Commission Decision of 18 February 2004 on restructuring aid implemented by Germany for Bankgesellschaft Berlin AG (notified under document number C(2004) 327) (Only the German text is authentic) (Text with EEA relevance) (2005/345/EC)

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(2005/345/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

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

Having regard to Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty[(1)], and in particular Article 7(3) thereof,

Having called on Member States and other interested parties to submit their comments[(2)] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) After approval of the rescue aid for Bankgesellschaft Berlin AG (BGB or 'the bank') by Commission decision of 25 July 2001[(3)] and after notification by Germany of the restructuring plan on 28 January 2002, the Commission informed Germany by letter of 9 April 2002 of its decision to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the restructuring aid[(4)].

(2) On 17 June 2002, after Germany had requested an extension of the deadline for a reply, which was granted, and after German representatives had twice met representatives of the Commission, Germany submitted its observations, with additional documents and information. On 31 July the Commission sent Germany a further request for information.

(3) When it published its decision to initiate the procedure in the *Official Journal of the European Communities*[(5)], the Commission also called on other interested parties to submit their comments. On 9 July and, after it had extended the deadline, on 22 July 2002, it received observations from a competitor and from another interested party who requested that his identity remain confidential. On 1 August these observations were forwarded to Germany for comment. Germany's comments were received, after extension of the deadline, on 23 September.

(4) In response to Commission requests, Germany supplied further information on the notified aid measure by letters dated 16 and 20 September, 14 and 18 November and 18 December 2002 and 14 February and 14 March 2003. The Commission was also informed of the stage reached in the restructuring process at a number of meetings with representatives of Germany, the *Land* of Berlin and BGB.

(5) At a meeting held on 26 March 2003, Germany informed the Commission of the reasons of the previous day's failure of the call for bids with a view to the privatisation of Bankgesellschaft Berlin AG, for which an international public tender had been launched back in 2002. On 31 March further information on this point was supplied, as were the balance sheet and profit#and#loss account for 2002.

(6) The Commission made further requests for information on 15 April, 6 May and 16 May 2003, which were answered on 15 May, 28 May and 24 June respectively. Further information was discussed in a letter of 1 July and at meetings with representatives of Germany, the *Land* of Berlin and BGB which took place on 4 April, 11 April, 14 May and 9 July.

(7) On 14 July 2003 the Commission asked the auditing firm Mazars Revision & Treuhandgesellschaft mbH, Wirtschaftsprüfungsgesellschaft, Düsseldorf, as a consultant, to analyse certain aspects of the restructuring plan. The conclusions were discussed with Germany on 3 October, and the final report was presented to Germany on 20 November 2003.

(8) In October 2003 the need for further compensatory measures was discussed, partly in the presence of representatives of the bank. In November the Commission informed Germany of the measures it was contemplating and gave it and the bank the opportunity to comment on the financial implications for the bank, which were discussed in December. On 18 December 2003 it was agreed that Germany would give the Commission an undertaking to divest Berliner Bank separately by 1 October 2006, the sale being effective no later than 1 February 2007, and to privatise the group by 31 December 2007, together with other divestment measures.

(9) Germany submitted to the Commission on 29 January 2004 the revised restructuring plan, which took account in particular of the recommendations

of the Commission's consultants, and on 6 February the commitments relating to the revised restructuring plan.

II. DESCRIPTION OF THE AID

BGB

(10) BGB is the holding company that owns the BGB group, which was formed in 1994 by the amalgamation of several credit institutions formerly controlled by the *Land* of Berlin; BGB also does business as a credit institution in its own right. In 2000 BGB had a group balance sheet total of about EUR 205 billion in 2000, about EUR 189 billion in 2001 and about EUR 175 billion in 2002. This put it in tenth place among German banks in 2001 and in twelfth place in 2002. It employed some 17 000 people in 2000, a little over 15 000 in 2001 and about 13 000 in 2002. For the purposes of the Banking Law (*Kreditwesengesetz*), its core#capital ratio was 5,7 % at the end of 2001 (total capital ratio of 9,4 %), while at the end of 2002 its core#capital ratio was 5,6 % (total capital ratio of 9,4 %). In June 2001, before the rescue aid was approved, the core#capital ratio had fallen to [...]*[(6)] % (total capital ratio of [...]** %).

(11) Before the capital injection of August 2001, the *Land* of Berlin held 56,6 % of the shares in BGB; it now has about 81 %. Other shareholders are Norddeutsche Landesbank (NordLB), with about 11 %, and Gothaer Finanzholding AG, with about 2 %. About 6 % of the equity is in dispersed ownership.

(12) The largest subsidiaries or divisions in the BGB group, which likewise engage in banking, are Landesbank Berlin (LBB) and Berlin#Hannoversche Hypothekenbank AG (BerlinHyp). LBB is an institution established under public law in which BGB has an atypical undisclosed holding (*atypisch stille Beteiligung*) of 75,01 %. There is a profit#and#loss transfer agreement which means that, in economic terms, BGB can be deemed to be LBB's sole owner. BerlinHyp engages in real estate financing; BGB owns 89,9 % of the equity.

(13) The group also includes IBAG Immobilien und Beteiligungen Aktiengesellschaft (IBAG), which operates in the real estate services business previously handled by Immobilien und Baumanagement der Bankgesellschaft Berlin GmbH (IBG). Directly or indirectly, BGB also controls or has controlled various other domestic and foreign firms, such as Weberbank, Allgemeine Privatkundenbank AG (Allbank, now sold), BGB Ireland, BGB UK, BG Polska (the retail and Inteligo internet businesses have now been sold, and liquidation of the remaining shell has begun) and the Czech bank Zivnostenska Banka a.s. (now sold).

(14) BGB's core business is retail banking for private and corporate customers, where it trades under the two names Berliner Sparkasse and Berliner Bank. These are not legally independent subsidiaries, but rather brands or branches. Since 1 July 2003 Berliner Bank has belonged to LBB, as Berliner Sparkasse

already did[7]. The corporate clients are mainly small and medium#sized enterprises in the region.

(15) Apart from retail banking, real estate financing and real estate services, BGB and its subsidiaries also operate on capital markets (money and securities dealings) and in two segments which are to be run down or drastically cut back, the large customer/international segment (e.g. project and export financing) and the public sector segment (lending). The investment banking business comprised only some relatively limited share and bond issues and will play no further independent role in future. Geographically, BGB's business is concentrated in the Berlin area and the *Land* of Brandenburg, especially as far as retail banking is concerned. But it does also operate countrywide, e.g. in real estate financing, and internationally, e.g. on capital markets.

(16) In the Berlin area BGB is the market leader in retail banking, with shares of individual segments ranging from about 20 % to over 50 %[8]. In terms of first giro accounts held by private customers, it estimates its own market share or penetration in 2002 at 48 %[9]. In terms of nationwide real estate financing (all mortgage lending), according to the information supplied with the notification, BGB had a market share of about 5 % in 2000, which put it in third place. According to more recent information, its ranking is not as high, or has fallen back in the meantime[10]. On 31 December 2001 BGB's portfolio of mortgages amounted to EUR 33 billion, of which 90 % was in Germany, and the rest related to real estate financing abroad. In other lines of business, BGB is not among the leading banks either inside Germany or internationally. Precise figures for market and segment shares here are not available.

(17) The difficulties at BGB that publicly emerged in 2001 had their origin in the first place in real estate services but also in real estate financing. Two important components in the real estate services provided in the 1990s by BGB's subsidiary IBG were real estate funds, project development and building work. IBG was set up at the beginning of the 1990s as a subsidiary of LBB; in the second half of the 1990s the shareholders were BGB itself (10 %), Berliner Bank AG (30 %), LBB (30 %) and BerlinHyp (30 %). Berliner Bank AG was then merged into BGB AG, and BGB AG inherited Berliner Bank's shares in IBG. The ownership structure is currently as follows: 40 % BGB, 30 % LBB and 30 % BerlinHyp.

(18) Prior to 2000 IBG set up an increasing volume of real estate funds. Investors in these funds were given extensive guarantees, particularly long#term guarantees regarding rent, dividends and renewal. In order to set up new funds, new property was acquired or built. The guarantees were based on an expectation that property values would be high or indeed rising, which meant that risks accumulated as prices and rents in fact dropped, especially in Berlin and the new *Länder*.

(19) When these problems began to emerge in the course of 2000, BGB considered selling IBG's main business. In December 2000, therefore, the bulk of IBG's business was transferred to the newly set#up IBAG, with the exception of 'old' risks and liabilities occasioned by IBG and its subsidiaries, which were transferred to the newly set#up LPFV Finanzbeteiligungs# und Verwaltungs# GmbH (LPFV). But the plans to sell IBAG came to nothing. Both IBAG and LPFV are now wholly owned subsidiaries of BGB. The old IBG kept only a few peripheral lines of business.

(20) Further problems arising in this period concerned real estate financing, carried on mainly by BerlinHyp but also by LBB and BGB itself. This comprises the granting of loans to finance large property projects, especially commercial projects, rather than the granting of mortgage loans to finance private housing, which falls within the retail banking business. As the property market slackened, there were increasing difficulties in real estate financing, as a result in particular of a level of risk provisions that had not been adequate.

(21) In the first half of 2001 BGB found itself in acute difficulty. The main causes were loan defaults in real estate financing and guarantee obligations on IBG/IBAG/LPFV that were falling due in the funds business, for which provisions of about EUR 1 billion had to be set aside at the end of 2000, along with the need to adjust the value of building projects in progress and to increase risk provision in real estate financing. In May BGB's own#funds ratio fell below the 8 % required by law. The shortfall that needed to be made up to reach a core#capital ratio of 5 % and thus to return to the own#funds ratio of 9,7 % that had obtained before the crisis was estimated at the time at about EUR 2 000 million. The *Land* of Berlin issued in May 2001 a declaration of intent guaranteeing that the necessary capital would be injected. The Commission authorised the aid as rescue aid, and in August 2001 BGB received a capital injection of exactly EUR 2 000 million: EUR 1 755 million from the *Land* of Berlin, EUR 166 million from NordLB, EUR 16 million from Parion (Gothaer Finanzholding AG) and EUR 63 million from small shareholders.

(22) In the months following, however, further risks were identified, especially in the real estate services operated by IBAG/IBG/LPFV. There was a danger that BGB's capital might once again fall below the required minimum solvency ratios. These risks arose once again out of the guarantee obligations in the real estate funds business and the sinking value of property that had been bought with a view to the setting up of new funds (reserve property). According to the information supplied by Germany, the interlocking profit#and#loss transfer agreements, guarantees and loans within the group made BGB liable for the bulk of these risks.

(23) In November 2001 the then Federal Credit Business Supervisory Office (*Bundesaufsichtsamt für das Kreditwesen*, 'BAKred')[11] threatened BGB with temporary closure if it did not take measures to provision these risks by the

end of 2001. On 20 December 2001, therefore, the *Land* of Berlin, BGB, LBB, BerlinHyp, IBAG, IBG and LPFV concluded an agreement in principle to cover these risks by means of comprehensive guarantees. The agreement in principle was replaced by a detailed agreement finally concluded on 16 April 2002. The guarantees assumed in this agreement were known as the 'risk shield' (*Risikoabschirmung*); they are described in more detail below.

Restructuring aid

(24) The aid measures form part of the restructuring plan initially submitted in January 2002 and revised in the course of the investigation procedure, most recently in January 2004; the plan provides for a substantial reduction in the BGB group's business and a concentration on private and corporate customers in the Berlin area. The capital market business and real estate financing are also to continue, though on a smaller scale (see paragraph 172 et seq.). Other areas, such as large customers and international business, including structured finance and mergers and acquisitions consultancy, are to be wound up, and others again, such as public sector business, are to be cut back drastically. Initially, real estate services were also to continue. But at an early stage in the procedure Germany undertook to see to it that this area was hived off and transferred to the *Land* of Berlin (see paragraph 277 and 278). With a view to reducing BGB's very large share of the Berlin retail market, Germany has also undertaken to sell Berliner Bank separately.

(25) As already mentioned, the *Land* of Berlin's shares in BGB are to be sold. The Commission has received a commitment to this effect. As part of the privatisation of BGB, BerlinHyp will be sold either together with BGB or separately (see paragraph 285). IBB is to cut its ties with BGB, and IBB's special reserve (being the capital of the old Wohnungsbau#Kreditanstalt (WBK) transferred to LBB as described above) is to be repaid to the *Land* of Berlin, in so far as this does not result in a core#capital ratio of less than 6 % or a total capital ratio of less than 9,7 % on the reference date of 1 January 2004 (see paragraph 279).

Capital injection

(26) One component of the restructuring aid notified on 28 January 2002 is the capital injection of EUR 1,755 million granted by the *Land* of Berlin as rescue aid in August 2001, following the authorisation given by the Commission on 25 July 2001[(12)]; BGB is now to retain this amount as restructuring aid.

Risk shield

(27) The other component of the restructuring aid is the 'risk shield' already referred to, which was agreed in principle in December 2001 by the *Land* of Berlin, BGB, LBB, BerlinHyp, IBAG, IBG and LPFV, and subsequently modified, supplemented and superseded by a detailed agreement concluded on 16 April 2002. The risk shield comprises the following guarantees, which are given by the *Land* of Berlin for 30 years in order to cover the risks arising

out of the real estate services business carried on by the subsidiaries IBAG, IBG and LPFV:

— *Loan guarantees*: BGB, LBB and BerlinHyp are guaranteed the contractual interest and capital repayments on loans granted by them to IBAG, IBG and their subsidiaries and certain other companies up to 31 December 2001. The companies and loans concerned are listed exhaustively in the annexes to the detailed agreement, which also lays down restrictions in respect of certain loans and a number of express exclusion clauses (negative list).

— *Book value guarantees*: IBAG, IBG and certain other companies in the group, primarily direct and indirect subsidiaries of IBAG and IBG, are guaranteed the value of the individual assets entered in the relevant audited balance sheet, with the exception of certain designated items such as intangible assets, cash, balances at the Bundesbank and credit institutions, and prepayments and deferred income (*Rechnungsabgrenzungsposten*). These book value guarantees are likewise subject to restrictions and exclusions (negative list).

— *Performance obligations taken over from LPFV*: LPFV is indemnified in respect of obligations arising out of the earlier real estate business of IBG and its previous subsidiaries Bavaria, Arwobau and Immobilien#Beteiligungsvertriebsgesellschaft der Bankgesellschaft Berlin GmbH ('IBV'): LPFV is liable for the first EUR 100 million, and thereafter such obligations are taken over by the *Land*. This does not apply to obligations in respect of funds newly set up after 31 December 2000 or in respect of new IBAG business described in the detailed agreement.

— *BGB indemnified in respect of guarantees*: BGB is indemnified in respect of all obligations arising out of the guarantees it gave up to 31 December 1998 on transactions entered into by IBG, IBV and Bavaria. Like the preceding indemnity, this does not apply to obligations in respect of funds set up after 31 December 2000 or in respect of new IBAG business described in the detailed agreement.

(28) Article 45 of the detailed agreement sets the maximum liability that may be incurred by the *Land* of Berlin as a result of these obligations at EUR 21,6 billion. It states that this is the theoretical nominal value of the risks covered, adjusted for duplication. In the agreement in principle, the ceiling was set at EUR 35,34 billion because the guarantees listed above sometimes covered the same risks. Article 45 explains that, where an outside creditor puts forward a claim under a rent guarantee, the *Land* may, for example, be liable both under the performance obligation taken over from LPFV and under the indemnity given to BGB in respect of guarantees. The detailed agreement states that, in such cases, the *Land* will be liable only once. The theoretical ceiling is therefore adjusted for such duplication, and this reduces it to EUR 21,6 billion. According to the provisional calculations submitted by Germany, the largest item in the EUR 21,6 billion figure is the performance obligation taken over from LPFV: it amounts to EUR [...]**, comprising EUR [...]** to indemnify LPFV in respect of liabilities arising out of rent and dividend

guarantees and EUR [...]** to indemnify it in respect of risks arising out of the renewal guarantees for buildings.

(29) However, this theoretical ceiling is based on the assumption that all the risks will, in fact, materialise in full. For the indemnity given to LPFV in respect of rent guarantees (ceiling of EUR [...]**), this means, for example, that all rents until 2025 would remain unpaid, and, for the indemnity given to LPFV in respect of renewal guarantees (EUR [...]**), it would mean that all buildings would have to be replaced in their entirety. However, even on very pessimistic assumptions, a 100 % rent default and the demolition and reconstruction of all buildings concerned is not realistic. Article 45 accordingly also states that, on the information currently available and after careful examination of the main economic risks, the probable rate of take#up can be put substantially lower. The real risk is estimated at EUR 2,7 billion in the best#case scenario, at EUR 3,7 billion in the base#case scenario and at EUR 6,1 billion in the worst#case scenario. The assumptions on which these estimates are based were communicated in the course of the procedure (see paragraph 138).

(30) In order to minimise the liability arising out of the guarantees, the detailed agreement also provides that the *Land* may entrust contract management under the detailed agreement wholly or partly to a third party. The *Land* has availed itself of this possibility and has set up a company wholly owned by it, BCIA Berliner Gesellschaft zum Controlling der Immobilien# Altrisiken mbH, which has been conducting this business on the *Land*'s behalf since January 2003. The detailed agreement also provides for a guarantee commission and a better#fortunes clause for 15 years. According to this, the *Land* receives from BGB an annual fixed guarantee commission of EUR 15 million until 2011 inclusive, which can as of 2012 be adapted for the remaining duration of the risk shield by mutual agreement between the parties. Moreover, if in one or more months of a financial year BGB achieves an own capital ratio of 12,5 % and a core#capital ratio of 7 %, BGB will pay 15 % of its annual profit to the *Land* of Berlin.

(31) The Law empowering the *Land* Government to issue a guarantee[13] provides that the shares in BGB held by the *Land* of Berlin are to be sold as rapidly as possible on terms fair to the *Land* and that, as part of a reorganisation of BGB's ownership structure, Investitionsbank Berlin (IBB) is to have its ties with BGB cut, leaving it as a separate development bank established under public law (see below).

Agreement on the treatment of any claims to repayment brought by the Land of Berlin arising out of the investigation procedure initiated by the Commission in respect of Landesbank Berlin # Girozentrale

(32) In its decision to initiate the procedure in the present case[14], the Commission also drew attention to an important fact that had not been taken into account in the initial restructuring plan. At the end of 1992 Wohnungsbau#Kreditanstalt (WBK) was transferred to LBB with all its assets; at the same time, all WBK's

functions were transferred to the newly set#up IBB. The transfer increased LBB's own funds by about DEM 1,9 billion. From 1995 onwards, LBB paid a remuneration of 0,25 % of the amount taken up. As the Commission doubted whether this remuneration was compatible with the principle of the investor operating in a market economy, it initiated the investigation procedure (C 48/2002) in July 2002[(15)]. If the Commission were to conclude that the remuneration paid was not compatible with the principle of the market#economy investor and if none of the tests for compatibility laid down in the Treaty were met, the difference between the remuneration paid and the ordinary market return on such an investment would constitute state aid incompatible with the common market that would have to be repaid by LBB to the *Land* of Berlin.

(33) The possibility that repayment might be required constitutes a substantial threat to the prospects for a restoration of profitability under the restructuring plan. In the decision initiating the procedure, therefore, the Commission asked Germany to identify an appropriate solution and noted that Germany was working on such a solution.

(34) To meet this need, an agreement was concluded between the *Land* of Berlin and BGB on 23 December 2002, entitled the 'Agreement on the treatment of any claims to repayment brought by the *Land* of Berlin arising out of state aid case C 48/2002 *Landesbank Berlin — Girozentrale*, currently being examined by the European Commission' (the repayment agreement).

(35) By this agreement the *Land* of Berlin undertakes that, in the event of a Commission decision requiring repayment, it will provide as a contribution to LBB's capital a reorganisation grant to the value necessary to prevent the threatened repayment requirement from forcing LBB or the BGB group, or both, to fall below the minimum capital ratios specified in the agreement. The minimum ratios specified in the repayment agreement are a total capital ratio of 9,7 % and a core#capital ratio of 6 %. The agreement is subject to the suspensory condition that the Commission must approve such aid.

(36) Although this measure had not yet been taken at the time of the decision to initiate the procedure, the risks arising from a possible repayment decision by the Commission were mentioned in the decision as a factor to be taken into account. The repayment agreement was finally concluded in order to take account of this misgiving. Given that this measure is essential to the success of the restructuring plan, the Commission considers it appropriate to assess this agreement together with the other aid measures, having been able to set the upper limit in this respect.

Grounds for initiating the procedure

(37) In its decision initiating the formal investigation procedure laid down in Article 88(2) of the EC Treaty, the Commission provisionally classified the measures under examination as state aid within the meaning of Article 87(1)

of the EC Treaty and Article 61(1) of the EEA Agreement because they were granted through state resources and because, by improving the recipient's financial position, they were likely to affect the economic position of competitors from other Member States[16] and consequently distorted or threatened to distort competition and affected trade between Member States.

(38) On the basis of its provisional assessment, the Commission concluded that the aid had to be assessed in the light of the Community guidelines on state aid for rescuing and restructuring firms in difficulty ('the guidelines')[17] and that there were no other provisions of the Treaty or other Community guidelines that might render the aid compatible. It agreed with Germany that BGB was a firm in difficulty within the meaning of paragraph 2.1 of the guidelines, but it seriously doubted whether the aid measures were compatible with the common market.

Restoration of long#term viability

(39) Paragraphs 31 to 34 of the guidelines state that, in the case of all individual aid measures, the Commission will examine the restructuring plan to establish whether it is capable of restoring the long#term viability of the firm within a reasonable timescale and on the basis of reasonable assumptions.

(40) The Commission took the view that in the restructuring plan initially submitted there was no explanation of future strategies on the market in investment banking. As regards future strategy in the real estate business, it wanted to see more detailed specification of the difference in costs between liquidation and continued operation of the real estate services subsidiary IBAG.

(41) The Commission doubted whether the market assumptions in the initial restructuring plan and the forecasts of supply and demand were sufficiently precise to allow conclusions to be drawn regarding the prospects of success of the restructuring measures proposed. It was difficult to see on what market assumptions the restructuring measures were based.

(42) The Commission also found that the information supplied by Germany with regard to the causes of the firm's difficulties in the past was relatively superficial. The following three causes were cited: (a) bad loans; (b) the issue of extensive guarantees for real estate funds; and (c) the late introduction (1999) and slow implementation of systematic risk control. The information supplied was essentially a summary of the financial difficulties. Only one real reason for these difficulties was put forward, namely ineffective group and management structures, including the lack of an effective system of risk control. There was no in#depth analysis of these structures or of specific management shortcomings, such as the implications of state ownership. However, the Commission took the view that an analysis of this kind was necessary if there was to be a proper assessment of the prospects for the restructured BGB. It doubted therefore whether the causes of BGB's

difficulties were properly identified and addressed in the restructuring plan. It thus asked Germany to provide an in#depth analysis of past shortcomings and of future prospects and problems, in the context of group structures, management and supervisory methods, control and reporting patterns and techniques for the introduction of commercially based decision#making processes.

(43) Germany spoke of negotiations with potential buyers with a view to a possible privatisation but gave no details of the procedures envisaged, the terms of sale or other relevant factors. The Commission therefore wondered whether privatisation, in whole or in part, was being seriously considered and whether, if privatisation did take place, it would be conducted by means of an open, transparent and non#discriminatory procedure.

(44) The initial notification referred to target profitability of just 7 %. The Commission doubted whether this could really be reached, especially given the problematic institutional and management structure of the group, the unclear market assumptions on which the restructuring measures were based, and the continuation of the problematic real estate business. Even if 7 % profitability were to be achieved, the Commission doubted whether such a return on the capital invested was enough to be compatible with the principle of the market#economy investor.

(45) The Commission also drew attention to the fact that the possibility of a claim for repayment resulting from the LBB case represented a substantial risk to the prospects of success of the restructuring plan and so, in the decision initiating the procedure, it called on Germany to come up with a solution.

Avoidance of undue distortions of competition

(46) The exception laid down in Article 87(3)(c) of the EC Treaty is subject to the condition that the aid does not adversely affect trading conditions to an extent contrary to the common interest. Paragraphs 35 to 39 of the guidelines state that measures must be taken to mitigate as far as possible any adverse effects of the aid on competitors. This condition usually involves limiting or reducing the company's presence on the relevant product markets by selling production capacity or subsidiaries or reducing activities. The limitation or reduction should be in proportion to the distortive effects of the aid and, in particular, to the relative importance of the firm on its market or markets.

(47) The compensatory measures originally proposed, such as the divestment of major shareholdings, reductions in the financial services, debt finance and real estate businesses, in the number of subsidiaries and staff and in lending to public authorities, and the giving#up of branches and business with large and with foreign customers, were imposed in order to reduce BGB's balance# sheet total by 26 % (from EUR 190 billion to EUR 140 billion). Given the description of the compensatory measures, which was vague in parts, and their individual contribution to the desired effects on BGB's assets and employment

situation, the Commission was not in a position to assess whether this entire effect could realistically be achieved or how the measures would affect BGB's future position in the markets or segments defined by Germany. It therefore needed detailed information as to the effect of each measure on BGB's assets, employment situation and future market/segment positions.

(48) Even if the above reduction (26 % or EUR 50 billion of the balance#sheet total) were achieved in full, the Commission questioned whether it would be sufficient in view of the large amounts of aid and its practice in previous decisions on restructuring aid for banks.[18] In this connection, the Commission suggested that the legal minimum capital requirements could serve as a guide for assessing the appropriateness of the compensatory measures since a bank that was undercapitalised would have to reduce its activities accordingly (undercapitalisation of EUR 1 billion with a legal minimum capital ratio of 4 % would require a theoretical reduction of risk#adjusted assets of up to EUR 25 billion). Such 'opportunity reductions' could serve as a rough guide for the degree of market distortion and the corresponding compensatory measures required. According to this approach, the EUR 1,755 billion capital injection from the *Land* of Berlin in the summer of 2001 would alone correspond to a theoretical asset reduction of up to EUR 44 billion. However, the Commission pointed out that this guide should not be applied 'mechanically' but should be subject to discretion in order to take account of specific circumstances and factors important for the survival and viability of the bank.

(49) When new risks were discovered following the capital injection, the solvency ratios again threatened to become insufficient. In order to avoid a new capital injection, the *Land* of Berlin opted for the solution of general guarantees by means of a risk shield. As a result, the guarantees have an effect similar to that of a capital injection. The problem with the risk shield, however, was that the amount of aid which would ultimately be granted was not clear. The nominal theoretical maximum specified in Article 45 of the detailed agreement is EUR 35,34 billion; when multiple coverage is taken out, the maximum is EUR 21,6 billion. This, however, is still a nominal value, i.e. it assumes full materialisation of all risks, something which is unlikely (see above). Consequently, for reasons of prudence, the Commission had to work with the only limit available, i.e. EUR 35,34 billion. Since this amount would though probably not be called in, it would be out of proportion to take it as a basis for establishing the necessary compensatory measures. The Commission was therefore unable to assess whether the proposed compensatory measures were sufficient in view of the amount of aid. It also had doubts that, even in the best#case scenario with aid of some EUR 3 billion in addition to the capital injection, the compensatory measures would suffice in the light of the above rough guide. Moreover, experience with restructuring cases had shown that best#case scenarios rarely came about.

(50) The Commission stated that BGB's extremely strong market position in retail banking at local and regional level would have to be taken into account when finally assessing the appropriateness of the compensatory measures. Given the absence of sufficient information, however, the Commission was not able to estimate the effects of the reduction measures on the individual markets or segments. However, the planned reduction in retail and corporate banking by way of the divestment of Weberbank and Allbank seemed relatively modest and would possibly be insufficient to mitigate the distortive effect of the aid. In view of the fact that BGB also appeared to be a key player on the real estate market, the Commission further wondered whether the reductions planned in this connection would be sufficient.

(51) To summarise, the Commission lacked important information needed for a proper and sufficiently thorough assessment of the effects of the proposed compensatory measures. On the basis of the available facts, therefore, it had serious doubts as to whether the planned reduction measures would suffice to mitigate the distortive effects of the very large amount of aid, the exact amount of which or the ceiling for which could not even be established. Accordingly, BGB's strong local and regional market position in the retail sector in particular also had to be taken into account.

Aid limited to the minimum

(52) Under paragraphs 40 and 41 of the guidelines, aid must be limited to the strict minimum needed to enable restructuring to be undertaken and to avoid providing the company with surplus cash which could be used for aggressive, market#distorting activities or even for expanding. The guidelines also state that aid beneficiaries will be expected to make a significant contribution to the restructuring plan from their own resources, including through the sale of assets that are not essential to the firm's survival.

(53) On the basis of the available information, the Commission was not in a position to assess accurately whether the aid, the amount of which was not even clear, represented the strict minimum necessary and whether, for example, the risks in the course of the restructuring might have been overstated or whether measures had been or would be taken to rule out multiple risk coverage.

(54) The Commission questioned whether the provisional authorisation as rescue aid of a core#capital ratio of 5 % and an own#funds ratio of 9,7 % and, as targets from 2003 onwards, a core#capital ratio of some 7,5 % and an own#funds ratio of some 12 % were really necessary for the firm's survival, including a solid rating by the rating agencies. In this context, it also had doubts about whether BGB's own contribution through the sale of assets or subsidiaries not essential for the firm's long#term viability met the 'significant contribution' requirement in view of the large volume of aid granted even in the best#case scenario. Given the strong position of BGB, together with

its subsidiaries and merged entities, on several markets and segments, it was questionable whether more and larger subsidiaries or assets could not be divested, not only from the viewpoint of compensatory measures but also as a serious own contribution in addition to taxpayers' money.

III. COMMENTS FROM GERMANY

(55) Germany submitted its comments regarding the initiation of the state aid procedure on the basis of the restructuring plan at the time, which essentially still applied in the summer of 2003 and which formed the basis for the advisers' report for the Commission. At the Commission's request, it subsequently provided further information in addition to the original restructuring plan, in particular regarding the following points of key importance for the Commission's decision:

Restoration of the firm's long#term viability

(56) Investment banking would in future no longer be a strategic focus or target product of the capital market business, which would concentrate on fields with a high yield potential, such as customer business with share, interest and credit products and, to a lesser extent, own#account business, and would diminish still further in its importance.

(57) The difference in costs between winding up and continuing the activities of IBAG was described in greater detail. The total costs of winding up comprised the operational liquidation costs (EUR [...]**) plus a balance#sheet shortfall. To determine the latter, a mock consolidated balance sheet was produced for three scenarios (best#case, real#case, worst#case), giving a figure of EUR [...]**, EUR [...]** and EUR [...]** respectively. To keep the firm going, on the other hand, the costs for the period from 2001 to 2005 would, depending on the scenario, amount to between EUR [...]** and EUR [...]** (for the real# case scenario, EUR [...]*)*. Winding up IBAG, as opposed to continuing its activities, would therefore, depending on the scenario, involve additional costs of between EUR [...]** and EUR [...]**. Moreover, winding up the firm would mean forgoing an annual positive profit contribution of EUR [...]** from 2006.

(58) The market assumptions for the real estate and funds business were explained in greater detail. According to information from the Central Association of the German Construction Industry, after contracting slightly in 2002 by some 2 %, the volume of construction output for the whole of Germany would come close to stagnation in 2003. In residential construction there would be no turnaround (2003: decline of some 1 % after contracting by about 3 % in 2002), with the fall#off being much greater in the eastern than in the western *Länder*, owing to the surplus supply of accommodation. Commercial construction would see only a slight increase of about 1 % in 2003. The firm Bavaria's capacity and turnover forecasts had been adjusted accordingly and a more targeted orientation adopted. In future, Bavaria would focus, in residential and commercial construction, on the top end of the market and, in view of

the strong regional differentiation in residential development, on the regions of Hamburg, Munich, Stuttgart and Rhine#Main in western Germany. In the funds business, the closed funds segment was expected to grow significantly in future, following a decline in 2001. Real estate funds would continue to play a key role, with close on 50 % of the placing volume, as an alternative form of investment, with yields and risk between those of fixed#interest securities and shares. New IBV funds would be launched only for premium commercial buildings and would be accompanied by significantly reduced guarantees. This higher#quality real estate could also help to improve yield security, although in any event business would be cut by more than half overall.

(59) Regarding the market assumptions for the retail sector, Germany explained that in the Berlin conurbation each bank branch looked after 4 000 inhabitants on average, which was significantly more than the average for Germany as a whole (1 400). Although there was not a surplus of branches in Berlin, it was to be expected that the number would drop further in the coming years on account of other channels such as call centres and the Internet. The plan for sustainable improvement in the profitability of the retail sector addressed both cost and yield. Key measures to lower costs included reducing branches according to current profitability, regional coverage and the estimated costs of closure/merger. The aim was to increase principal customer accounts per branch to [...]* at Berliner Sparkasse and [...]* at Berliner Bank by the end of 2003, as compared with an average of 2 300 customers in the case of direct competitors in Berlin. Further savings would result from the replacement of cost#intensive traditional cash#desk facilities by more modern facilities, thereby saving on 300 staff. Income could be increased still further by reallocating advice capacity to bring in the most attractive customer groups possible. Pure transactions business was to take place increasingly via online and self#service facilities, while branches should focus more on customer advice. The forecast of increased demand in the retail sector was based on information from the Landeszentralbank Berlin, broker reports and assessments by the Federal Statistical Office in recent years. As regards BGB's market position in the individual segments of the local and regional retail sector, Germany supplied corrected figures showing lower volume# based market shares ranging from a little over 20 % to more than 40 % in Berlin (see paragraph 291 et seq.). The growth forecast for Berlin, which, as a structurally weak region, lagged behind the national average of 2,5 %, was 2 %. Germany explained that, despite market shares of around 40 % in the retail deposit sector, BGB could not be said to be in a dominant position since the Berlin retail market was very competitive and customers could move from one bank to another without significant cost or effort. Furthermore, savings were overrepresented, whereas BGB was underrepresented compared with its market penetration when it came to more sophisticated forms of investment such as time deposits, savings bonds, security deposit accounts and other complex products, such as insurance, on account of its overwhelmingly low# income customers.

(60) The market assumptions for corporate banking were based, among other things, on broker reports and assessments by the Federal Statistical Office. Targeted portfolio management and the related exclusion of risk#bearing loans, the introduction of risk#geared pricing, and the focusing of business on the core segments of commercial customers and regional corporate banking would lead to a slight drop in the volume of loans from EUR [...]** to EUR [...]** despite average market growth in Berlin in the period 2001 to 2006 of 1 %. The reduction in risk assets was in order to avoid high cluster risks, especially in the large corporate customer segment (turnover of more than EUR 50 million). Outside Berlin, there would be a further reduction of EUR [...]**. The volume of deposits by corporate customers was expected, despite a targeted reduction in large#volume credit business through cross#selling, to remain more or less constant. For the regional and local corporate segments, Germany also supplied figures that had been adjusted downwards and showed market shares of a little over or just under 25 % in Berlin (see paragraph 291 et seq.). An average annual growth rate of 2 % was assumed for Berlin. Profitability would be significantly increased through the optimisation of marketing and service processes and the introduction of standard products. The number of locations was to be reduced from 73 to 35 across all customer segments. Improved contribution margins would result from a rearrangement of the Berliner Bank and Berliner Sparkasse price model by standardising (increased) lower limits and exhausting all cross#selling potential, together with greater division of labour among account managers.

(61) What had led to the troubled real estate loans and the provision of guarantees in the real estate funds sector were, as already mentioned in the notification, the extremely optimistic expectations of a rise in the value of properties in Berlin and the new *Länder* following the unification of Germany. On the basis of these expectations, BGB had granted a large number of commercial real estate loans and, in the period prior to 1999, had set up increasingly large real estate funds with extensive guarantees for which, at the beginning of the real estate crisis in the late 1990s, a valuation adjustment and liability reserves were sorely needed. On account of incomplete implementation of an early# warning system to identify risks throughout the group and inadequate risk analysis at divisional level, these risks were not sufficiently recognised, with the result that countermeasures were not taken early enough. It was only in 2000, at the instigation of the group's executive board and auditors and on the basis of BAKred's special audit, that a value audit was conducted with stricter criteria, requiring the updating of numerous real estate data. It was established in the course of this audit that the form and practical implementation of the early#warning system did not yet meet legal requirements.

(62) When in 1994 the various divisions were brought together under BGB’s roof, this was because the *Land* of Berlin, as shareholder, wanted to create a strategic entity with as many synergy effects as possible. It was not possible

to set up a standardised institution under the Banking Law without forgoing, pursuant to Section 40 of that Law, the name 'Berliner Sparkasse' and BerlinHyp's mortgage bond privilege. The absence of a single management feasible under company law meant that group#wide risk management could be introduced only in stages. There were also technical IT constraints and delays in establishing adequate data quality. Risk management received little support and had to compile risk#relevant data manually. It was therefore potentially always subject to error, was incomplete and was characterised by long lead times. Internal rating procedures were not validated using statistical methods.

(63) The introduction of efficient risk monitoring and a new data bank system by the end of 2002, however, constituted an operational guarantee that future problems could be identified and corrected in time. All activities of the entire group relevant in credit risk terms were consolidated in a risk register data bank. These data formed the basis for a limit management system for assessing credit risks for their risk potential and subjecting them to various limits. An information platform was therefore available on a same#day basis for all credit risk assessments. On this basis, a new credit risk report was developed for the executive and supervisory boards. The rating procedures had been completely reworked in cooperation with the DSGV and the German *Landesbanken*. The extensive exchange of managerial staff and the reduction in areas from 63 to 34 also helped to improve risk control.

(64) Simplifying the group and management structures and introducing efficient control systems involved, among other things, structural improvements in the areas of corporate governance, risk control, control/management of the real estate services subsidiaries and alignment of the IT infrastructure. Under the new structure, BGB itself would in future cover wholesale and real estate financing activities and centralise the staff. Landesbank Berlin would combine all marketing activities, including the entire corporate and private retail segment, but with the exception of the wholesale business and commercial real estate financing. The objective of a single management for the group had largely been achieved. Measures to improve structural and operational processes consisted in the appointment of a Risk Review Committee to conduct a comprehensive analysis of all the group's risks, the establishment of an independent risk register area to assess operational risks and the setting up of risk management units in the corporate banking and real estate financing business areas. A project team was also set up to deal with problems identified in audit reports. Existing loans at significant risk would in future be monitored centrally by the risk management area to improve risk assessment.

(65) Target yields before tax of around 6 to 7 % (according to the original notification) or [...]** % (according to the revised medium#term plan of 24 June 2003) for BGB in 2006 were sufficient. Yield rates before tax in Germany in the period from 1995 to 2000 ranged from 12,6 % to 17,6 % for regional banks/savings bank and from 13 % to 16,5 % for all banks (top 100).

Over time, however, a reduction in equity return could be observed. In the regional banks/savings bank sector in particular, it had fallen from 17,6 % in 1995 to 12,6 % in 2000. Given the worsening of the economic situation that followed and the faltering consolidation process in Germany, the figures in the following years remained lower, ranging from 7 % (2001) to 8,5 % (2006) for regional banks/savings banks and from 9,9 % (2001) to 12 % (2006) in the sector as a whole. For regional banks/savings banks, the potential for recovery was severely restricted both by the loss of institutional liability and guarantor liability (*Anstaltslast* and *Gewährträgerhaftung*) and by Basle II. The target yields before tax of around 6 to 7 % (according to the original notification) or [...]** % (according to the revised medium#term plan of 24 June 2003) were not directly comparable with the yields of competitors since BGB's core#capital ratio during the restructuring phase contained a 'safety buffer' to ensure refinancing on the capital market, partly to offset the total absence of hidden reserves. Consequently, the future core#capital ratio of [...]** % had to be significantly higher than the average core#capital ratio of 6,1 % for regional banks/savings banks in the period from 1995 to 2000. As a result of the safety buffer of some [...]** %, the equity return — for the same pre#tax earnings — also fell by about [...]** % compared with competitors since the pre#tax earnings related to a larger amount of own funds.

(66) The mere fact of being publicly owned did not call into question the possibility and value of restructuring the group. Giving black marks to public undertakings ran counter to Article 295 of the EC Treaty. Possible unlawful use of influence in connection with public ownership would be investigated by a parliamentary committee and by the Berlin public prosecutor. The *Land* of Berlin also intended to privatise BGB.

(67) Furthermore, LBB's business activity would be critically influenced by two special factors. First, under Section 3(6) of the LBB Law, it would in future have to continue to carry out development activities such as promoting saving and managing giro accounts also for private customers with limited creditworthiness (accounts for the man in the street). As a result, it had a disproportionately large number of customers in low#income brackets, and this significantly affected its yield potential. Changes could be made only over a long period of time. Second, it was still burdened by the structural weaknesses in the economy of the Berlin region, which were reflected in income per private customer that was some 15 % lower than the national average. Most of its competitors in Berlin could offset this through their presence in other regions. The takeover of the former Ost#Berliner Sparkasse gave LBB a far higher share in eastern Berlin, which was particularly weak structurally. Of LBB's customers, 55 % were from eastern Berlin, although they accounted for only 37,5 % of all Berlin residents. These special factors would continue to play a role after any privatisation.

(68) On the basis of the revised medium#term plan of 24 June 2003, Germany also provided a quantification of the effects of the proposals by the Commission's advisers (e.g. increase in risk provisioning), of the divestment of the real estate services business, to which it was already committed, and the hive#off of IBB, finding that the medium# to long#term effects of these three measures were insignificant.

(69) At the Commission's subsequent request, Germany and the bank outlined further the consequences of a separate sale of Berliner Bank by 2005 for the survival of the rest of the group. In Germany's view, this sale would have a negative effect on the group's medium#term plan. In total, there would be one#off effects in the period 2003 to 2005 of around minus EUR [...]**, [...]** of which would be accounted for by the extraordinary costs of the sale and the remainder by reserves for staff, IT, buildings and additional restructuring costs. In the medium to long term, the planned result before tax in 2006 of EUR [...]** (according to the revised medium#term plan and on the basis of the above three measures) would fall by about EUR [...]** to just under EUR [...]**, [...]** of this amount on account of the loss of Berliner Bank's income to the group and the remainder on account of the delays in staff cutbacks, the loss of the planned increase in fee income and remaining (fixed) costs (especially in the context of back#office diseconomies of scale). The return on equity would decline by [...]** percentage points to [...]** % in 2006. This calculation was based on the assumption that Berliner Bank would be sold as an independent bank to maximise the number of bidders, something which would entail higher costs than the sale of assets or of an operating division. Furthermore, the hive#off of Berliner Bank would reduce the retail business's share in the profits of BGB as a whole from a little over [...]** % to around [...]** %, while there would be a corresponding increase in the share of the capital market business from a little over [...]** % to around [...]** %.

(70) The Commission asked Germany and the bank to quantify the consequences of a separate sale of BerlinHyp by the end of 2006 for the survival of the rest of the group. According to Germany and the bank, this would have the following negative consequences for the rest of the group or would impose the following requirements, which the buyer could not necessarily meet: the buyer would have to take over as far as possible internal refinancing (currently some EUR [...]**) on comparable terms, i.e. have at least as good a rating as Landesbank Berlin, and BGB's guarantee for BerlinHyp in order to avoid applying the methodology for large credits (current estimated volume: about EUR [...]**). The buyer would also have to offer at least the book value of BerlinHyp as the purchase price since otherwise book value write#downs of [...]** might result, endangering the survival of the rest of the group. Even a negative outcome of the bidding procedure would involve a risk of further book value write#downs. A sale without serious consequences for the restructuring plan would be possible only if the marketing cooperation between BerlinHyp and the

group could be maintained. An obligatory separate sale would require a one# off write#down of the current book value of EUR [...]** by EUR [...]** to the book value of BerlinHyp's own funds of EUR 519 million. The expected earnings before tax in 2006 for the rest of the group would fall by a further EUR [...]** or so (difference between the loss of BerlinHyp's expected income of about EUR [...]** and the interest income from the expected proceeds of the sale of about EUR [...]**). This, together with the separate sale of Berliner Bank, would result in a further fall in the target equity return in 2006 for the rest of the group of some [...]** %, to just over [...]** % in all, and a core# capital ratio of just under [...]** %.

Avoidance of undue distortions of competition

(71) Germany submitted a 'medium#term plan' for the development of individual balance#sheet and profit#and#loss account items during the period from 2001 (actual situation) to 2006 (planned situation). It updated the plan several times in the course of the proceedings in line with the further sales, closures and reduction measures that were promised. The revised medium#term plan submitted in June 2003, which already takes into account the divestment of the real estate services business and of IBB as well as all the measures originally intended, suggests the following consequences in individual business areas over the restructuring period 2001 to 2006. The various items listed in the medium#term plan are presented here by way of illustration mainly in terms of segment assets and number of employees only.

(72) In the private customer segment, assets were to fall (by EUR [...]** or EUR [...]** %) from a little over EUR [...]** to just under EUR [...]** as a result of sales, closures and other reduction measures. Around 90 % of this fall was accounted for by sales of holdings (in particular in Allbank, Weberbank, BG Polska and Zivnostenska Banka). The workforce was to be cut by a disproportionately high figure of [...]** %. These figures take no account of the sale of Berliner Bank, promised for a later date.

(73) Assets in the other retail banking segment, corporate customers, i.e. business with small and medium#sized enterprises (rather than large customers), were expected to fall from almost EUR [...]* in 2001 to around EUR [...]* in 2006 (down by just under [...]* %). At the same time, the number of employees would be reduced by just over [...]* %. Once again these figures take no account of the promised sale of Berliner Bank.

(74) The compensatory measure in the real estate financing sector consisted mainly in a reduction in the risk portfolio and a refocusing on less risk#prone business. This was to reduce the segment assets by around [...]* %, from around EUR [...]* in 2001 to around EUR [...]* in 2006. The workforce is to be cut by around [...]* %.

(75) Scaling back the capital market business would lead to a reduction in the workforce of around [...]* %, while the segment assets would fall by

approximately [...]* %, from around EUR [...]* in 2001 to around EUR [...]* in 2006. Compared with the original plan, there was to be a stronger emphasis on less risk#prone business. Segment liabilities would be reduced disproportionately by over [...]* %.

(76) With the gradual winding#up of the large/foreign customer business the assets in that segment would fall by about [...]* and the number of employees would be cut by around [...]* %. Items still remaining at the end of the restructuring phase, mainly as a result of long#term contracts and agreements, would be reduced further after 2006.

(77) In the public sector business sector, abandonment of all supraregional business reduced the assets in that segment by almost [...]* %. This sector was to be assigned to corporate business.

(78) The planned divestment of real estate services, which was offered as an additional compensatory measure, will reduce the segment assets almost to zero.

(79) Combined with further reductions in asset items, e.g. in interest rate management or through the divestment of IBB's government assistance business (around EUR 20 billion of segment assets), and the effects of consolidation, these measures would reduce the balance#sheet total by some EUR [...]* — or [...]* % — from around EUR 189 billion in 2001 to around EUR [...]* in 2006. Leaving aside the divestment of the IBB, it being doubtful whether it qualified as a compensatory measure,[19] the balance#sheet total would fall by about [...]*.

(80) On the question of market shares, private and corporate retail banking were regional businesses, and so the relevant market shares referred to Berlin. By contrast, real estate financing and the capital market business formed national — and, in the latter case, largely international — markets. Compared with the figures submitted in the notification, the market shares in private and corporate business in Berlin were revised downwards (to between a little 20 % and over 40 % in the private business sector and just over or just under 25 % in the corporate business sector), as BGB's reports to the *Land* central bank on the statistics used to calculate them failed, according to Germany, to give the requisite regional and thematic breakdown (see paragraph 291 et seq. below).

(81) BGB's share of the Berlin market in loans to private customers was expected to increase slightly by 2006, accompanied by only a slight dip in its share of the deposit business market. The reason for this was a refocusing of BGB's business activities on the Berlin market. However, at the same time it would withdraw completely from the supra#regional market in line with the restructuring plan. The compensatory measures in the private customer sector would have barely any impact on the Berlin market shares, as reductions here primarily affected supra#regional operations.

(82) In the corporate business sector, the market share for loans would contract slightly between 2001 and 2006, while the share of the deposit market would remain almost constant.

(83) In the real estate financing sector, the national market share indicated initially had to be revised, on the basis of updated statistics, from around 5 % to around 3 %, falling further to around 2 % by 2006. There would probably be no change in the capital market sector by 2006.

(84) In the course of the proceedings, Germany stated that BGB had examined very closely the possibility of further compensatory measures. However, apart from the sale of the real estate services business — promised at an earlier stage, but not part of the original plan — no further compensation was possible [...]*.

(85) Overall, according to Germany, the compensatory measures were also appropriate. The total amount of aid used as a point of reference for assessing its appropriateness included the EUR 1,755 billion capital injection by the *Land* and the aid value of the risk shield, which in a worst#case scenario was equivalent in financial terms to EUR 6,07 billion. As remuneration for the risk shield, BGB would pay a guarantee commission of EUR 15 million each year.

(86) In its decision to initiate proceedings, the Commission had used as an indication of market distortion the scope for extending business on the basis of the solvency ratios required under banking supervisory legislation. However, Germany argued that the assumption that a core capital injection of EUR 1 billion could boost the risk#adjusted assets by up to EUR 25 billion could not be inferred directly from the basic rules of banking supervisory legislation. Only if core and supplementary capital were injected simultaneously could a bank boost its risk#adjusted assets by 25 times the amount of the core capital injection. Unless a bank had previously ineligible supplementary capital corresponding to the amount of the core capital injection, it was impossible *a priori* to apply a factor of 25. It was wrong to regard an extension of business that was possible only as a result of supplementary capital that was available to the bank in any case as a market distortion caused by an injection of core capital classified as aid. It was therefore considered that, from the very outset, the maximum possible market distortion should be set at no more than 12,5 times the amount of aid granted in the form of a capital injection.

(87) The *Land* of Berlin injected only core capital totalling (EUR 1,755 billion) into BGB, and not supplementary capital. The core capital injection meant that the previously ineligible supplementary capital of EUR 877,5 million could be taken into account. But, as explained above, this could not be regarded as market distortion caused by the core capital injection.

(88) Moreover, the (theoretical) core#capital ratio of 4 % and the own#funds ratio of 8 % constituted the minimum capital base required by law. Institutions needed a much larger capital base if they were to run an orderly business and

to have the room for manoeuvre necessary to operate in the financial markets. BAFin estimated that, from a market standpoint, BGB required at the time a core#capital ratio of [...]* % and an own#funds ratio of [...]* % in order to guarantee its liquidity and safeguard the restructuring process (cf. letter from BAKred dated 29 June 2001).

(89) On the basis of these considerations and the relevant capital ratios, the capital injection would cause market distortion equivalent to around EUR 18 billion (core capital injection of around EUR 1,8 billion multiplied by a factor of about 10).

(90) In response to the Commission's decision to initiate proceedings, Germany had already proposed as a further compensatory measure that the real estate services businesses (IBAG, IBG, LPFV) be separated from BGB. The effect of the risk shield was focused on the real estate services sector, which in itself was not subject to the solvency ratio requirements and could just as easily be carried out by another company not authorised to engage in banking. The risk shield related to old business, mainly investments already placed, and not to new business. It could though be argued that new business was possible only because of the risk shield. But in that case the size of the market distortion could be no more than the total volume of new business. In 2002 IBV was expected to sell fund investments totalling EUR [...]*. Bavaria anticipated a total project volume of EUR [...]* in 2002. IBAG's new business amounted to around EUR [...]*. At most, IBAG's new business up to the end of the restructuring period (end of 2006) could be attributed to the risk shield. After that, IBAG would be an efficient, reorganised undertaking able to compete in the market. So the risk shield could be regarded as constituting a market distortion only in relation to IBAG's new business up to the end of 2005, i.e. a total of EUR [...]* from 2002 to 2005. This total volume of market distortion lay between the best# and worst#case scenarios for the actual cover provided by the *Land* of Berlin under the risk shield (EUR 2,7 billion and EUR 6,1 billion respectively). In determining the market distortion caused by the risk shield, the Commission should therefore take as a basis the value established for IBAG's new business up to the end of the restructuring period, i.e. EUR [...]*. Otherwise, the market distortion caused by the risk shield could be estimated at best on the basis of the aid value of the risk shield in the worst# case scenario (EUR 6,07 billion).

(91) Accordingly, the market distortion to be taken as a starting point for assessing the compensatory measures consisted of:

— a new amount for BGB in the form of the capital injection: EUR 18,3 billion,

— a new amount for the real estate services sector — to be divested — in the form of the risk shield: EUR [...]* to EUR 6,1 billion.

(92) In its decision to initiate proceedings, the Commission had assumed that BGB enjoyed an extremely strong market position and had drawn appropriate consequences for the determination of compensatory measures. However, this

assumption, based on the information then available, was not borne out by the low market shares actually held by BGB. Overall, the proposed measures to offset the market distortion appeared to be appropriate, even allowing for any possible state aid implications that WBK's assets might have for LBB.

(93) Germany also argued that on competition grounds it was inadvisable to sell Berliner Bank before selling the *Land* of Berlin's shares in BGB. The remedies in the retail sector were sufficient: divestment of Weberbank, Allbank and the foreign subsidiaries BGB Polska and Zivnostenska Banka, the relinquishing of the six German private customer centres and the closure of around 90 branches, predominantly in Berlin. Moreover, the compensatory measures as a whole were in line with or went even further than the demands placed by the Commission on banks in previous restructuring decisions.

(94) After further objections from the Commission, especially in view of the fact that the closures and sales already undertaken or still to be implemented left BGB's position in the Berlin retail banking market virtually intact, Germany and the *Land* of Berlin finally agreed to sell the Berliner Bank after all. In so doing, Germany promised to ensure that the Bankgesellschaft group sold the 'Berliner Bank' division as an economic unit, including its trade mark, all customer relations, branch offices and accompanying staff, by way of an open, transparent and non#discriminatory procedure, with the sale to be legally effective by 1 October 2006.

(95) The divestment of Berliner Bank will reduce the assets in retail banking by EUR [...]* (EUR [...]* in the private customer sector and EUR [...]* in the commercial customer sector). Together with the measures already planned, the reduction in the assets will amount to EUR [...]*. The balance#sheet total will be reduced from EUR 189 billion to EUR [...]* billion.

Aid limited to the minimum necessary

(96) Germany argued that the risks had not been overstated in the course of the restructuring, although they were based on the information on LPFV available in January 2002. Assessment of the risks could change during the period covered by the guarantees as a result of macroeconomic factors and intensive real estate management. However, LPFV's indemnification agreements with IBG and the detailed arrangements of the *Land* of Berlin's risk shield for LPFV served to ensure that only the actual claims on guarantees by the *Land* of Berlin were refundable. The *Land* of Berlin had the right to intervene and issue instructions in respect of LPFV in order to guarantee high#quality management.

(97) Furthermore, appropriate control measures had been introduced to rule out multiple risk coverage in practice. The risks arising from renewal and the right of offer were not cumulative but interchangeable. This factor was taken into account in the description of LPFV's risks. However, there was actually multiple risk coverage in the case of rent guarantees and credit guarantees for

the BGB group. LPFV verified claims on rent guarantees to ensure they were legally and factually in order and calculated correctly. Since January 2003 the BCIA Berliner Gesellschaft zum Controlling der Immobilien#Altrisiken mbH, wholly owned by the *Land* of Berlin and acting on its behalf, had carried out checks to rule out simultaneous calls on the loan guarantee. All services performed by LPFV for which the *Land* had assumed obligations were checked by BCIA in detail from a legal, factual and accounting standpoint, with further checks on the legality of each claim on the credit guarantee and on balance#sheet guarantees. BCIA provided the *Land* with a powerful and effective means of minimising damage, as the *Garantiegesetz* (Guarantee Law) of 16 April 2002 explicitly stated that no payments may be made to third parties in connection with risk#shielding, except where there is a legal obligation to do so.

(98) More specifically, under the detailed agreement, the *Land* or BCIA, on whose activities the *Land* Parliament must receive a report every quarter, enjoyed the following rights with regard to approval, inspection, the issuing of instructions, etc. vis#à#vis companies protected by the risk shield, the exercise of which was more closely regulated by a regulation on responsibilities and procedures:

— right to reserve approval of payments on loan commitments, where certain value limits were exceeded,

— right to have a say in drawing up the positive list and the annual accounts for balance#sheet guarantees,

— right to reserve approval of sales of assets underlying the book value guarantee, where certain value limits were exceeded,

— right to reserve approval of investments which lead to additional acquisition and production costs, where certain value limits were exceeded,

— right to reserve approval of certain payments by LPFV,

— right to issue instructions to IBG and LPFV on protection against claims,

— right to reserve approval of assignments and other measures concerning claims arising from the detailed agreement,

— comprehensive rights to information and inspection,

— right to reserve agreement on the appointment of auditors by IBG, IBAG and LPFV,

— right of audit by the Berlin Audit Court (*Rechnungshof*),

— right to reserve approval of restructuring operations.

(99) The bank made its own significant contribution by selling assets or subsidiaries which were not essential for its long#term viability. The holdings in question were both substantial and profitable and were sold by open and transparent procedures. It was also planned to sell the real estate services business. BGB could make no further contribution of its own, having already

done its utmost in 2001 to counter the extensive loss of own resources and to prop up its own#funds ratio by reducing its risk#bearing assets.

(100) The core capital and own#funds ratios targeted from 2003 under the restructuring plan and provisionally approved as rescue aid were also necessary. If the undertaking was to survive and obtain a solid rating from rating agencies, it was vital that it achieved the provisionally approved core#capital ratio of 5 % and the own#funds ratio of 9,7 % and, from 2006, the target core#capital ratio of around 7,5 % and the own#funds ratio of around 12 %. Given [...]* and BGB's [...]* liquidity situation, an above#average capital base was essential if [...]*.

(101) Between 1995 and 2000 the average core capital and own#funds ratios of *Land* banks/saving banks ranged from 5,7 % to 6,8 % and from 8,9 % to 10,2 % respectively. BGB's provisionally approved core#capital ratio of 5 % was therefore below the long#term average of comparable banks, while the provisionally approved own#funds ratio was a mere 0,1 % above the mean value for the years 1995 to 2000. These ratios appeared to be very conservative and failed to take account of BGB's specific problems.

(102) In the market as a whole, i.e. private and public banks in Germany, solvency ratios ranged between 6,3 % and 7,3 % (core#capital ratio) and between 10,4 % and 11,3 % (own#funds ratio), partly because of the absence of guarantor liability in private banking. Even before the guarantor liability for public banks was discontinued, it was likely that the solvency ratios of *Land* banks/saving banks would gradually be aligned on the higher ratios of private banks. As a result, the average own#funds ratios of *Land* banks/saving banks would *ceteris paribus* increase from 9,6 % to around 10,9 % in 2006. The restructuring plan estimates BGB's own#funds ratio in 2006 at [...]* %; on this basis, BGB's own resources cushion would be reduced to no more than around [...]* %.

(103) When it came to assessing the own#funds ratio, what counted therefore was not the statutory minimum of 8 %, which BAFin had in fact increased to 8,4 % and which, allowing for volatility, actually lay around 8,6 %. Instead, the capital market and rating agencies tended to use appropriate benchmarks which entailed considerably higher own#funds ratios and hence reduced the apparently large own resources cushion from just under [...]* % to around [...]* %.

(104) An above#average own#funds ratio in 2006 was vital [...]*. Rating agencies attached considerable importance to capital structure and in the past have called for improvements in BGB's core#capital ratio. Given the close correlation between the financial strength rating and the long#term rating, on the one hand, and the forthcoming end of guarantor liability, on the other, a significant improvement in the financial strength rating was required to avoid negative consequences for the scale and cost of refinancing. Moreover,

the reappraisal of risk#bearing assets under Basel II would probably result in a higher own resources requirement from 2006 onwards because of the increasing volatility of risk#bearing assets.

IV. COMMENTS FROM OTHER INTERESTED PARTIES

(105) In response to the publication of the decision to initiate proceedings in the *Official Journal of the European Communities*, the Commission received comments from two other interested parties, namely Berliner Volksbank and a third party which asked for its identity to be kept secret.

Comments from Berliner Volksbank

(106) Berliner Volksbank argued that there could be no question of authorising the notified restructuring aid under Article 87(3) of the EC Treaty. The aid was also not covered by the statutory arrangements of institutional liability (*Anstaltslast*) and guarantor liability (*Gewährträgerhaftung*) and hence was not existing aid.

(107) The aid measures for BGB were on a completely new scale. The bank's financial difficulties were due in the first place to its extremely exposed business in closed#end real estate funds. The reason for BGB's losses was that virtually no checks had been made when the property had been acquired. Yet investors had been guaranteed an income. The undertaking had been regarded throughout the Federal Republic as the market leader — primarily, in all probability, on account of the favourable conditions for investors.

(108) Restructuring aid could be justified in individual cases given the serious negative consequences of a bank failure for the banking system and public confidence. Unlike in previous cases decided by the Commission, however, the aid recipient here operated on a limited regional scale so that the effect of the aid was concentrated on only a few competitors. These would be hit all the harder by the distortive effects, especially Berliner Volksbank, which competed with the BGB right across its business.

(109) The level and intensity of the aid should be limited to the minimum necessary for the restructuring. But this was not apparent. The *Land* guarantee for risks in the property sector was an unlimited additional funding commitment since the *Land* of Berlin's associated liability could not currently be estimated and was therefore a 'blank cheque' for future losses. No excess liquidity could be allocated to the undertaking, however. Given its amount (EUR 21,6 billion) and its duration (30 years), the guarantee was already disproportionate: it gave the bank virtually unlimited creditworthiness and distorted competition quite considerably. By being completely indemnified against the risks of property servicing in operational banking, BGB was receiving an 'unconditional licence' to submit offers on whatever terms it wanted, e.g. when selling or leasing property. Even if the bank were to make losses in the process, these would be fully compensated by the *Land* of Berlin. Consequently, the guarantee was an additional funding commitment of unlimited amount which,

by its very nature, could not be authorised and which was also not defined in the underlying legislation. In addition, the capital injection combined with the risk#hedging guarantee provided double cover. When determining the grant equivalent of the guarantee, the fact that much of it would definitely be used should be taken into account. In the least favourable scenario, the *Land* was assuming EUR 6,1 billion. Since it was realistic to expect that the guarantee would be invoked (though, plainly, a precise figure could not be given), its aid intensity would correspond to the nominal amount.

(110) The market for financial services was characterised by strong competition on terms, with considerable pressure on margins. It was therefore to be expected that BGB would pass on the full advantage conferred by the aid to the market and thus considerably distort competition to the detriment of its competitors. This was a particular cause for concern because the aid was being granted to the market leader in the Berlin/Brandenburg region, whose market share in that region relative to the lending business as a whole was, on BGB's own estimation, just under 50 % and which owned just over 50 % of all branches of credit institutions in Berlin. BGB was a direct competitor of Berliner Volksbank in the latter's main fields of business, i.e. personal banking and banking for medium#sized corporate clients, and already had a market share many times larger than Berliner Volksbank's. The aid thus contributed to a further economic 'consolidation of power' in the Berlin banking market. The bank's comparatively strong market presence was also a consequence of the multibrand strategy of BGB, which was operating with several institutions under different brands or business names. BGB was pursuing a business strategy which had detached itself from profitability strategies and, through its subsidised conditions, had become predatory.

(111) Because it lacked a cogent plan for a sustained recovery, the proposed restructuring programme would not restore the long#term profitability of the undertaking. It was based on overly optimistic assumptions, was not sufficiently specific and overemphasised positive aspects. Moreover, it was not suited to ensuring the long#term profitability and hence the viability of the undertaking since it set out to achieve a target profitability of only some 6 to 7 %, which was only half as much as the usual average for the sector. Lastly, the restructuring programme did not mention future aid reimbursement obligations associated with the pending investigation of the transfer of WBK to the *Land* bank in 1993.

(112) Insufficient attention was paid to the need, identified in the Commission's guidelines, to reduce the adverse effects on competitors by limiting the presence of the aid recipient on the relevant markets after restructuring since business activities in the relevant markets would actually expand. The restructuring programme would make it possible to increase profits in the private and corporate customer segments and to compensate for the closure of various sites outside Berlin, in particular by focusing and expanding those

activities in Berlin. BGB was planning to retreat only from those geographic markets in which it had not so far acquired considerable importance. The announced closure of branches might not lead to a reduction of BGB's market presence but it corresponded more to a general trend in the markets for financial services in Germany, which was regarded as 'over#banked'. The extent of the remedies to be provided by BGB would have to be calculated using its current dominant position in the Berlin banking market, since this was where the distortive effects were strongest. As a condition for offsetting the distortions caused by the aid, the Commission should consider the sale of part of the BGB group. One possibility would be to sell Berliner Bank, which in the relevant market segments had market shares similar to those of Berliner Volksbank. The advantage of selling Berliner Bank was that, organisationally, the institution was largely independent and had its own entrance to the market; it could therefore be taken over by a competitor with relative ease. Given the amount of aid, the size of the business sold off would be appropriate compensation for the aid's considerable distortive effects.

(113) Along with the public liability guarantees (*Anstaltslast* and *Gewährträgerhaftung*) and the transfer of Wohnbau#Kreditanstalt to the Berlin *Land* bank, the present aid measure was only one of the many financial public support measures for BGB. This resulted in a combination of aid which would also have to be taken into account in determining the remedies for the granting of the restructuring aid.

(114) Raising the own#funds ratio to 9,7 % was not essential. Only the 8 % minimum laid down in the German Banking Law (*Kreditwesengesetz*) was legally binding and, in the words of the guidelines, the 'strict minimum needed'.

(115) The combination of risk hedging and capital injection was not essential since the former by itself would cover the risk of losses in the property sector. The capital injection led to the *Land* of Berlin compensating for losses twice over. BGB might use the additional funds obtained for other business segments.

(116) Furthermore, there were indications of other aid. The *Land* government was negotiating with selected investors over the takeover of the bank. The sale was not at the market price since the tendering procedure was not open to all, was not transparent and was not being conducted without discrimination.

Comments from a third party that asked for its identity to be kept secret

(117) The bank's future strategy seemed in particular to be to reduce its activities, capacities and infrastructure and to concentrate on regional personal and corporate banking. This plan could be based only on the assumption that these regional markets and the bank's share of them would grow. There were some doubts and contradictions, however, about the bank's shares of these markets. It was also unclear whether the bank could build on a sound customer basis at all. The Berliner Bank brand had weaknesses in this respect. Because

of the problems of the property financing business in the past, there were doubts about its future success. Maintaining a large share of the capital market business was not typical of a regional bank.

(118) The successful implementation of the restructuring programme depended substantially on whether it managed to achieve the ambitious plans for reducing staff, introducing a new risk control system and improving information systems. There was a question mark against this, however, since staff reduction measures to date had not achieved their targets and since resistance from employees and unions was to be anticipated. Moreover, many of the reductions to date were attributable to outsourcing measures, but no long#term reduction in costs could be expected from these. Rather, it should be reckoned that the costs of the transferred workers would have to be borne by the bank in the form of higher service charges.

(119) In the future, the bank had to be able to compete in the marketplace on its own merits, in accordance with point 34 of the guidelines. There were doubts whether the target return on own resources of 7 % for 2006 was sufficient for this. It could not be assumed, therefore, that long#term viability would be restored. Nor could that low return be justified by the performance of public functions by the savings bank since these were irrelevant to an assessment of the return.

(120) With continuing public ownership, there were considerable doubts as to whether the bank's viability could be restored and guaranteed. The *Land* of Berlin would be exposed to considerable political pressure when terminating employment relationships. In general, it would not be able to implement the restructuring plan. The bank's bodies would still have political appointees on them, which would give rise to conflicts of interest. Even if it were taken over by another German regional bank, these problems would continue.

V. GERMANY'S REACTION TO THE COMMENTS OF OTHER INTERESTED PARTIES

(121) Germany commented on the observations of Berliner Volksbank and the anonymous third party. Berliner Volksbank's submission about alleged existing aid was unfounded. There were no substantial financial resources that had been built up through alleged aid. Otherwise the group would not be in difficulties. Further, the Commission had assessed the liability systems of institutional liability and guarantor liability as existing aid and these should not therefore be regarded as encumbering BGB. The capital injection provided through the rescue aid would indeed be made available to the bank permanently, but this was in accordance with the guidelines and the Commission's practice as regards restructuring aid. The transfer of WBK to LBB was being investigated by the Commission in a separate proceeding but was not described by Germany as aid.

(122) While BGB had a relatively strong position on the Berlin banking market in both personal and corporate banking, its market shares were not as high as Berliner Volksbank claimed. The market shares based on volumes were clearly smaller than those based on customers since Berliner Sparkasse had many accounts with small credit and deposit volumes, which was proving to be more of an additional cost factor.

(123) The restructuring programme was fully documented in sufficient detail. Germany viewed the current programme as a stable basis for ensuring BGB's profitability. The profitability of the entire banking sector in Germany had declined significantly on account of the difficult general economic situation. The average return on own funds had fallen from 11,2 % in 1999 to 9,3 % in 2000 and to as little as 6,2 % in 2001. In the Federal Government's communications, the results of each business segment for the period 2001 to 2006 were consistently shown separately and were derived in comprehensible stages. The general layout followed the same pattern: total earnings, operating result before and after provision for risks, and pre#tax profit.

(124) The steps necessary for implementing the restructuring programme were being planned by BGB in two stages:

— at conceptual level, it had first of all worked out a subdraft for each of the current business segments, irrespective of whether it was to be kept, liquidated, reduced or sold,

— at a practical level, it had then allocated to each subdraft specific measures necessary for its implementation and costed them in turn.

(125) Thus a complete draft was available. Since then, the individual measures had been filled out, with more detail added at segment level, and incorporated in a comprehensive overall plan. Two special instruments which complemented the usual monitoring of results had been developed for implementation purposes: one for general measures and the other for personnel measures. These made it possible to compare planned and actual values on a monthly basis and hence to run a permanent check on the success of the implementation.

(126) Only property financing was regarded by the bank as a typical task for a regional bank. This did not include property services, which was where the losses that had originally made the reorganisation of the bank and the authorities' risk shield necessary had largely occurred. BGB had offered to sell this business segment as a compensatory measure. The provisioning ratio in respect of real estate loans was not too small.

(127) In future, several measures would be taken in new and existing business and as regards monitoring in order significantly to reduce the risks in the property financing segment. As regards new business, activities would be concentrated at attractive locations, risk diversified by interregional

activities within Germany, foreign business largely terminated and high#risk segments, especially building, discontinued. In the existing business sector, risk specialists would be used for troubled exposures and asset portfolios would be critically reappraised and revalued. As regards controls, risk monitoring throughout the group would be introduced which would in turn provide the framework for individual control instruments. These included a limitation system for market and counterparty risks, an early#warning system, reorganisation strategies and a task force for exposures affecting more than one banking subsidiary.

(128) Contrary to Berliner Volksbank's view, the restructuring would lead to a reduction of market presence since the large customer and public authority segments would be discontinued and other segments reduced. It did not make sense commercially to discontinue the retail business segments since that would impair the undertaking's core business and hence jeopardise privatisation prospects. In addition, market presence in the retail segments would not be increased. The bank would withdraw completely from Brandenburg, except for Potsdam. In the *Land* of Berlin its market presence was being appreciably reduced through branch closures.

(129) The risk shield was not a 'blank cheque for future losses' since the risks covered by it were all existing risks. Risks from transactions conducted after 31 December 2001 were generally not covered, and risks from real estate funds were covered only if the fund concerned had been invested in before 31 December 2000.

(130) Nor was the risk shield an 'unconditional licence to submit offers on whatever terms it wanted, e.g. when selling or leasing property'. In Articles 17(2), 35(2) and 42(5) of the detailed agreement there were several conditions that were dependent on the *Land*'s consent. Moreover, Article 46 laid down a comprehensive 'avoidable consequences' requirement whereby the beneficiary companies were obliged to do their utmost to keep the *Land*'s involvement as small as possible, to utilise the assets covered by the book# value guarantee as favourably as possible and to lease or otherwise use property items on optimum terms. Infringement rendered the company concerned liable for damages.

(131) The risk shield did not constitute an unlimited additional funding commitment. Unlike an additional funding obligation under company law, for instance, the *Land* of Berlin's obligation under the risk shield was limited as to its total and its object, namely to those risks which were exhaustively listed in the detailed agreement and to which funds had already been committed by 31 December 2001. The risk shield had also been made sufficiently specific. The agreement in principle of 20 December 2001 already contained a complete list of the companies entitled to the credit guarantees and the balance#sheet guarantees, and the detailed agreement had altered the list in respect of a few details only. The shareholdings and legal relationships were

enumerated in the detailed agreement and the contracts referred to in it. The extent of the risks covered by the risk shield had also been made sufficiently specific.

(132) The own#funds ratio targeted by BGB was not too high. Lenders' and investors' confidence in BGB was shaken. BGB, moreover, no longer had [...]*; normally these would be taken into consideration, together with the own#funds ratio, when assessing a bank's ability to access the capital market. Further, privatisation of the bank required that, once the *Land*'s share had been abolished, capital could be raised in the capital market on tolerable terms. This meant that the own#funds ratio must permanently be significantly higher than the statutory minimum.

(133) For the rest, the privatisation procedure contained no aid elements and revealed no shortcomings. There had been no discrimination during the procedure.

VI. ASSESSMENT OF THE AID MEASURES

State aid under Article 87(1) of the EC Treaty

(134) The capital injection, the risk shield and the contribution promised in the refund agreement were provided by the *Land* of Berlin and therefore comprise state resources. The resources were granted on conditions which would not be acceptable to a market#economy investor. The total amount involved is several billion euros, which are being made available to an undertaking in serious financial difficulties.

(135) Through the capital injection of EUR 1,755 billion, on which it could not expect an appropriate return, the *Land* increased its share in BGB from just under 57 % to about 81 %.

(136) The risk shield was granted for a period of 30 years. The guarantees agreed amount to a nominal theoretical maximum of EUR 21,6 billion. This amount covers all theoretically conceivable risks and comprises, for example, the total loss of all rents in the case of the rental guarantees (EUR [...]*), the application of full production costs for all buildings and outside facilities in the case of the renewal guarantees (EUR [...]*) or the complete loss of the guaranteed book values of IBG/IBAG and its subsidiaries (EUR [...]*). A 100 % loss of rent, the demolition and reconstruction of all buildings and a complete loss of book values are, however, even on very pessimistic assumptions, unrealistic. Germany has therefore estimated the probable take#up as follows: EUR 2,7 billion in the best#case scenario, EUR 3,7 billion in the base#case scenario, and EUR 6,1 billion in the worst#case scenario.

(137) In the course of the proceedings, Germany also communicated the basis for these estimates. For the three scenarios, assumptions are made regarding the various risks of default. In the case of rent guarantees, there are, for example, different loss#of#rent assumptions concerning inflation (actual

inflation remains lower than forecast inflation), rental shortfall or vacancies. The forecast loss of rent is EUR 1,4 billion in the best#case scenario, EUR 1,9 billion in the base#case scenario and EUR 3,5 billion in the worst#case scenario.

(138) Germany also explained that, from a commercial standpoint, the total take# up expected corresponded to the worst#case scenario, with an estimated value of EUR 6,1 billion (EUR [...]* in rent guarantees, EUR [...]* in maximum price guarantees, EUR [...]* in renewal guarantees, EUR [...]* in book value guarantees and EUR [...]* in residual amounts), and hence to the economic value of the aid. This economic value was underpinned by an alternative calculation submitted by Germany: without the guarantees in the risk shield, liability for all the risks would have had to be 'discharged' with a capital injection of some EUR [...]*# [...]*. About EUR [...]* of this capital would be accounted for by the cash value of the guarantees described above (nominal economic value: EUR 6,1 billion); EUR [...]*# [...]* by the capital injection for supporting the group banks' loans, committed for the same purpose and utilised, to property service companies (which, if the nominal theoretical extreme risks are not covered from rent, renewal and book value guarantees, would have to be attributed to the risk assets at a value of EUR [...]*); and EUR [...]* to [...]* by a security premium.

(139) Germany also explained in this connection that it was nevertheless not possible for supervisory reasons to limit the maximum liability under the risk shield to the economic value of just over EUR 6 billion. Only if the amount were EUR 21,6 billion would all conceivable risks mentioned above be covered, so that the group banks' loans to property service companies, which on account of the risks were being committed and drawn down from rent, renewal and the other above#mentioned guarantees, play no role in the calculation of the subsidiary banks' and the group's own#funds ratios because they have a 0 % weighting in the calculation and are therefore not included and also not set off against the large#scale lending limits. Limiting the maximum amount of liability to the economically realistic risk would, on the contrary, mean in supervisory terms that the credits would have to count as risk assets to the tune of EUR [...]*, the large#scale lending ceiling would be exceeded and the falling own#funds ratios would make a further significant capital injection necessary. The need, from a supervisory standpoint, to start with all the theoretically occurring risks, despite a lower economic value, was confirmed by the BAF in its letter of 7 March 2003.

(140) The Commission recognises the need, from a supervisory standpoint, to start with all the theoretically occurring risks and an amount of EUR 21,6 billion. Further, for the state aid assessment of the measure, it assumes, on the basis of the justification presented by Germany, that the aid contained in the risk shield has an economic value of EUR 6,1 billion. This amount corresponds to the realistic worst#case scenario supported by Germany with assumptions and

is thus necessary for the assessment if only for prudential reasons. In addition, a value of roughly this amount would also result if, in the alternative, the liability from risks is discharged by capital injection.

(141) With regard to the contribution promised by the *Land* of Berlin in the refund agreement, it should be noted first of all that this will apply only if the Commission concludes the LBB/IBB proceeding[(20)] with a recovery decision and if, in this case too, only the necessary amount of the reorganisation grant is paid, in order to avoid undershooting the capital ratios mentioned in the agreement in the case of LBB and/or the BGB group. Since the examination in the LBB proceeding has not yet been completed, it is not possible at the moment to determine the exact economic value of this aid. For the purposes of the competition assessment, though, the theoretical upper limit can be given as EUR 1,8 billion.[(21)]

(142) The measures make it possible to improve BGB's financial position considerably. They have so far prevented supervisory intervention, e.g. temporary closure, and the probable insolvency of substantial subsidiaries in the group and are thus likely to distort competition. With its subsidiaries, the undertaking is one of the largest German banks. In 2002 it had a group balance sheet of approximately EUR 175 billion and was ranked twelfth. In its largest segments, BGB is active at regional, national and international level. The financial services sector as a whole is characterised by increasing integration, and in substantial subsectors the internal market is a reality. Competition between financial institutions in different Member States is strong and has been getting stronger since the introduction of the single currency. The measures and their effects on actual and potential competitors distort — or threaten to distort — competition. The distortions of competition thus also affect trade between Member States. The measures therefore constitute state aid under Article 87(1) of the EC Treaty. Germany has not questioned this view.

(143) In the decision to initiate the procedure, the Commission noted that not only the *Land* of Berlin but also NordLB contributed capital, although the amount was proportionately less than its shareholding prior to the capital injection (EUR 166 million, or 8,3 % of the capital increase, compared with a 20 % shareholding prior to the capital injection). The Commission could not evaluate this measure at the time because it lacked sufficient information and could not therefore conclude that the capital contributed by NordLB was also state aid within the meaning of Article 87(1) of the EC Treaty. It requested Germany to send the necessary information.

(144) Germany explained that NordLB's capital increase contained no aid since it had been made in accordance with the market#economy investor principle. Like the private shareholder Parion and the miscellaneous small shareholders, NordLB had participated in the capital increase to a less than proportionate degree, although the *Land* of Berlin and BGB had expected each to take part

in accordance with their respective shareholdings. NordLB's 20 % stake prior to the capital injection would have corresponded to a capital contribution of just over DEM 400 million. Such an exposure, however, did not seem good business to NordLB. On the other hand, to have refused to participate in the capital increase at all would have reduced NordLB's stake to 4 %. NordLB would thus have lost the participatory rights associated with a holding of at least 10 %, such as asking a court to appoint special auditors or asserting the company's claims against members of the management and supervisory boards. Further, in August 2001 NordLB had submitted an offer that 'promoted its interests' with regard to unfinished discussions on deepening cooperation and a possible merger. Without any participation in the capital increase, this would have hardly been credible. Altogether, this was a decision that carefully weighed up NordLB's business interests.

(145) Given that the relative weight of this measure in the restructuring plan is marginal and that the classification of the measure as state aid or normal market behaviour would not alter the Commission's assessment in this case, it is not necessary for the Commission to take a definite view on this issue.

(146) In the decision to initiate the procedure, the Commission pointed out that the capital injection and the risk shield together should be treated as non# notified aid, with the legal consequences of Article 13(2) of Regulation (EC) No 659/1999, since, in the detailed agreement, despite notification and the suspensory condition of aid authorisation, neither of the two measures can be suspended without attracting supervisory measures by the BAFin, such as a temporary closure of BGB. As Germany too has explained, both measures — the risk shield and the capital injection, which itself has been provisionally authorised as rescue aid — are part of a single restructuring plan. The Commission must, however, assess this as a whole and, consequently, the two measures cannot be given different legal classifications.

(147) In this respect, Germany explained in its comments that the suspensory condition leaves the legal effectiveness of the adopted schemes open, but it conceded that the capital injection and the risk shield have together produced effects because only through these measures could BGB continue in business. It also attached importance to the observation that the ban on implementing aid for firms in difficulty before the adoption of a final decision by the Commission constitutes a procedural problem in view of the duration of the authorisation procedure.

(148) As also acknowledged by Germany, the aid in its totality has produced actual effects before a final decision since only through these measures has BGB been able to continue in business. This applies not only to the capital injection and the risk shield, but also to the *Land*'s obligation to contribute under the refund agreement. Admittedly, this obligation applies only in the event of a recovery decision by the Commission in the LBB/IBB case, and only then if the amount to be recovered leads to the capital

ratios mentioned in the agreement not being met. However, the success of the restructuring, including the other two measures, would be jeopardised without such a precaution, so that this measure too, despite a suspensory condition relating to authorisation by the Commission, has produced economic effects on its conclusion and hence before the authorisation. The Commission notes, however, that through the suspensory conditions making the validity of the repayment agreement dependent on state aid approval by the Commission and the prompt transmission of comprehensive information Germany has expressed its readiness to cooperate.

(149) The financial burden imposed by the BGB restructuring plan on the *Land* of Berlin is — as will be shown below — lower than in the scenario involving use of only the existing state guarantees (institutional liability and guarantor liability) for *Land* banks. This fact, however, does not imply that the measures taken in favour of BGB are in line with the market#economy investor principle and would consequently not constitute state aid. Firstly, the existing state guarantees themselves, even if only until 2005, constitute state aid compatible with the common market[(22)]. Secondly, the Commission notes that the aid measures in question keep BGB in operation for restructuring purposes and thus benefit the entire group, including the various private#law companies. They are thus radically different in nature and scope from the pure implementation of the state guarantees, which exist only for the *Land* bank LBB, part of the group. For these reasons, all the measures under examination here constitute new state aid.

Compatibility of the aid measures with the common market

(150) Since the aid measures were not granted under an approved aid scheme, the Commission must assess their compatibility with the common market in the light of Article 87 of the EC Treaty.

(151) In accordance with Article 87(1), save as otherwise provided for in the EC Treaty, state aid or aid granted through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is, in so far as it affects trade between Member States, incompatible with the common market.

(152) However, Article 87 does allow exemptions from the principle of the incompatibility of state aid with the common market. Provided that the conditions governing exemption under Article 87(2) were met, aid could be deemed compatible with the common market. However, the aid measures under examination cannot be regarded as aid having a social character that is granted to individual consumers (subparagraph (a)), as aid to make good the damage caused by natural disasters or exceptional occurrences (subparagraph (b)) or as aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany (subparagraph (c)). These exemptions are not, therefore, applicable in the present case.

(153) As regards the exemptions under Article 87(3)(b) and (d), it is to be noted that the aid does not serve to promote the execution of important projects of common European interest or to remedy a serious disturbance in the economy of the Member State and cannot be regarded as aid to promote culture and heritage conservation.

(154) Accordingly, the Commission is vetting the aid measures in the light of the exemption in Article 87(3)(c). It is basing its assessment of aid to facilitate the development of certain economic activities, where such aid does not adversely affect trading conditions to an extent contrary to the common interest, on the relevant Community guidelines. In the Commission's view, the only guidelines applicable are those on state aid for rescuing and restructuring firms in difficulty[23] (hereinafter the guidelines). The Commission also takes the view that the measures described make a contribution to financing the restructuring of the firm and are, therefore, to be regarded as restructuring aid.

(155) According to the guidelines, restructuring aid is permissible only if it does not run counter to the Community interest. Under the guidelines, aid may be approved by the Commission only if certain conditions that are examined below are met.

Eligibility of the firm receiving the aid

(156) In the Commission's view, it has been sufficiently demonstrated that BGB is to be regarded as a firm in difficulty within the meaning of Section 2.1. (point 30, read in conjunction with points 4 to 8) of the guidelines.

(157) Point 4 of the guidelines assumes that a firm is in difficulty 'where it is unable, whether through its own resources or with the funds it is able to obtain from its owner/shareholders or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to go out of business in the short or medium term'. In the case of BGB, these circumstances clearly obtain. Although the measures in question, which benefited BGB before its business activities were terminated, were taken by the *Land* of Berlin, i.e. by BGB's majority shareholder, it had already been noted that a market#economy investor would not have provided those resources on the same terms.

(158) Without the *Land* aid measures, the capital ratios would have fallen below the thresholds prescribed by the Banking Law, with the result that BAFin (known at the time as BAKred) would have had to take the necessary measures under Sections 45 to 46a of the Banking Law, including, for example, temporary closure. Moreover, at the time the aid was granted, BGB satisfied other criteria governing the definition of a firm in difficulty under point 6 of the guidelines; these include increasing losses, mounting debt, rising interest charges and falling net asset value.

Basic principle

(159) According to point 28 of the guidelines, aid for restructuring can be granted only if strict criteria are met and if it is certain that any distortions of competition will be offset by the benefits flowing from the firm's survival, particularly where the net effect of redundancies resulting from the firm going out of business would exacerbate local, regional or national employment problems or, exceptionally, where the firm's disappearance would result in a monopoly or tight oligopolistic situation.

(160) The latter can be ruled out as regards Berlin given the number of banks doing business there and the structure of the market for private and corporate business, on which BGB in the shape of Berliner Bank and Berliner Sparkasse is still the market leader. In the event of any bankruptcy on the part of the leading regional bank and the sale of its component parts that would presumably follow, no deterioration of the economic structure is, therefore, to be anticipated. This is conceivable only in an extremely improbable and hence theoretical scenario in which, following the insolvency of one of the larger regional competitors, all the subsidiaries/assets of BGB that account for its strong regional position were acquired. Even then, however, the emergence of a monopoly or a tight oligopolistic situation is to be ruled out in view of the merger control procedure that would follow. The position of BGB on national and international markets is not sufficiently strong to result in a monopoly or oligopolistic situation following any bankruptcy and any ensuing disposals. Germany has not disputed this assessment by the Commission, which was set out in the decision initiating the procedure.

(161) As regards the economic and social repercussions in Berlin, Germany has already provided an estimate in which the impact of BGB's restructuring is compared with the impact of its going out of business/bankruptcy, especially in connection with employment and tax revenue for the *Land* of Berlin. It was claimed that an insolvency would lead to the loss of 7 200 jobs in Berlin (a decline of 59 %) by 2006, instead of the 3 200 jobs (a decline of 26 %) that would be lost in the restructuring scenario. The *Land*'s tax receipts in 2006 would fall by EUR 70 million in the event of a restructuring and by EUR 150 million if no restructuring took place. In the decision initiating the procedure, the Commission noted that it could not verify these estimates as no further explanations had been provided.

(162) Germany has provided additional information, including a calculation by the German Institute for Economic Research (DIW) according to which, if BGB had become insolvent, this would have resulted in the loss of between just over 7 000 and just under 10 000 jobs in Berlin (of the 12 200 jobs that existed in Berlin in 2001), whereas, according to the updated plan, the restructuring would lead to a loss of some 3 500 jobs in Berlin by 2006. The Commission regards as excessive the job losses assumed in the case of insolvency since in this eventuality too the business areas deemed to be fundamentally viable could have been retained by acquirers in a likewise

restructured form. Moreover, the job losses — currently estimated at some 5 000 — that would result in Berlin as a result of the restructuring are significantly higher than originally assumed. In any event, the Commission agrees with the assessment by Germany that a sudden insolvency would basically have resulted in significantly more job losses than an orderly and longer#term restructuring because a sudden insolvency would have led to 'fire sales' and the closure of areas of business that could be restructured. Account also has to be taken of the indirect job losses resulting from domino effects. Accordingly, direct and indirect tax effects would lead to annual revenue shortfalls which, at some EUR 300 million a year, can be seen as significant, especially since they continue for many years. To that extent, the Commission agrees with the Federal Government that the firm's survival will have economic and social advantages.

(163) In its notification, Germany had, in the case of a hypothetical insolvency scenario, also identified factors that would result in losses for LBB as well as the *Land*'s obligations to provide support. However, without any clear identification and quantification of these liability risks, the Commission could not make a proper assessment of these economic effects. In the course of the proceedings, Germany thus presented a legal opinion and calculations relating to the repercussions — over and above the revenue shortfalls mentioned — of a hypothetical insolvency of BGB for the *Land* of Berlin. These repercussions would materialise as a result of the very complex risk interlinkage within the firm (including internal loans, comfort letters, and profit#and#loss pooling arrangements), in conjunction with the institutional and guarantor liability for LBB that will continue until 2005.

(164) According to Germany, the insolvency of BGB would lead for LBB, which is linked to it by virtue of an atypical undisclosed holding, loans and guarantees, to losses amounting to between some EUR 18,5 billion and EUR 25 billion consisting essentially of: the declining value of LBB's claims on BGB (in the case of a balance#sheet total of EUR [...]* and depending on the default rate, some EUR [...]*# EUR [...]*) and of claims on customers (in the case of a balance#sheet total of some EUR [...]* and depending on the failure rate, some EUR [...]* # EUR [...]*); recourse to guarantees granted to BGB Finance in Dublin (some EUR [...]*# EUR [...]*); and insolvency costs (some EUR [...]*).

(165) According to Germany, this scenario would impose charges of some EUR 31 billion to EUR 40 billion on the *Land*. It was assumed here that the *Land* decides to terminate LBB's business and would, therefore, exercise not the institutional liability but the guarantor liability of the *Land*, i.e. liability for the total amount of LBB's liabilities not covered by assets[(24)]. The amount covered by the guarantor liability was estimated at between some EUR [...]* (base case) and EUR [...]* (worst case). Other charges on the *Land* amounting to between some EUR [...]* (base case) and EUR [...]* (worst case) would

result under this scenario from the claims of the Deposit Guarantee Fund of German private banks.[(25)] It was also assumed that the *Land*'s capital injection of just under EUR 2 billion would be lost and that the provision of liquidity during the winding#up would have interest#rate costs of some EUR 5 billion.

(166) The Commission has checked these figures and calculations and asked for further explanations. It has come to the conclusion that, in a hypothetical insolvency scenario, the existing state guarantees for LBB would impose on the *Land* substantial charges for which only a rough estimate could be made, with a distinction having to be drawn in any event between the subscenarios with or without the continued existence of LBB and assuming institutional liability.

(167) According to its own estimates, which are based on the figures supplied by Germany, the Commission assumes that, if LBB were to continue in business, the charges on the *Land* would be of the order of some EUR 13 billion to EUR 20 billion or more. This would comprise first the loss of the *Land*'s share in BGB's capital (just under EUR 2 billion). In addition, by virtue of its institutional liability for LBB, the *Land* would have to offset the effects of the claim represented by the guarantees granted by LBB to BGB Finance in Dublin (estimated by the Commission at some EUR [...]*) and the decline in value of LBB's claims on BGB (estimated at around EUR [...]*) to the extent that, subject to compliance with the solvency criteria, its continuing operation could be properly safeguarded. In view of the possible claims # indicated by Germany # of the Deposit Guarantee Fund of German private banks, a number of uncertainties exist — [...]*. Substantial legal doubts also exist regarding the legal validity of LBB's liability for certain third#party claims stemming from the fund business in the real estate services area (e.g. prospectus liability, exemption declarations for shareholders of investment and ad hoc companies acting in a personal capacity). Any risks cannot, therefore, be quantified.

(168) In the event of termination of LBB's business, there would be additional charges for the *Land* of approximately EUR 8 billion (some EUR 6 billion as a result of the loss in value for LBB of claims on customers as a result of liquidity problems triggered by the insolvency — virtually as a domino effect # for customers (in particular investment companies, shelf companies and residential property companies) and around EUR 2 billion by way of depreciation on participating interests).

(169) In the course of the proceedings, Germany has also claimed that, in the event of the hypothetical insolvency of the real estate service business (divestment and liquidation without the risk shield), these scenarios would not be significantly affected because of the risk interlinkage within the company. Of decisive importance here are the large amount of lending to subsidiaries in the growing and, at the same time, increasingly difficult real estate service business (IBAG/IBG/LPFV, including the IBAG subsidiaries IBV and Bavaria) by the group's subbanks (BGB, LBB and BerlinHyp),

as well as the profit#and#loss pooling arrangements between IBG and its subsidiaries Bavaria and IBV, on the one hand, and BGB and IBAG, on the other. In addition, BGB gave guarantees in respect of all the liabilities of IBG, Bavaria and IBV that were justified at the end of 1998. The Commission has no reason to doubt these observations by Germany. To this extent, it agrees with Germany that divestment and liquidation of the real estate service business IBAG/IBG/LPFV would, without the risk shield, also lead to the insolvency of BGB, together with the consequences described above, because of the risk interlinkage.

(170) Lastly, it should be pointed out that the repercussions of a hypothetical insolvency of BGB — with or without the survival of LBB — are difficult to calculate and that the estimations are subject to considerable uncertainty. The charges for the *Land* can, therefore, be estimated only roughly and range from some EUR 13 billion to over EUR 30 billion. However, taking a probable value between these extremes, it can be concluded that, with the help of the aid measures in question, a restructuring will impose less onerous charges on the *Land* of Berlin.

(171) During the proceedings Germany has not claimed that BGB or other firms in the group provide services of general economic interest within the meaning of Article 86(2) of the EC Treaty. Accordingly, as stated in the decision initiating the procedure, the Commission has assumed that this aspect is of no relevance to the assessment of the measure in question and has concluded that aid cannot be approved on the basis of Article 86(2).

Restoration of long-term viability

(172) According to point 3.2.2(b) of the guidelines, the grant of aid is conditional on implementation of the restructuring plan, which must be endorsed by the Commission in the case of all individual aid measures and examined to determine whether it is likely to restore the firm's long-term viability within a reasonable timescale. The restructuring plan must be of limited duration and be based on realistic assumptions. It must describe the circumstances that led to the firm's difficulties, thereby providing a basis for assessing whether the proposed measures are appropriate. It should enable the firm to progress towards a new structure that offers it prospects for long-term viability and enables it to stand on its own feet, i.e. it should enable the firm to cover all its costs including depreciation and financial charges and to achieve a sufficient return on its capital for it to compete in the marketplace.

(173) The Commission has based its assessment on information furnished by Germany, including detailed plans for the individual restructuring measures, forecast profit and loss accounts for the restructuring period 2001 to 2006 on the basis of a best-case, a worst-case and a base-case scenario, an analysis of the structural deficits responsible for the difficulties and the costs of the planned restructuring measures. In making its assessment, the Commission also relied on information supplied by Germany on the current

implementation of the restructuring plan and on modifications to individual measures including the scheduling of the sale of specific assets.

(174) In view of the failure of the initial attempt at privatisation and BGB's large annual loss of approximately EUR 700 million for 2002, the Commission considered it necessary, following notification by Germany at the end of March 2003, to investigate by its own means the bank's viability once more in depth and, if no clear conclusions could be drawn, to have it examined by independent outside experts. The Commission's aim was to establish with a sufficient degree of certainty that BGB can continue to compete in the marketplace on its own merits without any further state support. Without such a sufficient degree of certainty or if doubts subsist, the Commission would have to take a negative decision on all the measures at issue on the basis of the restructuring plan submitted. The failure of the privatisation process raised in particular doubts about the soundness of the remaining real estate financing business. Admittedly, the annual loss of approximately EUR 700 million (after tax) was due predominantly to exceptional items (minus EUR 593 million), in particular substantial write-downs on Euro-Stoxx holdings of EUR 399 million, while the operating result less the provision for contingencies was only slightly negative (minus EUR 23 million) and was indeed around EUR 30 million better than that anticipated in the plan for 2002 (minus EUR 53 million). However, this heavy loss had a considerable negative impact on the core#capital ratio intended as a cushion against possible further losses and hence essential to viability, which dropped as a result to 5,6 % and thus by a considerable margin of almost [...]* % fell short of the [...]* % figure originally planned for 2002.

(175) It should be pointed out in this connection that in early 2003 the Commission had held talks with Germany about whether further compensation measures were possible in the retail field. Germany quantified the effects of a separate sale of Berliner Bank under the conditions then prevailing in such a way that the Commission could not be sufficiently certain that the remaining group could continue to compete in the marketplace on its own merits.

(176) The Commission's investigation focused in particular on the credit risks and risk provision in the real estate financing field and, to a lesser extent, in the capital market field. In the Commission's opinion, the doubts about viability could have been allayed if the real estate financing business or at least the major part of it, together with its attendant risks, had been effectively insulated from the remainder of the group, e.g. by an early separate sale of the business. Up until June 2003, however, Germany presented figures which made it appear to the Commission that the scenario of such an outflanking, effective insulation of this business was not feasible. The main reason given was that the sale would have led to an immediate transfer of the assets of the real estate financing business (especially BGB's stake in BerlinHyp with a book value of EUR [...]*) from capital assets to current assets. This would have

necessitated a valuation of those assets at the current market value, [...]*. The resulting exceptional losses would, so Germany stated, have placed such a heavy burden on BGB's capital resources that without further state support its viability would no longer have been assured.

(177) Once such a short-term insulation of the remainder of the group from the risks of the real estate financing business no longer seemed possible, the Commission had no other choice but to appoint independent experts to examine BGB's viability under the existing restructuring plan. The outstanding issue was whether, in view of the existing risks in the real estate financing field, the risk provision could be regarded as adequate. The report mandate issued on 14 July 2003 for the auditing firm Mazars, which had been selected as the Commission's advisers, was, however, comprehensive and also covered other risks to the bank's viability (e.g. the capital market business of wholesale/foreign banking).

(178) The draft report was submitted as agreed on 30 September 2003. The main findings were discussed with Germany on 3 October. The final version of the report was transmitted to Germany on 20 November. In the light of the report by Mazars, the Commission, on the basis of the restructuring plan as it stood in the summer of 2003 (which did not yet include the divestment of Berliner Bank as this was offered by Germany only after completion of the study), came to the conclusions regarding the bank's viability that are set out below.

Analysis of the market study submitted to the Commission

(179) In January 2002 Germany submitted to the Commission, together with the notification, a detailed market study carried out by the bank and Morgan Stanley in which the current situation and the prospective situation in the banking market in Germany, and in Berlin in particular, are described. The Commission considers the market study, including the information which was submitted after the initiation of the procedure to be complete and inherently conclusive. On the points commented on in the decision to initiate the procedure, the Commission refers to Germany's additional submissions set out in paragraph 58 et seq.

(180) Germany stated in particular that BGB's retail business (private and corporate customers) was concentrated on the *Land* of Berlin and the immediately surrounding area, which constituted the relevant geographic market. In the most important market segments, i.e. in particular deposits and lending, BGB's market share during the years before the crisis underwent only slightly positive or negative changes or else remained unchanged. In Berlin a significantly larger number of inhabitants (just under 4 000) were served by a branch than the German (1 300) or European (1 800) average. In future, the number of branches would continue to fall slightly as customers increasingly carried out transactions on the Internet. Although there was in principle no surplus capacity, there was, however, intensive competition which further increased the pressure on margins and promised further consolidation.

(181) In the real estate financing field, the German mortgage lending rate was very low compared with the rest of Europe, and an increasingly strong concentration process was to be observed among mortgage lenders. Moreover, no substantial new company had been set up in the mortgage lending field in recent years. The heterogeneous supply-side structure and the resulting competition were also major reasons for the lack of profitability of the mortgage lending business in Germany. In the past, market participants had been able to achieve growth only through very aggressive pricing, which, however, in many cases later led to significant value adjustments, as the example of BerlinHyp or BGB showed. The strong fragmentation of the market had resulted in intensive competition and considerable pressure on margins. Whereas in western Germany demand was increasing, in the east a further consolidation was taking place in rents and asset prices. Generally speaking, demand looked set to grow over the next few years in some areas of the real estate market in Germany. Owing to the intensive competition and a further tightening of the regulatory environment, a significant recovery of the German mortgage market as a whole was not, however, to be expected.

(182) With regard to the real estate services business (funds business and project development/building work), no surplus capacity was directly perceivable in the domestic funds business. There was, however, highly intense competition, albeit largely unchanged for some time. It should be noted here that a commitment was given in the course of the procedure to hive off the entire real estate services business from BGB.

(183) In the capital market business, BGB is, according to Germany, active in share and bond trading (for its own account and on behalf of customers), in derivatives issuing and trading, and in foreign exchange and currency business as well as other money market transactions, mostly with German customers. The crisis in the capital markets had led to a sharp drop. The question of surplus capacity could not be answered conclusively as yet. A sharpening of competition and an increasing marginalisation of smaller competitors such as BGB to the benefit of larger providers were, however, expected.

(184) To sum up, the Commission would point out, in reply to Germany's arguments, that it takes a positive view in principle of the future development of the market environment and the market prospects of BGB in the retail business and the capital market business. In view of the better economic situation that is expected in the years ahead in the light of more recent data, relatively stable earnings should be achieved here. It is substantially for the company itself to translate its market strategies successfully into practice. On the other hand, the position with regard to the real estate financing business looks less favourable owing to the consolidation process, which is apparently not yet finished. The bank might thus have to adapt its strategy further in line with future developments in this area, where appropriate through further targeted contractions of the business should this prove necessary. Once the

real estate services business has been split off from the bank by the end of 2005, market developments in this area will play no more than a subordinate role as far as the bank is concerned.

Analysis of the structural and operational deficits responsible for the difficulties

(185) In assessing the structural and operational deficits responsible for the bank's difficulties, the Commission would refer to the information provided by Germany. It considers the analysis of the past deficits to be appropriate overall and to represent a suitable starting point from which to bring them under control and to draw up the restructuring plan.

(186) The Commission concludes that BGB's crisis was due above all to the accumulation of risks in the real estate services field through a steady increase in the granting of long-term rent, dividend and renewal guarantees which, from a business standpoint, could be regarded neither as manageable nor as reasonable from a cost/benefit angle. Instead, these were based on entirely unrealistic market estimates which can be described more as wishful thinking. The same applied to the real estate financing business: an aggressive rates policy that was aimed at achieving higher market shares and did not adequately cover the lending risks and the incorrect valuation of securities due to negligence led during the economic downturn of the late 1990s to massive loan defaults and corresponding losses.

(187) In addition, in both the real estate services and the real estate financing businesses, huge influence was exerted by a few local politicians who did not have the bank's business interests at heart or who lacked the necessary financial knowledge and gave priority to supposed local development objectives. In so far as these acts are punishable under criminal law, the matter is in the hands of the Berlin judicial authorities. These economically unjustifiable practices were greatly facilitated by a system for recognising and controlling risks which can be described as rudimentary and in no way appropriate to the standard requirements of effective risk management. Neither the bank's managing board nor its supervisory board adequately fulfilled its responsibility to manage or supervise the company properly. It must be added, however, that the then auditors and competent supervisory authorities likewise woke up far too late to the continuing accumulation of risks with which the bank could ultimately no longer cope and took the appropriate measures only shortly before the crisis broke.

(188) That the onset of the crisis could be delayed so long was a reflection of the fact that, as part of the group, Landesbank Berlin benefited from the comprehensive state guarantees, institutional liability and guarantor liability and refinanced the whole group, irrespective of the true business risks, at little cost on the capital markets and that the economic effect of institutional liability and guarantor liability was extended via private-law guarantee vehicles to other group companies, thereby making possible many transactions which made no sense for the bank. The abolition of institutional liability and

guarantor liability in July 2005 will ensure that a crisis engendered in this way will no longer be possible in future or will be recognised in time by the market and that the taxpayer will no longer have to stump up billions as a result.

Comprehensive description of the restructuring plan presented in the summer of 2003 and of the new business strategies

(189) Mazars analysed the detailed restructuring plan, as it stood in the summer of 2003 (it did not therefore include the divestment of Berliner Bank). The plan provided for measures which, in the Commission's opinion and in line with the assessment made by Mazars, are overall suited to clearing the structural and operational deficits responsible for the difficulties of the past and to restoring the company's long-term viability.

(190) The restructuring plan to overcome the bank's structural and operational deficits consists, on the one hand, of measures for the disposal, merger and liquidation of subsidiaries or business areas with a view to the future concentration of the bank on its core business and, on the other, of measures to increase the efficiency and profitability of the core business (reorganisation sphere) itself through cost reductions, concentration of activities and reduction of risk positions. Some of the restructuring measures, both within and outside the core business, may be regarded simultaneously as measures to compensate competitors in so far as they result in a reduction in the bank's market presence. The restructuring plan relates to the period 2001 to 2006.

(191) The target structure of the restructuring plan as submitted to the Commission in the summer of 2003 is that of a regional bank focused on the core business of retail banking (private banking and corporate banking under the names Berliner Sparkasse and Berliner Bank), supplemented by higher-margin capital market business (BGB and LBB) and real estate financing business (BGB, LBB and BerlinHyp). In 2006 the retail business should accordingly contribute just over [...]* of the group's earnings (just under EUR [...]*), the capital market business about [...]* % (approximately EUR [...]*) and real estate financing about [...]* % (approximately EUR [...]*). Owing to the relatively higher share of the costs accounted for by retail banking, retail and capital market business should, however, contribute about [...]* to the operating result.

(192) The essential principles of the restructuring are the permanent restoration of the bank's earning power and the lasting reduction of its costs, the lessening of risks to a normal market level and, through this, the improvement of the bank's ability to access the capital market. Specifically, during the restructuring period 2001 to 2006, the operating result should, as presented to the Commission in the summer of 2003, improve to well over EUR [...]* a year and, to this end, administrative expenditure above all should be reduced disproportionately by just over EUR [...]*. Risk positions, which are decisive when it comes to calculating the core#capital ratio, should be reduced between 2001 and 2006 by about [...]* % from just under EUR [...]* to a little over

EUR [...]*. The bank aims to raise the core#capital ratio in the medium term to at least 7 %.

Analysis of the structural and operational measures in the individual business areas

(193) In view of the main reasons for what went wrong at BGB, key measures such as a radical reduction in the number of employees by more than half overall (from some 15 000 to some 6 500), the abandonment, reduction or systematic closure of high-risk business areas or business areas not belonging to the core business of a regional retail bank, better internal control mechanisms and leaner structures both in-house and in subsidiaries are, in the opinion of the Commission and its advisers, reasonable steps towards making the company profitable once more and erasing the mistakes of the past. The operational improvements stem from internal measures and include the abandonment of loss-making activities. The Commission, in the light of the analysis undertaken by Mazars, views the prescribed measures as basically sound. They have already largely been implemented or are on schedule. The detailed picture is as follows:

Retail business in the private banking field

(194) For retail business in the private banking field, the original restructuring plan consisted in focusing on regional business under the names Berliner Sparkasse and Berliner Bank (the latter is now, according to Germany, to be divested separately), optimising the workflow and substantially cutting back the workforce. The plan, which has already largely been implemented, provides for the disposal of holdings which do not fit in with the defined regional core business and for branch closures. Total earnings are set to [...]* in the reorganisation sphere from 2001 to 2006, while total administrative expenditure during the same period should fall by more than [...]* % and profit before tax should rise from below minus EUR [...]* to about EUR [...]*. Risk positions are to be significantly reduced. The number of employees is to be cut from about 6 000 in 2001 to a little over [...]* in the reorganised group in 2006. Private banking's cost/income ratio is to be improved from just under [...]* % in 2001 to just under [...]* % in 2006.

(195) These measures have already been largely implemented according to plan. Only the sale of Weberbank with a total asset value of EUR 4,4 billion has been delayed but the likelihood is that it will be able to go ahead in 2004. The Commission, in line with the analysis conducted by Mazars, considers that the plan at this stage is a sound basis to achieve long-term viability in the private banking field.

Retail business in the corporate banking field and future remaining business with the public sector

(196) The measures taken or scheduled under the original plan in the private banking field have an extensive impact at the same time in the corporate banking field, in which category the remaining part of the public sector segment will in future be placed. The plan provides for a cessation of corporate banking outside

Berlin. Total earnings are set to fall only slightly, while total administrative expenditure during the same period should fall by just under [...]* % and profit before tax should increase from about EUR [...]* to about EUR [...]*. Risk positions are to be reduced significantly. Staff numbers are to be cut by more than [...]* %. Corporate banking's cost/income ratio is to be improved from just under [...]* % in 2001 to a little over [...]* %.

(197) As confirmed by Mazars, these measures had already largely been implemented or were generally on schedule. The Commission considered them likely, as the plan stood; to achieve satisfactory profitability in the corporate and public sector banking business and to restrict the bank to its core business in the Berlin/Brandenburg region in this field too.

Capital market business

(198) The capital market business is being restructured to free up capital through a suitable reduction in risk positions and to enhance workflow efficiency. To this end, own-account business (share and interest credit products) in all capital market areas is to be concentrated under one roof, clearly separated from private banking and reduced overall. It is to be restricted to Germany, Europe and the United States, while the emerging#markets business is to be abandoned. The interest derivatives portfolio is also to be sharply reduced and limited to customer-oriented positions. On the other hand, the less risky non-bank customer business is to be expanded, especially in relation to interest# rate and equity products. Total earnings should fall only slightly between 2001 and 2006, while total administrative expenditure should fall by about [...]* % during the same period and profit before tax should increase by about [...]* %. Risk positions should be reduced by about [...]* %, as should the workforce. It is intended that the cost/income ratio of the capital market business should be improved from just over [...]* % in 2001 to about [...]* % in 2006.

(199) According to Mazars, the planned measures had been largely implemented or were on schedule. The Commission considers them to be sufficient to safeguard the earning power of this business in the future and, at the same time, to keep the risks to the bank within manageable proportions. In the Commission's opinion, the focusing on non-bank customer business and the concentration and organisational separation of own-account business improves transparency, reduces risks and helps the bank to manage these better. Thanks to the significant reduction in risk positions, capital will be freed up, and this will be conducive to increasing the capital ratio and hence to securing the bank's future capital market capability once institutional liability and guarantor liability have been done away with.

Real estate financing business

(200) In restructuring the real estate financing business, risk reduction has top priority. To this end, an inventory of risks is gradually to be compiled with a view to eliminating the worst risks and restricting new business to low-risk customers. The risk management function is to be expanded. The workflow

is to be optimised and risk control improved. The core business is to include in future the financing of commercial investors and residential property construction companies primarily in selected large cities in western Germany less hard-hit by the crisis in the real estate market as well as, to a certain extent, in Berlin and Brandenburg. The financing of commercial investors is a relatively stable, low-risk business. A supra-regional focus is necessary to diversify risk and ensure a sufficiently varied portfolio as well as to exploit regional growth potentials and existing regional market know-how. Without supra-regional components in real estate financing, there was a threat of a substantial worsening in the credit rating and in refinancing rates. On the other hand, there is to be a move away from high-risk segments of the real estate business with unsatisfactory margins. The bank considers an improvement in earnings from new business through a reorientation of such business to be realistic.

(201) In order to improve earnings from existing business, risk specialists are to be employed increasingly for risky commitments. This will, according to the bank, lead to a review and critical reassessment of existing business, where appropriate with the help of outside consultants acting on instructions from and in conjunction with the team of in-house experts. Direct personnel and non#personnel costs are to be reduced by about [...]* % by 2005. Another important means of improving earnings is the development of reorganisation strategies for non#performing commitments and the introduction in 2002 of group-wide risk control, which previously existed in only a few areas, as well as the introduction of suitable early#warning instruments.

(202) Total earnings from 2001 to 2006 are set to rise by just over [...]* % to [...]*. Total administrative expenditure during the same period should, however, fall by about [...]* %. Pre-tax profit should increase from distinctly negative figures to about EUR [...]* in 2006. Risk positions should be reduced by over [...]* % and the cost/income ratio of the real estate financing business should rise by about [...]* %, inter alia owing to the above-mentioned cost-intensive measures aimed at introducing better risk management, to a little over [...]* %.

(203) These measures had already largely been implemented or were, in most instances, on schedule. The Commission regards them fundamentally as steps in the right direction. However, in the opinion of the Commission and its advisers, implementation of the desired improvements is, as regards data quality, still behind schedule. This unsatisfactory state of affairs might hamper the operability of the risk management system.

(204) In addition, the Commission, in line with Mazars' findings, doubts whether the bank will succeed in generating in future a sufficient volume of business with the desired high margins from customers with low risk profiles. According to Germany's own data, the real estate financing market is characterised by highly intense competition and is currently in the middle of a consolidation process. As the most attractive market segment in the real

estate financing field, the target customers aimed at by BGB are also being strongly wooed by other suppliers. Any slippage from target would have a direct impact on the desired future interest surplus. On the basis of the figures for the summer of 2003 made available to the Commission's advisers, the underperformance at the time in the generation of new business would have led on an extrapolated basis to a considerable interest earnings shortfall. If the underperformance were to deteriorate in future, then the shortfall in interest earnings would likewise increase. The future generation of sufficient new business depends crucially on market trends in the Berlin/Brandenburg region, where the focal point of BGB's business continues to lie. If the bank were to have insufficient success here, this would have a lasting impact especially on the value of BGB's holding in BerlinHyp and would necessitate further write#downs in the current book value of EUR [...]*, which would have a negative effect on earnings and, perhaps, the core#capital ratio of the bank. This question is discussed in greater detail below (paragraph 249). In line with Mazars' findings, the Commission considers, however, that the bank's overall viability is not called into question by the remaining problems in the real estate finacing business.

Liquidation of the large customer/foreign business area

(205) The bank intends to withdraw entirely from the large customer/foreign business area, which also includes consultancy business in the mergers and acquisitions field and structured finance/project financing and is not viewed as forming part of the bank's core business. It accordingly stopped acquiring new business in principle in 2002. In view of long-term commitments, especially in the structured finance field, an immediate exit is not possible, however, the only option being an extensive reduction in risk positions of about [...]* % by the end of the restructuring period in 2006. The remainder is to be terminated as soon as possible, apart from a limited number of export financing operations covered by export credit agencies and medium# to long-term financing of goods transactions in selected target countries in central and eastern Europe on the basis of proven country expertise; these are being integrated into the capital market business and are to be retained.

(206) The reductions to do are largely as planned. In the Commission's and Mazars' opinion, they are aimed at discontinuing this business area as a whole as soon as possible in an orderly manner and, thanks to the massive reduction in risk positions, at freeing up significant amounts of capital which will help to ensure future capital market capability. The abandonment of this relatively high-risk business area with high individual financing volumes, which does not form part of the core business, will also considerably ease the burden on management, which will be better able to perform its priority tasks in the key areas. The original plan of reductions was amended, however, in June 2003 to take account of the unfavourable market conditions in 2002. This might cause some, but on the whole not significant delay in the reduction of risk positions.

Scaling down and transfer of the real estate services business

(207) As an addition to its notification, Germany offered in its response to the Commission's decision to initiate the procedure not only a scaling down of the real estate services business but also its complete spin-off and — apart from a few companies to be defined and still sellable on the market — transfer to the *Land* of Berlin by the end of 2005 as a further compensatory measure. This measure accordingly became part of the restructuring plan. It covers all the real estate services companies protected by the April 2002 risk shield, and in particular IBAG, Bavaria, IBV, IBG and LPFV.

(208) The April 2002 risk shield covers all risks from the bank's old business in the real estate services field transacted before the cut-off dates mentioned above. This means that risks to the bank in the real estate services business area now arise only from new business transacted after those dates. Since the market for real estate services is still to be regarded as problematic and is characterised by a high degree of forecasting uncertainty, the Commission, supported by Mazars, considers the continuing significant reduction in new business in the real estate services field to be an important contribution to the restoration of long-term viability and concentration on the core business of a regional bank. The transfer of old business protected by the risk shield to the *Land* of Berlin at the market price likewise enables the bank to free up resources previously tied up outside the core business, although the transfer of old business already covered should not as such have any significant impact on the bank's risk situation.

(209) The Commission, in line with Mazars' findings, considers the complete abandonment of the real estate services business area to be to be a clear, economically meaningful step which should contribute to the long-term stabilisation of the bank's results. This measure should therefore be viewed favourably by the capital market and should ease the planned privatisation of the bank.

Staff

(210) The planned staff reductions during the restructuring period from 2001 to 2006 amount for the whole group to some 8 500, i.e. a reduction of almost 60 % from over 15 000 employees to just over 6 600. By 30 September 2003, the workforce comprised some 10 000 employees in total, i.e. a reduction of almost 5 200 or about 35 %. These figures are largely as set out in the plan.

Analysis of the financial measures

(211) The financial measures are, in the opinion of the Commission, supported by its advisers Mazars, necessary and appropriate as a means of restoring BGB's financial stability from the point of view of liquidity and capitalisation and of ensuring its refinancing on the capital markets as well as the financing of its restructuring. They consist of measures relating both to own capital and to borrowed capital. The details are as follows:

(212) The Commission takes the view that the sale of assets and participations will provide the bank with liquidity and reduce risk positions outside the core area. It is not clear, however, that accounting profits of any significance overall can be achieved in this way.

(213) The refinancing of the bank rests on three main pillars: savings deposits (approximately one third), bank deposits (approximately one third) and securitised liabilities (approximately one quarter). Consolidated liabilities fell from EUR 185 billion at the end of 2001 by EUR 32 billion to EUR 153 billion in mid-2003. This exceeded by a significant margin the planned target for 2003 of a little over EUR 160 billion. By 2006 the figure should have fallen to just under EUR [...]*.

(214) To prepare for the abolition of state guarantees, the bank aims to switch from its at present relatively large stock of short-term liabilities to medium# and long#term liabilities and to re-enter the capital market in the area of unsecured liabilities. To this end, it has drawn up objectives for the issuance of secured and unsecured liabilities and is seeking thereby to rebuild the trust of the capital market and to expand the investor base. It has held talks with ratings agencies about the realistically attainable rating in the event of successful implementation of the restructuring plan on the basis of the base-case scenario (A- or A3). [...]*. On the whole, an average increase in refinancing costs of [...]* basis points can be reckoned on as a result of the abolition of state guarantees in mid#2005.

(215) The Commission considers, in line with Mazars' findings, that the bank's refinancing strategy, and in particular the base scenario drawn up and the inference of correspondingly higher refinancing costs, is fundamentally plausible. However, a question mark hangs over the bank's future refinancing because of potential reluctance on the part of market participants, which might materialise especially if the bank's results fail to come up to expectations. In such an event, still higher refinancing costs would have to be reckoned with. What is more, how far possible saturation effects might be observed in the market in mid-2005 if all public banks in Germany lose the state guarantees is not yet fully foreseeable. The placing of certain securities issues might then be at least hampered.

(216) For this reason, the Commission sees in the further reduction of risk positions an essential precondition for the successful implementation of the restructuring plan. If the problems described were to occur in future, the bank could effectively combat them by stepping up the reduction effort and thus favourably influence the confidence placed in it by the capital market.

(217) Another essential precondition for securing the confidence of the capital market is the attainment of a satisfactory core#capital ratio that can act as a buffer against any losses incurred. The core#capital ratio depends firstly on the extent of the risk positions and secondly on that of the core capital

itself. The bank is aiming at a core#capital ratio at the end of the restructuring period of more than 7 %. A capital contribution by shareholders, in addition to the August 2001 capital increase, in order to further improve the bank's capitalisation is, however, not likely before privatisation takes place at the end of 2007. Accordingly, if it is to increase its core#capital ratio, the bank must fall back in particular on a reduction in risk positions or the sale of assets.

(218) The Commission is aware that the statutory minimum core#capital ratio of 4 % is insufficient to give a bank the necessary breathing space in day-to-day business. In its rescue aid decision of 25 July 2001, the Commission therefore recognised a core#capital ratio of 5 % as being necessary in order to enable a bank to continue to exist. This was based essentially on a letter from BAKred, as it then was. As confirmed by Mazars, the Commission is also aware that in the financial markets a core#capital ratio of 6 % is generally mentioned as being the threshold below which questions arise as to the strength of the institution concerned and the confidence of the financial markets suffers. According to Mazars, ratings agencies tend to view core#capital ratios as a reflection of a bank's financial strength, which is why credit institutions generally strive to exceed the required capital underpinning in order to ensure sound ratings, this being a precondition for access to the international capital markets on reasonable terms. A capital ratio higher than 6 % may also be wise in the light of the reform of international agreements within the Basel II framework and the abolition of state guarantees in order to fulfil the market's expectations of greater strength especially on the part of *Land* banks and thereby to achieve a better rating. The bank is aiming at an A rating and considers a core#capital ratio of at least 7 % to be necessary for this. On the basis of comparable market data (with the average core#capital ratio for the sector in Germany of 6 % being low by international comparisons and with 8 % or even higher being the average value for reputable credit institutions at European level), Mazars considers it indispensable for the bank to achieve in the medium term at least a core#capital ratio of some 6 to 7 %.

(219) The Commission, in line with Mazars' findings, likewise regards a medium# term increase in the core#capital ratio to over 6 % as being desirable. However, an increase to over 6 % is, in the Commission's opinion, solely a commercial objective the responsibility for which must be assumed by the bank and thus cannot be financed by state aid. The bank's competitors are faced with the same market situation but have to increase their core#capital ratios on their own without any state support. Authorisation of an increase in the core#capital ratio using state resources to over 6 % would therefore unjustifiably place the bank in a better position than its competitors, without this being absolutely essential to the bank's viability at the time of the decision. The aid would accordingly no longer be kept to the minimum required.

(220) For this reason, the Commission has insisted that, under the agreement between the *Land* of Berlin and the bank of 26 December 2002 on the

treatment of any claims to repayment brought by the *Land* arising out of a Commission decision in aid case C 48/2002, the amount of any repayment claim will be left in the bank in the form of a deposit only as far as is necessary to attain a core#capital ratio of 6 % (or a total capital ratio of 9,7 %, as already acknowledged in the decision on the rescue aid) on the basis of the 2002 annual accounts. However, this agreement can be approved by the Commission only in so far as the amount calculated under the agreement also does not lead to any overstepping of the core#capital ratio of 6 % for the BGB group as at 1 January 2004 and hence on basis of the figures current at the time of the Commission decision (thus taking into account the hiving off of IBB promised by Germany and described in paragraph 279).

(221) On the basis of the same considerations, the Commission has ensured that Germany commits itself to leaving the IBB reserve in the context of the divestment of government assistance business in 2005 in the bank only as far as is necessary to maintain the core#capital ratio at a level of 6 % on the reference date of 1 January 2004. This measure is to be viewed as part of the compensation to be provided by the bank in order to limit in the interests of competitors the distortions of competition caused by the aid. The above refunding of the IBB reserve ensures that, in the context of the divestment of government assistance business, the bank does not have a core#capital ratio in excess of the minimum essential to long-term viability which it might be able to use for expansive business strategies damaging to competitors. If the bank subsequently wishes to achieve a higher core#capital ratio, then it must do so via suitable changes to the risk assets, by building up reserves through its own efforts or by borrowing further funds on the market at the time of or following privatisation.

(222) To sum up, the Commission, in line with Mazars' findings, proceeds on the assumption that the bank will, in its own well-understood business interests, make every effort in the long term to reach a core#capital ratio which results in a satisfactory rating from its point of view. According to the bank, this is at least 7 %. The bank has almost three years before the end of the restructuring period in 2006 in which to raise the core#capital ratio through its own efforts from [...]* % to 7 % or more. The Commission considers the aim of successfully implementing the relevant measures so as to further increase the core#capital ratio within this period to be realistic.

Quantification and probabilities of the existing risks being realised and analysis of the risk provisioning

(223) Since the Commission was unable in the spring of 2003 to allay, on the basis of its own analysis, the remaining doubts as to the bank's viability raised by the failure of the privatisation process and the strongly negative aggregate result for 2002 and since a suitable, effective insulation of the credit risks existing above all in the real estate financing field was, according to Germany, impossible to achieve without further aid, the Commission made sure with the

help of independent experts that, apart from a few points, the bank had made adequate provision for the existing risks and had built up suitable reserves. With respect to these points, the Commission's advisers Mazars recommended measures to amend the restructuring plan as submitted to the Commission in the summer of 2003. At the Commission's instigation, these were incorporated by the bank and the revised restructuring plan was communicated to the Commission on 29 January 2004. The details are as follows:

Risks arising out of lending transactions

(224) Following an analytical examination of a suitable sample of the bank's loan portfolio, the Commission's advisers Mazars recommended that the level of risk provisioning be gradually increased up to the end of the restructuring period in the base-case scenario by EUR [...]* and in the worst-case scenario by EUR [...]*. They also identified an omission in the worst-case scenario which needs to be offset by an additional risk provision of EUR [...]*, broken down into EUR [...]* for 2003, EUR [...]* for 2004, EUR [...]* for 2005 and EUR [...]* million for 2006. Otherwise, the level of risk provisioning was to be regarded as adequate. However, the failure of a single large loan might lead to the risk provisioning being exceeded. This is especially relevant for project financing in the fields of air transport, energy and telecommunications. The worst-case scenario makes an additional risk provision for this of EUR [...]*. In view of the fairly sizeable stock of large loans, the Commission, in line with Mazars' findings, is aware that exceeding the risks provided for is theoretically possible in the event of the failure of a large loan amounting to at least EUR [...]*. If specific, previously absent signs of such a failure were to appear, the bank would have to increase its level of risk provisioning accordingly. The Commission, in the light of Mazars' findings, concludes that the bank would be able to take such a measure unaided.

(225) Following the improvement of the restructuring plan through the incorporation of the measures proposed by the Commission's advisers Mazars, the Commission regards the level of provisioning for the known risks as adequate. It notes with satisfaction that the bank's management has taken altogether appropriate measures to build up a suitable risk control system. The structure is well on the way to, but has not yet reached, completion. The Commission trusts that, in its own well-understood interests, the bank will continue this process with as much determination as in the past. It is aware that the bank's future profitability depends to a considerable extent on further economic development above all in Berlin and the five new Länder. In the Commission's opinion, these risks are, however, not tangible when viewed from the current perspective and affect every firm in the region differently. The Commission takes the view that the measures contained in the restructuring plan, which certainly point in the right direction, suffice. Absolute certainty is, of course, never attainable in the economic sphere.

Risks arising out of capital market transactions

(226) During the restructuring period, the bank's capital market transactions account for some [...]* % of the operating result. This shows that these transactions are essential to the bank's profitability. Obviously, the risks inherent in such transactions must be kept properly under control in the interests of the bank's viability. This is being done firstly by shifting the emphasis from own-account business to customer-related activities. The bank's risk positions are being reduced in this connection by [...]* between 2002 and 2006, while average earnings of EUR [...]* are being aimed at. The second way in which it is being done is by a risk management system that the Commission's advisers, on the basis of their investigations, regard as being entirely adequate. They advise, however, that the bank's dependence on interest#rate changes should be lessened by reducing the positions in the bank book. Bearing in mind this recommendation, the Commission thus considers the risks arising out of capital market transactions to be manageable and regards the buoyancy of this business area as guaranteed.

Risks arising out of the valuation of BGB's holding in BerlinHyp

(227) The Commission's advisers Mazars have discussed thoroughly the question of the risks arising out of the valuation of BGB's holding in BerlinHyp. The book value of the holding in BerlinHyp is EUR [...]*. If BerlinHyp were to miss its targets, e.g. owing to a further worsening of the situation in the real estate market, the business plan would have to be revised. In view of the increased risks that may ensue, the discount factor would then also have to be adjusted and additional risk premiums might be incurred. Such a scenario might even lead to a market price for BerlinHyp of [...]*, […]* .

(228) The difference between the holding's book value of EUR [...]* and the net own capital of approximately EUR [...]* represents the devaluation risk in a base-case scenario. This therefore amounts to EUR [...]*. An adjusted, more conservative business plan would include this devaluation risk, as would the annual accounts for 2003 and 2004. At the Commission's request, the restructuring plan was revised and the devaluation risk duly taken into account. As recommended by the Commission's advisers, the maximum devaluation risk in the worst-case scenario was also increased by EUR [...]*. However, this has not had any decisive impact on the Commission's overall assessment.

(229) For reasons of risk limitation and because of the uncertain further development of the real estate financing business, the Commission would consider it desirable in order to safeguard the bank's long-term viability for at least the major part of this business to be sold by the group or reduced in size. To this end, the Commission recommends to Germany that BerlinHyp be sold separately in order to improve the privatisation prospects of the remainder of the group. BerlinHyp accounts for about two thirds of the group's entire real estate financing business and is technically relatively easy to dispose of by selling the shares in BerlinHyp. The remaining third is concentrated in the

hands of BGB and LBB and should be restructured in accordance with the strategy worked out by the bank for the real estate financing business. The future risks to the remainder of the group would thereby be reduced by well over half overall.

(230) However, Germany provided the Commission with information according to which an immediate sale of BerlinHyp might have unacceptable consequences for the bank. The Commission would therefore ask Germany to determine at a later date whether and when a separate sale of BerlinHyp might proceed with a realistic expectation of success and on terms acceptable to the bank, i.e. at a price approximating to BerlinHyp's net own capital. In that event, potential losses from write#downs in the book value might be kept within bounds and, at the same time, liquid resources would be channelled to the bank and capital freed up. Germany has accordingly communicated to the Commission its intention to divest BerlinHyp either separately or as part of the overall privatisation of BGB by the end of 2007.

Risks arising out of the valuation of BGB's earnings and liquidation proceeds claim (24.99 %) with respect to LBB

(231) BGB has a claim to 24,99 % of profits including the corresponding liquidation proceeds with respect to LBB against the *Land* of Berlin and a 75,01 % interest in LBB in the form of a dormant holding.

(232) The Commission's advisers Mazars consider the valuation of this claim in BGB's books to be in need of auditing because LBB's underlying value may have fallen since the relevant year of 1998. A possible write#down would have a one-off effect on the group's consolidated pre-tax profit in 2005 of about EUR [...]* in a pessimistic scenario and of about EUR [...]* in an optimistic scenario.

(233) As recommended by its advisers, the Commission therefore considers it necessary to take this write#down effect properly into account in the restructuring plan through a write#down of EUR [...]* in the base-case scenario and through an additional writedown of EUR [...]* over and above the EUR [...]* writedown so far envisaged in the worst-case scenario. These provisionally estimated adjustments are dependent on a precise valuation of LBB and should finally be carried out as soon as that valuation has been effected following clarification of the outstanding issues relating to LBB (exact size of the remaining IBB reserve once IBB has been hived off, Commission decision on the consideration for the IBB housing-promotion assets). The Commission considers, however, that the resulting impact on the bank's consolidated core capital is not likely to put the group's viability at risk since, with a core#capital ratio of [...]* % or even more, this can be absorbed by the bank.

Risks arising out of the introduction of IFRS (IAS)

(234) The conversion of BGB's consolidated accounting to adapt it to IFRS (International Financial Reporting Standards) in 2005 calls inter alia for reassessment of the pension provisions. In the opinion of the Commission's advisers Mazars, these could have a negative impact on the consolidated own capital to the tune of some EUR [...]*. It will have to be borne in mind, however, that as a result of the introduction of IFRS opposite effects may also result from the adjustment of other balance#sheet items. In the opinion of the Commission and its advisers, these cannot at present be reliably assessed. Even if these balance#sheet effects were to prove negative on aggregate, they are unlikely to be able to impair the bank's overall viability. The introduction of IFRS leads only to a partial reassessment of already known facts, and not to the discovery of new risks. Moreover, it concerns all European companies, which must carry out adjustments on the basis of IFRS and resolve any transitional problems that arise in cooperation with the competent supervisory authorities. The bank's viability depends rather on its financial performance and its ability to manage the risks facing it, which are to be assessed separately.

Capacity to generate new business

(235) The bank's capacity to generate new business in its various areas of activity is the decisive factor as regards its viability and privatisation prospects. It has carried out studies into its market position and future market prospects from which it has derived its future business strategy.

(236) This shows that in most business fields the plans and strategies are realistic. The bank intends to introduce new products and marketing channels. However, the Commission considers the qualitative and quantitative objectives and the strategy in the real estate financing field to be overoptimistic. [...]*. This will depend crucially on how the overall economic situation develops and on the bank's ability to react to changes in the market situation and in customer needs and cannot therefore be conclusively assessed by the Commission at present. Should the bank not succeed in meeting its targets on a lasting basis, its viability may be endangered, especially if the real estate financing business remains at its current size. If the targets cannot be met in the event of a substantial scaling-down of the real estate financing business, the quantitative effects would also be considerably reduced and could be better absorbed by the bank's other business areas.

Commission request for further compensatory measures in the autumn of 2003 and corresponding reworking of the bank's restructuring plan in the winter of 2003/04

(237) After the report by its advisers Mazars on the restructuring plan submitted had made the Commission sufficiently certain in the autumn of 2003 about the bank's viability and, in particular, the fundamental suitability of risk provisioning, a positive decision on the aid requested could be considered only if the compensatory measures offered could be regarded as sufficient. As stated below (see paragraph 257 et seq.), the Commission still had considerable misgivings in this respect, particularly as regards retail business,

where the bank plays a prominent role on the Berlin regional market, but also as regards real estate financing, which also benefited from substantial aid. In the latter area, the Commission experts have also expressed misgivings regarding the bank's ability to generate sufficiently profitable new business in the future. In the Commission's view, therefore, the separate sale of at least a significant part of the real estate financing business as compensation for competitors would also generally improve the viability and privatisation prospects of the rest of the group.

(238) In the autumn of 2003, on the basis of the restructuring plan submitted and the conclusions reached by its advisers, the Commission therefore requested Germany to quantify the effects of a separate medium#term sale of Berliner Bank (accounting for some one quarter to one third of BGB's retail business) by the end of 2005 and of BerlinHyp (some two thirds of BGB's real estate business) by the end of 2006. This was to enable the Commission to ascertain whether such further compensatory measures would not jeopardise once again the banks' viability, which had basically been confirmed under the current restructuring plan.

(239) Germany and the bank began by summarising the underlying situation. On the basis of the medium#term plan of 24 June 2003, the expected additional charges resulting from the incorporation of the Commission advisers' proposals, from the already approved divestment of real estate services business and the hiving#off of IBB were quantified. Overall, in the base#case scenario these three measures would have one#off effects in the period 2003 to 2006 of minus EUR [...]* # EUR [...]*, of which minus EUR [...]* for the increase in risk provisioning and minus EUR [...]* # EUR [...]* for the negative sales proceeds, the write#down of the book value of investments and other consequences of the transactions involved in divesting the real estate services subsidiaries RGB and IBAG. However, the medium#term and long# term effects of those three measures were small. Thus, the planned tax savings in 2006 were reduced to only a minimal extent, by EUR [...]*, from EUR [...]* (according to the medium#term plan of 24 June 2003) to EUR [...]* (on the new calculation) and could, therefore, be achieved by the bank generally without any significant change in the planned magnitudes. The medium#term plan of 24 June 2003 was based on a target rating of [...]* for the group and a return on capital of [...]* % in 2006.

(240) Against this, Germany and the bank argued that a divestment of Berliner Bank by the end of 2005 would adversely affect the group's medium#term planning. Overall, there would be one#off effects in the period 2003 to 2005 of EUR [...]*, [...]* of which being accounted for by the extraordinary costs of the sale and the rest by provisions for staff, IT, buildings and additional restructuring costs. In the medium and long term, the planned pre#tax result in 2006 of EUR [...]* (according to the reworked medium# term plan incorporating the three measures mentioned above) would fall by

EUR [...]* to EUR [...]*, of which around half being accounted for by the discontinuation of Berliner Bank's earnings contribution to the group and the rest by the delayed staff cutbacks, the abandonment of the planned increase in commission earnings and remaining (fixed) costs (primarily on account of back#office diseconomies of scale). However, this calculation assumed that, in order to maximise the number of bidders, Berliner Bank would be sold as an independent bank, with further charges being incurred. The expected proceeds from the sale of Berliner Bank of EUR [...]* to EUR [...]* were already included in the one#off effect of the extraordinary costs of the sale. According to the bank, this was, in any case, more than offset by the necessary core capital for Berliner Bank equivalent to [...]* % of risk items amounting to EUR [...]*, giving a negative effect of EUR [...]* to EUR [...]*. In addition, the divestment of Berliner Bank would reduce the profit share of retail business in BGB's total business from just over [...]* % to around [...]* % and the share accounted for by capital market business would accordingly rise from just over [...]* % to some [...]* %. As a result, given the core#capital ratio, there could be a deterioration in the rating since capital market business was regarded as being riskier than retail business. This would have a negative effect on the refinancing, with the result that the sale of Berliner Bank would also give rise to operating problems during the restructuring period. The sale of Berliner Bank would reduce the return on capital by around [...]* % percentage points from [...]* % in 2006 according to the medium#term plan of 24 June 2003 to around [...]* %.

(241) The Commission has carefully analysed the arguments adduced by Germany and the bank. In its view, these do not represent any insuperable obstacles to the hiving#off of Berliner Bank on competition grounds.

(242) For one thing, with the relative reduction in the contribution of retail business to the bank's overall business to which the hiving#off of Berliner Bank threatens to give rise, the bank is free to maintain a balanced structure by carrying out corresponding reductions in the other areas of capital market transactions and real estate financing. The bank's structure and the core# capital requirements would thus remained unchanged. In fact, such reductions in the risk items would release additional capital, thereby helping to boost the core#capital ratio further. As an alternative to such reductions, the bank could, with a view to covering the higher risk, raise the core#capital ratio either by making further efforts of its own to reduce selected risk items more than planned, thereby releasing core capital, or by borrowing fresh medium#term capital on the capital market. This would prevent any significant deterioration in the rating and thus in the refinancing terms, with the result that the bank could cope with the hiving#off operation in operational terms too.

(243) In calculating the one#off effects of the divestment of Berliner Bank, Germany and the bank assume that Berliner Bank would be sold as an independent bank in order to maximise the number of bidders. Given that Berliner Bank

is at present incorporated into Landesbank Berlin as a dependent business area and branch, Landesbank Berlin would have to be hived#off for sale as an independent legal entity. According to the bank, a core#capital ratio of [...]* % of the risk items and hence core capital of around EUR [...]*, which would have to be provided afresh by BGB are necessary. However, in spite of a core capital of EUR [...]*, BGB expects that a sale would bring in only EUR [...]*# EUR [...]*. In the Commission's view, this calculation is very conservative. The amount of net equity usually serves as one out of several benchmarks for estimating the value of a company. If Berliner Bank's core capital is to be some EUR [...]*, it is, in the Commission's view, rather unlikely for the sale proceeds to be only EUR [...]* to EUR [...]*. Given the well#established brand name and client basis of Berliner Bank, the sales proceeds should tend to reach or even exceed the value of the core capital, which the bank regards as an expense, and should therefore reduce BGB's charges to a much greater extent. But even if, exceptionally and for reasons not clear to the Commission, the situation here were different, it would not make sense for BGB to sell Berliner Bank as an independent bank. The brand, the customers and other assets of the working company all have a positive value. If BGB considers that not even the core capital, which needs to be provided afresh by BGB, can be realised in the sale, Berliner Bank's assets can, of course, be sold as part of a so#called asset deal that should at least generate some proceeds and thus reduce an extraordinary negative effect from the sale for BGB. As a result, the negative one#off effect of EUR [...]* would be significantly reduced.

(244) In the Commission's view, the claimed negative recurring effect on the return on capital of [...]* % can clearly be improved on by the bank if the sale is spread over more than one year.

(245) Having considered the Commission's analysis, Germany finally agreed that BGB would be viable if Berliner Bank were sold separately. It has stated its willingness to sell Berliner Bank separately by 1 February 2007 (real effective date), with a tendering procedure being launched in 2005 and completed by1 October 2006. The formal commitment was submitted to the Commission on 6 February 2004.

(246) As a result, the entire year's result for 2006 is still attributable to BGB, and the adjustment costs can be spread over a longer period or it will be easier to take countermeasures such as a further reduction in the short#term fixed costs for IT, back#office staff and buildings. According to BGB's own figures, the negative effects stemming from abandonment of the planned increase in LBB's commission earnings attributable to reorganisation, workforce uncertainty and the use for restructuring purposes of management resources of EUR [...]*, from the delay in workforce cutbacks within the group of EUR [...]* and from the remaining costs caused by diseconomies of scale of EUR [...]* would not continue indefinitely. The Commission shares this view.

(247) The Commission's position is confirmed by its review of the one#off effects and the long#run effects on BGB's return on capital. The outturn figures will probably be much lower than those given by Germany and the bank. If this were not to be the case because of a series of unfortunate circumstances or because of unfavourable market developments, even a return on capital of [...]* % in 2007 (return on capital of [...]* % according to the medium# term plan of 24 June 2003 less [...]* % as a result of the divestment of Berliner Bank) would, on the Commission's estimation, not result in a situation where the remaining parts of the group would again be dependent on government assistance, which, under the 'one time-last time' principle of state aid legislation, could no longer be granted. The bank has it within itself to become more stable by raising the core#capital ratio to 7 % or more. This would have a positive effect on the rating and, from an operational viewpoint, would ensure satisfactory refinancing conditions. In the Commission's view, the return on capital of [...]* % to [...]* % expected in 2006 under adverse conditions would, given the current difficult situation in the German banking sector, be at the lower end, if anything, of the range that is regarded as satisfactory on the market for a bank's long#term viability. However, the Commission expects that the privatisation promised for 2007 will lead to a further strengthening of the bank. If the new investor were to regard the return on capital or the capital endowment of the bank at the time as unsatisfactory, it is to be expected that it would, in its own interests, carry out further rationalisation measures, e.g. reductions in unprofitable areas of business or capital injections, which would bring about the necessary improvement in the rating and in the refinancing situation.

(248) Against this, the Commission agrees with Germany and the bank that, as things stand, it cannot be ruled out with sufficient certainty that a strict requirement to sell BerlinHyp separately in the medium term might unduly prejudice the bank's viability. However, it still has — and this has been confirmed by its independent advisers — some doubts that the bank will manage to generate to the extent envisaged new, higher#margin business in real estate financing. For this reason, the Commission would generally regard it as a positive contribution to strengthening the bank's long#term profitability if it were to withdraw from real estate financing to a greater extent than hitherto planned. This could be achieved above all by selling BerlinHyp separately, and this was, therefore, thoroughly examined by the Commission.

(249) According to Germany and the bank, the binding requirement to sell BerlinHyp separately in the medium term would have the following adverse effects on the rest of the group and would impose the following requirements, which could not necessarily be met by the buyer. As far as possible, the buyer would have to take over the group's internal refinancing (currently EUR [...]*) on similar terms, i.e. it must possess a rating at least as good as that of Landesbank Berlin, and to assume responsibility for BGB's guarantee

for BerlinHyp in order to avoid applying the methodology for large credits (currently estimated at around EUR [...]*). In addition, the buyer would have to offer at least BerlinHyp's book value as the purchase price since otherwise the book value might be significantly written down, [...]*. Even if the tendering procedure had a negative outcome, there would still be the risk of the book value being written down further. Moreover, a sale that did not seriously impair the restructuring plan would be possible only if the cooperation on marketing between BerlinHyp and the group could be continued. The requirement of a separate sale would entail a one#off write# down of the present book value of EUR [...]* by EUR [...]* to the book value of BerlinHyp's capital of EUR 519 million. The expected pre#tax result for the rest of the group in 2006 would be reduced by a further EUR [...]* or so (difference between the disappearance of the planned BerlinHyp result of some EUR [...]* and the interest earnings on the expected sales proceeds of some EUR [...]*). Together with the separate sale of Berliner Bank, this would result in a further fall of some [...]* % in the target return on capital of the rest of the group in 2006 to a little over [...]* % generally and a core#capital ratio of only just over [...]* %.

(250) Since a binding requirement to sell BerlinHyp separately would thus give rise to further significant risks for the viability of the rest of the group, the Commission, as things stand, does not regard this either as an appropriate measure for strengthening long#term profitability or as a feasible compensatory measure on which the decision would rest. It thus welcomes Germany's intention that the feasibility of a separate sale of BerlinHyp at a later date should be re#examined in the light of the privatisation of the rest of the group and that, depending on which scenario is more likely to improve privatisation prospects, BerlinHyp will be sold either together with the rest of the group or separately by the end of 2007 as part of a transparent, open and non#discriminatory procedure. In the Commission's view, BerlinHyp could realistically be of interest once again, at least from 2006 onwards, to a strategic investor. BerlinHyp's business plan also assumes an improvement by then in the general market situation for real estate financing business. The Commission considers that a review of the prospects for a separate sale should, therefore, be conducted in 2006. It also expects that, in line with the recommendations of its advisers and with the restructuring plan reworked on this basis, the bank will [...]* as soon as unexpectedly poor business results show this to be necessary. This measure would, of course, minimise the potential risk stemming from the need to make a further write#down [...]*. In the Commission's view, such measures would be conducive to the long#term viability and privatisation prospects of the rest of the group.

(251) On 29 January 2004 Germany submitted the current restructuring plan including the medium-term financial plan, which is based on figures as at mid#January 2004. The latter updates the previous version of June 2003, on which the viability assessment by the Commission and its consultants'

was based, and takes into account, for instance, the recommendations of the Commission's consultants regarding the risk provisions. As to the divestment of Berliner Bank, which has not yet been incorporated in the current medium# term financial plan, Germany submitted estimates based on the analysis presented in December 2003. The figures of the current plan do not differ significantly from the version of June 2003 and therefore do not alter the Commission's assessment of BGB's viability prospects.

Commission's summary conclusions regarding long#term viability and privatisation prospects

(252) After incorporating the recommendations of its advisers Mazars, the Commission regards the restructuring plan as being generally plausible and complete in spite of the continuing uncertainties noted in connection with future developments. In its view, the operational, functional and financial measures that have already been taken or are envisaged are suited to restoring the bank's long#term viability and the failure to date to meet targets is not such overall as to give rise to any lasting misgivings regarding the feasibility of the restructuring plan. A number of measures are running below the targets set in the plan. But some of the leeway will be made good by overachieving targets in other areas.

(253) The prospects for viability are dependent to a large extent on future profits, on steps to strengthen the core#capital base and, in particular, on the ability to generate new business and on the restructuring plan being implemented in full. The bank will be extremely dependent on capital market earnings, especially during the restructuring period. The real estate financing strategy is ambitious and threatens to fall short of the targets set. A further deterioration on the real estate market in the Berlin area and a further decline in gross domestic product would threaten the bank's viability. To reduce this risk, the Commission considers that a larger share of the real estate financing business should be hived off through a separate sale of BerlinHyp and expects Germany to carry out a detailed analysis. The bank could then more easily offset any losses stemming from the smaller real estate financing business that would remain within BGB/LBB thanks to expected positive contributions from retail business and capital market business.

(254) The bank does not at the moment have any latent reserves or other financial resources that would absorb larger losses during the restructuring period. As a result, the Commission considers that a core#capital ratio of 6 % is the minimum necessary to ensure viability and hence the maximum that can be financed out of state aid. It expects the bank to make every effort to raise the core#capital ratio to around 7 % or higher by reducing risk assets further or by borrowing more on the market. The bank's capital market capability and privatisation prospects would thus be further improved.

(255) In the Commission's view, the maximum reduction in the anticipated return on capital in 2006 from around [...]* to [...]* % to some [...]* to [...]* %

that the additional compensatory measure of a divestment of Berliner Bank is expected to bring about does not threaten the bank's long#term viability. The Commission assumes that, following the bank's privatisation, an investor will take all necessary measures to achieve for the bank a level of profitability that is acceptable to a market#economy investor.

(256) The Commission considers that, after the restructuring period, the privatisation of the bank will have sufficient prospects of success. Germany has undertaken to introduce a privatisation procedure immediately after closure of the annual accounts for 2005 and to complete that procedure by the end of 2007. The Commission regards this as a realistic timetable. In this connection, it stipulates that Germany and the bank must, until then, make every effort to remove any remaining obstacles to the privatisation. These include the still complex structure of the group, which is to be further slimmed down as part of the restructuring process, and the concentration of the still insufficiently focused product range and an improvement in the group's internal transparency. In addition, the purchase price will tend to be adversely affected by the fact that the bank has leased a large proportion of its business premises at prices exceeding the market level. According to calculations by the Commission's advisers, the cash value of this disadvantage will be somewhere in the region of EUR [...]* to EUR [...]* in 2006 and an investor can be expected to take this into account in its tender. The planned privatisation will take place between one and two years after the expiry of the State's institutional and guarantor liability. In the Commission's view, this will allow a potential investor sufficient time to take a look at the bank's market operations on a stand#alone basis following expiry of the institutional and guarantor liability in 2005 and to conduct a proper analysis with a view to preparing its bid.

Avoidance of undue distortions of competition

(257) The exemption in Article 87(3)(c) of the EC Treaty is subject to the condition that the aid must not adversely affect trading conditions to an extent contrary to the common interest. According to points 35 to 39 of the guidelines, measures must be taken to mitigate as far as possible any adverse effects of the aid on competitors. This condition usually takes the form of a limitation on the presence which the company can enjoy on its market or markets after the end of the restructuring period. Point 37 states that the compulsory limitation or reduction of the company’s presence on the relevant market(s) should be in proportion to the distortive effects of the aid and, in particular, to the relative importance of the firm on its market or markets. Under point 38, a relaxation of the need for compensatory measures may be contemplated only if such a reduction or limitation is likely to cause a manifest deterioration in the structure of the market, for example by having the indirect effect of creating a monopoly or a tight oligopolistic situation. It has already been explained with regard to a hypothetical case of insolvency that, in view of the market structures and BGB’s position on those markets, a reduction or limitation of

BGB's presence will not lead to the creation of a monopoly or tight oligopoly (see below).

(258) Compensatory measures can take different forms, such as a hive#off of assets or subsidiaries or the closure of capacity. Point 39(i) of the guidelines states that, where there is structural excess of production in a market affected by the aid, the compensatory measures must make a contribution to the improvement of market conditions by irreversibly reducing production capacity and that a capacity reduction is irreversible when the relevant assets are rendered permanently incapable of achieving the previous rate of output or are permanently converted to another use.

(259) The markets in financial services are not markets where there is structural excess of capacity within the meaning of point 39(i) of the guidelines, which refers to 'production capacity' and 'plant' and thus implicitly to manufacturing rather than to service industries, where capacity can generally be adjusted much more easily. The excess capacity sometimes spoken of in banking, e.g. with regard to the density of branch networks, is not usually structural in the sense of being the outcome of a lasting drop in demand; rather the reference is to labour#intensive and hence cost#intensive areas where capacity is to be reduced primarily on grounds of profitability.

(260) But, even if the view were to be taken that financial services did indeed suffer from excess capacity, that capacity could not be 'rendered permanently incapable of achieving the previous rate of output' or be 'permanently converted to another use'. The capacities used to provide banking services # primarily staff, branches, advice centres, back offices and computer and telecommunications systems # are highly adaptable and can be reemployed, hired out or otherwise brought to the market at no appreciable cost. An irreversible reduction of capacity is thus impossible and cannot be a test to be applied to the case at issue.

(261) In what follows, therefore, the Commission considers whether the sales, closures and reductions of subsidiaries, assets and lines of business within the meaning of point 39(ii) offered as compensatory measures are sufficient to mitigate the distortive effects of the aid.

(262) The measures Germany initially offered as part of the restructuring plan can be summarised briefly as follows:

— divestiture of subsidiaries and holdings: The main sales were to be in retail banking: Allbank, represented throughout Germany (now sold), Weberbank in Berlin (not yet sold), BG Zivnostenska Banka a.s. in the Czech Republic (sold) and BG Polska SA (retail business and 'Inteligo' Internet business sold, remainder in liquidation),

— closures: Closure of some 90 branches serving private and corporate customers in Berlin and Brandenburg (the bulk of them in Berlin); 6 customer centres throughout Germany; 6 real estate financing offices in Germany and

3 abroad; 3 capital markets offices located abroad; and 14 large customer and international business offices located abroad,

— withdrawal from lines of business: long#term withdrawal from large customer and international business (e.g. loan transactions with foreign banks, advisory services for large customers, privatisation and aircraft financing),

— reduction measures: in capital markets, reduction of risk assets by [...]* % and of debt finance by [...]* %; in real estate, reduction of the volume of investment funds by over [...]* % (about EUR [...]*) and of project development by [...]* % (about EUR [...]*), and office closure and staff reductions of 50 %; reduction of the small public#sector business and integration of the remainder into the corporate business.

(263) Germany stated that these measures together would lead to a reduction in staffing of 50 % (from about 15 000 to 7 500) and a reduction in the balance# sheet total from roughly EUR 190 billion to EUR 140 billion.

(264) In the decision initiating the procedure, the Commission commented that, for want of sufficiently detailed information, it could not make a proper assessment of the impact of these measures, which in some cases were described only vaguely, as regards both BGB's individual areas of business and its position on the markets; it thus asked for further information. Germany then supplied detailed information on the effects on the individual business areas or markets (see paragraph 291 et seq.) and the overall impact: total assets reduced by EUR 51,5 billion, or 25 %; total liabilities reduced by EUR 57,8 billion, or 27 %; and consolidated balance sheet reduced by EUR 50,2 billion, or just under 27 %[(26)].

(265) But, in the decision initiating the procedure, the Commission had already expressed doubts as to the adequacy of the planned compensatory measures. It seemed questionable whether the proposed reduction in the balance#sheet total could be regarded as sufficient in view of the large sum to be provided in aid and the Commission's practice with regard to restructuring assistance for banks[(27)]. It drew attention to the minimum capital ratios required by law, which might provide a rough guide for the assessment of compensatory measures in the banking sector. The argument is as follows. In order to continue in business, an undercapitalised bank must either reduce its risk assets, and hence its volume of business, in proportion to the shortfall in capital (e.g. applying the legal minimum core#capital ratio of 4 %, the risk assets must be reduced by a factor of up to 25); or seek a capital injection equal to the shortfall. Such a capital injection will enable it to avoid the reduction that would otherwise be necessary. This concept of an 'opportunity reduction' can serve to render visible the market distortion caused by a capital injection and thus provide a rough guide for the assessment of compensatory measures. But the Commission had pointed out that this would not be a mechanical rule and that, in any particular case, account would have to be taken of the

economic circumstances, with special reference to the viability of the firm and the competitive situation on its markets.

(266) As regards the overall impact, Germany argued that the correct point of reference was not just the core capital but rather the own funds, made up of core capital and additional capital; here the legal minimum was 8 %, so that the expansion of business permitted by the aid, or the contraction of business it prevented, had to be valued using a factor not of 25 but of 12,5 at most. In reality, a bank could increase its risk#weighted assets by 25 only if a capital increase comprised additional capital as well as core capital. Even if the bank already had additional capital that could not previously be taken into account,[(28)] the assessment should not be based on an expansion of business that had been made possible only by the additional capital that had been available in any event. Germany further contended that the capital ratios actually required on the market were well above the legal minimum, at 6 % at least for core capital and about 10 % for own funds. BAFin had confirmed this approach and had explained it in detail in comparisons with the averages for German banks (a core#capital ratio of some 6 to 7 % and an own#funds ratio of 9 to 11 % or, in the case of private banks, 10 to 11 %) and with the averages for large European banks, which were higher (a core#capital ratio of 8,5 %). Germany concluded that the economic impact on the market of a capital injection of about EUR 1,8 billion should be valued at about EUR 18 billion. The Commission accepts these arguments.

(267) Turning to the risk shield, at the time of the decision initiating the procedure, the economic value of this aid was not clear. Since then Germany has argued that the economic value of the risk shield should be estimated at a little over EUR 6 billion (see paragraph 138). It has also stated that real estate services are not subject to the solvency rules, so that the contraction in business that is avoided cannot be derived from the capital ratios. It further contends that the risk shield relates essentially to old business in real estate services. According to Germany, it could be argued that, during the restructuring of IBAG, new business was made possible only because cover had been provided for the company. But, in that event, the market distortion could be measured only by reference to the new business (estimated at about EUR [...]* altogether in the restructuring phase; see paragraph 90) or, at most, to the overall value of the risk shield (EUR 6,1 billion).

(268) The Commission cannot accept this estimate. Without the risk shield or, alternatively, a capital injection of about EUR 6 billion, BGB would not have been able to continue in business as a result of the interlocking risks within the group. The effect of the risk shield is thus comparable to that of a capital injection of some EUR 6 billion. The same applies to the capital contribution provided for in the repayment agreement, which, in the event of a recovery decision by the Commission, can be estimated at a maximum value of EUR 1,8 billion[(29)].

(269) If the total economic value of the aid is EUR 9,7 billion and applying a factor of 10 to the own#funds ratio is actually required, the reduction in the balance sheet that serves as the point of reference for an estimate of the market distortion and as a rough guide for the compensatory measures would come to almost EUR 100 billion out of EUR 190 billion.

(270) This demonstrates the limits to the applicability of the opportunity argument. An immediate reduction on this scale would be possible only in the event of insolvency. Without the aid, therefore, the only possible course would have been for BGB to cease trading; conversely, the only acceptable compensatory measure would be the insolvency of BGB. But, within the time needed for an ordinary restructuring operation, compensatory measures on the scale described above can be implemented in the short and medium term only with difficulty or at the cost of heavy losses on the sale of parts of the organisation or the cancellation or termination of long#term contracts and positions if the viability of the firm is not to be jeopardised for a long time to come or indeed rendered in all probability impossible. Firstly, such a consequence would hardly be compatible with the objective of restructuring aid and the yardstick by which it is measured, namely the return of the recipient firm to long#term viability. Secondly, it would be out of proportion to the impact of the various aid measures on individual lines of business and markets. Consequently, the opportunity argument cannot be applied mechanically to identify the required level of the reduction in the balance#sheet total.

(271) The Commission has accordingly sought to ensure an overall contraction in the volume of business in line with its practice in the past but, above all, also an effective reduction in the bank's presence on the markets, having regard to the effects of the measures proposed on the individual lines of business.

(272) BGB operates primarily in private and corporate retail banking, real estate financing, real estate services (investment fund and project business) and capital markets (money and securities dealings).

(273) The other lines of business are less significant in terms of volume, are to be cut back or closed down and are of no further relevance here. This applies to the public#sector lending segment, which is to be substantially reduced and will in future form part of the corporate business, and to the large customer and international segment (e.g. project and export financing), which is to be wound up. Investment banking activities consisted only of a relatively small volume of share and security issues and will not play an independent role in future. IBB's development banking role is to be hived off from LBB when institutional liability and guarantor liability for LBB come to an end in 2005.

(274) On the basis of the information provided by Germany, the decision initiating the procedure treated real estate as one line of business but, in order to assess the compensatory measures further, this had to be divided into real estate financing and real estate services because of their different supply and demand

structures. According to BGB's in#house definition, real estate financing is large#volume financing (involving sums of EUR 5 million and upward) and thus primarily commercial real estate financing (for housing construction or shopping centres, for example). It is carried on mainly by BGB's subsidiary BerlinHyp, which accounts for about two thirds of the entire volume, but also by LBB and BGB itself. Private real estate financing falls predominantly within the group's private customer business.

(275) BGB's real estate services consist essentially of investment fund business and building and development work. It was formerly conducted by IBG and is now handled by IBAG, which is a wholly owned division of BGB.

(276) Real estate services are the area which was the main cause of the crisis and of the restructuring measures under consideration here, and they have benefited most from the risk shield, the measure that represents the largest volume of aid. From the outset, therefore, there were doubts about the continuation of this line of business.

(277) In the summer of 2002 Germany offered to hive the real estate services business off from BGB and to transfer it to the *Land* of Berlin. This general intention was spelt out in detail in the undertaking submitted by Germany in January 2004. Germany here undertakes to ensure that by 31 December 2005 the BGB group sells or liquidates all holdings in real estate service companies covered by the risk shield.

(278) In detail, the undertaking provides that by 31 December 2004 the *Land* and the bank are to take a final decision settling which holdings can suitably be sold to outsiders in a transparent, open and non#discriminatory bidding procedure. According to Germany, the number of such holdings can reasonably be expected to be small. Essentially, there is only one fairly large company involved which has about 160 employees and is covered by the book value guarantee afforded by the risk shield, so that under the detailed agreement any profit on the sale is to be transferred to the *Land*. If sold to outsiders, the company will no longer be covered by the guarantees in the risk shield. All holdings not sold or liquidated by 31 December 2005 will be acquired by the *Land* of Berlin on market terms, with the price being determined by an accountant commissioned by the *Land* or by arbitration if that proves necessary after the first valuation has been reviewed by an accountant commissioned by the bank. Under the detailed agreement, the *Land* already has special rights of assent, information and control in the real estate services area, which are exercised by BCIA.

(279) At an early stage in the procedure, Germany also announced its intention of divesting LBB of the development business of IBB and at least part of the IBB special reserve, which is currently available to LBB as core capital. This intention was likewise spelt out in an undertaking submitted by Germany in January 2004. Germany here undertakes to ensure that by 1 January 2005

IBB's development business is transferred to a newly set up, independent development bank belonging to the *Land* of Berlin and that, at the same time, the IBB special reserve is hived off from LBB towards the capital of the new development bank to the extent possible without falling below a core# capital ratio of 6 % on 1 January 2004. The section of the IBB special reserve still needed for the capitalisation of BGB will be invested by the *Land* in one or more dormant holdings in LBB and will bear interest at market rates. At the time these dormant partnerships are formed, in view of LBB's long# term rating (leaving aside the public institutional and guarantor liability) and having regard to the contractual structure of the dormant holdings, a premium will be determined at a reference interest rate in line with those of comparable core#capital instruments traded on the market. The comparability of such core#capital instruments is to be determined on the basis of the contractual rules governing them and the risk profile of the issuer.

(280) In the autumn of 2003 the following updated overall picture could be given of the measures envisaged by Germany to reduce the volume of business (measured on the basis of asset positions) in the individual business areas in the period from 2001 (end#of#year figures) to 2006 (planned balance sheets or profit#and#loss accounts):

REDUCTION MEASURES[0]

(in billion euro)

Business area	**Segment assets**		
	Balance sheet	**Plan**	**Change**
	2001	**2006**	
Retail banking — Private customers — SME customers	20,0 12,2 7,8	[...]* [...]* [...]*	[...]* [...]* [...]*
Public sector	11,0	[...]*	[...]*
Capital markets	109,7	[...]*	[...]*
Large customer/ international	10,8	[...]*	[...]*
Real estate financing	31,2	[...]*	[...]*
Real estate services	3,2	[...]*	[...]*
Subtotal	**185,9**	[...]*	[...]*

a There may be discrepancies due to rounding.

Interest management and consolidation	-16,8	[...]*	[...]*
Total assets (not including IBB)	**169,1**	[...]*	[...]*
IBB	20,1	[...]*	[...]*
Balance# sheet total (consolidated)	**189,2**	[...]*	[...]*

a There may be discrepancies due to rounding.

(281) The measures planned by Germany at this stage would result in an overall reduction in the balance#sheet total of 30 %. They include divestments (e.g. some EUR 6 billion in retail banking through the sale of Allbank, BG Polska, Zivnostenska Banka and Weberbank), closures (e.g. of some 90 branches and 6 private banking centres) and asset reduction. In the large customer/ international and real estate services business lines, which are to be wound up or hived off, residues will remain after 2006 which will have to be dismantled in stages. The public#sector business will be cut back significantly. After restructuring, therefore, the main pillars of the bank will be retail business in the Berlin area, real estate financing and capital market business.

(282) Even though the hive#off of IBB's development/support business cannot be viewed as a compensatory measure in that development business forms part of the public service provided by the *Land* of Berlin and is not a commercial activity[30], it is to be noted that a total reduction of roughly a quarter (not taking account of IBB) or just over EUR 40 billion is basically in line with the Commission's practice in similar cases in the financial services sector. However, reducing assets and balance#sheet items serves primarily to give an overall impression but cannot in general be equated to an effective reduction in business activity, let alone market presence. This applies in particular to the three remaining principal business lines. In retail banking, although shareholdings have been or will be sold (Polska, Zivnostenska, Allbank, Weberbank) and branches shut, the restructuring plan valid up to the autumn of 2003 aimed to keep market presence in Berlin more or less intact or even to consolidate it slightly in individual segments. The measures in this business area should therefore be viewed as primarily serving to concentrate on the regional core business and to cut costs by closing branches. In real estate financing too, the planned reduction is relatively modest in relation to total volume. In the capital market business sector, although there will be major cutbacks in business lines, a significant volume of business will remain.

(283) Germany and BGB stated that making further cutbacks or even abandoning an entire business line would be difficult and would jeopardise the bank's

viability. The real estate financing business of BerlinHyp, LBB and BGB, given current market conditions and the as yet incomplete restructuring of this business area, could not be sold in the short term or could be sold but only with major losses in book value. Furthermore, a positive profit contribution was expected from this area before the end of the entire restructuring process and would be needed to achieve the overall target result from 2004 at the latest.

(284) The Commission examined these arguments, together with the related data provided, and came to the conclusion that divestment of the real estate financing business in the short term would jeopardise the bank's viability (see paragraph 230). Moreover, an analysis of the competitive situation on the German market for real estate financing showed that BGB is not among the leading suppliers. According to the original notification, BGB, with a share of some 5 % in 2000, occupied third place. However, according to more up#to# date data submitted by Germany, which are adjusted for public#sector lending, actual market share in 2000 was only some 3 %, and this is likely to fall to 2 % by 2006. This coincides with other sources of information which show that in 2001 BGB did not reach the third place originally indicated or achieve a 5 % market share, either in the mortgage lending market as a whole or in the various segments.[(31)] Accordingly, it would not appear to be urgent to reduce BGB's market presence in this area in order to avoid unreasonable distortions of competition.

(285) Nevertheless, it would be preferable if the BGB group were to pull out of this business area since the mere continuation of its activities on the markets for real estate financing distorts competition to some extent. However, this would be on condition that a withdrawal would not endanger the restoration of long# term viability. In this connection, the Commission welcomes the intention of Germany and the *Land* of Berlin to sell the real estate financing business line separately or as part of the overall privatisation of BGB.

(286) The capital market business, whose segment assets have already been reduced by almost 20 %, was in 2002 the only business line to make a significant (i.e. hundreds of millions) positive profit contribution. At the end of the restructuring process in 2006, it is to be one of the main pillars, together with retail banking, of the group's result and profit. Consequently, the capital market business is, first, essential to the restoration of BGB's viability and cannot be reduced much more than it has been. Second, the competitive weight of BGB on the national money and securities markets, which are none the less becoming increasingly international and European, can be classed as not significant, i.e. as even less than its weight on the national real estate financing markets.

(287) Nevertheless, the Commission examined whether further, even if limited, reductions might be made. In view of the overall aim of the restructuring aid, which is for BGB to become a regional bank again, the Commission looked mainly at whether further foreign subsidiaries might be given up. After

the closures and divestments which had already been undertaken, however, subsidiaries remained at only three locations (London, Luxembourg and Dublin), whose continued existence Germany had described as being vital for the bank's retail business and refinancing. In the end, a commitment was given to abandon BGB (Ireland) plc in Dublin. The Commission accordingly did not seek further measures in the capital market sector, for the reasons set out above.

(288) Under point 37 of the guidelines, an assessment of compensatory measures must take account of 'the relative importance of the firm on its market or markets'. The retail banking business (private and corporate customers) is therefore by far the most problematic from a competition point of view. Already in its decision initiating the procedure, the Commission expressed doubts about the appropriateness of the compensatory measures primarily on account of BGB's strong regional and local position on this market.

(289) Through selling subsidiaries or other parts of assets and through closing branches and other sites, BGB has already significantly reduced the segment assets attributable to this business line. The 43 % reduction originally planned in the segment assets by 2006 (see table in paragraph 280) has thus almost been achieved, and essentially all that remains is to sell Weberbank. However, the Commission commented back in its decision initiating the procedure that 'BGB is extremely strong locally and regionally in the markets of retail and corporate banking, with shares ranging from 30 to 57 % in the individual segments at local level and from 23 to 46 % at regional level, and with huge gaps between itself and its nearest competitors, which achieve only half, a third or a fourth of BGB's shares.' The Commission already had doubts in this connection about whether the target reduction in the retail and corporate sectors by way of the planned divestments would suffice to mitigate the distortive effects of the aid in the greater Berlin region.

(290) The divestments in retail banking which have already been planned or carried out, with the exception of Weberbank, which is small and directed at wealthy private customers, do little or nothing to reduce BGB's presence in Berlin: Allbank is active countrywide and has only a few branches in Berlin, BG Polska and Zivnostenska Banka operate abroad. Although some 40 to 50 (private and corporate) branches were closed in Berlin in each category, closing branches in a large city with high branch density serves mainly to cut costs and, according to the comments by Germany, causes customers to change banks only to a limited extent.[(32)] Moreover, the additional information referred to and provided by Germany shows that the intention was not significantly to reduce market presence in Berlin, but to maintain BGB's position in individual segments or even to strengthen it slightly.

(291) In response to the Commission's doubts, Germany argued that the volume# based market shares originally submitted for BGB in the individual segments of the Berlin market were overstated. This was because of BGB's reports to

the *Land* central bank, which were for the whole group and did not distinguish between product markets or regions. This meant, for example, that lending and deposit volumes for the real estate financing and capital market business areas outside Berlin were included in the figures for local retail and corporate business. BGB's lending and deposit volumes and the corresponding market volume for Berlin had therefore been adjusted for the lending and deposits not attributable to the region or the product area. This gave private#customer market shares for BGB of some 43 to 45 % for deposits/payments business and some 22 % for lending in 2000 and 2001. In the corporate sector, BGB had market shares of some 25 to 26 % for deposits/payments and some 23 to 25 % for lending in 2000 and 2001. Compared with the originally notified figures, the market shares submitted by Germany for BGB in the individual segments, especially in the corporate customer segment, had thus fallen in some cases by almost half.

(292) For BGB's nearest three competitors on the Berlin retail market (Berliner Volksbank, Dresdner Bank and Deutsche Bank (group)), Germany gave market share estimates for 2001 of around 11 to 13 % for lending/private customers, 8 to 14 % for private customers/deposits, 5 to 16 % for corporate customer/lending and around 9 to 18 % for corporate customers/deposits. With estimates of over 50 % in the private customer sector (50 to 60 % for the deposit/payments segments and about 50 % for lending) and close on 60 % in corporate banking (over 40 % for deposits/payments and around 50 to 60 % for lending), Volksbank assumes far higher market shares for BGB. It estimates its own market shares at 6 to 10 % in the private customer segments and some 4 to 10 % in the corporate segments.

(293) Germany's corrected market shares for private and corporate retail business refer only to Berlin as it considered this to be the relevant region and retail banking to be a regional business[(33)].

(294) In its comments, the Berliner Volksbank also argued that Berlin was the relevant geographic market for assessing the aid in retail banking and that this was in line with the Commission's usual assessment criteria for defining the market in merger control. Merger decisions in the banking sector had cited such factors as the general preference of banking customers for local suppliers, the significance of a dense branch network and the need for the bank to be physically close to its customers[(34)]. If the Commission had none the less tended so far to assume in merger decisions relating to financial services that markets were national in scope, this was because an absence of competition concerns (indications of a dominant market position) meant that no thorough analysis of retail banking was necessary. However, it would be inappropriate to define the market as national when assessing the distortive effects of the aid in this case on competition on the Berlin retail banking market. It was precisely in this area, given its pre#eminent market position, that BGB would have to offer compensatory measures to reduce its market presence. On account of

its dual brand strategy, among other things, BGB's market position was far greater than was usual for regionally strong savings banks in some German cities. This concentration made market access more difficult for potential competitors and had meant that the market share of foreign banks in Berlin was negligible.

(295) For the purposes of this decision, the Commission has no cause to depart from the position of Germany and Berliner Volksbank with respect to the geographical focus on Berlin in retail banking. As stated in the decision initiating the procedure, it has to date in the area of merger control generally assumed that the markets in the financial sector are national in scope — with the exception of financial services - but has left room for a regional definition in private#customer and corporate banking[(35)]. The significance of the branch network and that of the bank's local physical presence in retail banking suggest that the focus should be on the Berlin market. Customer behaviour also points to this approach since, when branches are closed or sold off in a large city such as Berlin and to the extent that customers change banks at all, they tend to switch to another locally represented credit institution, despite the increase in telebanking. The inclusion of Brandenburg, apart from the areas adjoining Berlin, therefore seemed to be casting the net too wide, as BGB's withdrawal from Brandenburg and its concentration on the core region also suggest.

(296) For the purposes of this decision, however, a precise definition of the geographic market is not important since it is not a question of proving that there is a dominant position but of assessing whether the proposed compensatory measures suffice to offset the distortive effects of the aid at issue by reducing market presence. There can be no doubt and no disputing the fact that the aid has helped the bank to remain on the various markets and thus also to preserve its strong position on the Berlin retail market.

(297) The Commission has doubts about the reliability of the market share estimates that had been submitted by Germany and adjusted downwards, first because similar reporting problems in individual cases may also affect the other competitors but may not have been taken into account in the market volumes given, and second because third parties which submitted comments in the course of the proceedings and were asked for their own estimates more or less confirmed the original figures. However, independent market share calculations with verifiable distinctions by region and product are not available. Enquiries showed that no competition#based analysis in the antitrust/merger control field has been carried out in this connection by the Bundesbank/*Land* central bank, the Federal Cartel Office or the Commission. In the state aid field, the Commission does not have the necessary powers to conduct investigations among competitors.

(298) Nevertheless, for the purposes of this decision, a precise analysis of market share is not necessary since, as explained above, assessing state aid does not

involve proving that a dominant position exists. It is indisputable that the aid concerned here distorts or threatens to distort competition, especially on the markets on which BGB has a strong position; this also corresponds to BGB's view of itself as the leading retail bank in Berlin. The adjusted market shares of between a little over 20 % and more than 40 % in the individual segments do not contradict this even if they are correct, which is doubtful. In this connection, it should also be noted that, according to the information submitted by Germany, BGB's share or market penetration in 2002 in terms of first giro accounts held by private customers was 48 % and that, according to comments by BGB's chairman of the board, the bank's market share, with the brands Berliner Sparkasse and Berliner Bank, was in some cases more than 50 %[(36)].

(299) Consequently, there is no doubt that BGB enjoys a strong market position and is clearly the leading retail group in the greater Berlin area, which has a population of roughly 4 million. Its market position has not significantly changed since its foundation in 1994, when Berliner Bank and Berliner Sparkasse (then already combining the former Sparkasse in West Berlin and that in East Berlin, with the latter enjoying a quasi#monopoly position) were brought under one roof or since the start of the crisis in 2001. This 'stability' serves as an indicator for its market power vis-à-vis actual and potential competitors.

(300) Against this background, the Commission made it clear that approving restructuring aid on the basis of compensatory measures which leave BGB's position on the Berlin market for retail banking basically intact would not be compatible with the EU's state aid rules. Germany, however, remained preoccupied with the bank's arguments about the threat to its viability.

(301) After intensive further negotiations on 18 December 2003 with representatives of the Federal Government and the *Land* of Berlin, Germany finally committed itself to the divestment of Berliner Bank as a further compensatory measure with a view to enabling the Commission to approve the aid without imposing further extensive compensation measures. It accordingly undertakes to ensure that the group sells the 'Berliner Bank' division as an economic entity, including at least its trade name, all customer relations associated with the trade name, as well as branch offices and staff in a legally effective, open, transparent and non#discriminatory procedure by 1 October 2006 (closing by 1 February 2007). The effective date for the determination of the number of customers, branches and front#office staff is 31 December 2003, taking into account the planned implementation of the restructuring plan notified to the Commission and natural business fluctuations, i.e. increases and decreases in the number of customers, staff, assets and liabilities that are based on individual decisions (such as the relocation of customers or employees and dissatisfaction with the previous bank or employer) and not influenced by the bank. This means in particular that BGB is not allowed to

incite customers to transfer from Berliner Bank to other parts of the group, such as Berliner Sparkasse. A trustee appointed by Germany (the *Land* of Berlin) and approved by the Commission will ensure that the bank continues to restructure Berliner Bank in accordance with business sense, investing in it and not taking any steps to reduce its value, in particular by the transfer of private or corporate customers or sales staff to Berliner Sparkasse or other parts of the Bankgesellschaft group.

(302) By 2006[37] the sale of Berliner Bank will reduce the assets in retail banking by a further EUR [...]* (and, together with the measures already planned and promised, by some EUR [...]* in all. BGB's market share in the individual segments of the Berlin retail business will be reduced by one third to one sixth as a result of the sale. The balance#sheet total will be reduced from roughly EUR 189 billion to about EUR 124 billion.

(303) In the Commission's view, therefore, the completed, planned and promised divestments, closures and reductions of other kinds suffice as a whole to mitigate the distortive effect of the aid measures at issue.

(304) Lastly, it must be mentioned that, in its original notification, Germany stated that Berlin was a region within the meaning of Article 87(3)(c) of the EC Treaty and qualified for regional aid and that points 53 and 54 of the guidelines would have to be taken into account in assessing compensatory measures, without giving further explanations or specific details. Points 53 and 54 state that the assessment criteria in the guidelines also apply to assisted areas but that the capacity reduction required on markets with excess structural capacity may be less stringent. In its decision initiating the procedure, the Commission noted that it was not in a position, in the absence of further specific details, to assess the extent to which this criterion applied. Since Germany did not come back to this point in the course of the proceedings and since, as explained above, the banking sector does not involve markets with excess structural capacity, the Commission considers that points 53 and 54 are not applicable in this case.

Aid limited to the minimum

(305) In the Commission's view, Germany has demonstrated satisfactorily that the amounts of the three aid measures granted — the capital injection, the risk shield and the agreement on the treatment of any claims to repayment brought against the bank by the *Land* of Berlin — are limited to the strict minimum needed to enable restructuring to be undertaken in the light of the existing financial resources of the bank and its shareholders. The bank received no surplus cash or surplus own resources which it could have misused for the purposes of an unreasonable expansion of its business at the expense of its competitors.

(306) The EUR 1.755 billion capital injection in August 2001, initially granted as rescue aid, was assessed on the basis that it could help the bank secure

a core#capital ratio of 5.0 % and an own#funds ratio of 9,7 %. As stated above, the Commission regards this as vital for a bank's short#term survival. By its own efforts, in particular by reducing its risk exposure, the bank subsequently managed to increase its core#capital ratio to above 5 %. At the end of 2003 the ratio stood at around 6 %. In view of current practice on financial markets and the corresponding expectations of ratings agencies and market participants, the Commission regards a core#capital ratio of 6 % as absolutely vital in the longer term to ensure the bank's attractiveness to capital markets. The amount of the capital injection in 2001 was absolutely necessary to maintain the bank's core#capital ratio. In the assessment of restructuring aid as a whole, it can therefore be regarded as corresponding to the strict minimum and can thus be approved. Furthermore, as explained above, in order to prepare for the end of the two forms of public liability, the introduction of the IAS and the Basel II accord, the bank sees itself constrained to increase its core#capital ratio to at least 7 % by its own efforts and thus to secure the rating required for refinancing terms that are operationally defensible. The Commission welcomes these plans to stabilise the bank further.

(307) As explained in paragraph 138, the risk shield, which has a nominal value of EUR 21,6 billion, is worth EUR 6,1 billion in economic terms for the purpose of assessing the state aid. On this point Berliner Volksbank argues that the *Land*'s risk shield actually constitutes an unlimited additional funding commitment since the *Land* of Berlin's associated liability cannot be estimated at present and is therefore a 'blank cheque' for future losses. In Berliner Volksbank's view, it is disproportionate in both size and duration, affords the bank virtually unlimited creditworthiness and gives it an 'unconditional licence' to submit offers on whatever terms it wants and, as no precise figure can be put on the additional funding commitment, it is not eligible for approval. The Commission believes this argument to be incorrect and endorses Germany's views instead. Contrary to Berliner Volksbank's claims, the risk shield structure specifically does not allow the bank to expand its banking or other business. Of course, it ensures that the bank does not disappear from the market altogether. But its role is confined to protecting the bank from risks deriving from old business. It cannot be used as such to generate new business. At most, it makes new business possible in that the shielded real estate service companies in particular — and the bank in general — continue to exist. But this is no more than an indirect consequence of any aid measure and cannot be used as a criterion to determine whether the amount of the aid as such is limited strictly to safeguarding the continued existence of the undertaking. The risk shield does not provide the bank with liquidity but merely indemnifies it against the continuing losses of the real estate service companies which the bank could not absorb by itself. The *Land* only makes payments ex post for the amount of actual claims by creditors based on a legal entitlement. In addition, under the detailed agreement, the *Land* exercises — via its own risk#controlling company — extensive rights to carry out inspections and to reserve approval. For an in-depth description

of the workings of the detailed agreement, the Commission would refer to Germany's comments. The Commission accordingly regards the risk shield as a whole as being limited to the strict minimum.

(308) The Commission also considers that the aid with a maximum economic value of EUR 1,8 billion contained in the agreement between the *Land* of Berlin and the bank on the treatment of any claims to repayment brought by the *Land* of Berlin arising out of a decision in case C 48/2002 is limited to the strict minimum. Without that agreement the bank would, at the request of its auditors, have had to include in its 2002 annual accounts reserves against impending liabilities amounting to hundreds of millions of euros. This would have had a negative impact on the bank's annual results for 2002 and on its own funds. However, at the time when its annual accounts for 2002 were drawn up, and also thereafter, the bank reported a core#capital ratio that was no more than 6 % and was partly below that figure. The bank would not have coped with any further pressure on the core#capital ratio at this stage of restructuring. As explained above, the Commission believes that in the long term a core#capital ratio of 6 % is absolutely vital. If, in its decision in case C 48/2002, the Commission were to oblige the *Land* of Berlin to recover from the bank the aid element incompatible with the common market, the *Land* of Berlin would leave its claim in the form of a deposit with the bank. However, this would happen only in so far as it were necessary to maintain a core#capital ratio of 6 % on the critical date of 1 January 2004 and so, in the Commission's view, it constitutes the strict minimum. The authorisation by the Commission of the repayment agreement with a maximum economic value of EUR 1,8 billion is limited to an exceptional case similar to the present case, i.e. where and only to the extent the repayment would inevitably undermine the viability of the company and the restructuring plan is otherwise acceptable. Within this framework, the agreement itself constitutes restructuring aid and thus creates the need for additional compensatory measures to which Germany has finally committed itself, in particular with the divestment of Berliner Bank.

Conclusions

(309) The aid totalling EUR 9,7 billion consists of three measures: a capital injection of EUR 1,755 billion by the *Land* of Berlin for BGB in August 2001; the risk shield amounting to a maximum of EUR 21,6 billion in nominal terms that was made available by the *Land* of Berlin to BGB in the period December 2001 to April 2002 and that has an economic value of EUR 6,1 billion; and the repayment agreement between the *Land* of Berlin and BGB of December 2002 regarding a potential recovery following a Commission decision in case C 48/2002 (Landesbank Berlin # Girozentrale), which has an economic value of up to EUR 1,8 billion.

(310) All the preconditions for the existence of state aid under Article 87(1) of the EC Treaty are met (state resources, favourable treatment for a specific undertaking, distortion of competition, effect on trade between Member

States). Of the derogations from the principle of the incompatibility of state aid with the common market, only Article 87(3)(c) of the EC Treaty, read in conjunction with the Community guidelines on state aid for rescuing and restructuring firms in difficulty, is applicable.

(311) In its assessment — and in the light of the criteria in the guidelines — the Commission concludes that the restructuring measures already carried out and those planned are reasonable, logical and fundamentally appropriate in order to enable BGB to restore its long#term viability.

(312) In the Commission's view, the sales, closures and reduction measures already carried out, planned or promised are sufficient to offset the market#distorting effects of the aid measures in question.

(313) The Commission considers that the three aid measures granted — the capital injection, the risk shield and the agreement on the treatment of any claims to repayment brought against the bank by the *Land* of Berlin — are limited to the to the strict minimum needed to enable restructuring to be undertaken in the light of the existing financial resources of the bank and its shareholders. The bank received no surplus cash or surplus own resources which it could have misused for the purposes of an unreasonable expansion of its business at the expense of its competitors,

HAS ADOPTED THIS DECISION:

Article 1

1 The following measures for the Bankgesellschaft Berlin AG group (‘BGB’) constitute state aid within the meaning of Article 87(1) of the EC Treaty:

a the capital injection of EUR 1,755 billion by the *Land* of Berlin in August 2001;

b the guarantees (‘risk shield’) with a maximum nominal value of EUR 21,6 billion granted by the *Land* of Berlin on 20 December 2001 and 16 April 2002;

c the agreement of 26 December 2002 between the *Land* of Berlin and the Landesbank Berlin (LBB) on the treatment of any claims brought by the *Land* of Berlin against LBB following a final decision by the Commission in case C 48/2002, which is pending.

2 The aid measures referred to in paragraph 1 are compatible with the common market, provided that Germany fully observes the undertakings communicated by Germany and set out in Article 2(1) of this decision and in the Annex hereto and provided that the aid referred to in paragraph 1(c) does not give rise to a core#capital ratio, as at 1 January 2004 of over 6 % for BGB group (taking into account the hiving#off of IBB in accordance with Article 2(1)(d).

Article 2

1 Germany has undertaken:

a to ensure timely implementation of the notified restructuring plan in accordance with the conditions laid down in the Annex;

b to ensure that the *Land* of Berlin sells it holding in BGB in accordance with the conditions laid down in the Annex;

c to ensure that the BGB group sells or liquidates all holdings in real estate service companies covered by the risk shield of 16 April 2002 in accordance with the conditions laid down in the Annex;

d to ensure that IBB's special reserve is transferred back in accordance with the conditions laid down in the Annex;

e to ensure that the BGB group sells the 'Berliner Bank' division of LBB in accordance with the conditions laid down in the Annex;

f to ensure that the BGB group sells its holding in BGB Ireland plc by no later than 31 December 2005.

2 Where appropriate, and on a sufficiently reasoned request from Germany, the Commission may:

a grant an extension of the deadlines specified in the undertakings, or

b in exceptional cases, dispense with, amend or replace one or more of the requirements or conditions set out in those undertakings.

If Germany requests that a deadline be extended, a sufficiently reasoned request shall be sent to the Commission at the latest one month before expiry of that deadline.

Article 3

Germany shall inform the Commission, within two months of notification of this decision, of the measures that have been taken and the measures it intends to take to comply with this decision.

Article 4

This decision is addressed to the Federal Republic of Germany.

Germany is required to forward a copy of this decision to the recipient of the aid immediately.

Done at Brussels, 18 February 2004.

For the Commission

Mario MONTI

Member of the Commission

ANNEX[38]

Article 2(1)(a)

Germany will ensure will that the notified restructuring plan, as last amended in accordance with the Federal Government communication of 29 January 2004, will be implemented, including all the undertakings contained in Article 2(1), in line with the timetable indicated therein. As regards those elements of the restructuring plan in respect of which no deadline is indicated, they are to be implemented forthwith and, in any event, in sufficient time to allow the deadlines specified to be met.

Article 2(1)(b)

Germany will ensure that the *Land* of Berlin introduces an open, transparent and non#discriminatory tendering procedure as soon as the annual accounts of Bankgesellschaft Berlin AG for 2005 have been approved and completes the procedure by 31 December 2007.

The buyer must:

— be independent of the *Land* and must not be connected to BGB AG or Berliner Bank within the meaning of Article 11 of Commission Block Exemption Regulation No 2790/1999[39] regarding vertical agreements,

— be in a reasonable position to satisfy all the necessary conditions imposed by the relevant competition and other authorities for the acquisition of the holding in BGB AG, and

— be capable on the basis of its financial strength, and in particular its rating, to guarantee the bank's solvency in the long run.

In applying the review clause contained in Article 2(2) to the undertaking to sell, the Commission will take due account of the supply#side conditions and the situation on capital markets.

Article 2(1)(c)

Germany will ensure that, for balance#sheet purposes, the BGB group will, in accordance with the rules set out below, sell or liquidate by 31 December 2005 at the latest all holdings in real estate service companies that are covered by the risk shield of 16 April 2002.

By 31 December 2004 the *Land* and the bank will definitively determine those holdings in real estate service companies that appear suitable for sale to third parties. These holdings are to be sold by way of a transparent, open and non#discriminatory tendering procedure.

Holdings in real estate service companies that are neither liquidated nor sold to third parties by the balance#sheet date of 31 December 2005 will be acquired by the *Land* of Berlin on market terms. The purchase price will be determined by 31 March 2005 on the basis of a valuation carried out by an independent auditor commissioned by the *Land*, with a subsequent review by an independent auditor appointed by the bank. This will take place on the basis of recognised valuation procedures. In the event of a divergence between the two valuations and in the absence of agreement between the contracting parties, the value will be determined by a third expert to be appointed by the Institut der Wirtschaftsprüfer in Deutschland e.V. (German Auditors Institute). The independent value assessments will be sent to the Commission by 31 July 2005 at the latest.

The business of the real estate service companies that are to be transferred to the *Land* or wound up will be confined to the orderly management of the risks covered by the detailed agreement. The bank will invest in those companies to the extent necessary for that activity.

In order to avoid a heavy land transfer tax burden, a remaining holding of not more than 6 % in Immobilien- und Baumanagement der Bankgesellschaft Berlin GmbH (IBG) may remain

within the Bankgesellschaft group. The group will not, however, have any influence over the management of IBG. Moreover, Immobilien und Beteiligungen Aktiengesellschaft (IBAG) can remain within the Bankgesellschaft group following the change of trade name and re-orientation of the Work#out#Competence Center as the holding company for the companies on the so# called negative list[(40)] (companies excluded from the risk shield) in which the Bankgesellschaft group has shares. Apart from its function as the holding company for the companies on the negative list for the orderly administration and winding-up of the risks resulting from these companies and as the Work#out#Competence Center in connection with the liquidation of real estate financing, IBAG will, however, no longer carry on any real estate service business.
Article 2(1)(d)

Germany will ensure that, by 1 January 2005 at the latest, the development business of Investitionsbank Berlin (IBB), an unincorporated institution, which has to date been managed as a department of Landesbank Berlin (LBB), will be transferred to a new and independent development bank of the *Land* of Berlin.

The IBB special reserve of Landesbank Berlin will be used, to the extent possible on 1 January 2004, to provide capital for the new development bank and will, therefore, be hived off from Landesbank, without the core#capital ratio (tier one) within the Bankgesellschaft group (following the hiving#off of IBB) falling below 6 %, but not for an amount of more than EUR 1,1 billion.

The part of the IBB special reserve that may still be necessary to provide capital for the Bankgesellschaft group in accordance with the above paragraph will be injected into LBB by the *Land* of Berlin directly or indirectly as a contribution in kind (which may, however, not exceed EUR 1,1 billion) in the form of one or more dormant holdings ranking as core capital. A claim by the *Land* of Berlin on LBB for the transfer of the corresponding part of the special reserve can be created and will then be injected into the dormant holdings.

The dormant holdings bear interest at normal market rates. In this connection, when the contract to set up the dormant companies is signed, a mark#up on a reference interest rate determined according to the comparable core#capital instruments traded on the market will be calculated on the basis of the long#term rating of LBB, taking into account the discontinuation of institutional and guarantor liability (*Anstaltslast* and *Gewährträgerhaftung*) and in compliance with the contractual form of the dormant holdings. The comparability of the core#capital instruments will be determined on the basis of the contractual rules for those instruments and the rating of each issuer.
Article 2(1)(e)

Germany will ensure that the Bankgesellschaft group will sell the Berliner Bank department of LBB as an economic entity, inclusive at least of the trade name (and all related intellectual property rights), all private, corporate and other customers associated with the business carried on under the trade name Berliner Bank, the branches and the front#office staff. The effective date for the number of customers, branches and front#office staff is 31 December 2003, taking into account the planned implementation of the restructuring plan notified to the Commission in accordance with Article 2(1)(a) and natural business fluctuations, i.e. increases and decreases in the number of customers, staff, assets and liabilities, that are based on individual decisions (such as the relocation of customers or employees and dissatisfaction with the previous bank or employer) and not influenced by the bank. Other assets or staff may be included in the sale as appropriate. A trustee will closely monitor compliance with these conditions. The tendering procedure must be open, transparent and non#discriminatory and must be started in 2005. It must be completed by 1 October 2006 so that the sale can take effect by 1 February 2007 at the latest.

Within three months of receipt of this decision, Germany will propose to the Commission a suitable trustee mandate and an independent trustee who will be required by law to observe professional secrecy and who will, at the expense of Germany, monitor the proper course of the sale and ensure in particular that the bank continues to restructure Berliner Bank in a sound business manner, invest in it and do nothing that will reduce its value, above all by transferring private or corporate customers or sales personnel to Berliner Sparkasse or to any other part of the Bankgesellschaft group. The trustee will take up his work without delay after having been commissioned. If the trustee discovers any irregularities, the Commission is to be notified immediately.

The buyer must be independent of Bankgesellschaft Berlin and must have the financial resources, proven expertise and incentives to maintain and develop Berliner Bank as a viable and active economic force in competition with Bankgesellschaft Berlin and other competitors. This does not rule out incorporation of Berliner Bank into the buyer's company and corporate identity.

The amendments to the mid-term financial plan of 29 January 2004 that are necessary for the implementation of this commitment will be submitted forthwith by Germany to the Commission for approval.
General provisions governing implementation and reporting

(a) Germany will not amend the notified restructuring plan of 29 January 2004, which takes account of all the undertakings given in Article 2(1) of this decision, without the prior approval of the Commission.

(b) Germany will ensure that the divestments and sales provided for in Article 2(1)(b), (c) and (e) take place according to transparent procedures that will be open to any potential domestic or foreign buyer. The sales conditions must not contain any clause that inappropriately restricts the number of potential bidders or is tailored to a specific potential bidder. Germany will ensure that those divestments and sales are adequately publicised. With the exception of sales in accordance with Article 2(1)(c), this will take place via publication in at least one international press medium that is available throughout the Community in English. As far as the law permits, bidders will be afforded direct access to all the necessary information in the due#diligence procedure. The buyers will be selected on the basis of economic criteria. The proceeds from the bank's sales will be used in full to finance the bank's restructuring plan, in so far as they do not accrue to the *Land* of Berlin under the detailed agreement of 16 April 2004 (Annex 25 to the notification).

(c) Germany will ensure that the performance of all the undertakings set out in Article 2 can be verified at any time by the Commission or by an expert acting for it until such time as they have been carried out. It will ensure unrestricted access for the Commission to any information necessary for the monitoring of the implementation of this decision. The Commission may, with the consent of Germany, seek explanations and clarifications directly from the bank. Germany and the bank will cooperate fully in any enquiries made by the Commission or by a consultant acting for it.

(d) Each year until 2007 (inclusive) Germany will send a progress report to the Commission. The report must give the details of the sales and closures of subsidiaries and departments in accordance with Article 2(1) of this decision, with an indication of the date of sale or closure, the book value as at 31 December 2003, the purchase price, all profits and losses in connection with the sale or closure and the details of the measures still to be taken to implement the restructuring plan. The report must be submitted by the supervisory board of Bankgesellschaft Berlin AG within one month

of BGB group's annual accounts being approved for the relevant financial year, and in any event at the latest by 31 May of each year.

(**1**) OJ L 83, 27.3.1999, p. 1. Regulation as amended by the 2003 Act of Accession.

(**2**) OJ C 141, 14.6.2002, p. 2.

(**3**) OJ C 130, 1.6.2002, p. 5.

(**4**) See footnote 2.

(**5**) See footnote 2.

(**6**) Parts of this text have been edited to ensure that confidential information is not disclosed: those parts are enclosed in square brackets.

(**7**) Berliner Bank previously formed part of BGB, and Berliner Sparkasse formed part of LBB.

(**8**) See footnote 2 and speech to the general meeting by Mr Vetter, chairman of the managing board, on 4 July 2003 (http://www.bankgesellschaft.de/bankgesellschaft/20_ir/30_hauptversammlung/index.html); see paragraph 298.

(**9**) See http://www.bankgesellschaft.de/bankgesellschaft/50_pk/index.html (private customers, first giro accounts).

(**10**) Answer given by Germany, June 2002; according to 'Eurohypo' decision of 19 June 2002 of the German antitrust authority (Bundeskartellamt), the leaders of the various segments of the real estate financing business in 2001, by portfolio and by new business, were the new firm Eurohypo, the Hypovereinsbank group, the Depfa group, the BHF group, and BayLB. Deutsche Bank itself, without the business it had contributed to the new Eurohypo, was likewise still ranked ahead of BGB, which the decision does not list among the leading competitors.

(**11**) Since 1 May 2002, when banking, insurance and stock exchange supervision were merged, the Federal Institute for Financial Services Supervision (BAFin).

(**12**) OJ C 130, 1.6.2002, p. 5.

(**13**) Published in Gesetz# und Verordnungsblatt für Berlin, 58th year, No 13, 24.4.2002.

(**14**) OJ C 141, 14.6.2002, p. 11.

(**15**) OJ C 239, 4.10.2002, p. 12.

(**16**) Joined Cases C#278/92, C#279/92 and C#280/92 Spain v Commission [1994]* ECR I#4103.

(**17**) OJ C 288, 9. 10. 1999, p. 2.

(**18**) See, for example, Commission Decision 98/490/EC of 20 May 1998 concerning aid granted by France to the Crédit Lyonnais group (OJ L 221, 8.8.1998, p. 28).

(**19**) Commission observation: according to the agreement on German development banks, government assistance is a task for the public sector and does not therefore represent a commercial activity with implications for competition and so cannot be recognised as a compensatory measure. Institutional liability (Anstaltslast) and guarantor liability (Gewährträgerhaftung) can be preserved in the case of government assistance business only if that business is hived off to an independent development bank.

(**20**) OJ C 239, 4.10.2002, p. 12.

(**21**) This theoretical, rounded maximum is arrived at by applying the methodology used in the Commission WestLB decision 2000/392/EC (OJ L 150, 23.6.2000, p. 1) to work out a normal market compensation, taking into consideration the judgment by the Court of First Instance of the European Communities of 6 March 2003 in Joined Cases T#228/99 and T#233/99, Westdeutsche Landesbank Girozentrale and *Land* Nordrhein-Westfalen v Commission, Rec. 2003, p. II-435, and the relevant data for LBB, plus compound interest.

(**22**) See OJ C 146, 19.6.2002, p. 6, and OJ C 150, 22.6.2002, p. 7.

(**23**) OJ C 288, 9.10.1999, p. 2.

(**24**) On the basis of the institutional liability, which is applicable until July 2005, the *Land* of Berlin is, as regards its internal relationship with LBB, required to provide LBB, as a public#law body, with resources in such a way that it is able to perform its tasks. However, if the *Land* decides to terminate the business, the guarantor liability is triggered.

(**25**) In 1993 the *Land* of Berlin issued a statement to the Deposit Guarantee Fund of private German banks regarding Berliner Bank AG, which had in the meantime merged with BGB, to the effect that, according to the German authorities, the risk of liability on the part of the *Land* of Berlin towards the Deposit Guarantee Fund was not, however, ruled out. It is to this case that the estimates refer.

(**26**) This figure also took into account the hiving-off of the public development activities of IBB.

(**27**) See, for example, Decision 98/490/EC.

(**28**) In establishing the own#funds ratio, the amount of additional capital taken into account may not exceed the amount of the available core capital.

(**29**) See OJ C 146, 19.6.2002, p. 6 and OJ C 150, 22.6.2002, p. 7.

(**30**) Under the agreement on German development banks, development/support activities are a public service and not a commercial activity open to competition; they therefore cannot be viewed as compensatory measures. Institutional liability and guarantor liability can be maintained for the development business only if it is hived off as an independent development bank.

(**31**) According to the Federal Cartel Office's decision of 19 June 2002 in Eurohypo, the newly created Eurohypo, the Hypovereinsbank group, the Depfa group, the BHF group and BayLB led the various submarkets in the real estate financing sector in 2001, in terms of both existing and new business. Even Deutsche Bank itself (i.e. without its share in Eurohypo) came before BGB, which in this decision was not listed among the leading competitors with market shares of 5 % or more.

(**32**) In Berlin a bank retains around 75#90 % of its customers in the event of branch closures.

(**33**) Market shares for the Berlin/Brandenburg region (around 14 to 27 % in personal banking and around 18 to 21 % in corporate banking) were submitted subsequently for the sake of completeness. The reason why they are far smaller is that, even before the latest restructuring measures involving divestments and closures of sites in Brandenburg, BGB's presence in Brandenburg was limited. Updated country#wide figures were no longer submitted.

(**34**) Commission Decision of 11 March 1997 declaring the compatibility with the common market of a concentration (Case No IV/M.873 — Bank Austria/Creditanstalt) based on Council Regulation (EEC) No 4064/89 (OJ C 160, 27.5.1997, p. 4).

(**35**) Commission Decision of 11 March 1997 (Case No IV/M.873 — Bank Austria/Creditanstalt); Commission Decision of 25 September 1995 declaring the compatibility with the common market of a concentration (Case No IV/M.628 — Generale Bank/Crédit Lyonnais Bank Nederland) based on Council Regulation (EEC) No 4064/89 (OJ C 289, 31.10.1995, p. 10).

(**36**) Speech at the general meeting on 4 July 2003.

(**37**) The divestment of Berliner Bank has to take effect by 1 February 2007 at the latest. It is possible therefore that the effects will be shown only in the balance sheet for 2007.

(**38**) The following summarises the contents of the commitments communicated by Germany on 6 February 2004. The original German text of the communication contains the wording relevant for this decision.

(**39**) OJ L 336, 29.12.1998, p. 21.

(**40**) Annexes 4.1, 11.1, 22.1, 29.1, 37.1.2 and 44.1 to the detailed agreement of 16 April 2002; Annex 25 to the notification.

Status:
Point in time view as at 31/01/2020.

Changes to legislation:
There are currently no known outstanding effects for the Commission Decision of 18 February 2004 on restructuring aid implemented by Germany for Bankgesellschaft Berlin AG (notified under document number C(2004) 327) (Only the German text is authentic) (Text with EEA relevance) (2005/345/EC).