

## II

(Non-legislative acts)

## DECISIONS

## COMMISSION DECISION

of 15 December 2009

**on State aid C 17/09 (ex N 265/09) by Germany for the restructuring of Landesbank Baden-Württemberg**

(notified under document C(2009) 9955)

(Only the German text is authentic)

(Text with EEA relevance)

(2010/395/EU)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union and in particular the first subparagraph of Article 108(2) thereof <sup>(1)</sup>,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on the Member States and other interested parties to submit their comments <sup>(2)</sup> and having regard to their comments,

Whereas:

measure is compatible with EU State Aid rules with regard to valuation und burden sharing and initiated a formal investigation procedure.

(2) The opening decision was published in the *Official Journal of the European Union* <sup>(4)</sup>. The Commission called on all interested parties to submit their comments. The Commission received no comments from the parties concerned.

(3) On questions concerning the method of asset evaluation within the framework of the asset relief measure the Commission received technical support from external experts under contract to it (Duff & Phelps, Professor Wim Schoutens) and from technical experts in the European Central Bank (ECB).

## 1. PROCEDURE

(1) In Decision C (2009) 5260 of 30 June 2009 in Case C 17/09 <sup>(3)</sup> (hereinafter referred to as the 'opening decision') the Commission approved for a limited period an injection of capital and an asset relief measure by the State of Baden-Württemberg and other public entities for the Landesbank Baden-Württemberg (hereinafter referred to as 'LBBW' or 'the bank'). At the same time the Commission expressed doubts in the aforementioned Decision as to whether the asset relief

(4) On 9 October 2009 Germany presented the Commission with a restructuring plan for LBBW, which has been supplemented on several occasions with further details. The last details were sent on 3 December 2009.

(5) There were a number of meetings, exchanges of e-mails and telephone conferences between the Commission and Germany.

(6) On 3 December 2009 Germany gave a number of commitments concerning the implementation of the restructuring plan.

<sup>(1)</sup> With effect from 1 December 2009, Articles 81 and 82 of the EC Treaty have become Articles 101 and 102, respectively, of the TFEU; the two sets of provisions are in substance identical. For the purposes of this Decision, references to Articles 101 and 102 of the TFEU should be understood as references to Articles 81 and 82, respectively, of the EC Treaty where appropriate.

<sup>(2)</sup> OJ C 248, 16.10.2009, p. 9.

<sup>(3)</sup> OJ C 248, 16.10.2009, p. 9.

<sup>(4)</sup> See footnote 1.

## 2. DESCRIPTION OF THE FACTS

### 2.1. The beneficiary

- (7) LBBW is a German Landesbank. Shareholders of the bank are the State of Baden-Württemberg with a share of around 35,5 %, the savings banks association of Baden-Württemberg with around 40,5 %, the city of Stuttgart with nearly 19 % and the Landeskreditbank Baden-Württemberg with almost 5 %. All the shareholders are either public entities or in state ownership.
- (8) LBBW is one of the few vertically integrated Landesbanks. The focus of the activity of LBBW and its subsidiaries is dealings with German enterprises (SMEs and larger enterprises) and private customers. LBBW offers Private Banking and functions as a city savings bank in Stuttgart. Other business fields of LBBW are real estate financing and financial markets. The bank also offers services and products for savings banks.
- (9) LBBW's balance sheet amounted to EUR 448 billion at the end of June 2009. LBBW does not have a market share of more than [ $> 4$ ] (\*) % in any of the domestic markets in which it is active. Locally, i.e. in its core regions, the market shares are somewhat higher. In the business customer sector they reach [ $< 15$ ] % in Baden-Württemberg, [ $< 10$ ] % in Saxony and [ $< 5$ ] % in Rhineland Palatinate. In the private customer sector the market shares are [ $< 7$ ] % in Baden-Württemberg, [ $< 2$ ] % in Saxony and [ $< 1$ ] % in Rhineland Palatinate. LBBW's market share in financial markets is insignificant both in Germany and Europe-wide.

### 2.2. The Measures

- (10) The Bank has been granted two aid measures: an injection of EUR 5 billion of Tier 1 capital and an impaired asset relief measure through the taking over of guarantees of over EUR 12,7 billion for two portfolios of structured securities amounting to EUR 35 billion in total (5). All shareholders participated in the capital injection in accordance with their respective levels of shares and indirectly in the impaired assets relief measure.
- (11) The injection of capital was carried out through a proportional increase in the share capital, whereby priority was given to a distribution of the new share capital in proportion to the existing share capital. The Bank is paying a total compensation of 10 % for the

injected capital. It plans to repay the capital in five tranches each year from 2013 onwards.

- (12) The asset relief measure was granted in the form of guarantees which protect LBBW against losses and reduce the legally prescribed equity capital requirement for structured securities. The guarantees cover two different portfolios.

The first one, referred to as the 'ABS portfolio', consists of structured products with a volume of EUR 17,7 billion which are held directly by the bank. LBBW takes on the first-ranking risk (First Loss) for the ABS portfolio amounting to EUR 1,9 billion and Baden-Württemberg guaranteed the secondary-ranking risk (Second Loss) up to an amount of EUR 6,7 billion. According to information provided by Germany the real economic value of the portfolio on 31 March 2009 was EUR [15-16] billion and the market value was EUR 10,137 billion (6). The capital relief effect of the guarantee was EUR [1-2] billion.

The second one, referred to as the 'Sealink portfolio', relates to a loan of EUR 8,75 billion to a special purpose vehicle which holds a portfolio of structured products. In the Sealink portfolio the First Loss amounts to EUR 2,75 billion. It is covered by a guarantee of the Free State of Saxony which had been negotiated in the course of the takeover of SachsenLB by LBBW (7). Baden-Württemberg took over a Second Loss of EUR 6 billion with the result that there are no further risks of losses for LBBW. According to information provided by Germany the portfolio had on 31 March 2009 a real economic value of EUR [12-13] billion and a market value of EUR 8,006 billion. The capital relief effect of the guarantee was EUR [2,5-3,5] billion.

- (13) The two portfolios together have a market value of EUR 18,143 billion; their real economic value is around EUR [27-29] billion.
- (14) The guarantee was provided for an unlimited period and can be terminated by LBBW. LBBW undertook to pay an initial fee which is based on a capital relief effect of EUR 4,4 billion, on which an interest rate of 7 % p.a. is applied. For the first year the fee amounts to EUR 308 million; in subsequent years it will sink proportionally to the amount guaranteed and after a review during the restructuring procedure.

(6) Germany asserts that LBBW, according to its experts in the Stress Case, will only have to reckon on around [30-40] % of the total anticipated losses in the next five years. By 2020 according to Germany only EUR [1-2] billion of the anticipated losses would be incurred (i.e. less than the First Loss fixed at EUR 1,9 billion).

(7) See Commission Decision in Case C 9/08 of 4 June 2008, *Sachsen LB* (OJ L 104, 24.4.2009, p. 34). See also footnote 4 of the opening decision.

(\*) Confidential information, also shown thus [...] below.

(5) See the opening decision for details.

- (15) Germany has decided to adjust the guarantee compensation as follows. LBBW will pay retrospectively EUR 336 million per year. With that the compensation originally envisaged will be increased by EUR 28 million in the first year. This compensation is based on two different rates of interest: 6,25 % on the capital relief effect and 10 % on the part of the guaranteed value which exceeds the real economic value of the two portfolios. The capital relief effect has been corrected to EUR 4,476 billion.
- (16) The recapitalisation was necessary in order to offset heavy losses in 2008 and to cover the higher capital requirement. The asset relief measure became necessary when the value adjustments for large portfolios of structured securities drove the capital requirement steeply upwards and the regulatory capital requirements could no longer be met in the second quarter of 2009.
- sale of important associated and subsidiary companies.
- (19) The restructured LBBW will consist of five core business areas: Corporates I (German SME business customers), Corporates II (large customers), Retail (private customers), Savings Banks, Real Estate (real estate financing) and Financial Markets (capital markets). In addition LBBW will also in future offer business-related services, in particular transaction banking, treasury and securities settlement and certain products for savings banks. LBBW's foreign activities and foreign presence are to be considerably reduced, and the bank will concentrate its business activity on the three regional core markets of Baden-Württemberg, Rhineland-Palatinate and Saxony, in which it is active due to earlier Landesbank mergers.

### 2.3. Future Business model of the beneficiary bank

- (17) The restructuring plan envisages substantial changes to the LBBW business model. The basis for this is a clear focussing on LBBW's regional core business and concentration on markets and customers for which a high degree of penetration and considerable cross selling effects are expected. The capital market activities and trading for its own account will be reduced. All in all LBBW is to be converted from a capital market and customer-induced financial services group which offers a full range of services and products into a commercial bank with a clear focus on German SME business customers and private customers, which also offers a number of corporate finance and selected investment banking products for its business and savings bank customers. As regards its geographic presence, LBBW will withdraw from abroad or reduce its foreign presence and concentrate on a few core regions in Germany.
- (18) The restructuring is geared towards the following central themes:
- moderate growth in the medium term in German business and private customer activities; concentration of real estate financing on a few German states and selected properties,
  - complete reduction of investment in structured securities and other forms of credit substitute business which are the main cause of LBBW's current problems; adjustment of existing portfolios,
  - clear reduction in business activities, above all in large-volume business and abroad,
- (20) Despite the moderate growth envisaged in the current plan the restructuring will have significant effects on LBBW's balance sheet and profit and loss account, not only with regard to its composition, but also with regard to its total size. The Bank's balance sheet and the impaired assets (risk-weighted assets) are expected to fall by [25-30] % or [30-35] % in comparison with 2008 by 2013 through the reduction of non-strategic activities and the sale of holdings. Compared with the figures for the end of 2008 the balance sheet total will fall by a total of EUR 182 billion or around 41 % and the impaired assets by EUR [80-90] billion or [45-50] % after the complete reduction of the stated business fields. Around [35-45] % of the reduction in the balance sheet total and more than 50 % of the reduction in the impaired assets are due to the exit from the credit substitute business (which to a large extent fell within the asset relief measure). Cuts in the remaining core business fields are between 25 % and 40 %.
- (21) In detail LBBW will dismantle the credit substitute business, sell holdings, close a considerable part of its foreign subsidiaries and representation offices, abandon entire product lines of its current corporate business, close down its brokered mortgage loan business, abandon strategic trading for its own account and avoid more complex financial market activities, restrict real estate financing to a few regions and selected types of properties, and concentrate its large customer business on Germany's neighbours <sup>(8)</sup>.

<sup>(8)</sup> As a particularly large disinvestment Germany mentions the sale of LBBW Securities LLC (broker/dealer), [...] and LRI Invest SA. LBBW Securities LLC is a member of the US National Association of Securities Dealers and has a licence there for equity sales und private placements. It is the sole subsidiary of LBBW which offers such services to LBBW customers. [...] is the only provider of [...] in LBBW. LRI Invest SA administers investment funds, including funds whose shares belong partially to private banking customers of BW Bank (to a value of [...] EUR). In addition LRI Invest SA is the only LBBW company which can issue [...] in [...].

(22) The major part of LBBW's activities lies in its core business. Only around [6-8] % of the bank's total impaired assets are allotted to the holdings and subsidiary companies as a whole. LBBW has agreed to considerable cuts in its portfolio of holdings. The book value of all the holdings which are to be sold in the course of the restructuring is around EUR 4,5 billion (as at 31 December 2008), which corresponds to more than 50 % of the total book value of the bank's associated and subsidiary companies.

(23) A considerable part of the planned sales relates to the bank's core business, particularly holdings in companies in the savings banks financial group (Sparkassen-Finanzgruppe)<sup>(9)</sup>:

(a) DekaBank Deutsche Girozentrale (asset manager for the savings banks financial group);

(b) LBS Landesbausparkasse Baden-Württemberg (building society (Bausparkasse));

(c) SV Sparkassen Versicherung Holding AG (insurance company).

(24) In the course of the restructuring LBBW will cut around 2 500 of the core bank's current 10 000 staff (full time equivalents in each case). It is assumed that the restructuring will not only reduce administrative costs, but also stabilise the profit situation as the more volatile business sectors will be abandoned.

#### 2.4. Organisational structure

(25) The objective of the restructuring is a simpler, more transparent corporate structure in which fewer resources as a whole will have to be used for the administration of LBBW. The need for risk management and

financial control will diminish as LBBW will abandon entire business areas and product lines, reduce its presence abroad and sell subsidiary and associated companies.

(26) Existing business areas have been slimmed down and the services for savings banks are to be more clearly separated from other business areas, so that the results can be recorded more transparently. The assets from the credit substitute business which is to be wound up will be transferred to an internal restructuring unit and administered separately.

#### 2.5. Corporate Governance

(27) Important changes to the bank's existing corporate governance structure go together with the restructuring. Firstly, the reference to the public service in the Landesbank Baden-Württemberg Act (Gesetz über die Landesbank Baden-Württemberg) will be changed in order to underline that LBBW will conduct all business in accordance with business management criteria. This principle will also be embodied in the LBBW articles of association, business policies and internal procedures. In order to give expression to the fact that LBBW will be run like a private business despite its public owners, LBBW will be converted from a company governed by public law into a public limited company. This change in legal form will be carried out in such a way as to ensure that the conversion into a public limited company is concluded by no later than December 2013. In addition important aspects of the voluntary German Corporate Governance Code will be introduced by the end of 2010.

(28) Secondly, the functions of bodies such as the shareholders' meeting, Supervisory Board and Board of Managing Directors will be redefined in order to achieve a clearer distribution of responsibilities and more transparency. The powers of the shareholders' meeting will be restricted to the tasks which are typical of an annual general meeting under company law, in particular [as regards] rights relating to information and the taking of decisions on the use of profits. More extensive powers, which would allow improper influence on management, will be rescinded. Unlike the current situation the supervisory and monitoring functions of the Board of Managing Directors will be exclusively embodied in the Supervisory Board. Its influence on management decisions will be limited to those cases in which action is necessary under German company law or the Banking Act (Gesetz über das Kreditwesen). Responsibility for day-to-day operational management will clearly rest with the Board of Managing Directors, which reduces the possibilities of improper influence by the owners or their representatives.

<sup>(9)</sup> Some other sales also directly concern the core business with German SME business customers, private customers and institutional customers, thus for example the European LBBW subsidiaries [...] and LBBW Luxembourg, which mainly serve German customers in the LBBW core markets in activities outside the domestic market.



- (32) According to the baseline scenario 2009 will continue to be a difficult year and the gross domestic product (GDP) will shrink due to the continuing financial crisis. A gradual recovery is expected from 2010 onwards, with the result that the situation in the financial markets and the economy should fully return to normal. LBBW assumes that German GDP will fall by 6,2 % in 2009 and will rise by 1 % in 2010; it then expects a gradual rise in GDP growth to 2,5 % by 2013. A peak of 9,8 % unemployment is assumed for 2010, a continuing high level for 2011 and then a fall to 8,3 % in 2013. LBBW also expects low, slightly rising inflation, which will remain well below the ECB's inflation targets. Despite the expansionary monetary policy of the central banks and the massive expansion in budget deficits, it is assumed that inflation will prove low below potential in view of growth in real terms.
- (33) On the basis of these assumptions LBBW is expecting the following effects on its core business. The profit situation in private customer business which is mainly driven by securities will continue to prove moderate. The provisions should fall considerably and presumably not rise again so quickly as private customers are expected to switch to safer forms of investment, above all deposits. New legal requirements and high product transparency will in all probability increase the pressure on margins. On the other hand, a greater contribution to profits is expected from the corporate customer business, above all SMEs. In view of the partial withdrawal of national and international competitors LBBW also sees opportunities to expand its function as a bank for SMEs and is expecting rising demand here in 2010. LBBW also assumes that the profit situation will be improved by cross selling, in particular through the sale of hedging instruments for interest rate, currency and commodities risks.
- (34) As far as large customers are concerned, LBBW is expecting in the medium term a rise in demand for credit and also a rise in demand not only for traditional equity capital and debt capital products but also for balance sheet restructuring measures. LBBW's financial markets business is currently profiting from one-off effects and the extremely favourable financing conditions which are resulting from the availability of large amounts of money on favourable terms from the European Central Bank. In the medium term, on the other hand, LBBW assumes that market volume will be positive again when the volatility in the financial markets and economic developments return to normal. Specifically it is expecting moderate growth in structured capital market products and increased use of the capital market.
- (35) In view of these expectations LBBW's dependence on opportunistic business will be reduced and there will be an increase in the share of more stable sources of income. Market risks will decline and the proceeds from trading for its own account will be replaced by commission income. The present relatively high credit risk concentration has already been reduced and will be further reduced.
- (36) In a pessimistic scenario in which the impaired assets for 2011, 2012 and 2013 are estimated to be more than 10 % higher than in the baseline scenario, the capital ratios would prove considerably lower than in the realistic scenario. Nevertheless the bank would still meet the regulatory capital requirements, as the tier 1 rate would at no point fall below 7 % and the total equity capital ratio would be at least 10 % each year. The bank has carried out additional stress tests to determine the anticipated losses from the corporate loans business, as this area could be particularly affected by the collapse in world trade due to the export focus of customers in its core markets. Although this would further worsen the capital ratios, the bank would still have a sufficient capital buffer.
- (37) LBBW has a diversified financing mix. It mainly finances itself through (i) savings banks and other financial institutions, (ii) mortgage bonds and other securities and (iii) liabilities of its customers. According to the restructuring plan the bank will not get into financing difficulties. In particular financing from state guaranteed debenture bonds, which are due by 2015, will not cause a financing gap under the plan, as the underlying assets will be reduced. The Bank has a considerable pool of eligible assets which it could resort to in the event of liquidity shortages. In addition analyses that have been carried out internally for the purpose of liquidity management and stress tests have shown that the bank could overcome a further downgrading of its rating even under adverse conditions without any liquidity problems.

## 2.7. Commitments by Germany

- (38) Germany has undertaken that LBBW will implement the restructuring plan and has passed on the following commitments (with regard to the reduction of the balance sheet, impaired assets and sales) and behavioural undertakings:

The Federal German Government and LBBW hereby undertake to carry out the following measures to restructure LBBW:

[...]

3. LBBW will reduce its assets in 2008 (balance sheet total of around EUR 448 billion at 31 December 2008) by approximately EUR 182 billion, i.e. about 41 %. About EUR [125-135] billion of this will be achieved by 31 December 2013.

4. LBBW will reduce its impaired assets in 2008 (around EUR 178 billion at 31 December 2008) by approximately EUR [80-100] billion, i.e. around [40-60] %. About EUR [60-80] billion of this will be achieved by 31 December 2013.
  5. LBBW will sell in the best way possible the following holdings, where they have not already been sold, by no later than the stated times. In doing this the main value determining elements of the present volume of business of the holdings will be preserved until the sale and sold.
    - a. Sachsen DV Betriebs- und Servicegesellschaft mbH (sold in August 09)
    - b. quirin bank AG (sold in September 09)
    - c. DekaBank Deutsche Girozentrale (sale envisaged by the end of [...])
    - d. Lassarus Handels GmbH (sale/liquidation envisaged by the end of [...])
    - e. LBBW Securities LLC (broker/dealer) (sale/closure envisaged by the end of [...])
    - f. LBBW Luxemburg SA (sale of [...] envisaged by the end of [...], liquidation of [...])
    - g. LRI Invest SA (sale envisaged by the end of [...])
    - h. LBBW Asset Management (Ireland) plc (sale or closure envisaged by the end of [...])
    - i. LBS Landesbausparkasse Baden-Württemberg [...] (sale envisaged by the end of [...])
    - j. SV Sparkassen Versicherung Holding AG (sale envisaged by the end of [...])
    - k. LBBW Immobilien GmbH (housing stock) (sale envisaged by the end of [...])
    - l. [...] (sale envisaged by the end of [...])
    - m. [...] (sale envisaged by the end of [...]).
    - n. [...] (sale envisaged by the end of [...]).
  6. A sale of one of the holdings referred to in paragraph 5 may be postponed by [...] months, but until no later than 31 December 2013, if LBBW shows that the price that would be obtained by the transaction is lower than the book value of the holding in the individual accounts drawn up by LBBW in accordance with the German Commercial Code or would produce losses in the group accounts in accordance with the IFRS accounting standards.
  7. The complete and correct implementation of the commitments in paragraph 5 will be supervised and monitored in detail by a sufficiently qualified expert (*trustee*), preferably an auditor. The trustee will also check that the purchase price is established in accordance with business criteria. Within three months of notification of this Decision, LBBW is to nominate a suitable independent trustee to the Commission. The trustee is to be appointed only with the assent of the Commission. The Commission may require explanations and clarifications from the expert. The costs of the expert are to be borne by LBBW.
  8. If one of the associated companies referred to under paragraph 5 were not to have been sold by the specified date, even after using all the extension possibilities available, the Commission may then provide in a separate decision that the respective associated company is sold by a *divestiture trustee*. The costs of the divestiture trustee are to be borne by LBBW.
  9. LBBW will close the following representation offices as quickly as possible and no later than 31 December 2010:
    - a. Barcelona
    - b. Madrid
    - c. Paris
    - d. Amsterdam
    - e. Milan
    - f. Budapest
    - g. Warsaw
    - h. Prague
- The branches in London, New York, Singapore and Tokyo will be significantly reduced in size.

The Federal German Government and LBBW promise that LBBW will observe the following behavioural undertakings:

10. During the implementation of the restructuring plan LBBW will, up to 31 December 2012, only service subordinated capital or only avoid a participation in the losses of the subordinated capital in so far as it is obliged to do this without releasing reserves in accordance with section 340 et seq. HGB (German Commercial Code).
  11. Until 31 December 2012 LBBW will not effect any purchases of financial institutions in competition with LBBW. Other share transactions, which are to be allotted to the original customer business as part of LBBW's business model, will remain possible if they do not affect the viability of the bank.
  12. LBBW will assist in a general consolidation of Landesbanks in accordance with economic principles and LBBW's new business model. If mergers of individual Landesbanks come up for consideration by LBBW, LBBW will be guided by the need to ensure the long-term viability of the merged institution and its sustainable ability to make appropriate loans to the real economy. Any purchases/mergers as part of a possible consolidation of Landesbanks will require the prior approval of the European Commission.
  13. In the markets in which it has a significant market share, i.e. in German SME and private customer business, LBBW will until 31 December 2012 not offer any more favourable prices than the prices of the most favourable of its 10 most important competitors (by market share).
  14. LBBW will not use the granting of this aid or any advantages over competitors arising out of the aid for advertising purposes.
  15. In its lending and capital investment LBBW will take into account the credit requirements of business, especially small and medium-sized enterprises, by offering generally accepted market terms which are appropriate for regulatory and banking purposes.
  16. Furthermore LBBW will review the adequacy of its internal incentive schemes and take steps to ensure that they do not encourage unreasonable risk-taking, are geared towards long-term and sustainable business goals, and are transparent.
  17. LBBW will further extend risk monitoring and risk supervision. In the course of this it will separate the entire credit substitute business from the bank's core business areas and assign it to an organisationally and functionally separate Internal Restructuring Unit (IRU). This unit will ensure separate presentation, reporting and control of the activities to be reduced.
  18. LBBW will report separately on the savings bank business from 31 December 2010 onwards.
  19. LBBW will follow a prudent, sound business policy geared towards sustainability.
  20. LBBW will not exploit any liquidity advantage as a result of the ECB eligibility of the guarantee structure.
  21. LBBW will initially pay an annual fee of 6,25 % on the initial capital relief effect retrospectively to the time of the granting of the guarantee. This will be reduced in proportion to a reduction in the available size of the guarantee. LBBW will pay an additional annual compensation of 3,75 % on the part of the guarantee for the portfolio of securitised products (ABS portfolio) which will not exceed EUR 1,5 billion. In other words, LBBW will pay this additional compensation in full as long as the guarantee amount incurred on the portfolio is still at least EUR 1,5 billion; if the amount of the guarantee falls below EUR 1,5 billion, only a compensation of 3,75 % is to be paid on the outstanding amount of the guarantee.
- Commitments concerning corporate governance:
22. The current Administrative Board will be reshaped into an independent Supervisory Board in accordance with the model in the Corporate Governance Code.
    - a. The supervisory and monitoring functions will be exclusively concentrated in the Supervisory Board and no longer divided between two bodies (the owners' meeting and the Administrative Board). The normal approval reservations of the Supervisory Board will apply to transactions of fundamental importance.

- b. LBBW's Board of Managing Directors will be independent in its day-to-day operational management and only under obligation to the company. Instructions, whether from the Supervisory Board or the owners' or annual general meetings, are excluded.
- c. The current owners' meeting will be converted into an owners' or annual general meeting. Its powers will be concentrated on the typical tasks of an annual general meeting in accordance with company law (e.g. the taking of decisions concerning the use of the profits, the conclusion of business agreements, winding-up decisions etc.).
- d. All the members of the Supervisory Board are to have the qualifications laid down in the latest version of the Capital Requirements Directive <sup>(10)</sup>/ section 36(3)(1) of the Banking Act [Gesetz über das Kreditwesen]. Members will be suitably qualified if they are reliable and have the necessary expertise to carry out the supervisory function and to assess and monitor the business which LBBW carries on.
- e. The number of members of the Supervisory Board will be reduced to 21.
- f. Half of the seats for the shareholders will be held by external experts.
- g. During the restructuring phase, i.e. with the introduction of the governance aspects until the completion of the change in legal form pursuant to paragraph 24 (below) in 2013, the chairmanship of the Supervisory Board will be held by a person who is a member of the Supervisory Board pursuant to paragraph 22(f) (above). Subsequently the appointment will be made in accordance with the procedure laid down in German or European company law.

### 23. Committees

#### a. Risk Committee

The current Credit Committee will be converted into a traditional Risk Committee, which not only has to approve loan decisions, but also has to concern itself intensively with general risk management issues. A member of the Supervisory

Board with appropriate banking expertise will take over the chairmanship.

#### b. Audit Committee

The Audit Committee is to be led by a member of the Supervisory Board who has particular expertise in banking accountancy.

#### c. Presiding Committee (Personnel and Nomination Committee)

A Presiding Committee will be established for personnel issues. The shareholder representatives of this committee will also form the Nomination Committee, which presents suitable candidates for the Supervisory Board to the owners' or annual general meeting.

24. Change in legal form: All the main governance aspects of an SE or public limited company (described in paragraphs 22 and 23) are to be introduced immediately and no later than by 31 December 2010. LBBW will be converted into an SE or public limited company by no later than 31 December 2013, when following the milestone of the introduction of the governance aspects by the end of 2010, the legal adaptations in accordance with the articles of association for the change in legal form will be prepared for in such a way that this is concluded by no later than 31 December 2013.

#### 25. Management in accordance with business criteria

##### a. Overall

It is to be made clear in the Landesbank Baden-Württemberg Act [Gesetz über die Landesbank Baden-Württemberg] that the commercial activities of the Landesbank are to be carried out in accordance with business principles and the tasks for which the Landesbank is responsible should also be taken into account.

##### b. Specific to the business

It will be ensured that new business is calculated on the basis of reference interest rates which do not contain any distortion caused by guarantor liabilities.

<sup>(10)</sup> OJ L 177, 20.6.2006, p. 1. Amended by Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (OJ L 302, 17.11.2009, p. 97).

c. Relationship with shareholders

The arms-length principle which is typical between a corporation and its owners should apply in relations with the shareholders. Assets may only be distributed to the owners in the form of profits and liquidation proceeds.

26. Aim to achieve a normal return on equity: In accordance with the restructuring plan in the medium term (i.e. after the conclusion of the restructuring in 2013) and also in future LBBW will aim to achieve a return on equity of at least [10-12] % before tax with capital resources appropriate to the risk profile.

Other commitments:

27. Every year until 2013 inclusively, Germany is to send the Commission a progress report. The report must contain a review of progress in the implementation of the restructuring plan and details of all sales of holdings and closures of subsidiaries, departments and locations in accordance with this Decision. The report is to show the date of sale or closure, the book value at 31 December 2008, the selling price and all profits or losses in connection with the sale or closure. The report is to be sent each year within one month of the approval of LBBW's annual accounts by LBBW's Administrative Board (or supervisory board), but no later than 31 May' <sup>(1)</sup>.

### 3. GERMANY'S VIEWS

- (39) Germany is applying for approval of the restructuring plan. Germany does not dispute that the measures are State aid. However, Germany asserts that the measures are compatible with the internal market as restructuring State aid in accordance with Article 107(3)(b) TFEU after the adjustment of the compensation for the asset relief measure and the submission of undertakings.

### 4. REASONS FOR THE INITIATION OF THE INVESTIGATION

- (40) In the opening decision the Commission expressed doubts about the compatibility of the original measure with the Communication on the treatment of impaired assets in the Community banking sector <sup>(12)</sup> (hereinafter referred to as the 'Impaired Assets Communication'), in particular as regards the valuation and burden sharing. However, in the opinion of the Commission, the

requirements of the Impaired Assets Communication regarding the eligibility of assets, the choice of management arrangement for impaired assets, transparency and disclosure and the guarantee fee were fulfilled.

- (41) The Commission's doubts regarding the valuation concerned the method used and the assumptions by the LBBW experts in the calculation of the real economic value of the portfolios, which did not seem cautious enough to the Commission. Above all the assumptions concerning the likelihood of losses, the recovery rates, developments in real estate prices in some markets and the correlations were not conservative enough for the Commission. In addition the ABS portfolio had not been fully shielded.

- (42) The Commission consequently expressed doubts about the burden sharing (including compensation), as any correction to the real economic value would have immediate consequences for the valuation of the guarantee fee.

## 5. ASSESSMENT

### 5.1. Existence of aid

- (43) Under Article 107(1) TFEU 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 is incompatible with the internal market, in so far as it affects trade between Member States.

- (44) The Commission has already established in its opening decision that the recapitalisation of LBBW and the asset relief measure are State aid. The aid element in the capital injection amounts to EUR 5 billion. According to the Impaired Assets Communication the amount of the aid in the asset relief measure corresponds to the difference between the transfer value of the assets and the market price. The transfer value corresponds to the nominal value of the portfolio less the First Loss. Assuming a market value of EUR 18,143 billion (EUR 10,137 billion and EUR 8,006 billion) and an economic value of EUR 27,915 billion (EUR 15,635 billion and EUR 12,280 billion), a total aid amount of von EUR 9,772 billion results for the asset relief measure.

- (45) The amount of the aid for the two measures together is around EUR 14,8 billion; this corresponds to more than 9 % of LBBW's impaired assets.

<sup>(1)</sup> Source: Letter from Germany of 3 December 2009.

<sup>(12)</sup> OJ C 72, 26.3.2009, p. 1.

## 5.2. Compatibility of the aid with the internal market

### 5.2.1. Application of Article 107(3)(b) TFEU

(46) Under Article 107(3)(b) TFEU the Commission may decide that aid is compatible with the internal market if it serves to 'remedy a serious disturbance in the economy of a Member State'. The Commission stresses that there continues to be a danger of a serious disturbance in the economy in Germany and that measures to support banks are appropriate to counter this danger. The aid should therefore be investigated under Article 107(3)(b) TFEU.

(47) The two measures were approved for a limited period in the opening decision on the basis of Article 107(3)(b) TFEU and the detailed Commission Communications (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<sup>(13)</sup> ('Banking Communication'), Communication 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<sup>(14)</sup> ('Recapitalisation Communication'), Communication on the treatment of impaired assets in the Community banking sector<sup>(15)</sup> ('Impaired Assets Communication') and the Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules<sup>(16)</sup> ('Restructuring Communication')). However, the Commission initiated an investigation as it continued to have objections under competition law concerning the asset relief measure. For this reason the Commission has to examine at the current stage of the investigation firstly whether the objections under competition law concerning the asset relief measure still exist and secondly whether the extension of the aid approved for a limited period is compatible with the internal market as restructuring aid.

### 5.2.2. Compatibility of the asset relief measure with the internal market

(48) The Commission examines asset relief measures in accordance with Article 107(3)(b) TFEU and on the basis of the Impaired Assets Communication<sup>(17)</sup>. According to the Impaired Assets Communication measures which relieve the beneficiary bank from (or

compensate for) the need to register either a loss or a reserve for a possible loss on its impaired assets and/or free regulatory capital for other uses are asset relief measures which need to be investigated using specific criteria to check whether they are compatible with the internal market. This investigation is carried out using the following criteria: (i) eligibility of the assets, (ii) transparency and disclosure, (iii) management of the impaired assets, (iv) suitability and consistency of the valuation method, (v) appropriateness of the compensation and burden sharing and (vi) need for the assessment of the restructuring plan by the Commission.

(49) In the opening decision the Commission established that the asset relief measure adopted for LBBW – apart from the criteria concerning the valuation method and the burden sharing including compensation – fulfils all the abovementioned criteria. However, Germany was able to essentially dispel these doubts through a number of amendment proposals.

#### Valuation

(50) As part of the investigation the Commission valued the portfolio with the support of internal Commission and external experts. The real economic value of the ABS portfolio is EUR [14-15] billion and is consequently below the value stated by LBBW by EUR [1-2] billion. On the other hand the real economic value of the Sealink portfolio was correct. The Commission's doubts with regard to the valuation of the eligible assets have consequently been confirmed.

(51) In the course of examining various asset relief measures various methods were proposed to the Commission which the banks concerned use to calculate the real economic value of a portfolio. In the case of structured credit products one possibility (the one selected by LBBW) consists of subjecting the assumptions regarding the counterparty risk, correlations and loan losses for the underlying assets to a stress test.

(52) During the examination of the question of whether the assumptions were cautious enough, the Commission based its findings on other cases, in particular on LBBW's Sealink portfolio and on studies by third parties. In doing this different assumptions were used depending on the asset class. In order to establish how these assumptions would affect the ABS portfolio, the Commission asked LBBW's experts to evaluate a size-weighted random sample with 40 positions and the five largest positions once again on the basis of these assumptions.

<sup>(13)</sup> OJ C 270, 25.10.2008, p. 8.

<sup>(14)</sup> OJ C 10, 15.1.2009, p. 2.

<sup>(15)</sup> OJ C 72, 26.3.2009, p. 1.

<sup>(16)</sup> OJ C 195, 19.8.2009, p. 9.

<sup>(17)</sup> This Communication was used for the first time in the Commission Decision of 13 March 2009 in State aid case C 9/09, *Dexia* (not yet published).

- (53) Owing to the waterfall structure of the structured credit tranches, the use of the stress test assumptions produced very different effects. In the case of some asset classes, such as non-conforming loans in the United Kingdom, the portfolio tranches were particularly robust. Their real economic value consequently came very close to the market rate even in the case of cautious market rate assumptions, although their market value is generally below the nominal value. The situation was quite different with the tranches of some Commercial Mortgage-Backed Securities and Commercial Mortgage Obligations. With these asset classes the greatest discrepancies were not only between the two LBBW portfolios but also with regard to other cases. In the event, the evaluation of the random sample on the basis of these new, cautious assumptions produced a difference of EUR 143 million for a total random sample nominal value of EUR 1 559 million compared with the price obtained by the LBBW experts using their 'baseline case' model.
- (54) The Commission established the potential effects on the entire portfolio by extrapolation. In doing this it took account of a number of qualitative aspects of the random sample, in order to avoid any disproportionate strengthening of certain effects. According to the calculations the anticipated losses would be between EUR 2,9 billion and EUR 4,3 billion depending on the extrapolation method and correction factor.
- (55) Leaving aside certain portfolio-specific features which could have unjustified negative effects at portfolio level, the Commission comes to the conclusion that with the most balanced assessment the anticipated losses for the entire portfolio were EUR [3-4] billion. The real economic value is consequently estimated at EUR [14-15] billion, i.e. EUR [1-2] billion lower than in the notification.
- Burden sharing
- (56) According to the Impaired Assets Communication the banks should as far as possible themselves bear the costs associated with the impaired assets. The assets should therefore be transferred at a price which corresponds to the real economic value or lies below it. A write-down to the real economic value first has to be carried out for this or, in the case of a guarantee, a 'First Loss' clause must be included, according to which the first loss to be borne by the beneficiary bank corresponds to the difference between the book value and the real economic value.
- (57) In the current State aid case the asset relief measure was carried out without a previous write-down to the real economic value of the ABS portfolio. In order to ensure the requested burden sharing, however, LBBW promised to take on a First Loss which covers the initial losses from the guarantee portfolio amounting to a total of EUR 1.9 billion; in the meantime this amount has been fully written down.
- (58) As a result of the correction made by the Commission to the real economic value of the ABS portfolio, reducing it to EUR [1-2] billion lower than in the original valuation by the bank, the anticipated losses in the ABS portfolio are no longer offset in advance by a write-down or a sufficiently high first loss. For this reason, in order to ensure the compatibility of the measures with the rules on State aid under the Impaired Assets Communication, an additional write-down must be made which takes account of the fall in the real economic value or, the case of a guarantee for assets, a correction of the 'transfer value' (i.e. a rise in the attachment point) to the real economic value must be undertaken. Such a write-down would not be possible in this case for accounting reasons without changing the structure of the transaction, as the structured securities are protected from potential losses through the asset relief measure.
- (59) Consequently the transfer value is above the real economic value. In the event of an assumption of risk above the real economic value the criterion laid down in the Impaired Assets Communication of full ex ante burden sharing will not be fulfilled. Consequently the aid element in the asset relief measure is correspondingly larger and can only be approved if the measure is accompanied by the introduction of conditions allowing the recovery of this additional aid at a later stage (e.g. by means of a claw-back mechanism) or far-reaching restructuring (cf. paragraph 41 and section 5.2 of the Impaired Assets Communication).
- (60) With a claw-back mechanism the beneficiary bank normally repays the advantage arising from the higher assumption of risk at a later stage, i.e. it would have to repay the entire amount secured by the guarantee which exceeds the real economic value. If no full recovery (claw-back) is possible, far-reaching compensatory measures must be provided for.
- (61) In the case of a guarantee the recovery can be achieved through an appropriate compensation for the amount exceeding the real economic value. In the present case a compensation of 10 % p.a. is paid for the guarantee of EUR 1,5 billion. This compensation covers both the advantage arising from the capital relief for the guaranteed EUR billion 1,5 (current compensation rate 6,25 %) and the increase by 3,75 % (resulting in an overall amount of EUR 56,25 million p.a.)<sup>(18)</sup>.

<sup>(18)</sup> Recovery is also unaffected by a unilateral termination unless the guarantee is reduced to an amount of less than EUR 1,5 billion. In this case all further losses should be borne by LBBW.

(62) At first sight this increase may appear low. It should however be borne in mind that – as already pointed out – in the event of future losses the state guarantee only becomes effective if the first loss of EUR 1,9 billion has been fully utilised. It is consequently unlikely that the guarantee will be taken up before the State of Baden-Württemberg as guarantor of the State aid has formed substantial reserves for such payments from the fees paid by LBBW<sup>(19)</sup>. As it is unclear when the potential losses determined by the Commission will occur, it may be that the fee payments will be sufficient to cover all the losses that may arise. The increase in the compensation consequently contributes to dispelling the Commission's original doubts regarding burden sharing. In addition the scale and extent of the restructuring to be carried out by the bank and the compensating measures should sufficiently compensate for any inadequacies in the prescribed recovery. The Commission's doubts regarding appropriate burden sharing could be dispelled on this point.

(63) As the real economic value of the Sealink portfolio has been confirmed, no adjustments are necessary for this part of the arrangement.

#### Compensation

(64) In its opening decision the Commission established that the compensation paid by the beneficiary bank takes adequate account of the risk of future losses which exceeds the risk expressed in the real economic value in accordance with the Impaired Assets Communication. The compensation was calculated on the basis of an interest rate, which would have been used as a basis for a corresponding recapitalisation, in which the equity capital relief effect was used as a yardstick in accordance with the Impaired Assets Communication.

(65) In view of the equity capital relief effect the compensation should however be reduced by 0,75 % to 6,25 % p.a. At least 50 % of regulatory equity capital must consist of tier 1 capital. According to the current legal provisions<sup>(20)</sup> the tier 2 capital must not exceed 100 % of the tier 1 capital. This means that the equity capital can consist 50 % of tier 1 capital and 50 % of tier 2 capital in order to meet the regulatory requirements. As according to the Recommendation of the European

Central Bank of 20 November 2008 on recapitalisation measures a difference of 1,5 % exists between the price of tier 1 capital and tier 2 capital, a reduction of 150 basis points is appropriate<sup>(21)</sup>. If according to the Recapitalisation Communication 7 % can be regarded as appropriate compensation for tier 1 capital without the supply of liquidity, the tier 2 capital should then be compensated for at a rate of 5,5 %. The average of both rates is 6,25 %.

(66) On the basis of the above considerations LBBW has to pay a capital relief effect of EUR 4,476 billion at 6,25 % p.a., which corresponds to an amount of EUR 279,75 million p.a. Together with the recovery amount of EUR 56,24 million this produces a compensation amount of EUR 336 million p.a. which, in view of the aspects explained above, is proportionate.

#### 5.2.3. Compatibility of the restructuring aid with the internal market

(67) The Commission has to examine the continuation of all the current rescue measures as restructuring aid. Examination of whether the restructuring aid is compatible with the internal market is carried out against the background of the financial crisis on the basis of the Commission's Restructuring Communication. Although in previous decisions reference was made to the Community Guidelines on State aid for rescuing and restructuring firms in difficulty<sup>(22)</sup>, the Commission has clarified in paragraph 49 of the Restructuring Communication that all aid which is notified to the Commission on or before 31 December 2010 will be examined as restructuring aid for banks on the basis of the Restructuring Communication rather than the Community Guidelines on State aid for rescuing and restructuring firms in difficulty.

(68) As regards the necessity and range of a restructuring, it is not laid down in the Restructuring Communication under what conditions a bank may have to submit a restructuring plan, but reference is made to previous communications concerning this. The Commission holds the view that LBBW needs comprehensive restructuring as the aid prevented the closure of the bank by the banking supervisory authority and all in all corresponded to more than 2 % of the bank's total impaired assets. This view is in accord with paragraph 4 of the Restructuring Communication and paragraph 55 of the Impaired Assets Communication.

<sup>(19)</sup> See in particular footnote 4.

<sup>(20)</sup> Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (OJ L 177, 30.6.2006, p. 201).

<sup>(21)</sup> Commission Decision of 31 July 2009 in State aid case N 314/09, *German asset relief scheme* (OJ C 199, 25.8.2009, p. 3).

<sup>(22)</sup> OJ C 244, 1.10.2004, p. 2. This is expressly referred to in paragraph 42 of the Banking Communication of October 2008.

- (69) Under the Restructuring Communication it must first be explained in the restructuring plan that the restructuring process which the beneficiary bank is subjected to is suitable to ensure the return to long-term viability. Secondly the amount of the aid must be limited to the minimum absolutely necessary and both the beneficiary and its shareholders should as far as possible participate in the restructuring with their own funds. Measures must be taken in order to limit distortions of competition which arise as a result of the fact that the market power of the beneficiary is artificially supported and in order to ensure the maintenance of a competitive banking sector. In addition questions relating to monitoring and procedural issues need to be clarified.
- Restoration of long-term viability
- (70) In an assessment of a restructuring plan under competition law the Commission ensures that the bank is in a position to restore its long-term viability without State aid (section 2 of the Restructuring Communication).
- (71) According to the Restructuring Communication long-term viability is ensured if the restructured bank is able to compete in the marketplace for capital on its own merits in compliance with relevant regulatory requirements. This involves the bank being able to cover all its costs and provide an appropriate return on equity, taking into account the risk profile of the bank. Long-term viability also requires that any State aid received is either redeemed over time, as anticipated at the time the aid is granted, or is remunerated according to normal market conditions, thereby ensuring that any form of additional State aid is terminated. The restoration of viability should above all be achieved through internal measures and on the basis of a credible restructuring plan. Furthermore the restructuring plan should identify the causes of the bank's difficulties and the bank's own weaknesses and outline how the proposed restructuring measures remedy the bank's underlying problems. Restructuring requires a withdrawal from activities which would remain structurally loss-making in the medium term.
- (72) Firstly the restructuring initiated by LBBW on the basis of the restructuring plan submitted by Germany seems appropriate to restore LBBW's viability. In the restructuring plan a tier 1 capital ratio of [9-11] % and a return on equity of [10-12] % are estimated for 2013. These figures – even under extreme stress conditions – would lie far above the regulatory level and would correspond to the market's expectations of a bank with the risk profile of LBBW. According to the restructuring plan LBBW will be able to cover all its costs and start repaying the State aid in 2013. Furthermore there are no indications of any potential financing problems. LBBW's liquidity proved to be stable during the crisis and the bank still has sufficient liquidity reserves. Future financing and financial costs have been examined.
- (73) Even with the application of the pessimistic LBBW scenario the bank would not need any further aid, the tier 1 capital ratio would not fall below 7,0 % during the restructuring and the tier 1 capital ratio would be [9-10] % in 2013, but the return on equity would only be [6-7] %. Even if the risk costs and the impaired assets were to rise further, the bank would still meet the regulatory requirements for capital resources.
- (74) LBBW's revised business model is a decisive factor in ensuring that the restoration of viability is realistic. LBBW is to be converted into a commercial bank with a clear focus on German SMEs and private customers which makes a number of corporate finance and selected investment banking products available to some of its customers (corporate customers and savings banks. Its offering comprises good products which are used by a broad range of customers (these include bank relationships of many years). This should form a good basis for a sound commercial banking business and opportunistic transactions driven by the capital markets are in this way to be reduced.
- (75) The Commission examined the credibility of the restructuring plan on the basis of LBBW's business results and up-to-date LBBW reports (including results in the management information system and risk management reports). In addition the Commission based its decision on risk assessments which were undertaken by the competent supervisory authority in accord with the detailed European directives and on reports by rating agencies. Planning and underlying assumptions were investigated for their compatibility with the most recent economic forecasts and with scenarios which the Commission had also referred to in other aid cases.
- (76) The restructuring plan takes account of the detailed information currently available and takes into account the fact that forecasts concerning future development can only be made to a limited extent. The assumptions concerning the further development of risks, results and capital basis appear sufficiently pessimistic. The risks arising from the large and relatively concentrated loan book – i.e. the greatest risks after the risk in connection with investment in structured securities – were limited by the asset relief measure and consequently treated appropriately. For the remaining risks arising from other securities and the loan book risks LBBW anticipates a clear rise in risk management for 2009 even compared with 2008. From 2010 onwards the risk costs will fall and a normal level will have been achieved by 2013. Nevertheless it is assumed that even under standardised conditions the LBBW's risk costs will remain twice as high as the previous risk management and they will correspond to the risk costs of its peers.

- (77) In addition the restructuring plan does not assume a rapid recovery, but rather a considerable rise in risks and loan losses. The restructuring plan takes account of these aspects both through a higher risk management and with higher regulatory capital requirements due to risk migration and higher losses on results. This is the result of the joint calculations of the LBBW offices for risk management and lending and consequently the result of a combination of a model-based approach and the estimates of experts. While a slower recovery emerges from the models and, contrary to the estimates of the experts, a higher likelihood of losses is assumed, the experts hold the view that the losses are estimated as being too low in the models. The figures of both sides were adjusted accordingly. Furthermore both the historical comparisons and a comparison of the current plan parameters demonstrate a high degree of consistency with external economic indicators and show that the economic downturn effects have been taken into account in the plan.
- (78) It can also be seen from the restructuring plan that the risk costs for new business and loans will be considerably lower than up to now as the risks may be considerably reduced by the restructuring and the credit quality in the core business will be better. Thus, no further investments will be made in structured securities. The portfolios containing the greatest risk were the subject of asset relief measures which may be considered to be sufficient according to the Commission's investigation results. No further losses should therefore be expected concerning these. Nevertheless LBBW expects a considerable rise in risk costs for the restructuring phase, where it is assumed that these costs will be higher than the current risk management. The expectations regarding the development of the credit risks are cautious.
- (79) While the projections for losses are conservative, the likelihood of losses – in particular for corporate business – is estimated to be lower than as assessed by the Commission. However, LBBW was able to demonstrate that the loss expectations are far above the historical data (for the last recession in Germany) and correspond to those of other banks with the same group of customers. Furthermore the bank emphasised the financial strength of these corporate customers compared to other companies in Europe and stressed the advantages due to its strong corporate relationships. In addition it demonstrated that the loss expectations for this particularly important market segment for LBBW's overall credit risk correspond to those of its peers.
- (80) There is some uncertainty concerning the development of market risks, although investment in structured securities is no longer of importance as one of the largest risk drivers. Furthermore trading for its own account will be considerably reduced and the area of securities settlement will be directed at asset management and customer-focused business. In addition the range of traded products will be reduced and their complexity will be restricted. Appropriate account is therefore taken of market risk in the restructuring plan.
- (81) A further important aspect is developments in expenses. Thus LBBW assumes that it will be able to save 25 % in its administrative costs. Since the restructuring plan envisages a reduction in jobs of around 20 % and a slimming down of the structure, business fields and products, such projections are credible.
- (82) Despite a significant reduction in assets and business activities LBBW expects only a slight decline in income compared with previously. While the impaired assets will be reduced by around 30 %, it is assumed that 87 % of the 2009 income will be achieved. The composition of the income will change as the income from business with corporate customers will gain in importance. While it is also assumed that the bank's financial markets business area will continue to produce profits, there will be income from fees instead of income from trading for its own account. All in all a more stable profit situation less dependent on the fluctuation of market prices is expected.
- (83) Secondly, in order to be appropriate to restore the bank's profitability in accordance with the Restructuring Communication, the restructuring plan should identify the causes of the bank's difficulties and the bank's own weaknesses and outline how the proposed restructuring measures remedy the bank's underlying problems. It is the view of the Commission that this is the case since the restructuring plan envisages the bank's exit from the disproportionately extensive credit substitute business, and LBBW will reduce its capital market activities in both scope and complexity and it will reduce its foreign business in order to concentrate on its core competencies, which lie mainly in private customer business and in business with small and medium-sized customers in the regional markets.
- (84) Existing and potential weaknesses in the corporate governance structure must also be the subject of the restructuring plan. The Commission notes that the restructuring plan envisages fundamental changes to the legal status and corporate governance, with the result that LBBW will be less subject to improper influence by the shareholders and all in all better corporate governance will be ensured.

- (85) The measures being implemented will ensure that LBBW does not differ from its competitors either in its articles of association, business policy and internal procedures or with regard to the role and composition of its corporate bodies. There are sufficient safeguards to prevent business decisions being determined by other than economic considerations. In addition the quality of the corporate governance will be considerably improved. Moreover the roles of the various bodies (owners' meeting, Supervisory Board and Board of Managing Directors) are more clearly and more consistently separated from each other; the Supervisory Board will gain in professionalism through the inclusion of independent experts in supervisory boards and the introduction of aptitude tests for all members.
- (86) Thus the bank and its shareholders have agreed on a corporate governance framework which fully corresponds to the requirements placed on private undertakings and envisages the implementation of the (voluntary) German Corporate Governance Code. In addition the strict application of business management principles will be introduced in the Landesbank Baden-Württemberg Act and in LBBW's articles of association.
- (87) The current owners' meeting is a potential source of improper influence with its wide-ranging powers and it is being converted into an owners' or annual general meeting without scope for exerting influence. A clearer separation is envisaged between the tasks and responsibilities of the corporate management and the Supervisory Board. In accordance with the German Corporate Governance Code a third of the Supervisory Board are to be independent members. The suitability criteria introduced by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)) which are intended to ensure that newly appointed members of supervisory boards have a minimum of expertise will apply to all members. During the restructuring an independent member will assume the tasks of the chairman of the Supervisory Board. The Audit Committee and the Risk Committee are in accordance with best governance principles for banks and contain even stricter suitability criteria. In order to provide some finality to these changes in corporate governance, LBBW will be converted from a public entity into a public limited company.
- (88) Moreover risk management concepts and procedures are being and have already been changed in order to further reduce the number of decisions which involve an assumption of risk but which are not taken in accordance with purely business principles. These measures will ensure as far as possible that corporate governance aspects will not endanger the future viability of the bank.
- (89) In addition there is no evidence that LBBW will continue business segments which would remain structurally in deficit in the medium term or which would expose the bank to risks which would not correspond to the quality of its risk management or its capital resources. The credit substitute business has been fully closed down, existing portfolios are being dissolved, trading on its own account is to be considerably reduced, and credit risk – in particularly the concentration risk in LBBW's core business segments – will be subject to stricter review and is also to be considerably reduced. All in all the LBBW's profit and risk profiles will become more transparent and simpler.
- (90) LBBW has learned its lessons from the crisis and has made a number of changes to its business strategy and its risk management which should make it less susceptible in future. These include focussing on business segments in which it has particular expertise and many years of credit relationships and reducing the concentration risk.
- (91) Considered on the whole the LBBW restructuring plan is therefore appropriate for restoring the long-term viability of the bank.
- Own contribution by the beneficiary bank
- (92) According to section 3 of the Restructuring Communication aid should be limited to the minimum necessary and an appropriate own contribution to restructuring costs should be provided. It can be seen from the restructuring plan that LBBW envisages appropriate burden sharing in accordance with the Restructuring Communication, with the result that moral hazard is avoided.
- (93) The restructuring plan does not contain any elements which could lead to the assumption that the aid exceeds the coverage of the costs necessary for the restoration of viability. The aid received is necessary to ensure that LBBW in the baseline case has sufficient capital buffers and will be able in an unfavourable scenario to meet the regulatory capital requirements. LBBW has not received more capital.
- (94) In addition it is excluded due to scarcity of resources and the ban on acquisitions promised by Germany that State resources will be used for the acquisition of company shares or new investment.
- (95) As envisaged under paragraph 24 of the Restructuring Communication, LBBW bears part of the costs of its restructuring by paying an appropriate compensation for the capital injection and the asset relief measure.

- (96) Furthermore LBBW is making a contribution towards the restructuring through far-reaching sales (including the sale of units which are important for its business model).
- (97) As the shareholders have injected capital into the bank pro rata to their respective shareholding, the burdens are at least equitably distributed among the groups of shareholders.
- (98) Due to the prohibition on appropriating reserves for the servicing of coupons for tier 1 and tier 2 instruments, the lower-ranking capital owners are also contributing to the restructuring of LBBW. According to paragraph 26 of the Restructuring Communication a bank should not use State aid to pay compensation for own resources if there are insufficient profits. Germany has undertaken that financial instruments will only be serviced in the next three years if no appropriation of reserves is necessary for this. It is consequently ensured that compensation for own resources will only be made in the event of sufficient profits and that no State aid will be used for payments to shareholders.
- resources (situation as at 30 June 2009). As the beneficiary bank has consequently received a high level of aid, far-reaching measures are necessary to limit any distortions of competition due to State aid.
- (101) In addition, with regard to the scope and extent of the measures to limit the distortions of competition due to State aid, the scale of the beneficiary bank's own contribution and burden sharing should be taken into account. In view of the above finding that its own contribution and burden sharing were appropriate, no additional far-reaching measures are necessary. In order to limit any distortions of competition, Germany has undertaken both to take structural measures and to comply with a number of behavioural obligations.
- (102) As part of the structural measures LBBW will reduce its balance sheet by a total of 41 % compared with the balance sheet as at 31 December 2008 through the reduction of non-strategic activities and the sale of holdings. The existing impaired assets will be reduced by [40-60] %.

#### Measures to avoid distortions of competition

- (99) According to section 4 of the Restructuring Communication measures to limit distortions of competition due to State aid play an important role, as they are necessary to prevent any continuation of competitive distortions which were caused by excessive risk-taking and unsustainable business models. Such measures should be tailor-made for the specific problems of the markets in which the beneficiary bank is active after the restructuring. The type and nature of such measures are focussed on two criteria: firstly, according to the level of the aid and the conditions and circumstances under which the aid has been granted and, secondly, according to the characteristics of the market or markets in which beneficiary bank will be active.
- (100) In accordance with paragraph 31 of the Restructuring Communication the Commission assesses the level of the aid and the resultant distortions of competition by taking account of the amount of the aid both absolutely and in relation to the bank's impaired assets. The aid in this case amounts to EUR 14,8 billion and comprises a recapitalisation of EUR 5 billion and EUR 9,8 billion of aid in the form of capital relief. The amount of the aid after completion of the measures amounts to more than 9 % of the impaired assets. The capital equivalent of the measures amounts to [40-50] % of LBBW's own
- (103) It is envisaged that a large number of subsidiaries at home and abroad will be sold along with the sale of holdings in companies which are in common ownership by the public credit institutions in Germany and which are highly important for cooperation between the public credit institutions. LBBW has agreed to considerable cuts in its portfolio of investments. The sales involve, inter alia the only LBBW company which can issue [...] in [...], units which are part of LBBW's core business (namely the holdings in the companies of the 'S' financial group) and the European LBBW subsidiaries [...] and LBBW Luxembourg, which serves German core customers outside the German market. Germany has undertaken that LBBW will ensure that the value of the units to be sold will not be affected by the fact that customers or staff will be lured away from these units. The proper management of the sales will be fully monitored and checked in detail by a sufficiently qualified expert (*trustee*). The sales must be carried out by no later than the end of the restructuring period. Otherwise a divestiture trustee will be appointed who will be responsible for the management of the sales [...].
- (104) A considerable part of these reductions results from the abandonment of the credit substitute business.

- (105) Additional measures to dispel any objections under competition law regarding the characteristics of the markets in which the beneficiary bank will be active after the restructuring (cf. paragraph 32 of the Restructuring Communication) are not necessary. This is justified by the low market presence of the restructured bank. In principle LBBW has a strong market presence only in its core region of Baden-Württemberg. Its systemic importance does not lie in its strong position as a domestic credit provider but is justified by its interconnection with other banks and institutional investors. For this reason no additional measures are necessary to ensure and restore a competitive market. However, the Commission considers it positive that LBBW also envisages sales in its core markets. The planned reduction in the core business areas should open up more business opportunities for competitors in the core regions and may be regarded as a further element in the comprehensive restructuring.
- (106) In addition to these far-reaching structural measures LBBW has promised to comply with a number of behavioural obligations. These commitments go beyond the mere obligation to dispense with aggressive marketing. Germany has undertaken that in its core markets, i.e. in the German SME and private customer business in Germany, LBBW must not offer more favourable conditions than the conditions of the most favourable of its ten most important competitors by market share for three years. LBBW should therefore not be able to offer better terms than competitors which have not received any State aid.
- (107) In addition LBBW has agreed to a ban on acquisitions under which the bank may not acquire any competing undertaking. This prevents aid-financed inorganic growth of LBBW. In addition the commitment that a double-digit return on equity will be sought and that reference interest rates which involve no distortions due to guarantor liabilities will be used for new business means that the risk and the likelihood of competition on price rather than performance with competing banks which have not received any State aid will be reduced.
- (108) Moreover greater transparency will be ensured through a new corporate structure in which the business segment to be wound up is clearly separated from the core business areas and through a redifferentiation and separation of the various business segments. Through a considerable reduction in capital market business there will be fewer opportunities to conceal any unsatisfactory operating results in the credit business, with the result that market discipline will improve and potential distortions of competition will be reduced.
- (109) In view of this bundle of measures the Commission has reached the conclusion that sufficient precautions have been taken to limit any distortions of competition despite the high level of aid for LBBW.
- 5.2.4. Implementation and monitoring*
- (110) In accordance with section 5 of the Restructuring Communication the Commission must be regularly presented with detailed reports so that it can investigate whether the restructuring plan is being properly implemented. The first report should be presented to the Commission no later than six months after approval of the restructuring plan. In order to examine whether the restructuring plan is being properly implemented, Germany will appoint a trustee responsible for monitoring and submitting a progress report each year. The first report must be presented in May 2010. The Commission therefore comes to the conclusion that proper monitoring of the implementation of the restructuring plan is ensured.
- (111) It is the practice of the Commission to allow a Member State to adjust the commitments in the event of extraordinary circumstances<sup>(23)</sup>. If it is objectively justified, the Commission will therefore agree on the request of Germany to extensions in the implementation deadlines or the annulment and/or replacement of individual measures or all the measures it has committed to.
- 6. CONCLUSION**
- (112) In view of the modifications made by Germany on 3 December 2009 the Commission comes to the conclusion that the asset relief measure is in accord with the Impaired Assets Communication and consequently in accordance with Article 107(3)(b) TFEU is compatible with the internal market. The objections under competition law set out by the Commission in the opening decision of 30 June 2009 have been dispelled with this modified measure.
- (113) Secondly the Commission comes to the conclusion that the restructuring measures are appropriate to restore the long-term viability of LBBW, that they ensure sufficient burden sharing and that they are suitable and appropriate to make up for the distortions of competition due to the aid measures in question. The submitted restructuring plan for LBBW fulfils the criteria of the Restructuring Communication, with the result that the restructuring measures may be deemed to be compatible with the internal market in accordance with Article 107(3)(b) TFEU. The capital injection and the guarantees, as envisaged in the restructuring plan, can therefore be approved,

<sup>(23)</sup> See Commission Decision of 22 October 2008 in Case C 10/08, *IKB*, (OJ L 278, 23.10.2009, p. 32).

HAS ADOPTED THE FOLLOWING DECISION:

*Article 1*

The asset relief measure by the State of Baden-Württemberg in favour of the Landesbank Baden-Württemberg for two portfolios of impaired structured securities represents state aid within the meaning of Article 107(1) TFEU.

The aid is compatible with the internal market.

*Article 2*

The restructuring aid which was granted to the Landesbank Baden-Württemberg by its state shareholders represents aid within the meaning of Article 107(1) TFEU.

The aid is compatible with the internal market on condition that the commitments in the annex to this Decision are complied with.

*Article 3*

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 15 December 2009.

*For the Commission*

Neelie KROES

*Member of the Commission*

## ANNEX

**Commitments by Germany**

Germany has undertaken that LBBW will implement the restructuring plan and has passed on the following commitments (with regard to the reduction of the balance sheet, impaired assets and sales) and behavioural obligations:

The Federal German Government and LBBW hereby undertake to carry out the following measures to restructure LBBW:

3. LBBW will reduce its assets in 2008 (balance sheet total of around EUR 448 billion at 31 December 2008) by approximately EUR 182 billion, i.e. about 41 %. About EUR [125-135] billion of this will be achieved by 31 December 2013.
4. LBBW will reduce its impaired assets in 2008 (around EUR 178 billion at 31 December 2008) by approximately EUR [80-100] billion, i.e. around [40-60] %. About EUR [60-80] billion of this will be achieved by 31 December 2013.
5. LBBW will sell in the best way possible the following holdings, where they have not already been sold, by no later than the stated times. In doing this the main value determining elements of the present volume of business of the holdings will be preserved until the sale and sold.
  - a. Sachsen DV Betriebs- und Servicegesellschaft mbH (sold in August 09)
  - b. quirin bank AG (sold in September 09)
  - c. DekaBank Deutsche Girozentrale (sale envisaged by the end of [...])
  - d. Lassarus Handels GmbH (sale/liquidation envisaged by the end of [...])
  - e. LBBW Securities LLC (broker/dealer) (sale/closure envisaged by the end of [...])
  - f. LBBW Luxemburg SA (sale of [...]) envisaged by the end of [...], liquidation of [...])
  - g. LRI Invest SA (sale envisaged by the end of [...])
  - h. LBBW Asset Management (Ireland) plc (sale or closure envisaged by the end of [...])
  - i. LBS Landesbausparkasse Baden-Württemberg [...] (sale envisaged by the end of [...])
  - j. SV Sparkassen Versicherung Holding AG (sale envisaged by the end of [...])
  - k. LBBW Immobilien GmbH (housing stock) (sale envisaged by the end of [...])
  - l. [...] (sale envisaged by the end of [...])
  - m. [...] (sale envisaged by the end of [...])
  - n. [...] (sale envisaged by the end of [...]).
6. A sale of one of the holdings referred to in paragraph 5 may be postponed by [...] months, but until no later than 31 December 2013, if LBBW shows that the price that would be obtained by the transaction is lower than the book value of the holding in the individual accounts drawn up by LBBW in accordance with the German Commercial Code or would produce losses in the group accounts in accordance with the IFRS accounting standards.
7. The complete and correct implementation of the commitments in paragraph 5 will be supervised and monitored in detail by a sufficiently qualified expert (trustee), preferably an auditor. The trustee will also check that the purchase price is established in accordance with business criteria. Within three months of notification of this Decision, LBBW is to nominate a suitable independent trustee to the Commission. The trustee is to be appointed only with the assent of the Commission. The Commission may require explanations and clarifications from the expert. The costs of the expert are to be borne by LBBW.

8. If one of the associated companies referred to under paragraph 5 were not to have been sold by the specified date, even after using all the extension possibilities available, the Commission may then provide in a separate decision that the respective associated company is sold by a divestiture trustee. The costs of the divestiture trustee are to be borne by LBBW.
9. LBBW will close the following representation offices as quickly as possible and no later than 31 December 2010:
  - a. Barcelona
  - b. Madrid
  - c. Paris
  - d. Amsterdam
  - e. Milan
  - f. Budapest
  - g. Warsaw
  - h. Prague

The branches in London, New York, Singapore and Tokyo will be significantly reduced in size.

The Federal German Government and LBBW promise that LBBW will observe the following behavioural obligations:

10. During the implementation of the restructuring plan LBBW will, up to 31 December 2012, only service subordinated capital or only avoid a participation in the losses of the subordinated capital in so far as it is obliged to do this without releasing reserves in accordance with section 340 et seq. HGB (German Commercial Code).
11. Until 31 December 2012 LBBW will not effect any purchases of financial institutions in competition with LBBW. Other share transactions, which are to be allotted to the original customer business as part of LBBW's business model, will remain possible if they do not affect the viability of the bank.
12. LBBW will assist in a general consolidation of Landesbanks in accordance with economic principles and LBBW's business model. If mergers of individual Landesbanks come up for consideration by LBBW, LBBW will be guided by the need to ensure the long-term viability of the merged institution and its sustainable ability to make appropriate loans to the real economy. Any purchases/mergers as part of a possible consolidation of Landesbanks will require the prior approval of the European Commission.
13. In the markets in which it has a significant market share, i.e. in the German SME and private customer business, LBBW will until 31 December 2012 not offer any more favourable prices than the prices of the most favourable of its 10 most important competitors (by market share).
14. LBBW will not will not use the granting of this aid or any advantages over competitors arising out of the aid for advertising purposes.
15. In its lending and capital investment LBBW will take into account the credit requirements of business, especially small and medium-sized enterprises, by offering generally accepted market terms which are appropriate for regulatory and banking purposes.
16. Furthermore LBBW will review its internal incentive schemes and takes steps to ensure that they do not encourage unreasonable risk-taking, are geared towards long-term and sustainable goals, and are transparent.
17. LBBW will further extend risk monitoring and risk supervision. In the course of this it will separate the entire credit substitute business from the bank's core business areas and assign it to an organisationally and functionally separate Internal Restructuring Unit (IRU). This unit will ensure separate presentation, reporting and control of the activities to be reduced.

18. LBBW will report on the savings bank business from 31 December 2010 onwards.
19. LBBW will follow a prudent, sound business policy geared towards sustainability.
20. LBBW will not exploit any liquidity advantage as a result of the ECB eligibility of the guarantee structure.
21. LBBW will initially pay an annual fee of 6,25 % on the initial capital relief effect retrospectively to the time of the granting of the guarantee. This will be reduced in proportion to a reduction in the available size of the guarantee. LBBW will pay an additional annual compensation of 3,75 % on the part of the guarantee for the portfolio of securitised products which will not exceed EUR 1,5 billion. In other words, LBBW will pay this additional compensation in full as long as the guarantee amount incurred on the portfolio is still at least EUR 1,5 billion; if the amount of the guarantee falls below EUR 1,5 billion, only a compensation of 3,75 % is to be paid on the outstanding amount of the guarantee.

Commitments concerning corporate governance:

22. The current Administrative Board will be reshaped into an independent Supervisory Board in accordance with the model in the Corporate Governance Code.
  - a. The supervisory and monitoring functions will be exclusively concentrated in the Supervisory Board and no longer divided between two bodies (the owners' meeting and the Administrative Board). The normal approval reservations of the Supervisory Board will exist for transactions of fundamental importance.
  - b. LBBW's Board of Managing Directors will be independent in its day-to-day operational management and only under obligation to the company. Instructions, whether from the Supervisory Board or the owners' or annual general meetings are excluded.
  - c. The current owners' meeting will be converted into an owners' or annual general meeting. Its powers will be concentrated on the typical tasks of an annual general meeting in accordance with company law (e.g. the taking of decisions concerning the use of the profits, the conclusion of business agreements, winding-up decisions etc.).
  - d. All the members of the Supervisory Board are to have the qualifications laid down in the latest version of the Capital Requirements Directive/section 36(3)(1) of the Banking Act [Gesetz über das Kreditwesen]. Members will be suitably qualified if they are reliable and have the necessary expertise to carry out the supervisory function and to assess and monitor the business which LBBW carries on.
  - e. The number of members of the Supervisory Board will be reduced to 21.
  - f. Half of the seats for the shareholders will be held by external experts.
  - g. During the restructuring phase, i.e. with the introduction of the governance aspects until the completion of the change in legal form pursuant to paragraph 24 (below) in 2013, the chairmanship of the Supervisory Board will be held by a person who is a member of the Supervisory Board pursuant to paragraph 22(f) (above). Subsequently the appointment will be made in accordance with the procedure laid down in German or European company law.

### 23. Committees

#### a. Risk Committee

The current Credit Committee will be converted into a traditional Risk Committee, which not only has to approve loan decisions, but also has to concern itself intensively with general risk management issues. A member of the Supervisory Board with appropriate banking expertise will take over the chairmanship.

#### b. Audit Committee

The Audit Committee is to be led by a member of the Supervisory Board who has particular expertise in banking accountancy.

c. Presiding Committee (Personnel and Nomination Committee)

A Presiding Committee will be established for personnel issues. The shareholder representatives of this committee will also form the Nomination Committee, which presents suitable candidates for the Supervisory Board to the owners' or annual general meeting.

24. Change in legal form: All the main governance aspects of an SE or public limited company (described in paragraphs 22 and 23) are to be introduced immediately and no later than by 31 December 2010. LBBW will be converted into an SE or public limited company by no later than 31 December 2013, when following the milestone of the introduction of the governance aspects by the end of 2010, the legal adaptations in accordance with the articles of association for the change in legal form will be prepared for in such a way that this is concluded by no later than 31 December 2013.

25. Management in accordance with business criteria

a. Overall

It is to be made clear in the Landesbank Baden-Württemberg Act [Gesetz über die Landesbank Baden-Württemberg] that the commercial activities of the Landesbank are to be carried out in accordance with business principles and the tasks for which the Landesbank is responsible should also be taken into account.

b. Specific to the business

It will be ensured that new business is calculated on the basis of reference interest rates which do not contain any distortion caused by guarantor liabilities.

c. Relationship with shareholders

The arms-length principle which is typical between a corporation and its owners should apply in relations with the shareholders. Assets may only be distributed to the owners in the form of profits and liquidation proceeds.

26. Aim to achieve a normal return on equity: In accordance with the restructuring plan in the medium term (i.e. after the conclusion of the restructuring in 2013) and also in future LBBW will aim to achieve a return on equity of at least [10-12] % before tax with capital resources appropriate to the risk profile.

Other commitments:

27. Every year until 2013 inclusively, Germany is to send the Commission a progress report. The report must contain a review of progress in the implementation of the restructuring plan and details of all sales of holdings and closures of subsidiaries, departments and locations in accordance with this Decision. The report is to show the date of sale or closure, the book value at 31 December 2008, the selling price, and all profits or losses in connection with the sale or closure. The report is to be sent each year within one month of the approval of LBBW's annual accounts by LBBW's Administrative Board (or supervisory board), but no later than 31 May <sup>(1)</sup>.

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<sup>(1)</sup> Source: Letter from Germany of [...].'