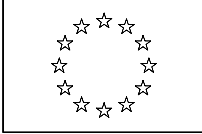

EUROPEAN COMMISSION

Brussels, 8 May 2009
C(2009) 3835 final

In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […].

PUBLIC VERSION

WORKING LANGUAGE

This document is made available for information purposes only.

Subject : **State Aid N 249/2009 – French Republic**

Injection of capital into the institution to be created by the merger of the parent companies of the Caisse d'Épargne and Banque Populaire groups

Dear Sir,

1. PROCEDURE

(1) Since October 2008, the parent companies of the Banque Populaire group (the "BP group") and the Caisse d'Épargne group (the "CE group") – namely, "Banque Fédérale des Banques Populaires" and "Caisse Nationale des Caisses d'Épargne", respectively – have been exploring the possibility of a merger which would create France's second-largest banking group in terms of deposits.

(2) On 8 December 2008, the European Commission approved a capital injection from the French Republic to six banks which play a crucial role in financing the economy[1]. The capital injection was capped at EUR 21 billion to be paid in two tranches of a maximum of EUR 10.5 billion each[2]. The aim of the measure was to increase by 1 % the capital ratio of

[1] The groups concerned are BNP Paribas, Société Générale, Crédit Agricole, Crédit Mutuel, Caisse d'Épargne and Banque Populaire.

[2] C(2008) 8278 final Commission Decision of 8 December 2008, not yet published.

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the concerned banks by allocating to them, under each instalment, an amount equating to 0.5% of their risk-weighted assets.

(3) A first capital injection tranche of EUR 10.5 billion was paid in exchange for subordinated debt securities eligible for inclusion in the banks' Tier One capital ratio. Thus, the BP and CE groups received capital injections of EUR 0.95 billion and EUR 1.10 billion, respectively.

(4) On 28 January 2009, the Commission authorised the French authorities to modify their capital injection scheme to give them the option of subscribing to preference shares eligible for inclusion in the banks' Core Tier One capital ratio[3]. The Commission also approved an adjustment of the amount of the second tranche to take account of the merger of the parent companies of the CE and BP groups within the limit of 0.5 % of the risk-weighted assets of the entity created by the merger (the "new entity"), namely, an increase of EUR 500 million. The maximum amount payable to the CE and BP groups under the second tranche was, therefore, increased to EUR 2.55 billion[4], and the amount payable to all six beneficiaries of the scheme rose to EUR 11 billion.

(5) On 24 March 2009, the Commission approved an amendment relating to the terms governing the remuneration and reimbursement of the preference shares which acted as a stronger incentive for the banks to buy back the securities subscribed by the State at the earliest opportunity[5].

(6) On 22 April 2009, the French authorities notified the Commission of their plan to increase the amount of EUR 2.55 billion already approved by the Commission in January 2009 by EUR 2.45 billion, to be paid to the CE and BP groups under the second instalment. The total amount of aid to be paid to the new entity under the second instalment will, therefore, reach EUR 5 billion. The graphic below depicts the aid schemes already approved and the notified aid scheme.

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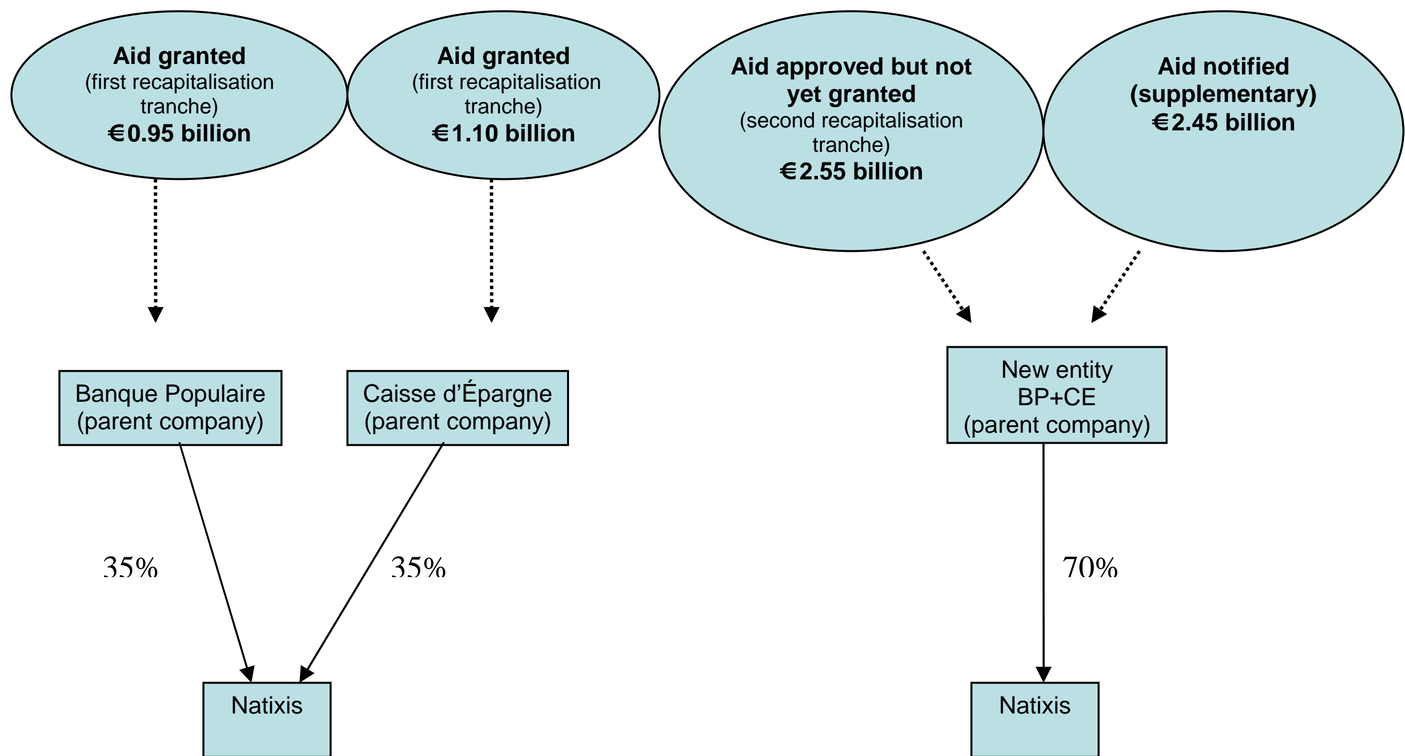
[3] C(2008) 597 final Commission Decision of 28 January 2009, not yet published.

[4] Pursuant to the above-mentioned Decisions of 8 December 2008 and 28 January 2009, the amounts allocated under the second tranche are actually EUR 1.10 billion for the Caisse d'Épargne group, EUR 0.95 billion for the Banque Populaire group and EUR 0.5 billion for the new entity to be created from the merger of the CE and BP groups. None of the aforementioned sums have yet been paid to those banks.

[5] C(2009) 2199 final Commission Decision of 24 March 2009, not yet published.



2. DESCRIPTION OF THE MERGER OF THE CE GROUP AND THE BP GROUP

(7) The CE group, whose balance sheet total is EUR 650 billion, has 51 700 employees and 4 780 branches. The BP group has a balance sheet total of EUR 263 billion, 44 450 employees and 3 390 branches. The CE and BP groups' main subsidiary, Natixis, has a balance sheet total of EUR 556 billion and 22 100 employees.

(8) On 8 October 2009, the CE and BP groups announced a planned merger based on the creation of a common parent company to which they will transfer most of the technical and human resources of their current respective parent companies. Only the assets of the parent companies of the CE and BP groups will be merged: the regional banks (*caisses régionales*), which currently own the parent companies of their respective groups and will continue to be linked by solidarity mechanisms and cross-guarantees[6], will have equal joint ownership of the new common parent company without being merged into a single network themselves. It is planned to retain the current parent companies of the CE and BP groups initially but to dissolve them in the long term.

[6] See recitals (9) and (10) below.

(9) The main subsidiaries of the two groups, in particular Natixis, which are currently owned by the respective parent companies, will be owned by the new entity. Like all parent companies of mutual and cooperative banks under French law[7], the new entity will be responsible for monitoring the cohesion between the two networks and ensuring the smooth running of the establishments affiliated with them. To that end, the new entity will take all necessary measures to guarantee the liquidity and solvency of each of these establishments and of the network as a whole. The draft law establishing the new entity provides that it will be responsible for "*taking all the necessary measures to guarantee the solvency of the group and of each of the networks, in particular by introducing the appropriate internal solidarity mechanisms within the group and setting up a common guarantee fund for the two networks*".

(10) The solvency of the new group created by the merger of the CE and BP groups will be based on both the capital of the new entity (which will head the group) and on the implementation of rules for solidarity providing for recourse to the guarantee fund (see the above recital) and, if that is insufficient, for a capital injection made by from the various affiliated regional banks. The new common parent company (along with the regional banks which own its capital) will also be the parent company of the group to which all the prudential rules apply (capital requirements, an internal audit function, rules on large exposures.

(11) With 22 % of all French bank deposits, EUR 530 billion of outstanding deposits and EUR 480 billion of outstanding loans, the new group will be the second-largest retail bank in France.

(12) Under French law, the creation of a new parent company of a mutual bank requires that a new law be voted in. The rules governing every French mutual bank are laid down in laws specific to each bank, not consolidated in a single law which is applicable to all mutual banks. The draft legislation governing the new entity should be reviewed by the Parliament in May 2009.

3. DESCRIPTION OF THE NOTIFIED MEASURE

(13) The total amount of EUR 5 billion that the French authorities wish to pay to the new entity under the second instalment of the recapitalisation scheme by adding EUR 2.45 billion to the amount already approved, will consist of the following:

- EUR 3 billion in the form of preference shares which are convertible into ordinary shares, on the initiative of the State, after five years from the date of issue. These preference shares are identical to those already approved by the Commission in its decisions of January and March 2009, although the previously approved preference shares were not convertible into ordinary shares. If the State chooses to convert those

[7] Article L.511-31 of the aforementioned French Monetary and Financial Code (*Code monétaire et financier*).

preference shares, its intervention will be capped at 20 % of the shares in the new group[8];

- EUR 2 billion in the form of subordinated debt securities on the terms already approved by the Commission.

4. POSITION OF THE FRENCH AUTHORITIES

(14) According to the French authorities, the process of transferring the respective assets of the two groups to the new entity requires that the assets transferred be valued on the basis of current market conditions […][*]. […].

(15) In addition, as confirmed by the ratings agencies, the performance risks are not negligible in the current climate.

(16) Furthermore, the merger entails a change in the accounting policy for the purpose of consolidating Natixis' accounts. Today, the share of Natixis' risk-weighted assets appearing on the balance sheet of the parent companies of the BP and CE groups is proportionate to their respective stakes in Natixis, i.e. 35 % each. After the merger, the new entity will own 70 % of Natixis' capital and will have to take on, by full consolidation, 100 % of its risk-weighted assets in accordance with prudential rules. The merger will, therefore, automatically lead to an increase in the amount of risk-weighted exposure, which constitutes the denominator of the new entity's Tier 1 ratio. The change in accounting policy is unconnected with the results posted by Natixis.

(17) The amount of core capital will, therefore, be automatically reduced by EUR 2.3 billion, plus a further reduction of EUR 2.9 billion as a result of the inclusion of EUR 5 billion of minority interests (within the regulatory limit of 50%) in the capital of the parent company and of the correlated capping of the hybrid capital instruments already issued by the two current parent companies (EUR 2.9 billion) and included in their capital prior to the merger.

(18) The implementation of those accounting and prudential rules will mean that the new entity has an additional requirement for EUR 5 billion of capital, i.e. a further EUR 2.45 billion in addition to the EUR 2.55 billion already approved by the Commission under the second recapitalisation tranche. This will take the Tier 1 ratio of the new entity from 8.6 %, as it is without the capital increase, to 9.1 %[9].

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[8] This limit is intended to avoid breaching a threshold which could potentially trigger an obligation to make a takeover bid for Natixis.

[*] Confidential information.

[9] On 30 June 2008, before the first tranche was paid, the Tier 1 ratio of the CE group was 8.3 % and that of the BP group was 9.6 %. On 1 January 2009, after the first recapitalisation tranche approved in December 2008, but prior to the payment of EUR 5 billion under the second recapitalisation tranche, the Tier 1 ratio of the CE group was 8.4 % and that of the BP group was 8.6 %.

Following the merger, the new merged group should have a Tier 1 ratio of 9.1 %.

(19) The French authorities consider the need for additional capital as the "automatic" outcome of the implementation of the applicable accounting and prudential rules, that is, they consider that need as something which is independent of the financial situation and risk profile of the BP and CE groups and of their joint and most important subsidiary, Natixis.

(20) They claim that the new entity will be a fundamentally sound group which will continue in the systemic role, hitherto played by CE and BP, in financing the French economy. They wish to ensure that the merger process is successful and is not destabilised by the extremely difficult current market conditions. The objectives requiring the additional capital injection of EUR 2.45 billion – i.e. to ensure that fundamentally sound banks are not destabilised by the current climate and can continue to finance the real economy – are therefore identical to those already taken into account in the Commission decisions of December 2008, January 2009 and March 2009 on the French scheme to inject capital into banking groups.

(21) The total recapitalisation of EUR 7.05 billion would equate to 1.6 % of the new entity's risk-weighted assets and would not, therefore, exceed the maximum ratio of 2 %.

(22) The CE and BP groups are currently rated "Aa3" by ratings agency Moody's and "A+" by Standard and Poor's and Fitch.

(23) The French authorities have indicated that it may take several months actually to carry out the merger of the CE and BP groups, which will be realised by creating a new parent company common to the two networks. They are therefore requesting authorisation to recapitalise that common parent company over a period of nine months starting from the date of the Commission's approval of the measure.

5. ASSESSMENT OF THE MEASURE

A. Aid character of the measure under assessment

(24) The characteristics of the notified additional capital injection into the entity to be created by the merger of the CE and BP groups are the same as those of the scheme to inject capital into the French banking groups which was approved by the Commission decisions of 8 December 2008, 28 January 2009 and 16 March 2009.

(25) The only difference is that, this time, the preference shares are convertible into ordinary shares. This does not mean that the measure no longer fulfils one of the four cumulative conditions making it classifiable as aid. Allocating preference shares convertible into ordinary shares to the State in exchange for the notified aid measure has no bearing on whether this additional State intervention – for the reasons given in recitals 76 to 79 of the Commission Decision of 8 December 2008 and in recital 30 of the Decision of 8 January 2009 **–** still confers on the new entity a significant financial advantage which is of a selective nature, financed by public resources and has the potential to distort competition and affect trade between Member States.

(26) The Commission therefore considers that the notified measure constitutes a State aid measure within the meaning of Article 87(1) of the EC Treaty.

B. Compatibility of the scheme with the common market

1) Applicability of Article 87(3)(b) of the EC Treaty

(27) Article 87(3)(b) of the EC Treaty provides that: "*3. The following may be considered to be compatible with the common market: (b) aid to* […] *remedy a serious disturbance in the economy of a Member State*".

(28) The Commission finds that the market conditions which gave rise to its Decisions of 8 December 2008, 28 January 2009 and 24 March 2009 are still the same and that the notified measure is limited, on the one hand, to an increase in the amount to be allocated to the two banking groups affected by the aid scheme approved in the Commission Decisions of 8 December 2008 and 28 January 2009 and, on the other, to allowing the inclusion of an option to convert the preference shares to ordinary shares. As stated in its previous decisions, the Commission observes that BP and CE – and, therefore, the group which is created from their merger – play a major role in financing the French economy. Consequently, if those banking groups were to be destabilised by the current crisis, that would give rise to a serious disturbance in the French economy. The aim of the notified aid measure is the same as the objective pursued under the terms of the aid scheme already approved, namely: to remedy a serious disturbance in the French economy. That is why the Commission considers that the notified measure is, in fact, intended to remedy such a disturbance.

2) Conditions for compatibility within the meaning of Article 87(3)(b) of the EC Treaty

(29) The compatibility assessment must be carried out having regard to the Commission Communication of 13 October 2008 on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis[10] (the "Banking Communication") and the Commission Communication of 5 December 2008 on the recapitalisation of financial institutions in the current financial crisis[11] (the "Recapitalisation Communication"). In those two communications, the Commission explains how it applies Article 87(3)(b) of the Treaty in its assessment of measures to recapitalise banks in the context of the current financial crisis.

(30) According to the Banking Communication, in order for a measure to be compatible with Article 87(3)(b) of the Treaty, it must cumulatively meet the following three conditions:

i. Firstly, the aid must be well-targeted. The means employed must be appropriate to the objective pursued, which is, in this case, to remedy a serious disturbance in the economy of a Member State;

ii. Secondly, the aid must be necessary, i.e. the amount must be limited to the minimum necessary to achieve its purpose and should not go beyond the most appropriate measures to remedy the disturbance in the economy.

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[10] OJ C 270, 25.10.2008, p.8.

[11] http://ec.europa.eu/competition/state_aid/legislation/specific_rules.html

iii. Finally, the aid must be proportionate in that the distortions of competition that it creates or has the potential to create must be counterbalanced by its positive effects. The distortions of competition must, therefore, be minimised as far as possible, not going beyond what is required to attain this effect.

(31) The Recapitalisation Communication describes in greater detail the principles which should govern the recapitalisation of financial institutions to ensure that such recapitalisation measures are compatible with Community rules on State aid.

(32) In the case of temporary recapitalisations of fundamentally sound banks, the Commission accepts a minimum remuneration based on the methodology adopted by Eurosystem on 20 November 2008. That methodology involves the calculation of a 'price corridor' using a 200 basis point equity risk premium and the bank's CDS spread for the preference shares having features similar to those of subordinated debt and a 500 basis point equity risk premium (increased by 100 basis points to cover administrative costs, reduce demand and provide incentives for banks to redeem the instruments as soon as possible) for ordinary shares relating to Euro area banks. Furthermore, the Commission requires there to be sufficient incentives for State capital to be redeemed when the market so allows.

(33) The recapitalisation of banks which are not fundamentally sound should be subject to stricter requirements (remuneration should be higher than for fundamentally sound banks to reflect the higher risk profile; possibility to take urgent action where necessary in cases of restructuring; use of State capital only on the condition of [a bank's] winding-up, or a thorough and far-reaching restructuring; safeguards for distressed banks: a restrictive dividend policy, the limitation of executive remuneration, an obligation to maintain an increased level of the solvency ratio, a timetable for redemption of State participation, etc.).

(34) Before assessing the compatibility of the notified measure, it is therefore important to establish whether the beneficiary is a fundamentally sound banking group.

3) Is the aid beneficiary a fundamentally sound banking group?

The requirement for additional capital was brought about by Natixis' financial situation

(35) Natixis was formed from the merger, in 2006, of the subsidiaries of the CE and BP groups' parent companies specialising in investment banking, namely, "Ixis Corporate & Investment Bank" (formerly a subsidiary of the group "Caisse des dépôts et consignation") and "Natexis Banques Populaires", respectively. Unlike the two mutual banks (the CE and BP groups) which each own a 35 % stake in Natixis, Natixis is listed on the stock market. In fact, approximately 30 % of its share capital was floated on the stock market shortly after its creation in 2006.

(36) In the 2008 financial year, Natixis recorded a net result for the group of EUR 2.8 billion and a loss of EUR [0.5 - 2] billion on segregated assets. Finally, Natixis reclassified some of its impaired assets, thus avoiding an additional loss in excess of EUR 300 million. In September 2008, Natixis had been given a capital injection of EUR 3.7 billion, of which EUR 2.5 billion was supplied by the BP and CE groups. In December 2008, BP and CE

carried out a EUR 1.9 billion capital injection into Natixis, which equates to almost all of the aid they had received under the first instalment of the payment made under the scheme to inject capital into the French banks.

(37) Moreover, […] the new entity created by the merger of the CE and BP groups will transfer to Natixis a sum of EUR […] billion out of the EUR 5 billion of aid allocated under the second recapitalisation tranche. Natixis […] had publicly announced that measure on 26 February 2009.

(38) Therefore, the Commission concludes that, from an economic point of view, the new entity's need for additional capital arises from Natixis' financial situation. Most of the aid received by CE, BP and the group created by their merger will, in fact, be used to recapitalise Natixis.

Does Natixis constitute a separate banking group or should it be considered, for the purposes of assessing the compatibility of the aid, as an integral part of the new entity?

(39) In the above paragraph, the Commission reached the conclusion that Natixis was the indirect recipient of most of the aid that the State has already granted to the BP and CE groups, and that it will also receive a significant proportion of the second recapitalisation tranche totalling EUR 5 billion. The total amount of aid received indirectly by Natixis exceeds 2 % of its risk-weighted assets.

(40) It is therefore necessary to determine whether Natixis constitutes a separate banking group since, if that is the case, there is a possibility that it is a bank which is *not* fundamentally sound and for which a restructuring plan is necessary, in accordance with the Recapitalisation Communication.

(41) The Commission considers that Natixis is an integral part of the new entity which will be created from the merger of CE and BP. The new parent company will, in fact, own 70 % of Natixis and the latter will be totally consolidated in the new group's accounts. As demonstrated by the massive amount of support which CE and BP have provided for Natixis under the internal solidarity mechanisms within the two groups, CE and BP consider Natixis as a subsidiary which is essential to their activities. The Commission has observed that the ratings agencies also tend to consider Natixis as a main subsidiary of the two groups and of the future merged entity, and analyse Natixis' financial stability taking account of the fact that it belongs to those two groups[12]. In light of the foregoing, the Commission concludes that the notified measure must be treated as aid allocated to the new group to be created from the merger of CE and BP, rather than as aid granted to Natixis taken in isolation from its parent compan(y)/ies. In other words, Natixis should be considered the "investment banking" division of the group created by the merger of CE and BP – with the group channelling its resources into that division which has been particularly

[12] The groups' merger plan was welcomed by the markets as a means of consolidating Natixis' position within the group: "*Natixis, CNCE and BFBP's long-term debt and deposit ratings are affirmed at Aa3 with a stable outlook, reflecting the full support expected from the solidarity mechanisms and cross-guarantees prevailing within the two mutualist groups' respective domestic retail networks, and both including Natixis, as affiliated subsidiary.*" (Moody's, 6.3.2009).

affected by the current crisis – rather than as an independent bank. The assessment of the fundamentally sound nature of the aid beneficiary should not, therefore, be carried out in respect of Natixis alone, but in respect of the banking group receiving the aid, namely, the new entity created from the merger of BP and CE.

Assessment of the fundamentally sound nature of the new entity

(42) In Annex 1 to the Recapitalisation Communication, the Commission described the indicators that it would take into consideration in order to assess the fundamentally sound nature of a bank.

(43) With regard to the indicator described in point (a) of Annex 1, the Commission welcomes the review it received in a letter from the French supervisory authority (*Secrétariat général de la Commission bancaire* [General Secretariat of the Banking Commission]) dated 21 April 2009 according to which the State intervention guaranteed the group's sound financial structure, giving it a Tier 1 capital ratio of 9.1 %, which is a level comparable to those of other French mutual banks. The Commission also observes that the group formed from the parent companies of BP and CE will constitute one of the largest retail banks in France, with 7 million members and EUR 530 billion in deposits, which equates to 22 % of all French bank deposits. Those elements can embed the financial stability of the new group, with the retail bank generating a steadier cash-flow than other banking activities.

(44) The Commission would also point out that the risk-weighted assets of the group to be created by the merger of BP and CE totalled EUR 420.8 billion at 1 January 2009. Consequently, the total amount of aid received by the two groups (EUR 7.05 billion) compared with its total risk-weighted assets would be 1.6 %, which is below the indicative limit of 2 % provided for in point (b) of Annex 1 to the Recapitalisation Communication.

(45) With regard to the CDS spreads of the entities concerned, the Commission would point out that only Natixis' CDS spread is indicative of an above-average level of risk.

(46) Finally, the Commission also notes that the current rating of BP and CE (A+) is in line with that specified in point (d) of Annex 1 to the Recapitalisation Communication.

(47) Beyond the four indicators described in Annex 1 to the Recapitalisation Communication, the Commission also notes that the measures were taken with a view to redressing the situation faced by CE and BP's joint subsidiary Natixis:

- The potentially risky assets were ring-fenced and transferred to a new business line for active management of ring-fenced portfolios (GAPC); EUR 31 billion of risky assets were therefore ring-fenced within that structure (proprietary investments, credit correlation business, mortgage-backed securities and complex interest-rate derivatives and complex equity derivatives);

- CIFG, a wholly-owned subsidiary of BP and CE, was the subject of a commutation agreement on 22 January 2009, enabling it to write off EUR 1.03 billion of exposure

consisting of financial guarantees or CDS, in exchange for shares in CIFG (the stake held by BP and CE in the share capital of CIFG having been reduced to 10 % and that held by Natixis, one of CIFG's counterparties, increased to 6.9 %);

- On 18 December 2008, the board of directors approved a rescue plan for Natixis designed to reduce the bank's fixed costs (by 10 % in 2009 compared with 2007), to bring the focus of its activities back to the traditional sectors (businesses in France, financial institutions in Europe and financing international projects) and to reduce its risk profile (narrower international presence and termination of proprietary trading activities).

(48) The Commission concludes that there is sufficient evidence that BP and CE, the entities which will be merging, are fundamentally sound.

(49) Given that the proposed recapitalisation will not take place for several months after the date of the present Decision, (after the actual merger of CE and BP), the Commission has taken note of the commitments made by the French authorities, which it considers to be necessary in order to be able to approve the measure, deeming it to constitute aid to a fundamentally sound bank. Under the terms of their commitments, the French authorities will provide the following to the Commission:

- ten calendar days before the date of the capital injection operation (which will not take place until after the actual creation of the new common parent company of CE and BP), information enabling the Commission to establish that on that date, the group to be created from the merger of the CE and BP groups can be considered as fundamentally sound[13]. If that is not the case, the French authorities must provide a restructuring plan for the whole group;

- the day on which the aid is due to be paid by the French authorities, a letter from the *Secrétariat général de la Commission bancaire* (i) giving its appraisal of the changes in the financial situation and prospects of the group to be created by the merger of the CE and BP groups since the initial notification of the capital injection scheme; (ii) confirming that, as at that date, the CEBP group can be considered fundamentally sound; and (iii) confirming, in particular, that as at that date, there is no reason to believe that the group will require a total amount of aid in excess of 2 % of its risk-weighted assets (including previous recapitalisations but excluding aid in the form of financing granted under scheme N 548/08 approved by the Commission);

- six months after the day on which the aid is due to be paid by the French authorities, information enabling the Commission to establish that the CEBP group remains

[13] The Commission would point out that, in order to assess whether a group is fundamentally sound, it is necessary to assess the prospects for its continued viability on the basis of the information referred to in point 40 of the Recapitalisation Communication. It therefore expects the French authorities to supply information such as a business model and the group's financial prospects showing that it will remain viable and will eventually be able to repay the public funds which it has received.

financially sound and viable with particular regard to the measures taken to deal with the crisis and complete the merger.

(50) The Commission would also point out that if, contrary to current forecasts, the new entity should require a scheme to deal with its impaired assets, this would trigger the obligation to submit a restructuring plan in accordance with the Communication from the Commission on the treatment of impaired assets in the Community banking sector[14].

4) Compatibility of the notified measure with Article 87(3)(b) and, in particular, with the conditions for recapitalising fundamentally sound banks laid down in the Recapitalisation Communication

Suitability of the measure to the aims pursued

(51) As previously indicated, the notified measure does not alter the conclusions of the Commission Decisions of 8 December 2008, 28 January 2009 and 24 March 2009 in terms of the context of the State intervention, the counterpart measures required of the banks and the control and mediation mechanisms put in place. The Commission's assessment regarding this point therefore remains the same as that given in these two decisions.

Need for the measure/Amount limited to the minimum necessary

(52) In order to assess the need for the measure, the Commission would refer, again, to its Decisions of 8 December 2008, 28 January 2009 and 24 March 2009, since the nature of the proposed aid measure is such that it does not in any way alter the Commission's conclusions that the amount of aid is, on the one hand, limited to the minimum necessary to achieve its purpose and, on the other, does not go beyond the most appropriate measures to remedy the disturbance in the economy.

(53) With regard to the amount, the Commission would also point out that the EUR 2.45 billion increase in the second recapitalisation tranche, taking the total of the second tranche to EUR 5 billion, will only be sufficient to compensate for the automatic reduction in eligible capital in accordance with prudential rules. From an economic perspective, the recapitalisation seems equally limited to the minimum necessary and not excessive, since the capital will, in large part, be reinjected into Natixis to help deal with its difficulties.

Proportionality of the measure

(54) In order to assess the proportionality of the measure, the Commission must establish that the distortions of competition created by such a State intervention are minimised with regard to the risks of a serious disturbance in the economy. In accordance with the Recapitalisation Communication, in order for the aid to be compatible with the common

[14] OJ C 72 of 26.3.2009, p.1 to 22.

market, a balance must be struck between the pursuit of common objectives and the distortions of competition between Member States and between banks. Recapitalisation schemes should also ensure a return to normal market functioning.

(55) Against this background, the Commission's view is that a remuneration rate which is close to market remuneration is the best way to ensure that distortions of competition are kept to a minimum[15]. "*An overall remuneration needs to adequately factor in the following elements:*

i. *current risk profile of each beneficiary;*

ii. *characteristics of the instrument chosen, including its level of subordination; risk and all modalities of payment;*

iii. *built-in incentives for exit for the State (for example, a capital gains incentive or early redemption clauses),*

iv. *appropriate benchmark risk-free rate of interest*".

(56) As stated in the Decisions of 28 January 2009 and 24 March 2009, the Commission observes, with reference to the Recapitalisation Communication[16], that the French authorities used a methodology which is in line with the recommendations of the ECB and Eurosystem. The notified formula is appropriately structured using an initial component comprising a risk-free interest rate and the risk profile of each beneficiary by means of the "credit-default swap" ("CDS") component, plus an additional charge. Furthermore, in accordance with the recommendations laid down in the Recapitalisation Communication, the proposed scheme provides exit mechanisms constituting incentives for credit institutions to buy back securities at the earliest opportunity.

(57) In the present case, unlike the securities previously approved by the Commission, the preference shares to be issued by the new BP-CE entity are convertible into ordinary shares after five years subject to a limit of 20 % of the capital of the new group.

(58) The Commission welcomes the fact that only the preference share-holder (i.e. the French government) may exercise the conversion option.

(59) The Commission would point out that since French commercial law makes no distinction, in terms of the level of subordination, between ordinary shares and preference shares, converting preference shares into ordinary shares would not allow a company to improve the quality of its capital. In prudential terms, both types of securities are classified as core Tier 1 capital. The conversion option does not, therefore, give the concerned bank a prudential advantage.

(60) Moreover, the conversion takes into account the step-up clause for the other preference shares issued under the bank recapitalisation scheme (an increase over time of the nominal value of the shares such that the conversion ratio is not fixed). Therefore, the option to

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[15] See recital 19 of the Recapitalisation Communication.

[16] See recital 28 of the Recapitalisation Communication.

convert preference shares into ordinary shares does not appear either to reduce the overall remuneration rate of the securities underwritten by the State, or to weaken the mechanism whereby the beneficiaries are incentivised to redeem at the earliest opportunity the aid allocated to them in the form of preference shares.

(61) Therefore, the Commission holds that the option to convert preference shares into ordinary shares does not invalidate its conclusions regarding the proportionality of the measure drawn in its Decisions of 8 December 2008, 28 January 2009 and 24 March 2009.

6. CONCLUSION

(62) Therefore, the Commission considers that the notified measure is compatible with the common market in accordance with the derogation provided for in Article 87(3) (b) of the EC Treaty, provided that it is carried out within nine months of the date of this Decision. As stated above, the conclusion that the measure is compatible is based in particular on the commitments made by the French authorities. The Commission therefore stresses the need to implement these commitments.

If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

http://ec.europa.eu/community_law/state_aids/index.htm

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
SPA3 6/5
B-1049 BRUXELLES
Fax: +32 2 296 12 42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission