

Summary of Government Interventions in Financial Markets *Germany*

Overview

Europe's largest economy, which officially fell into recession in mid November 2008, contracted by 3.8 per cent. at the start of this year, making it one of the worst hit European countries. The Deutsche Bundesbank's current economic prediction is that there will be a sharp recession in 2009 with a slight recovery in 2010.

Germany's economic bailout measures began with the enactment of the Financial Market Stabilisation Act in October and November 2008 followed by a stimulus plan in January/February 2009. The Financial Market Stabilisation Supplementary Act, which was enacted on 9 April 2009, supplemented the Financial Market Stabilisation Act and paved the way for the nationalisation of some banks, such as that of Hypo Real Estate AG. On 23 July 2009, the latest economic bailout measure, a further Supplement to the Financial Market Stabilisation Act (the "Bad Bank Act"), took effect.

State Guarantees and Summary of Key Legislation

Financial Market Stabilisation Act

The "Finanzmarktstabilisierungsfonds" (Financial Market Stabilisation Fund) is managed by the "Finanzmarktstabilisierungsanstalt" (Financial Market Stabilisation Agency). It is sometimes referred to as the "Sonderfonds Finanzmarktstabilisierung (SoFFin)" (Special Fund Financial Market Stabilisation) given its special temporary purpose. The European Commission ("EC") has provided its support to this plan.

The Financial Market Stabilisation Act (Finanzmarktstabilisierungsgesetz) established the Fund on 17 October 2008 after being passed by the German Parliament and the Chamber of German States. The federal government enacted the regulation

to the Act on 20 October 2008 and it is effective until 31 December 2009.

SoFFin is to be used to secure newly-issued refinancing instruments (up to 36 months) for German banks until the end of 2009 and is to be established by issuing debt securities up to a maximum of EUR 100bn.

Total volume of the package of measures EUR 480bn:

- EUR 400bn in guarantees (in return for a fee);
- EUR 70bn (+ 10bn if necessary) in fresh capital and assumption of risk positions.

German federal states are required to contribute to the stabilisation fund and German subsidiaries of foreign banks with German Banking licenses are included in the package.

The rescue package consists of:

- A recapitalisation scheme, providing new capital to banks and insurance companies in exchange for shares.
- A guarantee scheme covering new issuances of short- and medium- term debt, in return for market-oriented remuneration, to support the banks which are unable to access interbank funding. Eligible institutions include German credit institutions, insurance, pension funds, financial service providers, investment management companies and security and commodity exchanges. State guarantees will be issued with a maximum term of 36 months for liabilities entered into by the recipient bank after 18 October 2008. This is to aid the recipient bank to overcome a temporary liquidity shortage and to gain access to inter-bank lending. Guarantees are available for banks until the end of 2009.
- A temporary acquisition of assets under the condition that these assets are bought back after 36 months maximum without the state making a loss.

Though several have been made to the SoFFin fund plan, details on prerequisites, structure and conditions of the stabilisation measures are as follows:

Maximum limit per company for:

- grant of guarantees: depends on company's equity capital;
- recapitalisation measures: EUR 10bn; and
- risk assumption: EUR 5bn.

The authorities in charge of the stabilisation regulations may impose on the banks accepting stabilisation aid restrictions on their business activities depending on the type, amount and duration of the state aid as well as the economic situation of the bank, e.g.:

- (i) re-examination of business policy; reduction or waiver of certain risky transactions in the future;
- (ii) re-examination of compensation systems;
- (iii) overall compensation of board members and managing directors to be reasonable; monetary compensation not to exceed EUR 500,000 per year;
- (iv) no payout of compensation upon termination;
- (v) no bonus payments that are not legally required; and
- (vi) no dividend payments to shareholders other than the Fund; no re-purchase of shares; no reduction of capital except for reorganisation.

For the assumption of guarantees, the restrictions on the compensation system and dividends payments do not apply.

German states (*Bundeslaender*) are to take a 35 per cent. share in the risks from the Fund (capped at EUR 7.7bn) while at the same time protecting the state-owned Landesbanks.

In case of recapitalisation measures strengthening of tier 1 capital is intended. Some German banks have tier 1 capital below 8 per cent., against the 9 per cent. that has become required by the UK and been urged in France. They include Deutsche Postbank and various Landesbanks – Germany's regional, publicly owned wholesale lenders.

On 7 March 2009, the press reported that SoFFin had made a sizeable profit by collecting EUR 125.7m in commissions from banks which had asked for state aid. After deducting EUR 62.5m in costs, the fund was left with a profit of EUR 62.9m.

In a statement released by SoFFin on 3 March 2009, SoFFin advised that since its start in October 2008, SoFFin has received filed requests from 18 credit institutions, including three new ones asking for EUR 31bn in February, for a grand total of EUR 294bn in aid. Of this total figure, EUR 197bn already has been allocated, EUR 178bn has been for loan guarantees and EUR 19bn was in cash. There has been no defaults on payments thus far. SoFFin has a total of EUR 400bn in guarantees and EUR 80bn in cash to support the banking sector.

New Stimulus Package – February 2009

On 22 February 2009, Germany approved a new stimulus package worth EUR 50bn (USD 63bn) over 2 years, which is about 1.6 per cent. of gross domestic product. This package makes it the biggest economic injection in Europe. However, it is small compared to the US's plans for a 2-year stimulus program of about USD 775bn, or about 2.8 per cent. of GDP.

The new package envisages about EUR 18bn in new investments in infrastructure and education; EUR 1.5bn in aid for the domestic auto industry (e.g., Daimler and BMW) and a fund of EUR 100bn to provide credit guarantees to struggling businesses. Tax relief totalling EUR 2.9bn in 2009 and EUR 6bn from 2010.

Expropriation law – April 2009

On 9 April 2009, the Financial Market Stabilisation Supplementary Act was passed giving the government power to expropriate the shares from shareholders of struggling banks and paving the way for the nationalisation of Hypo Real Estate Holding AG. Below are key facts about the new law:

- It extends the "financial market stabilisation law" agreed in 2008, giving the government powers to seize control of banks whose failure would pose a risk to the stability of the financial system;
- Allows for the expropriation of shareholders as a last resort;

- Any expropriations would have to take place by 31 October 2009, and requests must be submitted by the end of June 2009;
- In special cases, it extends the current guarantees the government has made to bank loans to 5 years from 3; and
- In the event of a nationalisation, the law purports to help compensate shareholders of nationalised banks by paying them a price per share calculated by the average value during the 2 weeks prior to the nationalisation, or an even shorter period if the share price falls rapidly.

The Bad Bank Act – July 2009

On 23 July 2009, the Bad Bank Act, intended to relieve private banks of contaminated assets and encourage lending, came into force. The Bad Bank Act allows credit institutions and holding companies resident in Germany, as well as their domestic and foreign subsidiaries, two different bad bank options: a special purpose vehicle model which provides for the transfer of structured securities to special purpose vehicles and the institution model (also known as the AidA Model) which allows for the transfer of various risk positions and non-strategic business areas to a public legal entity (winding-up agencies).

The special purpose vehicle model allows eligible institutions to transfer structured securities (such as asset-backed securities or collateralised debt obligations) acquired no later than 31 December 2008 to special purpose vehicles (SPVs) established exclusively for the transferring company in question. The transfer to the SPV will be at the actual economic value or at 90 per cent. of the book value on 30 June 2008 or 31 March 2009 (whichever is greatest) with the book value on 31 March 2009 constituting the maximum amount. The deduction of 10 per cent. from the book value will only be effective to the extent that the transferring company can comply with a core capital ratio of at least 7 per cent. In return for transferring the structured assets to the SPV, the institution will receive government-guaranteed bonds issued by the SPV up to the amount of the transfer value of the assets. The bonds will be eligible for repo funding with the ECB thus generating liquidity for the banks. In addition, banks will be able to reduce their loans and non-strategic business areas.

Under the AidA-Model, the eligible institutions are able to transfer their risk positions acquired by 31 December 2008 as well as non-strategic business areas to winding-up agencies set up for that purpose.

On 31 July 2009, the EC confirmed the Bad Bank Act complies with EU state aid rules and approved it.

Measures to strengthen financial supervision – July 2009

On 29 July 2009, a German law aimed at strengthening financial market supervision (*Gesetzentwurf zur Stärkung der Finanzmarkt- und Versicherungsaufsicht*) took effect. This law reforms the existing financial market supervision instruments, namely the law on banking and the law on insurance supervision, which proved ineffective during the financial crisis and improves the effectiveness of supervision. The proposed amendments increase the powers of the Federal Financial Supervisory Authority (BaFin). Some of the key provisions are as follows:

- BaFin may require a bank to maintain higher own funds if the sustained adequacy of an institution's capital ratio can no longer be guaranteed or if the institution's risk-bearing ability is no longer certain;
- BaFin may increase the own funds ratio if an institution does not have an orderly business organisation and no improvement can be secured by other means;
- an institution must report its leverage ratio annually and any material change immediately;
- BaFin may impose prohibitions on credit and profit distribution if there is a threat of failure to meet supervisory ratios. Currently such measures are only possible in the case of actual failure;
- BaFin may also prohibit payments on equity instruments if there is a threat of failure to meet supervisory ratios, even if the equity instruments are based on liabilities that do not count as part of own capital and have to be serviced regardless of whether there are available profits;
- institutions, financial holding companies and insurance groups must declare any concentrations of risk within their group; and

- BaFin may prohibit or restrict certain payments to companies belonging to a group if these transactions prejudice the company making the payment. This would help prevent a foreign parent or foreign associated companies withdrawing liquidity from a German subsidiary in a crisis.

*New Minimum Requirements for Risk Management
– August 2009*

On 14 August 2009, BaFin published the revised Minimum Requirements for Risk Management (“**MaRisk**”) which introduce tougher and more wide-ranging supervisory requirements with respect to stress testing, liquidity risk and risk concentration. Some of the key new measures are as follows:

- all institutions will be obliged to stress test their material risks based on their identified risk factors;
- stress tests will be required to have particular regard to concentration of risk;
- banks will have to manage and monitor their liquidity risks in such a way that impending shortages of liquidity are recognised at an early stage;
- institutions will have to demonstrate that they have sufficient risk-bearing capacity for the group as a whole rather than at the level of each individual company as was previously the case;
- institutions will have to ensure bonuses of employees involved in high-risk positions are based on the profitability of the organisational unit and overall profitability of the institution; and
- institutions will be able to claw back bonuses from employees if it later emerges that a particular transaction involved unacceptable risks.

The rules go into effect immediately. Banks and financial services institutions are required to implement the new MaRisk by 31 December 2009.

Government loans

SoFFin provides capital injections into financial institutions in return for shares or other equity instruments to be issued in a simplified and accelerated form. The government may in the future sell the shares it receives, and it will have shareholders’ subscription rights.

So far, SoFFin has approved government guarantees for EUR 90bn (USD 126bn) in loans. It has received requests for another EUR 100bn in liquidity assistance.

State aid loans sanctioned by the EC

On 17 December 2008, the EC adopted a Temporary Framework under state aid rules to help Member states tackle the effects of the credit squeeze on the real economy.

As a first measure, on 30 December 2008, the EC approved a EUR 15bn German loan programme (“KfW-Sonderprogramm 2009”) in accordance with the Temporary Framework. The loan programme provides for interest rate reductions on loans to finance investments and working capital of up to EUR 50m to be granted to undertakings with a turnover of less than EUR 500m. The programme will be administered by the Kreditanstalt für Wiederaufbau (KfW), the main public development bank in Germany, in close cooperation with the undertakings’ own bankers.

On 19 February 2009, as a second measure, the EC authorised, under the temporary federal framework scheme (“*Bundesregelung Kleinbeihilfen*”), to permit German authorities at federal, regional and local level to grant aid in the form of reduced interest rates on loans granted before 31 December 2010 and to provide subsidised guarantees for investment and working capital loans granted before 31 December 2010. On 5 June 2009, the EC approved an amendment to the temporary federal framework scheme which is aimed at facilitating the access to risk capital for undertakings and allows Germany to make available risk capital in the form of direct grants of up to EUR 500,000 to each undertaking.

These are the first cases to be approved under the EC’s new temporary framework providing EU member states like Germany with additional economic tools to tackle the effects of the credit squeeze on the real economy.

Notable developments with commercial banks

Bailout of Commerzbank

On 3 November 2008, Commerzbank became Germany's first commercial lender to turn to the government for capital, taking a capital injection of EUR 8.2bn. On 7 May 2009, the EC approved Germany's rescue of Commerzbank after Germany had added to the original rescue package of November 2008 with an additional EUR 10bn, taking the grand total government capital injection to this bank to EUR 18.2bn. In return the German government now holds 25 per cent. plus one share in the bank.

As part of the agreement, Commerzbank will dispose of Eurohypo within the next five years. In addition, the bank plans to divest Kleinwort Benson Private Bank, Dresdner Van Moer Courtens S.A, Dresdner VPV NV, Privatinvest Bank AG, Reuschel & Co. KG and Allianz Dresdner Bauspar AG by the end of 2011. Commerzbank is not to undertake any acquisitions of financial institutions for three years.

Bailout of Hypo Real Estate

SoFFin acquired 90 per cent. of Hypo Real Estate Holding AG ("**HRE**") through a takeover offer in May and the approval of a capital increase of up to EUR 5.64bn at an extraordinary general meeting on 2 June 2009. On 8 June 2009, SoFFin submitted a demand to HRE requesting that a resolution be passed at HRE's next general meeting to transfer minority shareholders' shares to SoFFin (squeeze-out). The Financial Market Stabilisation Supplementary Act enables SoFFin to demand a squeeze-out with a 90 per cent. majority instead of the 95 per cent. which is normally required pursuant to German law. The squeeze-out enables SoFFin to acquire 100 per cent. in HRE without a formal expropriation pursuant to the Expropriation Act. SoFFin has set the cash settlement for the minority shareholders' shares at EUR 1.30 per no-par value share. HRE has convened a general meeting for 5 October 2009, which shall resolve on the squeeze-out of minority shareholders. SoFFin's plan to acquire HRE was approved by the EC on 15 May 2009.

SoFFin's acquisition of HRE is the first German nationalisation of a listed bank since World War II, though Germany already holds more than 25 per cent. in the country's second-biggest lender Commerzbank. HRE's largest minority shareholder, J.C. Flowers (the private equity group which held 24 per cent. of HRE prior to SoFFin's share acquisition) said it may take legal action to block the squeeze-out.

Since the inception of SoFFin, Germany has provided EUR 102bn of credit lines and debt guarantees to HRE. In October 2008, the German government and the German Central Bank provided HRE with a EUR 50bn bailout package and an extra EUR 15bn in aid under the Financial Market Stabilisation Act. The government provided EUR 26.6bn, in two tranches, with a consortium of banks providing the remainder. The EUR 50bn bailout package is due to expire on 31 December 2009.

On 11 February 2009, SoFFin granted HRE a EUR 52bn framework guarantee which the bank will use to collateralise debt securities to cover short- and medium-term liquidity. The expiration of the guarantee has been extended from 19 August 2009 to 18 November 2009. HRE is to pay SoFFin a pro-rata commitment fee of 0.1 per cent. p.a. on the undrawn portion and a 0.5 per cent. p.a. fee on any drawn portion of the guarantee.

In view of the large amount of aid involved, the EC announced on 7 May 2009 that it is to carry out an in-depth investigation into state support measures for HRE.

Bailout of BayernLB

Bayerische Landesbank ("**BayernLB**") announced it would seek EUR 5.4bn from the Fund plus an additional EUR 1bn for a capital increase, making it the first lender to draw on the Fund after being hit by third-quarter losses. While the EUR 5.4bn payment will come straight from the rescue program, the additional EUR 1bn capital injection is being provided by BayernLB's public sector owners with the state of Bavaria contributing EUR 700m and the state's savings banks EUR 300m.

BayernLB has received a EUR 10bn recapitalisation injection from its main shareholder, the Bavarian regional authorities, and EUR 15bn euros in guarantees from the federal government's banking sector support fund, under the Financial Market Stabilisation Act. BayernLB had a EUR 5bn operating loss for 2008.

On 13 February 2009, a German prosecutor announced that BayernLB may face a criminal probe over subprime-related losses. No decision has been taken yet.

On 13 May 2009, Moody's downgraded its long-term rating on BayernLB from Aa2 to A1, while confirming its short-term rating in the highest category at Prime-1. BayernLB's financial strength rating was simultaneously downgraded from C- to D-.

The EC announced on 12 May 2009 that it is to carry out an in-depth investigation into state support measures for BayernLB, due to the combined value of capital injection and state guarantees. Almost simultaneously on 13 May 2009, BayernLB announced that Germany had submitted an extensive restructuring plan for BayernLB to the EC. The investigation must be conducted before the EC can commence its approval procedure for the restructuring. The result of the investigation is expected this autumn.

On 1 August 2009, revisions to the Bavarian Landesbank Act came into effect. In addition to requiring external experts to join BayernLB's Board of Administration, the revisions allow BayernLB to merge with other legal entities or to become a public limited company. As part of restructuring its operations, on 1 July 2009, BayernLB spun off non-core activities with a nominal value of EUR 95bn into an internal restructuring unit.

Bailout of IKB

On 21 October 2008, the EC approved a EUR 9bn restructuring package for German bank IKB, caught up in the US-born financial crisis. The rescue package would allow for restructuring of the bank, while the significant scaling back of IKB's activities would, according to the EC, limit the distortion of competition created by the state support.

On 17 August 2009, the EC approved the extension of the guarantee for new bonds by an additional EUR 7bn.

Together with the EUR 5bn guarantees included in the original EUR 9bn package, IKB's guarantees now total EUR 12bn. All state guaranteed bonds will expire by 31 December 2014.

WestLB SoFFin aid and proposed auction

On 26 March 2009, WestLB announced that it plans to sell itself in an auction. This comes after attempts to consolidate with other banks stalled due to the on-going financial crisis. It intends to sell itself by the end of 2011 as part of an accord between Germany and the EU. Back in August 2008, the owners of WestLB made it clear to the EC that they preferred to bring about the change of ownership wanted by the EC in the context of the restructuring through a consolidation solution in the Landesbank sector.

In November 2008, WestLB announced its intent to tap the SoFFin fund for an undisclosed amount of state guarantees. This came after the bank received a EUR 5bn state-guaranteed risk shield in April 2008. WestLB also disclosed its intent to increase its current tier 1 capital of 6 per cent. On 12 May 2009, the EC approved, under EC Treaty state aid rules, the EUR 5bn risk shield and accompanying restructuring measures, following an in-depth investigation opened in October 2008. On 7 June 2009, the state extended the scope of the EUR 5bn guarantee by a further EUR 4bn.

On 6 May 2009, Standard & Poor's downgraded WestLB's long term debt rating from A- to BBB+.

SoFFin aid for HSH Nordbank AG

From 3 April 2009, following shareholder approval as required by SoFFin, HSH Nordbank AG ("**Nordbank**") can access EUR 30bn of government-backed aid. The shareholders approved a EUR 3bn increase in capital and a EUR 10bn guarantee to cover potential losses. This allows Nordbank to access SoFFin liquidity guarantees. The rescue aid was endorsed by the EC and Germany is required to submit a viable plan for the future of Nordbank to the EC within 3 months.

On 29 April 2009, Nordbank successfully placed its second benchmark bond guaranteed by SoFFin. The bond's placement volume amounted to EUR 3bn. At the time of closing the order book was oversubscribed more than twice at more than EUR 8bn. The bond will have a term of 2 years.

On 6 May 2009, Standard & Poor's downgraded Nordbank's long term debt rating from A to BBB+ because of negative earnings outlook.

Deutsche Bank

In May 2009, the shareholders of Deutsche Bank, Germany's biggest bank, passed a resolution allowing the bank to raise capital. The bank wants to sell 342m shares which would be worth approximately EUR 11bn at the current market price. Deutsche Bank has resisted pressure to take government aid and it expects to return to profitability this year after scaling back risky businesses and shedding toxic assets.

Swap facilities

SoFFin is permitted to acquire or secure special risk positions of financial institutions and to sell to third parties were possible.

The criteria for the temporary acquisition of assets are aligned on the rules of the guarantee scheme.

In particular the state will take over the assets but not bear their risk, as the assets need to be bought back after 36 months maximum for essentially the initial sales price. Moreover, a minimum premium similar to that of the guarantee and the costs for the provision of liquidity must be paid by the beneficiary.

Interest rates

Base interest rates, which are changed in July and January each year pursuant to section 247 of the German Civil Code (Bürgerliches Gesetzbuch), were reduced on 1 July 2009 to 0.12 per cent., down from 1.62 per cent. in January 2009.

Other Developments

Short Selling Ban

The Federal Financial Supervisory Authority (BaFin) has extended the ban on uncovered/naked short selling. The ban was originally in place by Decrees set in place on 19 and 21 September 2008. The ban has now been extended to 31 January 2010.

Moratorium on Kaupthing Bank

On 22 June 2009, BaFin lifted its moratorium on the German branch of Kaupthing Bank after receiving confirmation from the Icelandic government that German depositors will be reimbursed in accordance with EU legal requirements.

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