EUROPEAN COMMISSION

Brussels, 15.09.2009
C(2009)6958 final

Subject: State aid nr. N 456/2009 - Germany
Scheme to facilitate the refinancing of export credits

Sir,

1. PROCEDURE

1. On 29 May 2009, Germany pre-notified a scheme to facilitate the refinancing of export credits. After several information exchanges with the Commission, Germany formally notified the scheme on 27 July 2009. On 31 August 2009, Germany provided an amendment to the notification, by giving a formal commitment that the scheme will be limited to the financing of bank loans to non-EU purchasers of goods produced by companies in Germany. On the same day, Germany informed the Commission that, for the reason of urgency, it exceptionally accepts an adoption of the decision in the English language.

2. DESCRIPTION OF THE SCHEME

Situation on the export credit market

2. The German authorities provided comprehensive information of the current situation in the export credit market. At present, banks are only capable of sourcing short to medium-term financing in the capital markets and the costs of financing have substantially increased. As mismatches in the maturities on the asset and liability side of the balance sheet have caused enormous problems during the current crisis, banks have become very cautious to provide credit over longer periods and in large volumes. As a consequence, there is a lack of supply of long term export finance which is causing problems for exporting enterprises as financing constitutes an integral part of export business. The industry is therefore worried of massive difficulties in selling products like capital goods, industrial plants or airplanes.

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3. The restricted access of banks to long term funding, especially in foreign currencies, has led banks to either exit from this market, or even to withdraw from existing credit mandates. In this context, it has to be noted that a lot of such export contracts have been already signed a long time ago and only the financing of the delivery is missing.

Design of the scheme

4. Germany envisages that the KfW Bankengruppe (KfW, a bank which is owned by the German State and German Länder) would buy from export finance banks, at its own account and after agreement of the German Government, existing export loans which are covered by a 100% State guarantee (guarantee of Hermes, the German export credit agency). Hence the KfW is, through the existing Hermes Cover, 100 % protected against default on the purchased export loans. According to the German authorities, KfW will not purchase any impaired loans.

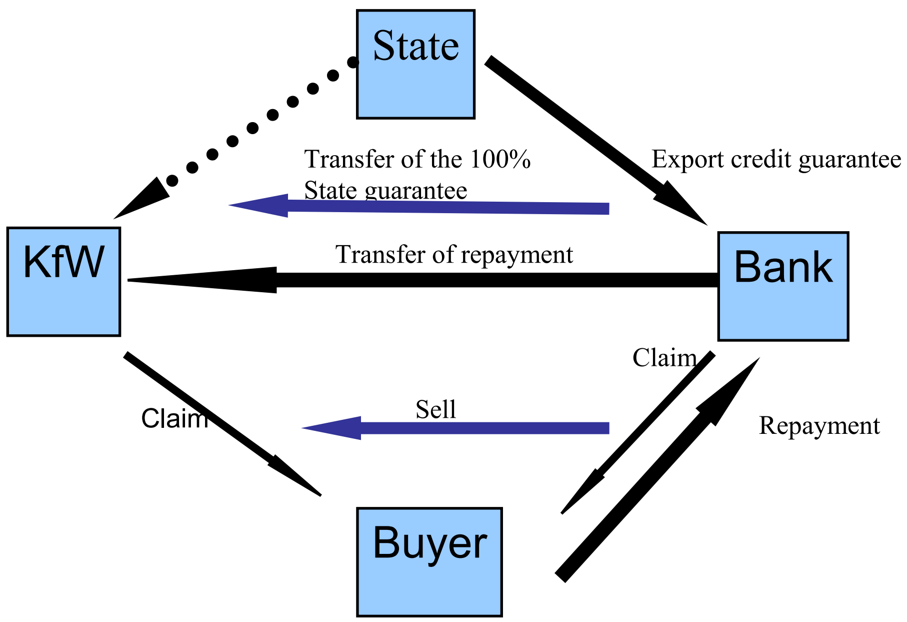
5. Banks who wish to benefit from the scheme, will have to commit to grant new export loans financing the purchase by buyers located outside the EU of products of companies in Germany. The new export loans have to fulfill the conditions to be eligible for a Hermes guarantee. In order to determine the amount of its existing export loans to be potentially purchased by KfW, a bank has to provide to the State a description of the planned new export loan business. After approval of the appropriateness of the planned new export loan business, the bank receives the refinancing via the scheme and has to provide proof to the Government that the new export loan business has been granted. The accumulated financing volume assigned to one exporter cannot exceed a maximum of 50% of the total volume of the scheme.

6. The proposed scheme encompasses EUR as well as USD denominated loans and its initially intended total volume amounts to EUR 1.5 billion. If the banks' demand considerably exceeds the initially envisaged volume, and if the situation on capital markets permits, KfW shall consider the possibility of selling the purchased loans to the capital market by issuing collateralized debt securities. This would allow KfW to use the aforementioned volume on a revolving basis; thereby purchasing a total amount of existing loans of […][*].

7. The German authorities propose a scheme duration of 6 months. They intend to notify a prolongation of the scheme beyond this period.

[*] Covered by the obligation of professional secrecy

Figure 1 The proposed German Scheme: Purchase of existing State guaranteed export credits



Applicants

8. The scheme foresees the purchase of loans which are covered by an export credit guarantee of the State (Hermes Cover). Hence, all banks established in Germany and which are eligible for Hermes Cover can apply for participation in the scheme.

Criteria for loans to be purchased by KfW

9. Eligibility criteria for loans to be purchased by the KfW:

   - loans are granted by the benefiting bank directly to the foreign customer or to another bank in the country of the foreign customer
   - loans are 100% guaranteed by State export credit guarantees
   - loans have to be fully paid out at the time of sale
   - contractual currency is EUR or USD
   - maximum loan amount is 250 EUR million
   - minimum residual maturity of 3 years

Price calculation for the purchase of State guaranteed export loans

10. The calculation of the purchase price is based on at least:
   - the base interest rate (swap rate) for the weighted average life of the loan
   - plus surcharge equivalent to the capital market spread for public Pfandbriefe applicable at the time of funding through KfW[1]
   - plus levy for the expected transaction costs for selling the loans to the capital market

[1]The level is determined on the basis of the Public Pfandbriefe Index (http://www.pfandbrief.de/d/internet.nsf/tindex/de_vdp_kurve_oepf.htm) published by the Verband Deutscher Pfandbriefbanken (Association of German Pfandbrief Banks).

- plus KfW fee (partly per upfront payment)

11. Furthermore, the discount rate resulting from the above formula and used to calculate the purchase price has to amount at the minimum to the corresponding swap rate increased by the historical 5 year CDS spread of the bank[2] increased by 20 basis points.

Compatibility with OECD Arrangement

12. The German authorities further indicate that the scheme complies with the OECD Arrangement on Officially Supported Export Credits (hereinafter 'OECD Arrangement') which had been transposed into EU law. In particular, the new export loans will have to comply with the OECD Arrangement's conditions regarding maturities, interest rates and amounts.

3. OPINION OF THE GERMAN AUTHORITIES

13. The German authorities consider that EU legislation on state aid does not provide any obstacle to the scheme's implementation due to the absence of any advantage offered by the state. Germany points out that this follows from the very fact that the market oriented purchase prices of the loans by KfW exclude the possibility of any state-supported advantage.

14. Given the difficulties currently faced by German exporters, the proposed model would require implementation as early as possible.

4. ASSESSMENT

4.1 State aid character of the scheme

15. As set out in Article 87(1) of the EC Treaty, any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

16. As regards the existence of State resources and the imputability of the measure to the state, the Commission observes that KfW is state owned and controlled by the State. The Commission also observes that this measure has been introduced by the German authorities in order to relieve the difficulties of German exporters to finance financing for their customers.

17. As regards the existence of an advantage, the Commission observes that the purpose and effect of the scheme is to enable beneficiary banks to receive funding that would hardly be possible to collect, or only under very unfavorable terms, in the light of prevailing

[2] The CDS component is calculated in accordance with the Recommendations of the Governing Council of the ECB on government guarantees for bank debt of 20 October 2008.

conditions in the financial markets. Indeed, KfW will purchase existing export loans of the banks which can not, or only under very unfavorable terms, refinance their portfolio of existing export credit loans[3].

18. The scheme is available to all banks having a portfolio of export loans benefiting of a Hermes Cover (i.e. not only German banks but also of foreign banks). The measure is therefore selective.

19. The measure distorts competition by favoring these banks. It affects trade between Member States since several foreign banks are operating on the German market and several German banks are operating in other Member States.

20. The Commission concludes that the notified scheme constitutes aid to the participating banks.

21. The Commission observes that the scheme also contains aid to the foreign purchaser of German products and to the German exporters, since, without the scheme, the banks would have granted less export credits such that certain export contracts would have been cancelled or not concluded because of the absence of financing.

4.2 Legal basis for the assessment of compatibility

22. Article 87(3)(b) empowers the Commission to declare aid compatible with the common market if it is intended to "remedy a serious disturbance in the economy of a Member State".

23. The Commission observes that the situation on the export credit market is abnormal. Whereas the banks receive Hermes covers on new export loans, they are not ready to grant such loans. This is due to the exceptional drying up of the wholesale funding market happening in the current financial crisis, which entails that banks can not obtain the medium and long term liquidity they would need to grant new export loans. As a consequence of the difficulty to obtain export credits, certain contracts are threatened or cancelled. In its communication of October 2008, Communication from the Commission - The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis[4], (hereinafter "the Banking Communication"), the Commission acknowledged that the exceptional situation on the wholesale funding market threatened the lending to the real economy and measures adopted to remedy this exceptional situation can be assessed under Article 87(3)(b). Since the notified measure precisely aims at ensuring financing to banks in the context of the current financial crisis to ensure financing of the real economy, the Commission considers that it can be assessed under Article 87 (3)(b).

4.3 Compatibility with Article 87(3)(b)

24. As indicated in the Banking Communication, to be compatible with the common market under the Article 87(3)(b) of the Treaty, the aid measure must be well targeted, limited to the minimum necessary and not causing undue distortions of competition.

[3] The German authorities indicate that, while some banks have an Öffentliche Pfandbriefe programme at their disposal, thanks to which they can issue Pfandbriefe using as collateral the export loans, other banks do not have similar program and can therefore not refinance their portfolio of export loans.
[4] OJ C 270/8 of 25.10.2008

a) Appropriateness: Aid well targeted

25. Different sources confirm that, as claimed by the German authorities, a radical shift in the activities of the main players leading to shrinkage of export credit supply in this market has be perceived.[5]

26. The Commission acknowledges that export credits are particularly hit by the reduced credit supply in the context of the current financial and economic crisis. As asset and liability maturity mismatches have caused substantial problems to banks during the current crisis, they have become very cautious to provide credit over longer periods and in large volumes and are mainly restricting lending activities to core clients which also generate new deposits[6]. As a consequence, banks are very reluctant to grant long term export finance. The Commission notes that the envisaged scheme aims at solving those funding difficulties experienced in particular in the domain of export credit. It will allow banks, by selling their existing medium and long term export loans, to receive funding in euro and US dollar and to solve the difficulty of finding financing of sufficient long duration.

27. On the basis of the above, the scheme can be considered as appropriate to address a major market disruption.

28. It should be noted that the Commission has already approved a scheme in which the State purchases high quality assets of banks as a way of increasing their liquidity and to encourage them to grant more credit to businesses and households[7].

b) Necessity: Aid limited to the minimum

29. First, the Commission observes that the scheme does not allow banks to get rid of impaired assets. Indeed, KfW will only purchase loans which are currently covered by a 100% State guarantee (Hermes Cover). This limits the size of the advantage to the banks. Further, banks can grant the new loans financed by the purchase of existing loans exclusively to purchasers outside the EU.

30. As regards the duration of the State financing, the Commission observes that, until now, it has approved bank refinancing schemes only if the maximum duration of the State guarantee or loans granted was 5 years and, in the case of asset purchase, if the purchased loans have a remaining duration of maximum 5 years. The purpose of this limitation is to limit the period during which the banks will enjoy state supported financing and to incite

[5] Press articles report that the trade credit market has been dislocated by the financial crisis. While much of the market used to be in the hands of Fortis, Citi and RBS, the combination of near-collapse (for the former) and balance sheet shrinkage (for the other two) has left a larger share of the market for a handful of others. Further, according to additional information received by Airbus representatives, the number of banks providing bids for export credit loans has dramatically declined during the last years (from 20-30 bids per contract to 1-3 bids currently) due to bankruptcies, mergers and acquisitions, refinancing and pricing issues. This is also confirmed by the banks' restructuring plans that the Commission has received from different banks. They are currently exiting from credit exports activities, notably trade aviation, because of the funding needs it requires.

[6] Banks currently try to reduce their reliance on wholesale funding by trying to collect more customer deposits and reducing lending.

[7] Commission Decision C (2008) 6713 final corr. (OJ C 125 of 5 6.2009, page 9) – Spain- Fund for the Acquisition of Financial Assets and Decision C (2009) 6294 final – Spain-Prolongation of the Fund for the Acquisition of Financial Assets (not yet published).

banks to refinance themselves on the market once it will have reopened. The current scheme deviates from the 5 year limit since KfW will be allowed to purchase loans with a remaining duration longer than 5 years as conditions of the OECD Arrangement, including maturity limitations, will apply to these loans. The Commission notes for instance that the OECD Arrangement authorises very long term maturities (e.g. up to 18 years for renewable energies and water projects; up to 12 years for large aircrafts and ships). Contacts with banks have confirmed that, if the KfW is allowed to purchase only loans with at the maximum 5 years to maturity, banks will on that basis not be ready to grant export loans of 10, 12 or 18 years.

The Commission considers that this exception is necessary to make the scheme work as, indeed, export loans are long term loans. Moreover, banks can grant the new loans financed by the purchase of existing loans exclusively to purchasers outside the EU. Thus, the mechanism can not be used for stimulating export inside the EU and therefore does not constitute export aid within the single market, which is highly distortive of competition.

31. The Commission indicates that the present difficulties of the export credit market are a result of the financial crisis and in particular the drying up of the wholesale financing market. As regards the duration of the scheme, it is limited to six months, as all the bank guarantee and refinancing schemes authorised in the context of the current crisis. The purpose is to ensure that this state measure is not used after the wholesale market has recovered its liquidity and is limited to the minimum necessary. The German authorities intend to re-notify the scheme before the end of this period. This limitation of the duration of the scheme limits the aid to the banks and consequently also the aid to export companies in Germany and their foreign purchasers.

32. As regards pricing, the Commission notes that the discount rate used by KfW for calculating the purchase price of export financing loans is a market driven rate. Indeed, the German scheme will use a pricing mechanism of the loans to be purchased by KfW based on the interest rate of the weighted average life of the purchased loan plus the capital market spread for public covered bonds (Pfandbriefe). Furthermore, the German authorities committed that the interest rate used to calculate the purchase price will amount at least to the relevant swap rate increased by the historical CDS spread of the bank increased by an add-on fee of 20 basis points. The Commission notes that this safeguard ensures that the financing received under the scheme would be along the line proposed by the ECB Recommendations on government guarantees for bank debt, referring to a minimum guarantee fee made of the bank's CDS spread increased by 50 basis points. In the Commission decision in case N548/08 on the French measures to support financial institutions[8], the price for government guarantees on high quality assets was reduced to CDS spreads increased by an add-on fee of 20 basis points. As the German scheme exclusively addresses the purchase of State guaranteed loans, a similar add-on fee of 20 basis points can be applied to the loans purchased under the scheme. In conclusion, this pricing mechanism contributes to limit the aid to the banks to the minimum. In addition by limiting the aid to the banks this mechanism also contributes to limit the potential aid that export companies in Germany and their foreign purchasers can receive.

33. The Commission also observes that the banks have no incentive to subsidise the interest rates on new export loans. In addition, the interest rate will have to comply with the

[8] OJ C 123 of 3. 6.2009, page 2

minimum rates defined in the OECD Arrangement. The design of the scheme therefore tends to limit the potential aid to the foreign borrowers and therefore to export companies in Germany.

34. The overall initial budget of the scheme is limited to a maximum amount of EUR 1.5 billion. If the banks' demand considerably exceeds the initially envisaged volume, and if the situation on capital markets permits, KfW shall consider the possibility of selling the loans to the capital market by issuing debt securities to use the volume revoltingly. This illustrates that the size of the scheme is very small compared to the size of the guarantee scheme approved in favor of German banks (budget of 400 billion)[9]. The small budget of the scheme contributes to limit the aid to the banks to the minimum and consequently also the aid to export companies in Germany and their foreign purchasers.

35. On the basis of the above, the aid can be considered as limited to the minimum.

c) Proportionality: limitation of distortion of competition

36. The small size of the overall initial budget limits the distortion between banks.

37. The Commission also observes that the adequate limitation of the duration of the scheme and the market oriented pricing contributes to limit the size of any distortion of competition.

38. Moreover, the Commission recalls that all banks which are eligible for Hermes Cover would be able to benefit from the scheme. This means that the scheme is open to subsidiaries of foreign banks and even, under certain conditions, foreign banks. This contributes to limit the distortions of competition between banks.

39. Importantly, banks can grant the new loans financed by the purchase of existing loans exclusively to purchasers outside the EU. This entails that this mechanism can not be used for stimulating export inside the EU and therefore does not constitute export aid within the single market, which is highly distortive of competition.

4.4 Conclusion

40. The Commission concludes that the scheme can be authorized under Article 87(3)(b) of the EC Treaty.

5. DECISION

The Commission concludes that the notified scheme is compatible with the Common market and raises no objection. The Commission approves the scheme for a period of 6 months.

The Commission notes, that for the reason of urgency Germany exceptionally accepts the adoption of the decision in the English language.

[9] Commission Decision of 12 December 2008 in case N 625/2008 Rescue package for financial institutions in Germany (OJ C 143/2009) - http://ec.europa.eu/community_law/state_aids/comp-2008/n625-08.pdf ; Commission Decision of 22 June 2009, N 330/2009**,** Prolongation of the German bank rescue scheme (OJ C 160/2009) http://ec.europa.eu/competition/state_aid/register/ii/by_case_nr_n2009_0330.html#330

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Yours faithfully,
For the Commission

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