State guarantees to German public banks: a new step in the enforcement of State aid discipline to financial services in the Community

Stefan MOSER and Nicola PESARESI, Directorate-General Competition, Karl SOUKUP, member of Commissioner Monti’s cabinet

By letter of 11 April 2002, the German government accepted the amendment of 27 March 2002 of the Commission’s proposal for appropriate measures as regards the system of State guarantees to German public banks (Anstaltslast and Gewährträgerhaftung). By its acceptance, the German government formally put an end to the procedure of appropriate measures initiated in January 2001. It cleared the road to bringing the German system of State guarantees for public banks in line with the State aid rules of the EC Treaty, thereby removing a longstanding distortion of competition in Germany’s and Europe’s financial system.

The successful conclusion of this case marks a significant achievement in State aid policy. In this article we first present what we believe are the main lessons that can be derived from this case. A description of the case follows in the second part of this article.

I. What lessons can be derived from this case?

The successful conclusion of this case represents an important result for many reasons and has notable implications in several respects. We suggest that they may be grouped into three separate categories: From a political point of view, some lessons can be derived on the role of the State aid provisions and the relationship between the Commission and the Member States. We suggest it may also represent a useful element in the present debate on the reform of the European Union and its institutions. We then discuss the economic implications of the case for the enhancement of competitive conditions in the European banking market. Finally, we describe the implications for State aid control policy. Although the three categories overlap to some extent, we believe that such a separation gives a useful key to interpret this case.

a) Political implications

This case confirms the Commission’s determination to carry out its duties, conferred on it by the Member States, to enforce the Treaty’s provisions in the EU, and demonstrates that the Commission, in its role as a competition authority, takes into account in particular the interest of European consumers. It shows that the Treaty, which as regards competition rules had decisively been modelled along German thinking, works. It shows also that the Commission can play a useful role as a ‘facilitator’ when a Member State has difficulty in making necessary changes acceptable to stakeholders, which may have opposing interests.

The conclusion of this case is also a major political achievement for the German federal government to have effectively co-ordinated, in close collaboration with the Commission, the process of finding a workable solution in a matter which involves within Germany the competence of the Länder, and to have finally found a way to bring the sector of public banks in line with the principles of the Treaty.

It is worth mentioning that discussions started already in 1996 and were delayed by several factors. This was certainly partially due to the complexity of the file and the need to take account of the federal structure of the German State in terms of number of interlocutors and differentiated legal systems. However, it also shows the hesitations of the German side to accept that these basic legal arrangements could be subject to the Treaty’s State aid rules. It was also difficult to accept the economic consequences of the adaptation of these traditional structures.

In 1998, at the Treaty negotiations in Amsterdam, Germany proposed an amendment to the Treaty to protect the functions carried out by their public banks from the application of State aid rules. In the end, the other Member States accepted only a rather general declaration. By this initiative, the whole Community learnt about the problem.

Against this background, the Commission maintained that all Member States are treated equally. The handling of this case reaffirmed this basic principle. In its previous actions, the Commission had...
been equally firm vis-à-vis other Member States. It had already shown its determination in the handling of the French and Italian financial services crises of the 1990s (Crédit Lyonnais amongst others (1)). In the handling of the present case, the Commission also had to take into account the relationship between German public banks and other pending banking cases. While conducting the final discussions with Germany, the Commission had to decide upon an Italian aid scheme for bank restructuring (2), which was also of significant importance as regards aid amount and number of beneficiaries: the Commission maintained that the two cases were to be assessed along the same principles.

The Commission’s action was closely watched by the competitors. The European Banking Federation had lodged a complaint and submitted documentary evidence to show the negative effect of the aid on competition. The presence of active complainants indicated to the Commission that action was of priority. The complainants also submitted useful information. They even threatened to take action against the Commission before the European Court, had the Commission, in their view, shown that it was not willing to take their interests into due account. The complainants’ contribution was highly valuable; however, the Commission was keen to maintain a wider perspective and to strike a fair balance in the interest of European competition and consumers.

It should be recalled in this context that the Commission first attempted to bring the private and public banks together to find a solution at the national level. When it became clear that this was not possible, the Commission decided to carry out a threefold exercise: explaining the reasons of its action under the Treaty obligations, clarifying that the scope pursued was not the suppression of the German system of public banks but only the removal of the anti-competitive advantages attached to such a system, and showing its determination to apply the Treaty’s provisions in an equal way also in politically sensitive cases.

It is interesting to note that once the scope and the reasons of the Commission’s initiative had been understood, as well as the Commission’s determination to ensure compliance with Community law, the public banks themselves came up with the outline of a solution which then became the basis for the discussions between the Commission and Germany.

Indeed, the gradual ‘rapprochement’ between Germany and the Commission was made possible thanks to the specific procedure under Article 88 (1) of the Treaty. This procedure provides for the possibility that after a Commission’s proposal to bring aid into line with the Treaty rules, the Member State concerned actively participates in finding the best solution. This procedure has been specifically designed to facilitate the transition to full compliance with State aid rules for “existing” aid, i.e. those aid systems, like the guarantees for German public banks, which were either introduced before the Member State’s accession to the Union or which did not constitute aid at the time they were put into effect and subsequently became aid due to the evolution of the common market. This shows that Community law provides the tools that allow to find good solutions for difficult long-standing problems.

This leads us to a broader reflection on the future of the European Union and its institutions, and possibly for the work of the Convention. In spite of strong political and economic pressures the Commission as a collegial body showed its ability to stand as an impartial guardian of the Treaty. It is not evident that had the same function been attributed to an external body, the same pressures would have been equally resisted. The Commission was actually created and equipped with the necessary powers precisely because situations like this were foreseen and the need for independent and uniform treatment was recognised.

Finally, it is worth considering that the political implications of this case go beyond the current Member States and extend to the Candidate Countries. In the context of accession to the EU the Candidate Countries are required to demonstrate that they are able to respect the Community’s acquis including the Treaty’s competition rules. The Competition chapter cannot be successfully closed if the Candidate Countries are not able to prove that they have adapted their legislative and administrative frameworks to comply with the State aid rules. They also have to show a sufficient and credible record of enforcement of these rules. It is clear that this represents a big challenge and requires considerable efforts on both political and economic levels. The adaptation of a former planned economy to a market-oriented model entails not only severe restructuring for the Candidate Countries’ industrial sector but also a huge reform of their financial system. An attitude of the Commission vis-à-vis Germany, which would

(1) GAN, SDBO, CFF are other examples of the Commission’s attitude. In Crédit Lyonnais, as the Commission accepted a large amount of aid, the importance of the decision lies in the establishment of a policy to require significant counterparts to offset the distortion of competition resulting from the aid.

(2) See Commission’s decision of 11 December 2001, still to be published.
have been inconsistent with its principles and previous practice, would have meant a significant loss of political weight and credibility for advocating the need for an effective application of State aid rules in the Candidate Countries.

b) Economic implications

The Commission’s determination hinged on its consciousness of the necessity to remedy a very significant economic distortion in the European banking market. At the same time, the Commission affirmed its willingness to grant sufficient transitional periods to allow for an orderly adaptation process and give a fair chance to the undertakings in need of change, thus avoiding disruption of the markets. The decisive criterion for the Commission is the balancing of the interests of the competitors in levelling out the distortion of competition as soon as possible, the interest of the affected undertakings to adapt themselves with a fair chance of success, and the interest of consumers for an orderly adjustment which brings more competition together with better and cheaper services.

Firstly, the aid scheme was advantaging a large number of banks which represent around a third of the German banking market in terms of assets.

Secondly, although difficult to quantify precisely, the system of public guarantees probably has conferred more than 1 000 million Euro per year of economic advantage to the German public banking sector. This represents the highest amount per case examined by the Commission. No other Member State has ever granted equivalent amounts on a regular basis (1). Although even larger aids have been granted in the 1990s to some banks in France and Italy, they were ad hoc interventions in the context of serious banking crises (2).

It is evident that fair competition cannot be established when the State so heavily distorts the market mechanism. German private banks and other European banks suffered from such a distortion. Moreover, as aid in general helps to perpetuate inefficient structures and discourages innovation, it finally results in a penalisation of the most efficient financial intermediaries. The whole economy and consumers eventually bear the costs.

It is probably worth considering that the Commission’s action became even more necessary after the introduction of the Euro. The single currency entails at the same time the removal of a significant cost component for the integration of European financial markets and encourages cross-border activities of banks. Besides other reasons, the distorting advantage from which the public banks benefited contributed to making the German banking market rather unattractive to enter for non-German banks.

It should also be recalled that State aid rules are one of the essential components of the legal framework establishing the Common Market. Without them, Member States would probably not resist attracting undertakings away from other Member States or protecting their national undertakings by ever more generous subsidies. Competition would become unfair, the Common Market would disintegrate and the level of subsidies would replace the performance of an undertaking as the most decisive criterion for survival on the market. The waste of taxpayers’ money in such spiral for ever higher State aids would only be another negative consequence.

The abolishment of the State guarantees represents thus a fundamental contribution towards the achievement of a single market for financial services in Europe as also advocated by Member States at the European Council of 15-16 March 2002 in Barcelona. The prerequisite of a single market is access for all undertakings in the Community to the markets of all Member States.

This also paves the way for the Commission’s next actions vis-à-vis similar aid schemes in other Member States. Following the successful conclusion of the German case, the Commission has decided to take the first step to bring a similar Austrian system of State guarantees in favour of certain public banks (Ausfallhaftung in favour of Landeshypothekenbanken and certain savings banks) in line with the Treaty rules. Guarantees and guarantee schemes in other Member States are also currently being examined to determine whether they must be altered or discontinued.

c) Implications from the point of view of State aid control policy

This case is also relevant from the point of view of State aid control policy under several aspects. It breaks new ground in the Commission’s assessment of the types of aid in favour of banks. Four

\(^{(1)}\) The Commission has examined some other national schemes but of less importance. Among the most relevant is the previously mentioned Italian aid scheme for bank restructuring, which is considered to be worth between 1 000 and 3 000 million Euro.

\(^{(2)}\) The banking crises of the 1990s probably had a cost between 20 000 and 30 000 million Euro for France and between 5 000 and 10 000 million Euro for Italy. Very large aids to banks were also granted by the Nordic countries before their accession to the EU.
categories of aid can be distinguished in this respect:

(i) Ad hoc aid to ailing banks (rescue and restructuring aid);

(ii) Investment aid (e.g. to stimulate the reorientation of banks or to allow them to expand their business);

(iii) Operating aid;

(iv) Aid to compensate extra-costs of services in the public interest.

When in the 1990s the Commission started to extend State aid control to fight distortions caused by State interventions in the financial sector, it first examined aids which fall under the first two categories above. Those were the most visible forms of aid. The Commission developed a quite large experience with ad hoc aids to ailing banks (1), following the crisis of the French and Italian banking systems of the 1990s. It then extended its practice by addressing State support in form of investment aid to banks that, although not being in distress, needed a reinforcement of their capital basis (negative final decision in 1999 on the WestLB/Wfa capital transfer case, ordering recovery of more than 800 million Euro, which served also as a «test case» for several other still pending cases on German Landesbanks).

Only more recently, the Commission extended its attention to less visible State interventions in the form of state guarantees to banks which constitute operating aid falling under the third category above.

In that, the Commission benefited from the experience gained in other sectors. In 1993, the Commission concluded with the Italian government an agreement to phase out State guarantees to undertakings in 100 % public ownership (Andreata-Van Miert agreement, Efim case). In 1999, the Commission adopted a Notice on the application of the State aid rules to State guarantees, in which it gave rather precise indications under what conditions State guarantees can be presumed to constitute State aid and fall under the requirement of notification to the Commission.

In the case of the German public banks, the aid takes the form of a double guarantee by the respective public owners to the banks. The advantage of such guarantee consists mainly, but not exclusively, in the better conditions for the bank when it raises funds on the financial markets. The guarantees are not stipulated in a commercial contract, but derive from the specific long standing public status of the banks. The system has no (immediate) direct cost to the State budget, while providing the banks with on going indefinite support.

Furthermore, this case demonstrates that it is possible to respect State aid rules without putting into question the public status of a Member State’s institutions. One of the main reasons for the German banks’ and Länders’ opposition to the Commission’s action was the concern that the abolishment of the guarantee would have meant the loss of the public status of the banks. This has not been the case. Indeed, in applying the State aid rules the Commission fully respects Article 295 of the Treaty, which provides for the Community’s neutrality vis-à-vis private or public ownership of undertakings. However, in the present case it was not the public ownership of the banks, which led to the presence of State aid but the guarantees attached to it. By removing the guarantees for the commercial business of the public banks the Commission succeeded in ensuring fair competition without putting into question the public ownership and the public legal status of the banks.

The Commission’s decision on the German banks is also important as it is one of the first to address the relationship between the banks’ commercial business and activities in the public interest from a State aid point of view (see fourth category of aid above). This represents quite a new field of analysis. When an undertaking’s business includes both commercial activities and activities in the public interest, it is essential that aid granted to the activities in the public interest does not spill over into the commercial area. In the present case, the Commission had to examine this for the special purpose banks, in particular KfW. It came to the conclusion that the aid was likely to produce such an effect and that an effective separation between the two fields of activities was necessary. The Commission concluded that if KfW wanted to keep the aid in the form of the State guarantees it would have to hive off the commercial business into a separate legal entity without any State support. Such a solution constitutes the benchmark against which the Commission will examine in the future similar aid schemes in favour of commercial institutions charged with public service tasks.

Finally, the Commission’s decision also strengthens the enforcement of State aid provisions in the financial services sector from another perspective. By enlarging the scope of its analysis from ad-hoc rescue or restructuring aid to oper-

ating aid schemes and checking that public services activities or the fulfilment of public tasks are not over-compensated, the Commission has in a sense shifted its focus to a more structural approach. State aid control with respect to support to ailing banks, even when such support is considered incompatible, cannot prevent the distortion of competition, which in most cases has already occurred when the ailing bank pursued its imprudent business policy (1). State aid control which removes structural imbalances eliminates potential sources of distorting business behaviour and thus can be considered to be more effective.

II. Development and analysis of the case

1) Overview of the German banking system

The German banking system consists of universal banks and special banks.

There are 3 types of universal banks: nearly 300 commercial banks of private legal form (private Geschäftsbanken), nearly twice as many banks of public legal form (12 Landesbanken, DGZ-Dekabank and about 560 Sparkassen), and about 1 800 cooperative banks (Genossenschaftsbanken).

The special banks consist of about 30 private mortgage banks (Hypothekenbanken), about one dozen special credit institutions of public legal form and ca. 30 buildings & loans associations.

The public banking sector consists of both the universal and the special credit institutions of public legal form. This sector constitutes roughly one third of the German banking market and employs approximately 300,000 people. In addition, there are also some banks of private legal form in public ownership.

All credit institutions of public legal form (öffentlich-rechtliche Anstalten) have traditionally benefited from State guarantees: Anstaltslast and Gewährträgerhaftung, and, in some cases instead of Gewährträgerhaftung, a special refinancing guaranty of the State.

2) Description of the State guarantees and their economic effects

Anstaltslast is considered to be a general principle of law and says that the guarantor (‘Gewährträger’) is obliged to secure the economic basis of the Anstalt, to maintain it functioning for the complete duration of its existence and to cover possible financial gaps through the use of subsidies or other appropriate means. It was first recognised in 1897 as a general principle of law by a German court. Bankruptcy is practically impossible. Anstaltslast is creating, from a strictly legal point of view, only a liability in the inner relationship (‘Innenverhältnis’). Anstaltslast is limited neither in time nor in amount. The Anstalt does not pay a remuneration for the guarantee.

Gewährträgerhaftung is not considered a general principle of law but requires an explicit legal basis. It was explicitly introduced in several Länder laws in 1931/32 when the previous direct liability of the municipalities was replaced. It is defined as a direct liability and based on statute or by-laws, on the part of a regional authority or an association under public law with respect to the creditors of a public law credit institution for all of its obligations. Gewährträgerhaftung therefore creates the obligation for the guarantor (‘Gewährträger’) to step in in the case of insolvency or liquidation of the credit institution. It creates direct claims of the creditors of the credit institution against the guarantor, who can, however, only be called in if the assets of the credit institution are not sufficient to satisfy the creditors. Gewährträgerhaftung is limited neither in time nor in amount. The credit institution does not pay a remuneration for the guarantee.

Anstaltslast and Gewährträgerhaftung combined have generally caused rating agencies to attribute the best possible rating (Triple-A) to the banks concerned. The risk for creditors of these banks has been classified as the same or very close to the risk of the German State. Consequently, investors ask only for a greatly reduced risk premium compared with the one based on the respective stand-alone rating of these banks. The guarantees thus result in extremely advantageous funding conditions and confer a significant economic advantage to the banks because of their specific construction (no remuneration, no limitation in time or amount). In addition, the guarantees confer also other advantages (e.g. improvement of reputation, banks can take higher risks, possibility to carry out certain derivatives business).

3) Assessment under the State aid rules

a) Characterisation of the measure as an aid scheme

The measure under review constitutes an aid system within the meaning of Article 88 (1) EC.

(1) See for instance Crédit Lyonnais.
Thus, the Commission conducted its analysis by reference to the terms of the scheme, and not by reference to the potentially numerous individual aids that have been granted under the scheme and which might be granted in the future. The measures necessary to bring the scheme into line with the Community State aid rules had to be determined by reference to the scheme as a whole, and not by reference to specific undertakings. As long as the scheme under review potentially admitted incompatible State aid, the scheme as a whole was not in line with the requirements of the Treaty State aid rules. The Commission had to be satisfied that the scheme as a whole is modified so as to eliminate any possibility of incompatible State aid.

b) Ownership and legal form of a company

According to Article 295 EC the Community is neutral as regards the national systems of property ownership and nothing in the Treaty prevents the State from owning undertakings. On the other hand, the competition rules have to be applied in the same way to private and to public undertakings. Neither the one nor the other type may be advantaged or disadvantaged by the application of these rules.

It was the Commission’s opinion that it is not possible to justify Anstaltslast and Gewährträgerhaftung by referring to Article 295 EC. If the legal form of a company is associated with advantages that produce a distortion of competition which is prohibited by the State aid rules, then this legal form must be subjected to the discipline of these rules. The Member States are free to choose the legal form for undertakings, but they have, when doing so, to respect the competition rules of the Treaty.

In particular, this means that if a State guarantee is automatically linked to a certain legal status of a company, such guarantee may constitute State aid under Article 87 (1) EC, and cannot be justified under Article 295 EC.

c) Aid within the meaning of Article 87 (1) EC

Anstaltslast and Gewährträgerhaftung provide a very effective protection for creditors and business partners, because they reduce or even eliminate the risk of entering into business with the public law credit institutions concerned and providing capital to them. This has consequences for the terms at which business partners are willing to deal with these credit institutions or creditors are willing to provide them with financial funds and make these terms more favourable for the public law credit institutions. Because of this effect Anstaltslast and Gewährträgerhaftung could be considered as having an effect on the competitive situation of these credit institutions.

In particular they improve the creditworthiness of the credit institutions and so normally the financing conditions because creditors ask a lower risk premium and offer better conditions when granting capital or are more willing to enter into business. The evaluation of the creditworthiness of the credit institutions is considerably based on the guarantees. The credit institutions in question explicitly point to the guarantees when raising financial funds.

The advantages arise, in particular, but not only, for activities on the (international) capital markets (e.g. issuing bonds or raising subordinated equity), in the business with large institutional investors, in the derivative and OTC business and, to a lesser degree, in the interbank business. The guarantees linked to the public ownership presumably increase also the general standing and reputation of the credit institutions in the public. The advantages in particular take the form of lower interest rates asked by creditors, the form of lower (or no) security asked or they can also decide whether a business partner on the market enters into a business relationship at all. These advantages on the funding side can be translated into advantages when the public law credit institution offer their services to (potential) customers. It should be remarked that in the financial services sector in some lines of business small differences in conditions can in fact be decisive for the choice of these (potential) customers.

The coverage by State guarantees generally allows public banks also to take higher risks, e.g. in terms of financing volume, and therefore to take on business which banks threatened eventually by the risk of insolvency as an ultimate sanction would not do, in particular for internal risk management reasons. Banks covered by guarantees can therefore out-compete other banks either by taking over larger financing volumes (with a given risk per chunk) or accepting business with a higher risk content per chunk.

The State aid rules of the Treaty apply only to State measures which distort competition by favouring certain undertakings and only insofar as they affect trade between Member States. The more favourable conditions and the better market access, respectively, improve the competitive situation of the public law credit institutions. Within the sector of financial services the single market has to a large extent been achieved, there is strong competition between financial institutions of different Member States which is further intensifying with the European Monetary Union and the introduc-
tion of the single currency. Distortion of competition affects thus also trade between Member States. In this context reference has also to be made to the jurisprudence of the Court, stating that relatively small aid amounts and State aid to relatively small companies which are only active within their home country can in principle have effects on trade within the Community.

Therefore, the guarantees therefore constitute State aid within the meaning of Article 87 (1) EC.

d) Existing aid within the meaning of Article 88 (1) EC

Anstaltslast has been, since its recognition as general principle of law in 1897, an integral element of an Anstalt, to which public tasks are transferred. Also where Anstaltslast is introduced explicitly in written legal provisions this is based on this general legal principle. The facility of Anstaltslast could thus be regarded as a scheme for public law credit institutions in Germany. The creation of Anstaltslast dates back to before entry into force of the EC Treaty.

Gewährträgerhaftung is — contrary to Anstaltslast — not accepted as a general principle of law, but requires an explicit legal basis to be created. Given the founding dates of certain public law credit institutions and changes in the relevant laws it could not be excluded that for individual credit institutions Gewährträgerhaftung was created after entry into force of the EC Treaty. However, good reasons pleased in favour of treating the aid contained in Gewährträgerhaftung, when qualifying it as new or existing aid, in total in the same way as Anstaltslast.

Especially it had to be taken into account that Gewährträgerhaftung is in practice linked in its existence to Anstaltslast and is in its practical importance subordinate to the latter. This is because the obligation of the guarantor to intervene in the case of financial problems of the credit institution already under the concept of Anstaltslast actually prevents that situations arise in which Gewährträgerhaftung would be called upon. This means that as long as Anstaltslast exists Gewährträgerhaftung has practically no importance. This is underlined by the fact that in practice Gewährträgerhaftung has never been used by now in the German public banking sector because in the case of difficulties of a public credit institution the guarantors already stepped in under Anstaltslast. Gewährträgerhaftung therefore is merely an reinforcement of Anstaltslast. It always presupposes Anstaltslast, whereas Anstaltslast may exist on its own without Gewährträgerhaftung.

Because of this linkage the Commission arrived at the opinion that Anstaltslast and Gewährträgerhaftung form, as regards their assessment under the State aid rules, a single scheme in favour of the public law credit institutions. With regards to the subordinated character of Gewährträgerhaftung the legal status of Gewährträgerhaftung under State aid law had to follow that one of the Anstaltslast, i.e. the status as ‘existing aid’. Therefore, the Commission took the view that the State aid contained in Anstaltslast and Gewährträgerhaftung constituted existing aid.

e) Compatibility of the aid

It appeared clearly from the examination that none of the exemption clauses of Article 87 (2) and (3) EC were applicable in the situation at hand.

In connection with the question of compatibility it has also to be noted that the aid involved in Anstaltslast and Gewährträgerhaftung favours the credit institutions concerned on a permanent basis and therefore has to be considered to constitute operating aid.

f) Article 86 (2) EC

Article 86 (2) EC provides for interventions by the Member States in the case of undertakings entrusted with the operation of services of general economic interest. It allows exemptions from the full application of the rules of the Treaty, including the rules on State aid, in so far as the application of these rules obstructs the performance, in law or in fact, of the particular tasks assigned to such undertakings. As an exemption clause it has, as confirmed by the jurisprudence of the Court, to be interpreted in a narrow sense. As explained in the ‘Report on services of general economic interest in the banking sector’, adopted by the Commission on 17.6.1998, the following conditions must be satisfied in order for Article 86 (2) EC to apply (1):

(1) Note: This approach is based on the rulings FFSA and SIC of the CFI, which were unquestioned at the time of decision and also acceptance by the German authorities, and which also formed the basis of the communication of the Commission on services of general interest of 20.9.2002 and the report of the Commission to the Laeken European Council of 17.10.2002. The possible change initiated by the ECJ in its judgement Ferring vs. ACOSs has in the opinion of the authors no impact on the assessment of this case. With the possible exception of the last criterion of Article 86(2) EC, the same examination would be conducted within the second element of Article 87(1) EC (“favouring of a certain undertaking”). This issue awaits further clarification by the ECJ, in particular in view of the conclusions of Advocate-General Léger on 19.3.2002 in the Altmark case, largely supporting the doctrine based on the rulings FFSA and SIC of the CFI.
The service in question must be a service of general economic interest and must be accurately defined by the Member State. It is primarily the competence of the Member States to determine the services of general economic interest. This definition is only subject to control for manifest error. According to Article 86 (3) EC the Commission must ensure the proper application of the exemption contained in Article 86 (2) EC. As explained in the Communication from the Commission on ‘Services of general interest in Europe’ these services ‘are different from ordinary services in that public authorities consider that they need to be provided even where the market may not have sufficient incentives to do so.’ (1)

The undertaking in question must explicitly be entrusted by the Member State with the provision of such clearly defined service.

The application of the competition rules of the Treaty must obstruct the performance, in law or in fact, of the particular tasks assigned to undertakings entrusted with the operation of services of general economic interest. The exemption should be limited to what is necessary. This means that any compensation granted for the provision of services of general economic interest must be proportionate to the costs of the particular task provided, i.e. the State aid must be limited to what is necessary for the undertaking to perform the specific service in question. In order to ensure that this principle of proportionality is met the specific costs of the services of general economic interest as well as the value of any compensation facility granted have to be duly identified and calculated.

The exemption must not affect the development of trade within the Union to an extent that would be contrary to the Community’s interest. As laid down in the Report, it is in the Community’s interest that the distortion of competition is kept to a minimum and the Commission will have regard to the extent to which there is competition on the market, that is, to the extent to which the market in question has been liberalised. With respect to the liberalisation of the market, the financial services sector has been the subject of Community legislation aiming at establishing fair and open competition. Free movement of capital, right of establishment and freedom to provide services have been widely achieved in this field of economic activities. Competition is already strong and will further intensify with the European Monetary Union and the introduction of the single currency. With that in mind, it must be noted that each intervention by Member States in this sector risks causing significant distorting effects, which can only be balanced by a Community interest carrying particular weight.

The information provided by the German Government did not allow the Commission to conclude that the existing aid scheme of Anstaltslast and Gewährträgerhaftung would always satisfy the conditions for the application of Article 86 (2) EC. To the contrary it appeared from the analysis of the Commission that at least significant parts of the activities of most of the credit institutions benefitting from Anstaltslast and Gewährträgerhaftung might not be regarded as services of general economic interest. Furthermore for most situations where services of general economic interest are claimed, the Commission was not informed of precise definitions of the services in question exist. Also, it appeared that no calculations of costs of possible services of general economic interest exist; lacking such calculation no assessment of the proportionality of possible compensation measures could be made.

4) Development of the case and solution found

a) Non-paper of 1995 and first discussions

On the basis of a non-paper prepared by DG Competition in 1995, Commissioner van Miert voiced for the first time in 1996 to the German authorities that he regarded the State guarantees to constitute State aid under Article 87 EC. The strong reaction by German politicians showed the high sensitivity of the issue. The Commission’s statement was followed by contacts and exchanges of information and opinion between the Commission and the German Government and a reinforced debate in the public and academic world.

b) Amsterdam Declaration on Public credit institutions in German of 18.6.1997

On 18.6.1997 the Declaration on ‘Public credit institutions in Germany’ was adopted as annex to the ‘Amsterdam Treaty’ at the request of the German authorities that he regarded the State guarantees to constitute State aid under Article 87 EC. The strong reaction by German politicians showed the high sensitivity of the issue. The Commission’s statement was followed by contacts and exchanges of information and opinion between the Commission and the German Government and a reinforced debate in the public and academic world.

connected with such services to be taken into account in full.’

c) Report on services of general economic interest in the banking sector of 17.6.1998

The Presidency conclusions linked to that Declaration requested the Commission to establish a ‘Report on services of general economic interest in the banking sector’, adopted by the Commission on 17.6.1998. This Report was presented to the Council of Ministers on 23.11.1998. It is based on an enquiry with Member States on the respective framework and provision of such services and analyses further to application of the State aid rules in this context.

d) Commission Notice on State guarantees of 23.11.1999

On 23.11.1999 the Commission adopted the ‘Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees’ (1). This Notice explains the principles the Commission applies in assessing State guarantees under the State aid rules. In its paragraph 2.1.3. the Notice states that the ‘Commission also regards as aid in the form of a guarantee, the more favourable funding terms obtained by enterprises whose legal form rules out bankruptcy or other insolvency procedures or provides an explicit State guarantee or coverage of losses by the State. The same applies to the acquisition by a State of a holding in an enterprise if unlimited liability is accepted instead of the usual limited liability’.

e) Complaint by the European Banking Federation of 21.12.1999

On 21.12.1999 the European Banking Federation filed a complaint against Anstaltslast and Gewährträgerhaftung. This complaint was supplemented later by detailed information on the guarantee system and its effects.

f) Beginning of the procedure for appropriate measures

As provided for in Regulation (EC) No 659/1999, the Commission services, after having entered into consultations with the German authorities sent on 26.1.2001 a letter according to Article 17 (2) of the Regulation to the German authorities, informing them of the Commission’s view that the existing aid scheme of Anstaltslast and Gewährträgerhaftung was not compatible with the Common Market and giving them the opportunity to submit their comments.

g) Formal recommendation of appropriate measures of 8.5.2001

On 8.5.2001, the Commission adopted a recommendation of appropriate measures in order to adapt the existing aid scheme of State guarantees for public credit institutions in Germany to comply with the State aid rules of the EC Treaty. The Commission proposed to the Federal Republic of Germany the following appropriate measures:

‘(i) that the Federal Republic of Germany takes any legislative, administrative and other measures necessary to eliminate any State aid within the meaning of Article 87 (1) EC resulting from the system of Anstaltslast and Gewährträgerhaftung and granted to public law credit institutions, or to render such aid compatible with the common market within the meaning of Article 87 EC, or in conformity with the rules provided for in Article 86 (2) EC;

(ii) that any such aid is eliminated or rendered compatible with effect from 31.3.2002 unless the Commission agrees (for all public law credit institutions or for certain undertakings or groups of undertakings) to a later date or to later dates, should that be considered objectively necessary and justified by the Commission in order to allow an appropriate transition for the undertaking or undertakings in question to the adjusted situation; and

(iii) that the Federal Republic of Germany communicates the relevant measures adjusting the aid scheme to the Commission as soon as possible and in any event no later than 30.9.2001.’

Subsequently, a number of discussions took place between the Commission and the German authorities, and supplementary information was provided.

h) Understanding on Landesbanks and savings banks of 17.7.2001

On 17.7.2001, Commissioner Mario Monti concluded with State-Secretary Caio Koch-Weser, the Finance Ministers of Baden-Württemberg, Bavaria and Northrhine-Westphalia, Gerhard Stratthaus, Kurt Faltlhauser and Peer Steinbrück, and the President of the German savings banks association, Dietrich Hoppenstedt, an understanding on Anstaltslast and Gewährträgerhaftung as regards Landesbanken and savings banks.

The understanding provides for a 4-year transitional period, which lasts from 19 July 2001 to 18 July 2005. During this period the two existing guarantees may remain in place.

After that, on the basis of the so-called ‘platform-model’, one guarantee (Anstaltslast) will be replaced by a normal commercial owner relationship governed by market economy principles, implying no obligation of the State to support the bank any more. The other guarantee (Gewährträgerhaftung) will be abolished.

However, Gewährträgerhaftung can be maintained (grandfathered) also after 18 July 2005 to protect creditors along the following lines:

— For liabilities existing at 18 July 2001, Gewährträgerhaftung can be maintained without any limits until they mature.

— For liabilities created between 19 July 2001 and 18 July 2005, Gewährträgerhaftung will only be maintained for those maturing before the end of 2015. Otherwise, for those maturing after 2015, Gewährträgerhaftung will not be grandfathered.

The German authorities engaged themselves (i) to submit to the Commission before 30 September 2001 concrete measures they intend to take in order to make the guarantee system compatible and (ii) to submit by the end of 2001 the necessary legal measures to the relevant federal or Länder legislative bodies and to adopt them by the end of 2002. In case of non-compliance with the deadline for adoption by the Federal State or a Land, the State aid elements contained in the guarantees will be treated as new aid from beginning of 2003 for banks falling under the legislation of the respective Land or the Federal State. Consequently, the State aid element could be recovered from these banks with effect from 2003.

i) Formal acceptance of the recommendation by the German authorities on 18.7.2001

The German authorities unconditionally and unequivocally accepted the proposal for appropriate measures by letter of 18.7.2001.

j) Discussions on implementation

The German authorities submitted on 27.9.2001 concrete proposals for implementing the understanding, which were subsequently subject to further discussions between the Commission and the German authorities. Two issues could not be solved until the end of the year 2001: firstly, the elements to be put in the legal texts, recitals or separate engagements of the German authorities to ensure the replacement of Anstaltslast, and, secondly, the exact content of the grandfathering of Gewährträgerhaftung concerning liabilities entered into during the transitional period (from 19 July 2001 to 18 July 2005).

The German authorities failed to submit the draft legal amendments to all respective legislative bodies by the deadline of 31.12.2001. Discussions between the Commission and the German authorities continued until the end of February 2002.

k) Conclusions on Landesbanks and savings banks of 28.2.2002

On 28 February 2002, Commissioner Mario Monti, State-Secretary Caio Koch-Weser, the Finance Ministers of Baden-Württemberg, Bavaria and Northrhine-Westphalia, Gerhard Stratthaus, Kurt Faltlhauser and Peer Steinbrück, and the President of the German savings banks association, Dietrich Hoppenstedt reached conclusions on the two above issues and two other new issues, which were discovered after the conclusion of the understanding of 17.7.2001. These two new issues concern, firstly, a subsidiary obligation (Nachschusspflicht) in some Länder for owners of savings banks to provide institutional security funds (Institutssicherungsfonds) with financial means, and, secondly, State guarantees to so-called free savings banks. The conclusions constitute an agreement on the elements of the legal texts, the recitals and separate engagements to be made by the German authorities.

l) Understanding on special credit institutions of 1.3.2002

On 1st March 2002, Commissioner Mario Monti and State-Secretary Caio Koch-Weser reached understanding also on the German special credit institutions. They may continue to benefit from the State guarantees to the extent that they are entrusted with promotional tasks in compliance with the State aid rules of the Community. The fulfilment of promotional tasks shall be governed by the respect of the prohibition of discrimination under Community law. Another public task, which will also in the future be allowed under the umbrella of the State guarantees, is participation in financing of projects in the interests of the Community, which are co-financed by the European Investment Bank. In addition, special credit institutions can keep activities of purely social character, financing of the State and municipalities, and export financing outside the EU, the European Economic Area and candidate countries, which is in line with the WTO-rules and other relevant international obligations binding for the Community. The understanding is without prej-
udice to the examination of these activities under the Community State aid rules vis-à-vis the beneficiaries.

The understanding of 1st March 2002 provides that the German authorities will have to specify public tasks clearly in the relevant laws by the end of March 2004. Commercial activities will have to be discontinued or isolated from the State guarantees by a split into a legally independent undertaking without State support. This has to be implemented by the end of 2007.

m) Amendment of the recommendation of appropriate measures of 27.3.2002 and formal acceptance by the German authorities on 11.4.2002

The understandings of 17.7.2001 and 1.3.2002 and conclusions of 28.2.2002 were transformed into a Commission decision on 27 March 2002, which amended the Commission recommendation of 8 May 2001 with effect as of 31st March 2002, and which was accepted by the German government on 11 April 2002.