsche Immobilienbank*), but is targeted at the whole system of guarantees.

The question of maintenance and guarantee obligations has to be distinguished from the cases of equity transfers to Provincial Banks (the *Westdeutscher Landesbank* and similar casess). On 8 July 1999 the Commission adopted a final negative decision regarding the transfer of equity to *Westdeutscher Landesbank* and ordered the recovery of a state aid element of DM 1,580m plus interest for the period from 1992 to 1998. This decision has been challenged before the European Court of Justice. The appeals do not suspend the implementation of the decision. Two proposals by the German authorities on how to recover the aid could not be accepted by the Commission. Therefore, the latter on 25 May 2000 also referred the matter to the Court, for failure of Germany to implement the Commission's decision. ■

The FIA / FAO Case

Recently, the Fédération Internationale de l 'Automobile (FIA) and Formula One Administration (FAO) reached agreement in a case involving important issues relating to the management and governance of motor sport in general, as well as specific issues relating to the broadcasting and related rights for Formula One motor sport. As a result, the Commission is satisfied that the FIA's role in future will be limited to that of impartial motor sports regulator. FOA has sold its interest in Rallying and all other forms of motor sport other than Formula One, and has agreed to make a number of changes to the current arrangements relating to the marketing and broadcasting of Formula One races. The changes already adopted, together with those agreed in principle, will benefit all citizens interested in motor sport, as well as the sport's participants. However, before giving its final approval, the Commission wishes to give third parties the opportunity to comment. To this end a full description of the new arrangements, an Article 19(3) Notice, will be published in the Official Journal of the European Communities in the coming weeks; and third parties will be invited to submit their comments on the new arrangements to the Commission.

(Source: Commission Statement IP/01/120, dated 26 January 2001.)