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PUBLIC VERSION

WORKING LANGUAGE

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Subject: State aid N 655/2008, Germany
Secured guaranteed medium-term note programme

Dear Sir,

1. PROCEDURE

(1) On 19 December 2008, Germany declared the measure as rescue aid.

2. DESCRIPTION OF THE AID SCHEME

2.1. The beneficiary

(2) The beneficiary is Norddeutsche Landesbank Girozentrale (below: "NORD/LB"). NORD/LB, with a consolidated balance-sheet total of EUR 245.4 billion, is a major commercial bank in North Germany, with the focus of its business policy on Northern and North-East Europe. NORD/LB operates as the Landesbank for Lower Saxony and Saxony-Anhalt and acts as central bank for 58 savings banks in Lower Saxony, Saxony-Anhalt and Mecklenburg-Western Pomerania.

(3) NORD/LB is also a leading bank in Germany for national and international bond issues. NORD/LB offers a wide range of financial services to its private, corporate and institutional customers and the public authorities.

(4) The main areas of specialisation of NORD/LB are investment, agricultural and real estate banking, corporate finance, ship and aircraft financing and private banking.

His Excellency Mr Frank-Walter Steinmeier
Federal Minister for Foreign Affairs
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(5) As an international commercial bank, NORD/LB maintains a presence in major financial and trading centres, including London, Singapore and New York. It has representations and service offices worldwide.

2.2. The events leading to the establishment of the aid scheme

(6) On account of the increased issues of State-guaranteed securities by competing credit institutions, it is becoming increasingly difficult for Nord/LB to place non-guaranteed securities on the market. The placement of non-guaranteed, but secured instruments (Pfandbriefe) is also severely impaired.

(7) Consequently, refinancing the credit business to be extended and the current supply of credit for NORD/LB customers is in jeopardy. These funding shortfalls affect NORD/LB especially in the medium-term segment of the refinancing needs, since the short-term refinancing needs can be met from the liquidity made available by the central banks as part of their ordinary refinancing operations.

2.3. The measure

(8) NORD/LB intends to cover part of its medium-term refinancing needs by means of a State-guaranteed note programme. The guarantee is to be provided by the Länder of Lower Saxony and Saxony-Anhalt outside the framework of the rescue package for financial institutions in Germany aid scheme, which was approved by the Commission on 12 December 2008 (below: “financial aid scheme”).[1] However, as is clear from the comments below, the detailed conditions are predominantly based on the financial aid scheme.

(9) A "secured guaranteed medium-term note programme" is established (below: "programme"). The programme consists of issues of medium-term securities (with a maximum maturity of five years), which are secured by an insolvency-proof guarantee pool similarly to Pfandbriefe. Guarantees for these securities are provided by the Länder of Lower Saxony and Saxony-Anhalt (below "guarantors").

(10) This involves a special purpose vehicle, set up by NORD/LB under the programme, floating various note issues guaranteed by the Land of Lower Saxony and/or the Land of Saxony-Anhalt. The special purpose vehicle forwards the proceeds from the note issues to NORD/LB.

(11) The special purpose vehicle is provided with a portfolio of assets (below: "guarantee pool"), which are recorded in the NORD/LB refinancing register. The outstanding nominal value of the assets of the guarantee pool must at all times amount to at least 150% of the nominal amount of the guarantees extended by the guarantors. This results in excess collateral. Compliance with the excess collateral is examined on a quarterly basis. If there is a reduction in the excess collateral, new assets must be included in the guarantee pool and recorded in the refinancing register until the excess collateral again reaches the 150% level (obligation to provide subsequent collateral). Finally, there is also special diversification and granularity of the guarantee pool as a result of the fact that it is assigned various claims from different business sectors, such as for example

[1] See the Commission Decision of 12 December 2008 in Case N 625/2008 *Rescue package for financial institutions in Germany*, not yet published.

real estate finance, project finance, agricultural loans, ship finance, aircraft finance, other corporate loans, but not the ultimately critically rated consumer loans.

(12) In consideration of the high level of protection of the guarantee pool, each guarantor has a claim on the special purpose vehicle for remuneration for the guarantee amounting to 20 basis points plus the NORD/LB 5-year CDS spread (to be determined in accordance with the European Central Bank recommendations of 20 October 2008), in each case calculated on the outstanding amount of the guarantees provided. According to the NORD/LB calculations, the Bank pays the two Länder remuneration for the guarantee amounting to 68 basis points (for terms of more than one year).

(13) In the event of calls on the guarantees, the guarantors have a claim for reimbursement of expenses. To secure their claims, the guarantors are granted, directly or through a security trustee, liens of equal ranking to the claim of the special purpose vehicle to transfer of the securities belonging to the guarantee pool. After redemption in full of the securities it has issued, the special purpose vehicle is to transfer any remaining assets to NORD/LB. Likewise, the guarantors must refund any surplus proceeds from realisation of the guarantee pool to the special purpose vehicle.

(14) The term of the guarantees is to amount to a maximum of five years. In this respect, the special purpose vehicle will have the possibility to issue up to 75% of the securities guaranteed under the programme (i.e. a maximum of EUR 7.5 billion per year) with a maturity of five years. The remaining at least 25% can be issued with a maturity of only up to three years.

(15) The programme in principle provides that State-guaranteed issues of a maximum of EUR 10 billion per year can be floated in 2009 and 2010. However, it has an initial duration of 6 months. The Commission's agreement is necessary for a possible extension of the programme to up to 2 years.

3. COMMENTS FROM GERMANY

(16) The German authorities have notified the measure as aid to remedy a serious disturbance in the economy of a Member State within the meaning of Article 87(3)(b) of the EC Treaty.

(17) The German Bundesbank confirms that, on account of its close involvement in the workings of the German banking system, NORD/LB is of systemic importance for German banking. If the measures were not implemented, it is to be assumed that within a short period NORD/LB would no longer be able to play its important role in the financial sector of the Federal Republic of Germany.

(18) The German authorities and NORD/LB give the commitment that NORD/LB, as beneficiary of the guarantee, is a "solvent" undertaking which is "appropriately" endowed with equity. NORD/LB is heading for liquidity difficulties, with this situation being attributable exclusively to the financial market crisis. However, on account of the economic situation of the bank, according to the information provided by the German authorities, the shareholders have no plans at present to recapitalise the bank under the conditions prevailing on the market.

(19) With due discretion, the German authorities have examined the importance of NORD/LB for the stability of the financial markets and in so doing considered the relevant criteria, such as the balance-sheet total and the deposit intensity, for example.

(20) In the opinion of the German authorities, normal market remuneration is charged for the guarantee. Serious cross-border distortions of competition are not anticipated, since credit institutions in other Member States too are currently being given access to equity or guarantees. On the contrary, elimination of possible liquidity bottlenecks in Germany may be beneficial to the credit industry in other Member States. Furthermore, distortions of competition are unlikely as, in Germany's view, potentially unfair competition is minimised by the market-oriented premium.

(21) The issue of securities under the programme and the forwarding of the corresponding amounts to NORD/LB can take place, according to the programme, until 31 December 2010. However, the German authorities undertake that, after a six-month period, State-guaranteed notes will still be issued by the special purpose vehicle only if the Commission has agreed to a programme extension.

(22) The term of the guarantees is warranted by the fact that the business transacted for customers by NORD/LB has an average term of five years. This is attributable to the fact that NORD/LB grants a substantial volume of loans to small and medium-sized enterprises and in the transport and logistics sector, including ship and aircraft finance, which, on account of the particularities of these transactions, are regularly granted for a 5-year term. If the future refinancing needs of NORD/LB are broken down according to the term of the loans to be refinanced, the loans underlying 75% of the global refinancing volume have terms of 5 years or over.

(23) The global refinancing volume of NORD/LB amounts in 2009 and in each of the following years to approximately EUR 20 to 22 billion. This results in an annual refinancing volume of approximately EUR 14 to 18 billion in relation to loans with terms of 5 years or over. The German authorities expect that for NORD/LB refinancing will remain difficult on the currently unsettled markets precisely for such terms in view of the accumulation of State-guaranteed bond loans and the comparatively long term of the underlying loans.

(24) Risks would arise from non-matching refinancing terms for NORD/LB especially from the interest rate risk. On account of the currently very low interest rates and the risk of higher inflation arising from the high growth rate of the money supply, it can be considered likely that in the case of non-matching refinancing terms (shorter-term refinancing than the term of the loans to be refinanced) higher interest rates will exist in 2012 than agreed with customers in 2009. In the extreme case, this could lead to a situation which would threaten the stability of NORD/LB.

(25) In view of the dependence of NORD/LB on matching refinancing terms, the need arises to issue 75% of the securities guaranteed under the programme at a term of 5 years and to extend the guarantee over this term.

(26) The German authorities and NORD/LB give the commitment that the assets serving as collateral in total will have a fair value which, irrespective of the nominal value, will ensure excess collateral of 150%. The security mechanism ensures this in particular by making provision for fixed criteria for the selection of the respective assets. In addition to belonging to a limited number of asset classes, these criteria include in particular that the debtors of the assets comply with NORD/LB internal rating requirements, NORD/LB has set aside no loss reserves for them and real estate, ship and aircraft finance is secured by adequate real estate/aircraft/maritime liens.

(27) The German authorities and NORD/LB give the commitment in particular that, in accordance with the Commission-approved regulations of the Financial Market Stabilisation Fund Act (*Finanzmarktstabilisierungsfondsgesetz* – FMStFG) and the Financial Market Stabilisation Fund Order (*Finanzmarktstabilisierungsfonds-Verordnung* – FMStFV), their stabilisation conditions for guarantees are complied with as follows:

- NORD/LB will review its commercial policy for its sustainability and where necessary adapt it to the results of its review.
- With reference to the acceptance of guarantee by the Länder of Lower Saxony and Saxony-Anhalt, NORD/LB will not advertise publicly and will not use the present programme to extend its business fields.

(28) The German authorities and NORD/LB pledge that NORD/LB, in accordance with the requirements of the Financial Market Stabilisation Fund Act (*Finanzmarktstabilisierungsfondsgesetz* – FMStFG), will take account in its lending of the borrowing requirement of the national economy, and especially of small and medium-sized enterprises, through normal market conditions.

(29) The German authorities and NORD/LB give the commitment that, throughout the aid scheme, NORD/LB will carry out monitoring of compliance with the conditions for stabilisation. The Commission will be sent corresponding six-monthly reports on the subject.

(30) The German authorities and NORD/LB undertake, in the event of a call on a guarantee (occurrence of the case covered by the guarantee and payments by the Länder on their guarantees), to present a restructuring plan to the Commission within six months.

4. ASSESSMENT

4.1 Existence of aid

(31) The Commission first establishes that the measure constitutes State aid within the meaning of Articles 87(1) of the EC Treaty, as the guarantees comprise State resources which favour NORD/LB and which consequently distort or threaten to distort competition and affect the trade between Member States in which NORD/LB participates as an internationally operating bank.

(32) In particular the Commission finds that a selective advantage accrues to NORD/LB from the measure. The Commission recalls that any intervention financed through State resources through which an undertaking is favoured represents State aid within the meaning of Article 87(1) of the EC Treaty unless an investor acting under normal market economy conditions would also have taken such a measure on these terms.[2] The decision of the Länder of Lower Saxony and Saxony-Anhalt to make available the deficiency guarantee in question must therefore satisfy the market economy investor principle to be able to preclude elements of State aid. In this respect, the Commission considers that a market economy investor would not have granted a guarantee on this

[2] See Commission communication on public undertakings in the manufacturing sector, OJ C 307, 13.11.1993, p. 3.

scale and on these terms in the present crisis of confidence which has gripped the capital market.[3]

4.2 Compatibility with the common market

4.2.1. Application of Article 87(3)(b) of the EC Treaty

(33) The German authorities plan to grant NORD/LB a guarantee measure. NORD/LB is viewed by the German authorities as a bank with system relevance for the German financial market. Under the prevailing financial market conditions, the Commission has already accepted to examine such measures with direct application of Article 87(3)(b) of the EC Treaty.[4]

(34) Article 87(3)(b) of the EC Treaty 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". The Commission would point out that the Court of First Instance has expressly stated that Article 87(3)(b) of the EC Treaty needs to be applied restrictively so that the aid may not benefit only one firm or one sector of the economy, but must serve to remedy a disturbance in the whole economy of a Member State.[5]

4.2.2. Compatibility under Article 87(3)(b) of the EC Treaty

(35) According to the Commission Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis[6] ("Banks Communication"), it must be stressed in the context of the application of Article 87(3)(b) of the EC Treaty that an aid measure or scheme may be declared compatible with the common market only if it satisfies the general criteria for compatibility under Article 87(3) of the EC Treaty viewed in the light of its general objectives and in particular Articles 3(1)(g) and 4(2), which imply compliance by such measures with the following conditions:[7]

a. *Appropriateness:* The aid measure must be precisely targeted at its objective, i.e. in this case remedying a serious disturbance in the entire economy. This would not be the case if the measure is not appropriate to remedy the disturbance.

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[3] This was already expressed in the Commission Decision of 12 December 2008 in Case N 625/2008 *Rescue package for financial institutions in Germany*, not yet published.

[4] See point 47 of the Commission Decision of 12 December 2008 in Case N 625/2008 *Rescue package for financial institutions in Germany*, not yet published.

[5] See in principle Joined Cases T-132/96 and T-143/96, *Freistaat Sachsen and Volkswagen AG v Commission* [1999] ECR II-3663, paragraph 167. Confirmed in Commission Decisions in Cases C 47/1996, *Crédit Lyonnais* (OJ L 221, 8.8.1998, p. 28, paragraph 10.1), C 28/2002 *Bankgesellschaft Berlin* (OJ L 116, 4.5.2005, p. 1, paragraphs 153 *et seq.*) and C 50/2006 *BAWAG*, not yet published, paragraph 166. See the Commission Decision of 5 December 2007 in Case NN 70/2007 *Northern Rock* (OJ C 43, 16.2.2008, p. 1), the Commission Decision of 30 April 2008 in Case NN 25/2008 *Rescue aid for WestLB* (OJ C 189, 26.7.2008, p. 3), and the Commission Decision of 4 June 2008 in Case C 9/2008 *Sachsen LB*, not yet published.

[6] 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; OJ C 270, 25.10.2008, p. 8.

[7] See the Commission Decision of 12 December 2008 in Case N 625/2008 *Rescue package for financial institutions in Germany*, not yet published.

b. *Necessity:* The aid measure must, in its amount and form, be essential to achieve the objective. This means that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form (e.g. a temporary and limited guarantee instead of a capital injection) were sufficient to remedy a serious disturbance in the entire economy, the measure in question would not be necessary. This is confirmed by settled case-law of the European Court of Justice.[8]

c. *Proportionality*: The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives. This follows from Articles 3(1)(g) and 4(1) of the EC Treaty, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87(1) of the EC Treaty prohibits all selective measures granted by a State or through State resources that are capable of distorting trade between Member States. Any derogation under Article 87(3)(b) of the EC Treaty which authorises State aid must ensure that such aid is limited to that which is necessary to achieve its stated objective, limiting to a minimum consequential distortions of competition.

(36) The Banks Communication draws up general conditions for support measures in the financial crisis, including for capital increases. These principles are applicable not only for aid schemes, but also *mutatis mutandis* for individual cases.

(37) On 12 December 2008, the Commission approved the German aid scheme concerning the rescue package for financial institutions in Germany (financial aid scheme).[9] This is essentially based on the provisions of the Financial Market Stabilisation Fund Act (*Finanzmarktstabilisierungsfondsgesetz* – FMStFG) and the Financial Market Stabilisation Fund Order (*Finanzmarktstabilisierungsfonds-Verordnung* – FMStFV). Insofar as, in the present case, the underlying conditions of the financial aid scheme are met, even though the measures themselves are carried out outside the financial aid scheme, the Commission can assume that the measures are compatible with the common market.

(38) In its Decision on the financial aid scheme, the Commission already established that a guarantee scheme can help to revive interbank lending and is therefore an appropriate means to overcome the present difficulties in the financial markets.[10] There is no evidence for the Commission to judge the guarantee provided by the two Länder otherwise in this case.

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8 See judgment in Case 730/79, *Philip Morris* [1980] ECR 2671. This judgment was recently reaffirmed by the European Court of Justice in its judgment of 15 April 2008 in Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive,* where the Court held that: "As is clear from the judgment of 17 September 1980 in Case 730/79 *Philip Morris Holland* v *Commission* [1980] ECR 2671, paragraph 17, aid which improves the financial situation of the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market."

9 Commission Decision of 12 December 2008 in Case N 625/2008 *Rescue package for financial institutions in Germany,* not yet published.

10 Commission Decision of 12 December 2008 in Case N 625/2008 *Rescue package for financial institutions in Germany*, point 71, not yet published.

(39) Firstly, NORD/LB is a suitable recipient, since with a core capital ratio of well over 7% it meets the solvency criteria of the financial aid scheme.

(40) In addition, the scope of the present measure fundamentally corresponds to the requirements of the Commission Decision on the financial aid scheme, since it relates to short-to-medium-term interbank financing and not to subordinated debt. In addition, existing debt cannot be covered but only newly issued debt. Finally, NORD/LB initially is to have a window of only six months to assume new liabilities that are covered by the guarantee, although this may possibly be extended.

(41) According to the Commission Decision on the financial aid scheme, the term of the guarantee for new liabilities is in principle to amount to up to three years. However, according to the Decision, in justified exceptional cases and up to a limited amount of one third (of the entire guarantee framework), exceptions can be made in the form of a longer term of a maximum of five years. With an increased proportion of up to 75% of the guarantees with terms of up to 5 years, the present measure ostensibly does not comply with the financial aid scheme in this respect.

(42) In the present case, however, the German authorities provide justification for the longer term of the guarantees in that the business transacted for customers by NORD/LB has an average term of 5 years. NORD/LB in fact grants a substantial volume of loans to small and medium-sized enterprises and to the transport and logistics sector, including ship and aircraft finance, which on account of the particularities of these transactions are regularly granted for a term of 5 years or more.

(43) Moreover, the German authorities also demonstrate that the terms of the loans underlying nearly 75% of the global refinancing volume amount to 5 years or more. The granting of long-term loans therefore is clearly in keeping with the commercial policy of NORD/LB. Since the aim of the guarantee scheme is to achieve financial stability and not to influence the business model, securing the debt instruments for 5 years to the amount indicated seems justified.[11]

(44) In addition, when comparing the individual measure in question here to the financial aid scheme, reference should be made to the fact that the latter is a framework scheme whereby the compatibility of an aid scheme is determined in this framework. However, possible derogations from this framework are not precluded in well-founded individual cases following individual notification. This is the case here.

(45) Furthermore, as regards proportionality, it is to be found that the amount of aid in the present case is minimised through a market-oriented premium. The premium to be paid by NORD/LB is based on the amount described by the European Central Bank in points 3 to 8 of its recommendations of 20 October 2008. In its recommendations, the European Central Bank considers a provision premium of 0.5% as a rule and a risk premium corresponding to the credit default swap spread of the individual financial institution to be appropriate. This premium was already considered proportionate in the context of the financial aid scheme.[12]

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[11] See paragraph 44 of the Commission Decision of 29 October in Case N 533/2008 *Guarantee scheme for banks in Sweden*, not yet published.

[12] See point 77. Furthermore, this corresponds in its broad lines to previous decision-making practice in paragraph 61 of the Commission Decision of 13 October in Case N 507/2008 *Guarantee scheme for banks in the United Kingdom*, not yet published.

(46) Moreover, the financial aid scheme allows for the case that where guarantees granted for liabilities are collateralised through valuable securities, a basic remuneration of 0.25% for a guarantee amounting to 70% of the economic (fair) value of the securities applies instead of the basic remuneration of 0.5%.[13] The present measure departs from this, as a basic remuneration of only 0.2% is to apply. However, the Commission notes that the guarantee pool is subject to extraordinary excess collateral, i.e. 150% of the amount based on the fair value of the securities (see in particular point 26). Firstly, this is over and above the excess collateral required in the financial aid scheme; in similar cases, the Commission has already been able to accept a reduction of the basic remuneration to 0.2%.[14] Secondly, the guarantee pool is characterised by particular diversification and granularity, leading to a further reduction in the risk compared to the financial aid scheme, which makes no pronouncement on the composition of the guaranteed securities. Thirdly, subsequent collateralisation of the securities contained in it is also undertaken, which is not provided for in this form in the financial aid scheme. In addition, the specific structure of the special purpose vehicle provides additional security, as the creditors have an additional claim on the special purpose vehicle, which is a better debtor than a bank as no competition with other creditors is to be feared. Considering these points, the Commission concludes that the proposed remuneration is appropriate and is able to accept it under the special circumstances described on which this individual case decision is based.

(47) Finally, as stated above, the guarantee includes the same strong behavioural constraints as the financial aid scheme. Moreover, in accordance with the requirements of the FMStFG, NORD/LB, through its lending, meets the borrowing requirement of the national economy, and especially of small and medium-sized enterprises, by taking account of normal market conditions. Finally, NORD/LB has also given a commitment to report every six months on the guarantees and, in the event of a call on the guarantee, to present a restructuring plan within six months.

(48) On this basis, the Commission concludes that the guarantee scheme is to be considered appropriate, necessary and proportionate.

5. DECISION

The Commission concludes that the measure constitutes State aid within the meaning of Article 87(1) of the EC Treaty.

Since the measure fulfils the conditions under Article 87(3)(b) of the EC Treaty, the aid is compatible with the common market, with the result that the Commission raises no objections to it.

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[13] In this respect, the value of the securities is to be checked regularly and the remuneration adapted accordingly if the value changes. The Commission has already considered such an arrangement to be appropriate previously in paragraph 44 of the Commission Decision of 29 October 2008 in Case N 533/2008 *Guarantee scheme for banks in Sweden*, not yet published, and in paragraph 42 of the Commission Decision of 12 November 2008 in Case N 567/2008 *Guarantee scheme for banks in Finland*.

[14] Commission Decision of 2 November 2008 in Case N 548/2008 *Guarantee scheme for banks in France*, not yet published.

The Commission would recall that, according to the commitment given by the German authorities, the measure is limited in duration to six months and that an extension is possible only if an application to this effect is first submitted to the Commission.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen days of the date of receipt. If the Commission does not receive a reasoned request by then, you will be deemed to agree to publication of the full text of this letter in the authentic language on the internet site:

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

Any such request specifying the relevant information should be sent by registered letter or fax to:

- European Commission
  Directorate-General for Competition
  State Aid Registry
  Rue de la Loi/Wetstraat, 200
  1049 Brussels
  Belgium
  Fax: (32-2) 296 12 42

Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission