II

*(Acts whose publication is not obligatory)*

# COMMISSION

## COMMISSION DECISION

**of 20 May 1998**

**concerning aid granted by France to the Crédit Lyonnais group**

*(notified under document number C(1998) 1454)*

**(Only the French text is authentic)**

**(Text with EEA relevance)**

(98/490/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular Articles 92 and 93 thereof,

Having regard to the Agreement on the European Economic Area, and in particular Articles 61 and 62 thereof,

Having, in accordance with the abovementioned Articles, given the interested parties notice to submit their observations [1],

Whereas:

### 1. INTRODUCTION

Crédit Lyonnais (CL) is a publicly owned financial group operating in the banking sector. Since 1992 it has experienced considerable difficulties which led the State in 1994 to grant it aid in the form of a capital increase and the creation of a hive-off vehicle for property assets worth about FRF 40 billion. In 1995 other assets were hived off amounting to a total of approximately FRF 190 billion [2], the losses being covered by State guarantee. These measures were the subject of Decision 95/547/EC, in which the Commission decided on 26 July 1995 to approve on certain conditions the State aid in question, provided that the net cost to the State did not exceed FRF 45 billion [3]. In response to CL's deteriorating financial situation, the French authorities, in September 1996, submitted a plan to grant emergency aid totalling nearly FRF 4 billion in order to avoid serious adverse effects. On 25 September 1996 the Commission decided to approve the emergency aid and at the same time to initiate the Article 93(2) procedure [4] with regard to the other recovery measures recommended to CL. In that context it would examine the compatibility of any restructuring measure in the light of all the relevant information — including that on which Decision 95/547/EC was based and the obligations imposed by that Decision on France — and of any new facts, including the failure to meet certain conditions, the new arrangements proposed and the additional compensating measures.

The same day, Mr Van Miert, Member of the Commission, sent a letter to the French Minister, M. Arthuis, informing him of the inevitable difficulties associated with examination of the new restructuring plan for the

[1] OJ C 390, 24. 12. 1996, p. 7.

[2] Including the FRF 40 billion of assets hived off in 1994.
[3] OJ L 308, 21. 12. 1995, p. 92.
[4] OJ C 390, 24. 12. 1996, p. 7. The decision was notified to the French authorities by letter dated 16 October 1996, ref. No SG(96) D/9029.

bank, given the extremely large amount of aid already authorized by the Commission, and that it was therefore not possible to predict the final outcome of the case. The French authorities replied to the letter notifying the initiation of the Article 93(2) procedure in the following letters:

— that of 8 November 1996, attached to which were an analysis of the first recovery plan, the consolidated accounts of CL and the Consortium de Réalisations (CDR) at June 1996, a note on CL's management and internal auditing systems and a note on the partial securitization of the loan to the Etablissement Public de Financement et de Restructuration (EPFR);

— that of 23 May 1997, enclosing *inter alia* CL's draft annual report for 1996;

— that of 31 July 1997, in which the French authorities submitted the restructuring plan for the bank as requested by the Commission when the present procedure was initiated.

Other letters were sent by Mr Van Miert to the French authorities, in particular that of 25 June 1997 explaining to them the Commission's concern about the delay in the transmission of the new restructuring plan for the bank, and that of 16 October 1997 explaining the principles on which the Commission would base a decision. On 31 March 1998 the Minister for Economic, Financial and Industrial Affairs, M. Strauss-Kahn, wrote to Mr Van Miert informing him of new measures which the French State was ready to take with a view to securing conditional approval for the aid to CL. On 2 April, having obtained the Commmission's approval, Mr Van Miert wrote to M. Strauss-Kahn setting out the conditions which, in the Commission's view, would make it possible to regard the aid in question as compatible with the common interest. On 6 April, as a supplement to that letter, Mr Van Miert wrote to M. Strauss-Kahn informing him of the reasons why the undertakings made in the letter from the French Minister dated 31 March could not be regarded by the Commission as sufficient to secure a positive decision. On 24 April M. Strauss-Kahn wrote to Mr Van Miert again, repeating the position of the French authorities, emphasizing the constraint on the bank's viability and challenging the amount of aid calculated by the Commission. On 4 May M. Strauss-Kahn wrote to Mr Van Miert a third time, proposing additional compensating measures to offset the distortive effect of the aid. In three separate letters to Mr Van Miert dated 13 May, M. Strauss-Kahn set out all the undertakings made by the French authorities.

In evaluating the CL restructuring plan, the Commission decided to base its analysis on advice from the internationally reputed merchant bank Lehman Brothers (the Commission's consultant bank), which, in connection with the bank's viability, was instructed to examine the restructuring plan submitted by the French authorities and to propose any changes which it thought necessary. The Commission's consultant bank was also asked to assess the new compensating measures proposed by the French authorities and to examine additional ones if necessary. The CL restructuring plan was submitted to the Commission at the end of July 1997. The Commission's consultant bank carried out a thorough, detailed analysis and submitted its report, which is confidential, in November 1997. The French authorities and CL were able to consult the report and did not challenge its principal conclusions.

Mr Van Miert gave an oral progress report on the case to the Commission at its meetings on 25 November 1997 and 28 January, 25 February, 18 March, 31 March and 6 May 1998.

The Commission also consulted a group of 'wise men', former governors of central banks, to discuss the various problems associated with the case and the possible consequences of the failure of a large bank.

The observations of third parties are set out in section 5.

The measures examined here in connection with the increase in the aid approved by the Commission in Decision 95/547/EC and the Decision of 25 September 1996 comprise:

— the defrayal by the State of the additional losses of the Consortium de Réalisations (CDR) through the mechanism of a participating loan ('prêt participatif') from the Etablissement Public de Financement et de Restructuration (EPFR) to CDR;

— EPFR's carrying costs and additional losses, including the 'neutralization' of the loan from CL to EPFR from 1997 to 2014;

— the abandonment of the zero-coupon bond provided for in the 1995 business plan and Decision 95/547/EC, the discounted income from which had been deducted from the approved aid;

— a number of measures likely to contain additional aid components, in particular a possible capital increase.

## 2. BACKGROUND

### 2.1 Aid to CL in 1994 and 1995

After almost five years of rapid growth, CL recorded losses in 1992 (FRF 1,8 billion) and 1993 (FRF 6,9 billion). These were very heavy losses in proportion to CL's own funds, and its solvency ratio — the ratio of own funds to risk-adjusted assets — would have fallen below the 8 % legal minimum if the French authorities, acting at the request of the authority responsible for supervising the French banking system (the Commission Bancaire), had not taken financial support measures in 1994, essentially consisting of a capital increase of FRF 4,9 billion and the underwriting by the State of the risks attached to about FRF 42,7 billion of non-performing property assets transferred to a special hiving-off company (Omnium Immobilier de Gestion, OIG). At the beginning of 1995 it became clear that CL would be recording further losses which would threaten its solvency; the French State put together a new rescue package, involving the setting-up of another special hive-off vehicle consisting of, firstly, CDR, a hiving-off consortium for taking over CL's compromised assets, including those which had already been transferred to OIG, and secondly of a holding company (SPBI), responsible for financing the hiving-off and controlled by the main shareholders in CL (the Government, Thomson-CSF and CDC). CDR is a wholly owned, non-consolidated subsidiary of CL. SPBI was subsequently transformed (by the Law of 28 November 1995) into a public administrative institution, EPFR, which enabled it to qualify for an unlimited State guarantee in respect of all the risks and costs associated with the commitments transferred to CDR, including carrying costs. The setting-up of this vehicle limited CL's accounting loss for 1994 to FRF 12,1 billion.

According to the plan communicated by the French authorities and approved by Decision 95/547/EC, CDR purchased nearly FRF 190 billion of assets from CL, including those hived off in 1994, to which were attached FRF 55 billion in liabilities. The net value of the hived off assets, therefore, would be about FRF 135 billion. All the assets concerned were to be sold or liquidated. At least 50 % of them were to be sold within three years, and 80 % within five years if market conditions allowed. In the case of the banking subsidiaries transferred to CDR, the healthy part of these banks was either to be sold to third parties or taken back before 31 December 1995 by CL, with the result that at the end of financial 1995 CDR would no longer contain any active banking structure.

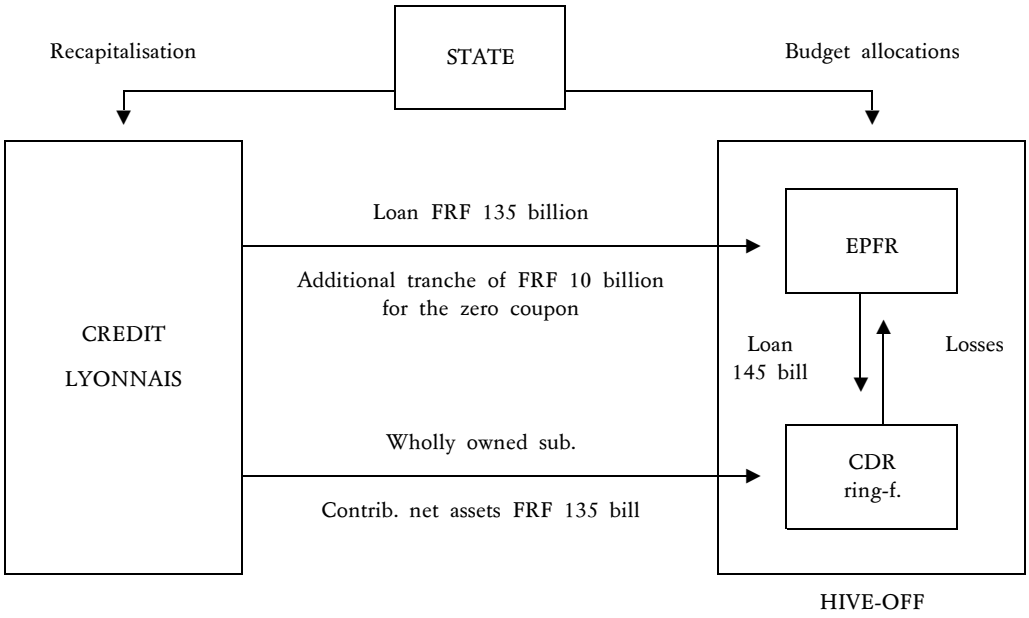
To enable it to buy the CL assets, CDR received a participating loan of FRF 135 billion from EPFR, with the possibility of increasing it to FRF 145 billion through an additional tranche of FRF 10 billion. The arrangement was financed by CL through a non-participating loan up to a maximum of FRF 145 billion. With this, EPFR was able to grant the participating loan of FRF 135 billion to CDR and should have been able to buy long-term zero-coupon bonds amounting to FRF 10 billion. The bond transaction would have enabled EPFR to earn an income initially estimated in 1995 at about FRF 35 billion by the end of 2014, thus allowing it to absorb the balance of the losses which will be recorded at that time in CDR.

The maturity date for both the CL loan to EPFR and EPFR loan to CDR is 31 December 2014. The CL loan will be repaid early as the assets are sold, in step with the amounts received, provided however that the repayments from CDR to EPFR are greater than the annual interest charged on the CL loan. The annual rate of interest applicable was initially fixed at 7 % in 1995 and at 85 % of the money market rate (MMR) from 1996. The participating loan granted to CDR is partly amortized at the end of each financial year: EPFR receives a repayment equal to the amount of the sales during the year and, if capital losses are incurred on the sales, it abandons the claim (by activating the guarantee) to the extent of the losses incurred by CDR.

Through the mechanism of the participating loan, CDR's losses are borne by EPFR and hence in the last resort by the State, up to a maximum of FRF 135 billion. However, the State guarantee was not subjected to a ceiling by Parliament when it adopted the Law of 28 November 1995 setting up EPFR, and is therefore *de facto* unlimited, even if in the extreme case the hive-off should make losses whose total exceeds the amount of the participating loan. Thus CL is covered by the State for the repayment of its loan to EPFR, which makes it possible for CDR not to be consolidated either prudentially or for accounting purposes within the CL group. This mechanism has enabled CL to record reduced provisions and losses and to comply with the statutory solvency ratio. The diagram below shows the main features of the arrangement.

As a *quid pro quo*, EPFR is entitled to the income from a 'better fortunes' clause in respect of CL. Thus it receives a contribution of 34 % of CL's net consolidated result, group share (prior to the entry in the accounts of the contribution and the appropriation from the financial year to the fund for general banking risks and prior to French corporation tax) plus 26 % of the fraction of that result exceeding 4 % of the consolidated capital and reserves, group share.

COMPOSITION OF THE HIVE-OFF VEHICLE




The CL restructuring plan submitted to the Commission in 1995 contained several measures concerning strategy redefinition, the sale of subsidiaries, cost reduction and risk management and control. These measures should have enabled CL to make a profit from 1995 on. By the end of 1999 CL should have recorded a return on its equity of 12,4 %. Under the better fortunes clause, its contribution to the cost of the hive-off vehicle should have been a total of FRF 6 136 million nominal over the period 1995-99.

2.2 **Decision 95/547/EC**

In Decision 95/547/EC the Commission conditionally approved the aid granted by the French State to CL during 1994 and 1995, regarding it as compatible with the common market under Article 92(3)(c) of the EC Treaty and in particular with the Community guidelines on State aid for rescuing and restructuring firms in difficulty [5]. The substantive provisions of the Decision are reproduced below:

'Article 1

*The aid contained in the recovery plan for Crédit Lyonnais in the form of a capital increase of FRF 4,9 billion, the underwriting of the risks and costs associated with the assets transferred to the hiving-off structure (up to a maximum of FRF 135 billion) and tax concessions inherent in the "better fortunes" clause, the total net cost of which to the State, taking into account the revenue accruing to the State, is estimated at a maximum of FRF 45 billion, is hereby declared to be compatible with the common market and with the EEA Agreement under point (c) of Article 92(3) of the EC Treaty and point (c) of Article 61(3) of the EEA Agreement.*

Article 2

*The aid referred to in Article 1 is authorized subject to France meeting the following conditions and commitments:*

*(a) it must ensure that all the recovery measures and all the arrangements provided for under the scheme described in Article 1 are implemented;*

[5] OJ C 368, 23. 12. 1994, p. 12.

*(b) it must not amend the conditions laid down in the recovery plan, except with the Commission's prior agreement. At all events, the "better fortunes" clause may be transferred no earlier than at the time of the privatization of Crédit Lyonnais, and only at the market price; that price will be verified by independent assessments;*

*(c) it must ensure, given the size of the estimated overall cost of the scheme to the State of FRF 45 billion, that the commercial capacity of Crédit Lyonnais is reduced by means of a cut of at least 35 % in its commercial operations abroad, including its European banking network, by the end of 1998 in accordance with the commitments given by France in its letter of 18 July 1995. If that objective cannot be achieved by the deadline set without causing substantial losses that require the shareholder in question to provide further financial assistance in order in particular to ensure compliance with the Community solvency ratio, the Commission undertakes to examine the possibility of extending that deadline. If the costs of the scheme, estimated at FRF 45 billion, are exceeded, it will be necessary to re-examine the scale of the reduction in the commercial operations of Crédit Lyonnais as accepted by the abovementioned letter;*

*(d) it must prevent Crédit Lyonnais from benefiting from a carry-over of tax losses in respect of the 1994 tax loss covered by the capital increase of FRF 4,9 billion;*

*(e) it must prevent Crédit Lyonnais from repurchasing hived-off industrial and commercial assets, except at the price at which the assets were transferred to CDR or at the market price if that is higher than the price at which the assets were transferred to CDR, and at all events subject to an overall limit of FRF 5 billion;*

*(f) it must prevent Crédit Lyonnais from sharing in any of the proceeds of sales from CDR;*

*(g) it must achieve a separation between CDR and Crédit Lyonnais as regards their managers, their administration and the system of monitoring and supervising the management of the hived-off assets;*

*(h) it must ensure that the committees responsible for managing the hived-off assets are independent of Crédit Lyonnais;*

*(i) it must eliminate any possibility of a carry-over of residual tax losses for years prior to 1995 for Crédit Lyonnais if, at the time of privatization, the "better fortunes" clause is transferred;*

*(j) it must ensure that Crédit Lyonnais uses the proceeds of sales to restructure non-performing assets and activities;*

*(k) it must ensure that Crédit Lyonnais pays to SPBI the levy sums in accordance with the "better fortunes" clause;*

*(l) it must pay to SPBI the proceeds of privatizing Crédit Lyonnais, particularly those deriving from the sale of the shares currently held by SPBI, and ask Parliament to endorse payment to SPBI of the proceeds of privatizing the remaining shares.*

Article 3

*The Commission has taken account of the French authorities' statement that their firm objective is to privatize Crédit Lyonnais and that the anticipated recovery should enable it to be ready for privatization within five years. Any deferment of privatization beyond five years will have to be notified to the Commission.*

Article 4

*The French authorities must cooperate fully in monitoring compliance with this Decision and must submit the following documents to the Commission every six months as from 1 March 1995:*

*(a) a detailed report on the application of the plan, together with the reports presented to Parliament;*

*(b) the balance sheets, profit and loss accounts, and reports of the directors of the companies involved in the hiving-off operation, namely OIG, CDR, SPBI and Crédit Lyonnais;*

*(c) a list of the hived-off assets that are liquidated or sold, with details of selling prices, the names of purchasers, and the names of the banks to which the selling instructions have been given;*

*(d) a detailed list of abandonments of CDR claims to be set against the participating loan granted by SPBI;*

*(e) a detailed list of the banking assets sold by Crédit Lyonnais outside the hive-off vehicle, with an evaluation, based on objective and verifiable criteria, of the reduction in its commercial operations abroad;*

*(f) detailed figures for Crédit Lyonnais's contributions to the hive-off vehicle in the form of a levy or dividends.*

*The Commission may ask for these documents and the implementation of the plan to be assessed by means of special audits.*

Article 5

*This Decision is addressed to the French Republic.*'

As a supplement to this decision it should be pointed out that, in its letter of 18 July 1995, France undertook to ensure that CL reduced its commercial presence in Europe outside France by 50 % in balance-sheet terms by the end of 1998, on the same conditions as in Article 2(c).

2.3 **Emergency aid**

In late September 1996 the French authorities submitted further aid for CL, amounting to nearly FRF 4 billion, to the Commission. In order to prevent considerable losses for CL and the deterioration of its rating, which could have had negative consequences for other financial institutions, the French authorities declared that emergency aid measures were necessary, namely:

— emergency aid which was designed to preserve the liquidity position and the solvency of the institution and which related to 1995 and 1996;

— restructuring aid which was designed to facilitate the recovery of CL beyond 1996 and which would not be implemented before the Commission had taken a final decision in its respect.

The proposed measures consisted in altering the conditions attaching to the loan from CL to EPFR, so as to 'neutralize the weight of the past in CL's accounts'. Since the results in the other activities were less good than forecast, the interest arrangements on the loan, according to the French authorities, imposed a net burden on CL of FRF 3 billion in 1996, 2,7 billion in 1997 and 2,5 billion in 1998. The calculation took into account the difference between the rate for the loan to EPFR (85 % of MMR) and the weighted average rate for the CL refinancing secured by the corresponding liabilities.

Initially and at 25 September 1996 these measures were to be implemented in respect of 1995 (retroactively, through incorporation of exceptional proceeds in 1996) and 1996. Subsequently, and subject to the Commission's final decision, they could possibly be introduced for the whole term of CL's loan to EPFR, in the form of restructuring aid.

The proposed changes were designed to compensate CL fully for the burden of the said loan. Thus it was planned that the rate of interest on the loan should offset the cost to CL of collecting the funds necessary to finance the loan. Consequently, the French authorities decided to increase the rate of interest from 7 % to 7,45 % in 1995 and from 85 % of MMR to 5,84 % in 1996. In particular, in respect of 1996, the French authorities did not confine themselves to cancelling the 15 % subsidy on the rate for the original loan so that CL would be remunerated at the MMR level, but they also proposed to increase the rate on the loan beyond the MMR by a percentage that would offset CL's higher refinancing cost caused by its long-term liabilities. The increase compared with MMR was about 2 %. The changes in respect of 1995 and 1996 would have the effect of giving CL an advantage of FRF 3 560 million, which was to be sufficient to prevent any liquidity and confidence problem for the bank in 1996.

As the French authorities have admitted, part of the plan approved by the Commission in 1995 has never been implemented. This is the FRF 10 billion part of the FRF 145 billion loan from CL to EPFR enabling the latter to issue long-term zero-coupon bonds which would have earned it an income of FRF 35 billion nominal by 2014, or FRF 7,8 billion discounted. The French authorities planned therefore to abolish this part of the plan. As with the other measures described above, the change was first introduced on 25 September 1996, in respect of 1996, in the form of a suspension of the operation. Subsequently, and in accordance with the Commission's final decision, the change would be proposed by the French authorities for the following years, in the form of restructuring aid.

Implementation of the zero-coupon operation would have had the result of further increasing the above-mentioned losses of CL by imposing on it an annual burden of carrying additional outstanding loans of FRF 10 billion, at an interest rate not covering its refinancing cost.

The French authorities also affirmed, when submitting their request for emergency aid, that such aid was not sufficient to sustain the definitive recovery of CL, since the new redundancy programme and the shedding of retail banking activity outside France, provided for in the measures submitted, involved substantial provisions and capital losses in respect of several non- or poorly performing subsidiaries (a capital loss of about FRF 6.5 billion). For this reason, the French authorities proposed to effect a capital injection, probably when the 1996 accounts were closed, 'for an amount exceeding those capital losses'. The Commission had, in 1996, estimated the possible amount of such an additional transaction at FRF 8-10 billion.

On 26 September 1996 the Commission therefore decided to approve the emergency aid and to initiate the procedure with regard to the other measures concerning CL. It announced that, as part of the procedure, it would examine the compatibility of any restructuring measure concerning CL on the basis of all the relevant information — including that on which Decision 95/547/EC had been based and the obligations which that Decision had imposed on France — plus any new facts — including failure to satisfy certain conditions, the new arrangements proposed and the additional compensating measures.

It should also be emphasized that the approval of the emergency aid for 1995 and 1996 has in no way prejudged the present decision, with the result that France's and CL's obligations concerning the introduction of the zero-coupon bond and the financing of the loan to EPFR, as defined in Decision 95/547/EC, have remained unaltered as from 1 January 1997.

### 2.4 **Background to the examination of the supplementary restructuring aid for CL**

In its examination of the supplementary aid for CL, the Commission takes account of the fact that it has already approved the aid granted by France to CL in 1994 and 1995, regarding it as compatible with the common market under Article 92(3)(c) of the EC Treaty and in particular with the Community guidelines on State aid for rescuing and restructuring firms in difficulty [6].

As the guidelines affirm, *'aid for restructuring raises particular competition concerns as it can shift an unfair share of the burden of structural adjustment and the attendant social and industrial problems on to other producers who are managing without aid and to other Member States. The general principle should therefore be to allow restructuring aid only in circumstances in which it can be demonstrated that the approval of restructuring aid is in the Community interest'*. Thus, *'aid for restructuring should therefore normally only need to be granted once'.*

The Commission finds that to the substantial amount of aid accepted in 1995 further aid is now being added on an unprecedented scale. In the September 1996 Decision initiating the procedure, the Commission noted that the considerations presented lead inevitably to the conclusion that such supplementary aid can be regarded as compatible with the State aid rules of the EC Treaty only if serious, substantial *quid pro quos* are provided. These should be made both inside and outside France, in retail banking and in CL's other areas of activity. The Commission assessment of the compatibility of the supplementary aid will also depend on the extent to which it exceeds the amount approved in 1995. Consequently, the Commission must ensure that such aid is not declared compatible, if at all, without a particularly substantial contribution from CL, which takes account of the circumstances in which the French authorities submitted these aid measures to the Commission, the scale of the supplementary aid compared with the FRF 45 billion authorized by Decision 95/547/EC, and the recurrent nature of the aid. It will ensure in particular that CL makes compensating arrangements proportionate to the exceptional nature and size of the aid it has been granted. Such arrangements must not be limited to businesses which are no longer part of the bank's strategic priorities but must also relate to businesses whose sale may compensate for the damage caused to competitors by the aid, and everything which is not strictly necessary to the viability of CL's core business.

[6] See footnote 5.

## 3. DESCRIPTION OF CL AND ITS RECENT PERFORMANCE

*Table 1:*

**Breakdown of the functions of CL at end 1996**

| Function | France | Europe | Rest of world |
|---|---|---|---|
| Commercial banking | Personal banking:<br>1 954 branches<br>Business banking: 201 business centres<br>Corporate banking: 143 business centres and corporate offices<br>Regional banking subsidiaries<br>Leasing<br>Factoring<br>Specialist financing | Personal and corporate banking: 679 branches<br>BfG Bank (Germany),<br>CL Austria,<br>CL Belgium,<br>CL Espana, Banca Jover (Spain),<br>CL Greece,<br>Credito Bergamasco (1) (Italy),<br>CL Luxembourg,<br>CL Sweden,<br>CL Switzerland,<br>CL Portugal,<br>Woodchester (1) (Ireland),<br>CL branches in the UK<br>14 branches in Eastern Europe (CL Russia, CL Bank Praha, CL Ukraine, CL Bank Hungary, CL Bank Slovakia, International Bank of Poland)<br>Leasing<br>Factoring | Corporate banking: 564 branches Of which 265 in N and S America, 39 Asia, 224 in Africa, 36 in the ODT |
| Third-party management | Management of 120 UCITS<br>Management under mandate: for private individuals, institutions and firms | Management of 80 UCITS<br>Specialist subsidiaries<br>CL International Asset Management (Hong Kong, Milan, New York, Singapore, Tokyo)<br>CL Private banking directed by CL Switzerland (other sites: Paris, Monaco, Luxembourg, London, Vienna) | CL Private banking in Hong Kong, Singapore, Miami, Montevideo |
| Insurance | UAF<br>broker's offices | Broker's offices | |
| Merchant banking | 4 trading rooms<br>17 trading counters<br>Stockbroking companies: Cholet-Dupont and Michaux | Trading rooms in Brussels, Frankfurt, London, Luxembourg, Madrid, Milan, Zurich<br>Specialized subsidiaries<br>CL Capital Markets (London) Iberagentes (Madrid) | 36 trading rooms including: Hong Kong, Montreal, New York, Singapore, Seoul, Sydney, Taipei, Tokyo<br>Specialized subsidiaries: CL Capital Markets Asia, CL Sec. (USA) |

*Source:* CL Annual Report 1996.

(1) The Credito Bergamasco (It) and Woodchester (Ire) subsidiaries were sold in 1997 and are no longer consolidated in the 1997 accounts.

CL is a banking group engaged in various areas of financial intermediation. Its business includes retail and wholesale commercial banking, merchant banking, third-party asset management, leasing, factoring and insurance. At the end of 1997 CL employed 50 789 people, slightly less than two thirds of them in France. Its balance sheet total then stood at FRF 1 499 billion, FRF 692 billion of which related to activity in France (46,2 %) and FRF 474 billion to activity in Europe excluding France (32 %). After buying up Thomson's shareholding in December 1996, the French State held 78,05 % of the capital and 96,01 % of the voting rights in CL (including the shares held by EPFR). The Caisse des Dépôts et Consignations, a publicly-owned specialist credit institution, held 3,7 % of the capital and 3,99 % of the voting rights. The rest of the capital (18,25 %) consisted of non-voting preference shares quoted on the stock exchange. The breakdown of CL's functions and the number of its establishments in France and abroad at the end of 1997, plus the geographical distribution of some of its key financial elements are given in the tables below.

*Table 2:*

**Geographical distribution of some of CL's key financial elements at end 1997**

*(%)*

| Financial elements | France | Europe | Rest of world |
|---|---|---|---|
| Customer applications (loans) | 46 | 30 | 24 |
| Customer resources (deposits) | 58 | 30 | 12 |
| Staff | 68 | 21 | 11 |
| Net receipts from banking (NRB) | 58 | 28 | 14 |
| Gross operating result (GOR) | 50 | 30 | 20 |
| Total assets (balance sheet) | 46 | 32 | 22 |

*Source:* CL Annual Report 1997.

CL's activities are organized by function and grouped in a number of directorates, i.e. French business (DCAF), European business outside France (DCAE), other international business outside Europe (DCAI), capital markets (DCMC), management and relations with institutional investors (DGRI), financial engineering and asset and project financing (IFAP), and miscellaneous. DCAF is the main division in the group, since it contributes nearly half of CL's consolidated income and one third of its net profit (excluding holding and intra-group adjustments). Table 3 below gives the contribution of each directorate to certain group financial aggregates in 1996.

Table 3 shows that, compared with weighted commitments and capital allocated, the result for European activities was very modest in 1996, whereas the opposite is true for other international business. French business, for its part, produced substantial gross revenue, but its net result was not so high, in particular on account of overheads and the high level of risks and asset-related losses. The situation evolved significantly in 1997 (see below).

Since the first aid was granted in 1994, CL has undertaken a major restructuring of its organization and all its activities. The restructuring has covered strategy, operations and finance.

CL has abandoned its aspiration to become a universal bank on a world scale. While retaining this objective in France, where it is at once a personal bank, a bank for small and medium-size firms, a bank for large firms and institutional investors, an insurance bank, and a business and merchant bank, in the rest of the world CL has reduced its commercial presence, as constrained by Decision 95/547/EC, by disposing of foreign banking subsidiaries specializing in retail operations, in Europe (CLBN, Credito Bergamasco and Woodchester), in Latin America (Banco Frances e Brasileiro) and in Africa. Since 1 January 1995 international sales have concerned 17,9 % of the assets in that field, which corresponds to about FRF 171,2 billion, of which FRF 136,1 billion in Europe and FRF 35,2 billion in the rest of the world (principally in Latin America). By contrast, it has maintained and reorganized its wholesale and capital market banking business throughout the world. It has also set up alliances with specialist partners, acquiring a pre-eminent role on their markets (in particular with Allianz in non-life insurance and Cetelem in France in consumer credit).

*Table 3:*

**Contribution of the group's activities to certain financial aggregates (1996 data)**

| | Weighted commitments | Net receipts form banking | Gross operating profit | Net result |
|---|---|---|---|---|
| DCAF and subsidiaries | [...] (*) | [...] | [...] | 32 % |
| DCAE inc trading rooms | [...] | [...] | [...] | 6 % |
| DCAI inc trading rooms | [...] | [...] | [...] | 30 % |
| DCMC inc trading rooms | [...] | [...] | [...] | 23 % |
| DGRI and subsidiaries | [...] | [...] | [...] | 5 % |
| IFAP and subsidiaries | [...] | [...] | [...] | 4 % |
| Total absolute values (FRF billion) | 872 | 44,5 | 11,4 | 0,3 |

(*) In the published version of this Decision, some information has been omitted pursuant to the provisions concerning non-disclosure of business secrets.

Excluding holding and intra-group adjustments. — *Source:* CL's business plan.

*N.B.* The loan of FRF 135 billion to EPFR is not included in the weighted commitments.

From the operations standpoint, two main courses of action have been followed. First, the portfolio has been improved, having benefited from the transfer to CDR of FRF 190 billion of largely non-performing assets and from the introduction of more efficient instruments for the control, management and monitoring of risks and of suitable management and internal auditing systems. The ratio for the coverage of doubtful debts by provisions was increased to 65 % in 1997. Secondly, a major effort has been made to reduce overheads. Successive redundancy programmes have reduced staff from 59 323 in 1995 to 50 789 in 1997 and total labour costs over the same period from FRF 20,6 billion to FRF 19,8 billion. Staff numbers have fallen by 14,4 % (7) compared with 1995, a much bigger reduction, even assuming a constant range of business, than that achieved by CL's principal French competitors. A further decline in staff numbers is expected in 1998 as part of the implementation of the third redundancy programme, which envisages a reduction of 5 000 jobs in 1996-98. Measures to retain customer loyalty and safeguard net receipts from banking (NRB) have been taken to halt the decline in the latter recorded in 1996.

Financial restructuring has been slower. Compared with the plan submitted to the Commission in 1995, CL has not managed to achieve the objectives it had set itself, for several reasons. On the liabilities side, CL has continued to be saddled with its long-term liabilities contracted several years ago, whose rate conditions have become increasingly burdensome compared with the gradual decline in market rates. CL's credit rating has remained particularly low and unfavourable compared with the strategy pursued by the bank. Despite the recent improvement in its operational performance, CL's debt rating, as attributed by the international rating agencies, is currently BBB+ (Standard & Poor's) and A3 (Moody's), defined as adequate capacity to pay interest and repay principal, but with great sensitivity to changing economic circumstances (8). This compares with the ratings of AA-/Aa3 for Société Générale and A+/Aa3 for BNP, the two private French banks of roughly comparable size to CL, and with the generally higher ratings of the other publicly-owned banks. A rating in the range AAA-A- (S & P) or Aaa-A3 (Moody's) is normally a necessary condition for the long-term viability of a bank, in particular so that it can finance itself under competitive conditions on markets. The rating also reflects CL's weak capitalization compared with the functions exercised and with the extensiveness of its activities, which are subject to changes in economic circumstances throughout the world. The solvency ratio went up from 8,4 % in 1995 to 9,3 % (in 1997) and its tier one from 4,4 % to 4,8 %. Although these ratios are normally quite sufficient for an average bank, they remain below what the markets normally require for banks which claim to pursue a broad strategy such as that of CL. In January 1998 Moody's

(7) Data not corrected for changes in the consolidation limits.

(8) The rating definitions of Standard & Poor's-ADEF are the following: AAA: capacity to pay interest and repay principal extremely strong; AA: very strong capacity; A: strong capacity although susceptible to adverse effects of changes in circumstances and economic conditions; BBB: adequate capacity to pay interest and repay principal but with great sensitivity to changing economic circumstances; BB and B: speculative characteristics and uncertainty of payments; CCC, CC and C: doubtful claim; D: already in payment default. Moody's scale is as follows: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2.

placed all CL notes under surveillance on account of the bank's exposure to Asia and of the uncertainty surrounding approval of the aid plan by the Commission.

Despite these difficulties on the liabilities side, the main problems for CL lie with its assets, on account of the delayed repayment of the loan to EPFR, which hampers its operation, and also of the decline in its market shares in 1995-96 (halted in 1997). A further factor was the unfavourable economic situation in those years, which explains the inadequacy of the NRB and the results — the reasons behind the rescue aid approved by the Commission in 1996.

On the assets side it will also be noted that the return on the claims portfolio declined automatically as a result of the fall in market rates and of the greater competition associated with the disintermediation on the more sophisticated levels of the financial markets and with technological progress and the integration of markets. The decline in interest income (interest receivable less interest payable) has been progressively offset by the increase in commissions on securities and on third-party asset management. The loan to EPFR is still at a high nominal level (more than FRF 100 billion), and its remuneration, which is lower than the market rates (85 % of MMR), has affected the bank's accounts, which led to the granting of the emergency aid in 1996.

Table 4 provides a financial and operational analysis of CL over the period 1994-97.

It should be stressed that CL's accounts in 1995 and 1996 include the neutralization of the loan to EPFR. Similarly, the 1997 accounts were drawn up by the bank on the assumption that the Commission would approve the neutralization of the loan. After the results were announced on 19 March 1998, the Commission made it known, through a statement by Mr Van Miert, that the inclusion in the bank's results of the aid relating to the neutralization in 1997 of the loan to EPFR was premature and had not yet been approved, that the Commission could not anticipate the present decision and that therefore, pursuant to the State aid rules, it was unlawful at this stage. Without this aid in 1997 — it amounted to more than FRF 3 billion — the bank would have recorded a loss. Despite this reservation, the results, as presented, are comparable to those for 1996 and 1995, which contained similar aid, and give an important indication of the trend of CL's activities.

*Table 4:*

**CL's financial results and indicators from 1994 to 1997**

*(FRF million)*

| | 1994 | 1995 | 1996 | 1997 | variation 1997/1996 |
|---|---|---|---|---|---|
| **Net receipts from banking** | **45 677** | **43 355** | **44 509** | **46 020** | + 3,4 % |
| Overheads and depreciation | (39 502) | (36 709) | (35 049) | (34 981) | − 0,2 % |
| **Gross operating result** | **6 175** | **6 646** | **9 460** | **11 039** | + 16,6 % |
| Allocations to provisions | (13 981) | (5 835) | (5 711) | (5 073) | − 12,2 % |
| **Current result** (1) | **(7 809)** | **811** | **3 749** | **5 966** | + 59 % |
| Exceptional items and miscellaneous | (485) | 546 | (1 623) | (1 800) | Not specified |
| Corporation taxes | (1 300) | (931) | (1 296) | (982) | n.s. |
| Results of associated companies | 451 | 920 | 831 | 110 | n.s. |
| Depreciation of goodwill | (2 192) | (197) | (68) | (70) | n.s. |
| Better fortunes clause | — | (6) | (107) | (850) | n.s. |
| **Overall net result** | **(11 274)** | **1 143** | **1 486** | **2 370** | + 59 % |
| **Net result, group share** | **(12 102)** | **13** | **202** | **1 057** | n.s. |
| Capital and reserves, | 45 545 | 42 148 | 44 421 | 44 074 | n.s. |
| of which: group share | 26 304 | 24 282 | 25 603 | 28 293 | n.s. |
| fund for general banking risks | 5 492 | 5 018 | 5 054 | 4 985 | n.s. |
| Minorities | 14 749 | 12 848 | 13 763 | 10 796 | n.s. |
| Balance sheet total | 1 752 971 | 1 663 030 | 1 623 682 | 1 498 698 | n.s. |
| Return on equity, group share, beforeclause (ROE) | n.s. | 0,08 % | 1,24 % | 6,74 % | — |
| Return on assets (ROA) | − 0,64 % | 0,07 % | 0,09 % | 0,15 % | — |

*(FRF million)*

| | 1994 | 1995 | 1996 | 1997 | variation 1997/1996 |
|---|---|---|---|---|---|
| Solvency ratio, of which: | 8,4 % | 8,5 % | 8,7 % | 9,3 % | — |
| Tier 1 | na | 4,5 % | 4,6 % | 4,8 % | — |
| Operating ratio | 86,5 % | 84,7 % | 78,7 % | 76 % | n.s. |
| Staff | 68 845 | 59 373 | 56 748 | 50 789 | n.s. |
| Loans to customers | 830 758 | 878 500 | 878 489 | 845 800 | n.s. |
| Deposits from customers | 684 600 | 700 800 | 694 000 | 712 700 | n.s. |
| Managed capital | 441 400 | 401 200 | 452 600 | 491 300 | + 8,5 % |

*Source:* CL Annual Reports.

*N.B.* 1997 data as presented by the bank, including the neutralization of the loan from CL to EPFR.

(1) The current result in 1997 excludes provisions in respect of Asia, which are included in the balance of exceptional items.

The table shows that after a very noticeable fall in 1995, the bank's net receipts from banking stabilized in 1996 and recovered appreciably in 1997. The noticeable rise in NRB in 1997 is due, firstly, to a significant increase in commissions (+ 11,5 %, assuming constant consolidation limits) resulting from the high level of activity on financial markets in 1997. Commissions now account for 33,8 % of CL's NRB and have increased in all the major activities of the bank, both in France (where they have gone up from FRF 6,6 billion to FRF 7,1 billion) and internationally. Secondly, lending activity was steady in 1997: outstanding loans grew in Europe (+ 11 %, assuming a comparable range of activity) and in the rest of the world (+7,6 %). The rise in Europe is due to the marked increase in loans from the BfG and a sterling exchange effect (+ 20 %). The figure for the rest of the world includes a dollar effect (+ 14 %). Capital market operations and the operations of the other foreign subsidiaries, notably in the United States and Asia, made a considerable positive contribution to the bank.

According to the bank, CL's market shares in France, after the fall recorded in 1995-96, stabilized, both in the granting of loans and in the collection of resources.

*Table 5:*

**CL's market shares in France**

*(%)*

| | Dec. 1995 | Dec. 1996 | Sept. 1997 |
|---|---|---|---|
| Customer applications | | | |
| — individuals | 6,1 | 5,7 | 5,6 |
| — firms | 4,1 | 4,3 | 4,4 |
| Customer resources | | | |
| — individuals | 5,9 | 5,7 | 5,7 |
| — firms | 6,3 | 5,5 | 5,4 |

*Data:* CL Annual Report 1997.

In 1997 there was a rapid improvement in the profitability of CL's commercial banking in France: NRB France remained stable on account of the slight fall in outstanding loans to customers (− 2,6 %, excluding securitization) and the erosion of rate margins (intermediation margin, debtor rates less creditor rates), but the control of overheads in connection with activity in France, which fell by 1,4 %, was a favourable factor, as was the fall in provisions resulting from better risk control. The level of provisions for commercial banking activities in France fell considerably in 1997 compared with 1996, from FRF 3,7 billion, or about 1 % of weighted assets, to less than FRF 2 billion, thus making possible an improvement in the result (the pre-tax result went up by FRF 2 billion).

Overheads for the group as a whole have fallen significantly since 1995, as a result in particular of the reduction in staff numbers and total staff costs. The operating ratio has thus been reduced from 84,7 % to 76 %. However, it is still particularly high in France (about 82 %), a level which has to be compared with that of the bank's main French competitors (approximately 70-72 %). By contrast, international overheads increased appreciably in 1997. The overall result is that the operating ratio (ratio of overheads to NRB) is falling slowly despite the rise in NRB. This is much better than forecast for 1997 in the plan (80 %), but CL is still a long way from the ratio of its main competitors and from the objective it set itself (ratio of 70 % in 2000).

Provisions reached a total of over FRF 8 billion in 1997, i.e. twice as much as forecast. The increase is due mainly to the exceptional provision of FRF 3 billion for Asia. Compared with 1996, provisions (excluding Asia) are declining, falling from FRF 5,7 billion to FRF 5,1 billion. They are nevertheless FRF 1 billion higher than was forecast in the plan and have increased, on a constant activity basis, as a result in particular of a substantial provision for risk-countries of FRF 900 million in 1997 (further to a provision of FRF 333 million already made in 1996).

The bank's net result increased appreciably in 1997 but is difficult to interpret in view of the size of the non-recurrent exceptional items (neutralization of the loan to EPFR, provision for Asia, capital gains from sales). The solvency ratio (Cooke ratio), taking account of the improvement in the results (positive effect on the numerator, after allocation of the result) and of the stability of the weighted assets (the denominator in the ratio) is increasing appreciably, rising from 4,6 % to 4,8 % (tier one) and from 8,7 % to 9,3 % (overall solvency ratio).

The results now available show that CL's recovery is still fragile and its profitability insufficient to provide a return on equity of the level which a private shareholder would normally expect. Without the emergency aid approved by the Commission in 1996, the bank's results would still be negative. It should also be remembered that without the neutralization of the loan (anticipated and, in accordance with the State aid rules, unlawful at this stage), CL would still have recorded losses in 1997.

On this basis alone, therefore, the Commission cannot conclude that the recent trend of the bank's activity shows that it has returned to profitability and viability. It is essential in this respect to examine the restructuring plan submitted by the authorities in July 1997 (see below).

## 4. ANALYSIS OF THE PROGRESS MADE IN IMPLEMENTING THE MEASURES PROVIDED FOR IN DECISION 95/547/EC

In Decision 95/547/EC the Commission subjected the aid to a series of conditions, the implementation of which is examined below. The most important conditions are:

(a) full implementation of the restructuring plan submitted to the Commission;

(b) a 35 % cut in the bank's commercial presence outside France in balance sheet terms;

(c) introduction of the EPFR loan and the zero-coupon bond;

(d) payment of the better fortunes clause;

(e) payment of the dividends from CL to the State as shareholder;

(f) use of the proceeds of sales for restructuring purposes;

(g) abolition of the carry-over of tax losses relating to the aid.

### (a) *Implementation of the restructuring plan submitted to the Commission*

Since the approval by the Commission in July 1995 of the aid plan for CL, including the protocol between the French State and CL of 5 April 1995 concerning the hive-off vehicle, the French authorities have sent the Commission several amendments to the protocol, some of them in order to comply with Decision 95/547/EC (separation of CL and CDR) and with the Commission's Decision of September 1996 (emergency aid). Attention is drawn here to Amendment No 9 of 6 May 1997, which adapted the arrangements for the repayment of the participating loan by CDR to EPFR by doing away with the obligation on CDR to repay in advance each year to EPFR a sum corresponding to the sums collected from the assets less sums made available to controlled companies, operating expenses and interest owing to EPFR. Since the date of the amendment, CDR must submit each year to EPFR a multiannual financing and cash-flow plan, under which it repays in advance to EPFR, on 30 June, an amount equal to its estimated available cash flow at that date less one sixth of the sale proceeds set out in the budget for the year in progress.

The same amendment introduced a guarantee from EPFR to CDR making it easier for the latter to obtain external financing up to a limit of FRF 10 billion. The amount of

the additional drawdowns under EPFR credit which CDR can make from 1 January 1998, up to a limit of FRF 10 billion, is reduced by the amount of the guarantees in existence at the date of each drawdown. The changes reflect CDR's increased cash-flow needs, which were a factor behind the delayed repayments of the participating loan and, consequently, of the loan from CL to EPFR.

On 16 December 1997 the French authorities informed the Commission of the reform of the structures for supervising CDR presented to the Finance Committee of the National Assembly by the Minister, Mr Strauss-Kahn. According to the French authorities, the reform was necessary in order to correct the defects in the previous arrangements, in particular:

— the fact that liquidation was the sole objective, and the binding nature of the timetable;

— the fact that CDR was not made sufficiently responsible;

— a plethora of supervisory bodies and procedures;

— political interference;

— uncertainty as to the outcome of lawsuits.

The reform is based on three principles: independent and responsible management, rigorous and effective supervision, and the State to be impartial and concerned to see justice. In practice this means that:

— in order to obtain the best value for them and optimize the financial result for the State, the assets will no longer be managed with a view simply to their liquidation;

— CDR will alone be responsible for the sell-off process, as part of a strategy to be reviewed each year, and profit-sharing arrangements will be introduced;

— internal control will be strengthened by the transformation of CDR into a company with a supervisory and management board, the assumption of the functions of the advisory committee by the supervisory board, the creation of a risks division, and the simplification of internal accounting arrangements and middle management structures;

— EPFR will exercise vis-à-vis CDR the prerogatives of the State as shareholder, in a supervisory function for which it may bring in outside experts;

— political interference is prohibited, and instances will be systematically referred to the courts, whose resources will be strengthened for the purpose.

The Commission supports the principle of a management which is keen to defend the asset-related interests of the State; this should have the effect of minimizing the aid granted by the State to CL through the hive-off vehicle. The Commission notes that CDR's operations during the 1996 and 1997 financial years have already shifted from a liquidation perspective and that, in particular, CDR has abandoned claims and effected recapitalizations, and granted fresh guarantees to its subsidiaries or their buyers, under conditions likely to include the grant of State aid to the beneficiaries of these transactions. The Commission stresses that the abandonment of the liquidation rationale makes it less likely that the original (indicative) timetable, whose target was that 80 % of the hived-off assets should be sold within five years (i.e. by the year 2000), will be complied with. The advantages which the authorities see in such non-liquidation management must be evaluated in the light of the increased carrying costs associated with extending the hiving-off of a number of assets. The authorities have not provided any evidence on this point to show that they are minimizing the aid in the process.

The Commission would point out that CDR's resources are state resources within the meaning of Article 92 of the Treaty, not only because CDR is the wholly owned subsidiary of a public undertaking but also because it is financed by a participating loan guaranteed by the State and because its losses are borne by the State. The Commission notes that such transactions do not qualify for any derogation exempting them from the obligations arising out of Articles 92 and 93 of the Treaty, and in particular that the French authorities and CDR cannot be exempted from such obligations under Decision 95/547/EC or under this Decision. It should be noted that CDR's operations with regard to its subsidiaries are deemed not to include any aid component only if they conform with the 'market economy investor' principle and that any injection of funds (or abandonment of claims) complies with this principle. In its communication to the Member States [9] concerning the principles to be applied to determine whether public intervention should be regarded as aid, the Commission considers that injections of capital into public undertakings contain elements of State aid if, in similar circumstances, a private investor, in view of the expected return on the contribution of funds, would not have made the capital injection in question. In a letter dated 16 October 1997 addressed to the Minister for Economic, Financial and Industrial Affairs, Mr Van Miert pointed out that CDR operations involving a recapitalization of its assets, a sale at a loss or a cancellation of debt were likely to include aid and should be notified to the Commission. Similarly, sales of CDR assets other than by open, transparent tendering procedures must also be notified to the Commission.

[9] OJ C 307, 13. 11. 1993, p. 3.

Only operations definitely below the *de minimis* aid threshold of ECU 100 000 are exempt from this obligation.

The other aspects of the implementation of the restructuring plan submitted to the Commission in 1995 are examined below.

(b) *Reduction of the bank's commercial presence outside France*

In accordance with the undertakings given by France in the letter from the Minister, Mr Madelin, dated 18 July 1995, Decision 95/547/EC called for a reduction of at least 35 % in CL's commercial presence abroad, including the European banking network, by the end of 1998. The letter states that the reduction will have to be valued in balance sheet terms and that an international reduction of the magnitude of the above percentage represents a reduction of 50 % in the European network. The contribution of the international assets to the bank's total assets at the end of 1994 was FRF 960 billion, whereas the contribution of the European assets was equivalent to FRF 620 billion. Consequently, 35 % of the international assets corresponds to FRF 336 billion, of which FRF 310 billion are in Europe (= 50 % of CL's European assets outside France).

At 31 October 1997, CL had sold assets with a balance sheet value at 1 January 1995 of FRF 171,2 billion, or 17,9 % of international assets. The reduction is the result of sales of FRF 136,1 billion in Europe and FRF 35,2 billion in the rest of the world. The reduction in Europe corresponds to 22 % of European activities. Consequently, CL must still sell, by 31 December 1998, nearly FRF 174 billion of European assets in order to fulfil this obligation.

(c) *Introduction of the loan to EPFR and the zero-coupon bond*

In order to buy the FRF 135 billion of assets, net of liabilities, transferred from CL to the hive-off vehicle, CDR received a participating loan of FRF 145 billion from EPFR (of which FRF 10 billion were converted into an EPFR guarantee in for CDR borrowings from third parties). EPFR, for its part, obtained its finance from CL through a non-participating loan of FRF 145 billion. The two loans have a maturity date of 31 December 2014. The annual rate of interest applicable to the loan from CL to EPFR was originally set at 7 % in 1995, then at 85 % of the money market rate (MMR) from 1996 ([10]). Since the larger part of this loan (FRF 135 billion) has made it possible to finance the transfer of assets, the balance (FRF 10 billion) should have been used by EPFR to purchase zero-coupon bonds for the same amount, which would have enabled it to earn an income of FRF 35 billion (nominal) in 2014, which the Commission estimated in Decision 95/547/EC to be worth about FRF 8 billion in present value terms.

Several changes have been made to this plan. The loan from CL to EPFR has been set up, but only the first part relating to FRF 135 billion, which means that EPFR has not been able to set up the zero-coupon bond. Since the expected income for EPFR from the zero coupon had been deducted by the Commission from the gross aid to CL, the failure by CL to grant the FRF 10 billion loan to EPFR and the consequent failure to set up the zero-coupon bond constitute an additional cost to the State and additional aid to CL (compared with what was authorized in 1995), of an amount equal to the deduction of approximately FRF 8 billion calculated in 1995. Part of this aid, estimated at FRF 400 million and relating to the failure to set up the bond in 1995-96, was however approved by the Commission in its Decision of September 1996 concerning emergency aid for CL.

The same Decision approves other emergency aid of about FRF 3,5 billion deriving from the increase in the interest rate for the loan from CL to EPFR for 1995 (*ex post facto*) and 1996. The Commission also decided to initiate the procedure with regard to the application of this change in the years ahead.

Amendments to the 1995 protocol between the State and CL were made after it had been signed, in order to change other clauses that had been approved by the Commission. Thus, as regards the mechanism for financing the hive-off, the failure by EPFR to draw down FRF 10 billion from CL did not result in a reduction by a similar amount of the participating loan from EPFR to CDR, but in the transformation of this possibility of an additional drawdown by CDR into a guarantee for the same amount enabling it to borrow direct from third parties.

In addition, although progress on CDR sales is in keeping with the original objective of selling 80 % of the hived-off assets within five years and 50 % within three, the increase in the proceeds from sale to EPFR, and hence the repayment of the loan from CL, have been much slower and more limited than initially planned, since CDR has kept the bulk of these sale proceeds for financing its operating costs, the costs of carrying its assets (in particular the repayment of third-party liabilities), and for supporting certain hived-off assets in various forms (through recapitalizations, advances and abandonments of claims).

([10]) Overdue interest is paid at the monthly rate for 13-week Treasury bills (TMB), published by the Caisse des Dépôts et Consignations.

The delay in repayments and the unexpected trend of interest rates have had an effect on CL's accounts. The assets transferred to CDR were partly financed by long-term liabilities not transferred to the hive-off vehicle and contracted by the bank in its expansion phase (1988-93) at rates higher than the return on the EPFR loan after 1995 (85 % of MMR). From 1996 on, this should have entailed carrying costs for CL (projected at the time as FRF 2,1 billion in 1997, FRF 1,8 billion in 1998 and FRF 1,4 billion in 1999). In accordance with the intentions of the French authorities, this constituted a contribution from CL to the costs of the mechanism, and therefore to its own restructuring. The projections of the bank's net receipts from banking indicated in 1995 that CL would be fully able to support these costs. In reality, the delayed repayment of the loan to EPFR and the unexpected trend of market interest rates increased these costs. However, the increase would not have required emergency aid if CL had lived up to its NRB projections. It is therefore this latter element, namely the lower than forecast outturn of NRB, which is at the root of the emergency aid. In the 1996 decision, the Commission had concluded, on the basis of the data supplied by the French authorities, that the effect of the rate would have additional costs for CL of only FRF 1 billion over the three-year period 1996-98 ([11]).

(d) *The better fortunes clause*

The terms of the better fortunes clause have been applied correctly since the adoption of Decision 95/547/EC. However, under this clause, CL paid only FRF 6 million in 1995 and FRF 107 million in 1996, amounts which are well below the FRF 339 million and FRF 505 million initially scheduled for these two years, owing to the bank's performance, which was less good than originally forecast. The new plan submitted in July 1997 foresees, on the basis of a complete neutralization of the EPFR loan and the other assumptions concerning the sales of assets, an improvement in the bank's results from the year 2000 compared with the 1995 plan, and hence payments under the clause, if it is maintained.

*Table 6:*

**Payments under the better fortunes clause**

*(FRF million)*

| | 1995 | 1996 | 1997 P | 1998 P | 1999 P | 2000 P |
|---|---|---|---|---|---|---|
| Revised estimate, 1997 | 6 | 107 | 1 018 | 1 247 | 2 309 | 3 553 |
| Projection, 1995 | 339 | 505 | 1 065 | 1 901 | 2 326 | 2 487 |
| Differential | (333) | (398) | (47) | (654) | (17) | + 1 066 |

*Source:* CL's business plans, 1995 and 1997.

Such an improvement should compensate, subject to the clause being maintained, for the lack of initial payments. However, the plan submitted to the Commission in July 1997 (see below) leaves a question mark as to whether the clause will be kept or replaced by an alternative solution.

*(e) Payment of dividends to the State as shareholder*

As with the clause, the fact that CL has recorded results which are worse than forecast has reduced the dividend payments from CL to the State as shareholder and the value of the shares held by the latter, compared with the estimates initially used. The Commission would point out that in Decision 95/547/EC it estimated that the value of the State's share of CL's results was FRF 10 billion discounted. The following table shows the original projections and the revised estimates of CL's net, post-clause results.

([11]) For further details of the emergency aid, see the Commission Decision of September 1996, published in the Official Journal on 24 December 1996.

*Table 7:*

**CL's net results, group share, after payment of the clause**

*(FRF million)*

| | 1995 | 1996 | 1997 P | 1998 P | 1999 P | 2000 P |
|---|---|---|---|---|---|---|
| Revised estimate, 1997 | 13 | 202 | 1 270 | 1 452 | 2 217 | 3 095 |
| Projection, 1995 | 659 | 912 | 1 318 | 1 923 | 2 252 | 2 385 |
| Differential | (646) | (710) | (48) | (471) | (35) | + 710 |

*Source:* CL's business plans, 1995 and 1997.

(f) *Use of sale proceeds for restructuring purposes*

CL stated that it used FRF 14,8 billion from the proceeds of sales to finance all the restructuring measures. The actual amount used was FRF 7,5 billion, the rest being invested in cash flow or in debt refinancing. It will be noted, however, that CL also invested nearly FRF 254 million abroad. These investments were small-scale and represent only 1,7 % of the proceeds from sales made since the beginning of 1995.

(g) *Abolition of the carry-over of tax losses relating to the aid*

In accordance with the principles of the guidelines on restructuring aid, the Commission obliged the French State to remove from CL the possibility of carrying over the tax loss associated with that part of its negative results covered by the 1994 capital increase of FRF 4,9 billion. The Commission also requested the French authorities to remove from CL the possibility, at the moment of privatization, of carrying over the other tax losses, if the better fortunes clause is transferred.

With regard to the first condition, CL stated that, in its view, this concerns only the 1994 losses corresponding to the capital increase financed by the State and the Caisse des Dépôts et Consignations (FRF 3,75 billion). The Commission would observe that in Decision 95/547/EC it considered that all the assistance from CL shareholders, including the Thomson group, in which the State had a majority holding, and whose resources are therefore state resources within the meaning of Article 92(1) of the EC Treaty, was to be regarded as State aid. Consequently, it confirms that this condition applies to the total amount of the capital increase (FRF 4,9 billion). The Commission also confirms that it is necessary to fulfil the second condition.

## 5. COMMENTS FROM THIRD PARTIES

### 5.1 Comments from third parties

As part of these proceedings, the Commission received comments from Société Générale (SG) and the UK authorities by letters dated 21 and 23 January 1997 respectively, which were forwarded to the French authorities. The latter replied by letters dated 10 and 27 February 1997. Other written comments were received on 19 May 1997 from the British Bankers' Association, on 2 July from Nederlandse Vereniging van Banken and on 26 August 1997 from Bundesverband deutscher Banken. The comments cannot, however, be taken into account as they were sent after the deadline for receipt of comments provided for in the Commission notice published in the Official Journal of the European Communities.

SG decided to refer to the Court of First Instance of the European Communities the Commission Decision of September 1996 approving emergency aid to CL, as it had already done with regard to Decision 95/547/EC.

As regards the additional restructuring aid covered by these proceedings, SG considers that it is not intended to facilitate the development of an activity within the meaning of Article 92(3)(c) of the Treaty, although it acknowledges that the sole prospect of the crisis that would be caused by the failure of CL justifies and indeed demands that the State, as both shareholder and guardian of the market place, take steps to reassure the depositors and intrabank creditors of this major institution.

SG takes the view that the Commission must require the French authorities to consider alternative solutions such as controlled liquidation and selling in blocks. This would be especially justified in view of the recurrent nature of the aid. Whilst its main argument is that the alternative

solutions referred to above are the only outcome that complies with the Treaty, SG also considers that the Commission should compensate competitors for the damage caused them by requiring CL to sell not only all its foreign businesses (including those in the United States and South-East Asia, which are the most profitable), but also activities in France such as collective and individual third-party asset management, consumer credit and life insurance subsidiaries or certain sections of the retail network itself. Similarly, SG points out that the assistance provided by the French authorities and the Commission for the redundancies envisaged by CL would not constitute a binding condition for the grant of financial aid but rather an additional form of aid, as private banks would not receive such assistance and would thus be prevented from raising their profitability to the level of their European competitors.

Lastly, SG drew the attention of the Commission to the conditions of the future privatization of CL, in particular the plan to strengthen the solvency ratio before privatization to nearly 6 % in tier one (i.e. the 'hard' ratio of own funds in the narrow sense), which would seriously distort competition, in view of the effects in terms of the rating given by rating agencies and in comparison with the 1987 privatization of SG with a solvency ratio of only 3 %, which it was able to increase to 6% only ten years later.

The UK authorities support the Commission's in-depth investigation and note that the recurrent aid could generate future expectations of aid on the part of the bank's management, which could distort competition. They stress that CL should give serious and substantial *quid pro quos* which would involve all the activities of the bank not strictly necessary to the viability of its basic activity. For that reason, they suggest that future aid be staggered over time and that their approval should be subject to restructuring measures and compensating arrangements.

### 5.2 **Comments from the French authorities and CL**

By letter dated 6 December 1996 to the Commission, the Chairman of CL stated that he had informed the French Government of the prospects for 1996 very early that same year, and again in July, pointing out that a rapid decision was needed. He also disputed the reference date for the reduction in CL's commercial operations abroad, stating that the letter of 18 July 1995 from the Minister, Mr Madelin, forwarded to the bank only several months after it was sent to the Commission, did not fix a reference date at all and that the restructuring of the bank began at the end of 1993.

The French authorities commented on the letter from SG forwarded to them by the Commission, pointing out that they had fully assumed their twofold responsibility as shareholder and guardian, as acknowledged by SG when the emergency aid was notified. They disputed the analysis of SG and the UK authorities concerning the distorting effect of the emergency aid and the need for compensating measures, claiming that CL had been severely restricted in the 1995 plan and that refocusing on a more limited core of activity was provided for in the new restructuring plan. They nevertheless said that restructuring aid was needed, chiefly to neutralize the CL-EPFR loan, but also possibly to recapitalize the bank in order to ensure its viability, the amount of the increase being strictly in proportion to CL's financial requirements for rapid privatization. They also stated that, when considering methods of providing the bank with financial support, they would bear in mind that state resources should be granted in step with completion by the bank of the targets contained in its strategic plan.

### 5.3 **Observations of the Commission on the comments submitted**

The comments of third parties are examined in the following sections of this Decision.

The comments made by CL call for the following response from the Commission. As regards the date on which CL informed the French authorities of the deterioration of the bank's financial position and the need for assistance from the State, the Commission can only deplore the fact that the French authorities concealed the true position of the bank instead of meeting their obligation to provide the Commission with regular reports on the progress of the plan approved by it in July 1995. Although it may not alter the need for the aid approved by the Commission in September 1996, especially as the Commission could not completely rule out the risk of serious consequences for CL without aid, it is obvious that the French authorities should have notified the aid in question much earlier.

As regards the reference date for assessing the reduction in CL's commercial operations abroad, the Commission is unable on legal grounds to agree with the date suggested by CL, i.e. 1 January 1994. The French authorities did not notify the Commission in 1994 of the first instalment of State aid to CL; the restructuring plan was notified to the Commission, at its request, only in 1995 and only after a new aid plan had been set up. Nor can the fact that the terms of the letter from the Minister, Mr Madelin, of 18 July 1995 were officially communicated to CL only later be invoked against the Commission. The most appropriate legal basis for defining the date by which that obligation should have been fulfilled continues to be the letter of 18 July 1995 from Mr Madelin, in which the words 'd'ici fin 1998' (by the end of 1998) are unequivocal.

Accordingly, in order to assess the reduction in CL's commercial operations abroad, the Commission takes as reference the contribution at 31 December 1994 from the various geographical areas to the bank's total assets as shown in the annual report of CL, the balance sheet at the end of 1994 thus constituting the sole and last public, objective basis which can be taken into account.

## 6. THE RESTRUCTURING PLAN PRESENTED BY THE FRENCH AUTHORITIES IN JULY 1997

### 6.1 Chief characteristics of the plan

The plan submitted to the Commission in July 1997 was drawn up with a view to the gradual bringing in of new shareholders to CL, approved in principle by the State in the preceding plan approved by the Commission in 1995. The plan is based on a macro-economic environment characterized by an average growth in gross domestic product in France of 2,3 % and inflation of some 2 % a year. The strategy is based on two large centres of activity: on the one hand, a bank for private individuals, businesses and SMEs in France; on the other, in the main regions of the world, including France and Europe, a 'wholesale' bank for big businesses and institutions. The two large centres would continue to rely on CL's skills in market activities, financial engineering and third-party asset management, which the bank plans to retain.

The plan is built around the following hypotheses:

— total neutralization of the net costs of carrying the loan from CL to EPFR;

— sale of a substantial portion of the bank's retail operations in Europe;

— reinvestment in cash flow of the proceeds from the asset sales.

The strategy presented by the French authorities was relatively conservative in terms of growth, its chief aim being to restore the profitability of CL. Net receipts from banking (NRB) at consolidated level would, overall, stagnate in nominal terms as against the 1996 level (taking account of sales) and overheads would fall by nearly FRF 4 billion, so that the bank operating ratio (ratio of overheads to NRB) would drop from 79 % in 1996 to about 70 % in 2000, i.e. close to the level of CL's main French competitors, Société Générale and BNP. In practice, the plan provided for a recovery in net receipts from banking which, following a sharp dip forecast for 1997 (– 7 % in value, or nearly – 9 % in volume), should become stable by 1998 and rise in 1998 and 1999. Whilst the recovery would be appreciable in 1998 as regards the bank's activities in France, it would, because of the sales in the European network, be deferred to the end of the period for the group as a whole.

*Table 8*

*(FRF million)*

| | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Net receipts from banking | 44 509 | 41 404 | [...] | [...] | [...] |
| Overheads and depreciation | 35 049 | 33 059 | [...] | [...] | [...] |
| Operating ratio | 79 % | 80 % | 77 % | 74 % | 70 % |
| Staff | 56 748 | 50 773 | [...] | [...] | [...] |
| Net result (before better fortune clause) | 1 593 | 3 377 | 3 608 | 5 468 | 7 640 |
| Better fortunes clause | 107 | 1 018 | [...] | [...] | [...] |
| Return on equity | | | | | |
| — before better fortunes clause | 3,9 % | 7,9 % | [...] | [...] | [...] |
| Own funds 'Tier one' | 40 626 | 42 565 | [...] | [...] | [...] |
| 'Tier one' ratio | 4,56 | 4,93 | 4,91 | 5,07 | 5,39 |

*Source:* French authorities, plan submitted to the Commission.

An improvement in risk control, reflected in a reduction in the provisioning rate [12] from 0,78 % to 0,55 %, was to have made a significant contribution to the results. In particular, however, the bank had planned for two major variables to restore its margins and profitability:

(i) *a very significant reduction in operating costs in France*

For a universal bank like CL, having a domestic market is a considerable advantage and provides a relatively stable turnover. It is vital for the bank to be able to operate with the most performing operators on the French market in order to be able to produce the margins which improve its position in France as a reliable and strategic base point. Thus by the end of the plan, the anomaly of the bank's inability to produce satisfactory margins would be corrected: CL would again secure substantial profits on its domestic markets, especially at retail level, and obtain most of its cash flow from that source.

*Table 9:*

**A major effort in the French network**

*(FRF billion)*

| | 1996 | 1997 | 1998 | 1999 | 2000 | Variation 1996-2000 |
|---|---|---|---|---|---|---|
| Net receipts from banking | 22,4 | 21,5 | [...] | [...] | [...] | [...] |
| Staff costs | 7,8 | 7,5 | [...] | [...] | [...] | [...] |
| CL SA (France) staff | 34 339 | 32 454 | [...] | [...] | [...] | [...] |

*Source:* French authorities.

The plan provides for several packages of measures aimed at the recovery of CL on the French market. An overall project to 're-engineer' the decision-making processes (projects with the title of 'challenges') should lead to a radical restructuring of the bank's commercial activity and the information processing chain. New risk assessment tools will be set up for credit for SMEs. An agreement with Cetelem, a consumer credit specialist, will allow CL to expand its position on the consumer credit market, until now dominated by specialized establishments. Lastly, CL will launch telephone banking in order to improve contact with its retail customers.

The plan presented by the French authorities has a large number of social measures. The job cuts under the third redundancy programme, started in mid-1996 and finishing at the end of 1998, should involve some 5 000 persons, chiefly those in the bank's mainland network. The reductions will affect the network staff (3 140 persons) and operational units (1 860 persons). According to the plan submitted to the Commission, they were not intended to reduce the bank's commercial capacity significantly but essentially to cut operating costs and improve the operating ratio.

*Table 10:*

**Successive redundancy programmes**

| | Redundancies |
|---|---|
| (1) From 30.3.1994 to 30.3.1995 | 1 124 |
| (2) From 30.3.1995 to 30.6.1996 | 2 398 |
| (3) From 30.6.1996 to 31.12.1998 | [...] |
| Additional redundancies 1999-2000 | [...] |

*Source:* French authorities.

[12] Ratio of provisions to weighted amounts outstanding.

Further reductions are planned after 1998, in 1999 and 2000, involving [...] persons, of whom [...] in the branches and [...] in the bank's functional units. All in all, the workforce would shrink by [...] in France compared with 1996 (and [...] at consolidated level, taking account of the sales of subsidiaries). The reductions would produce savings in staff costs of 9 % in France over the life of the plan, thus significantly cutting CL's charges and helping it return to profitability.

*Table 11:*

**Workforce trend, France**

| Employees | 31.12.1997 | 31.12.1998 | 31.12.1999 | 31.12.2000 | Variation |
|---|---|---|---|---|---|
| France (DCAF) | 25 520 | [...] | [...] | [...] | [...] |
| Other | 6 934 | [...] | [...] | [...] | [...] |
| Total | 32 454 | [...] | [...] | [...] | [...] |

*Source:* French authorities.

The plan provides for rationalization of the network outlets in France, involving the closure of 243 loss-making branches in 1997 and 1998 (out of a total of 1 954 branches for retail customers in 1996), and the reorganization of business centres and retail outlets for business customers (see Table 12 below). Overall, the number of branches in the parent company in France would fall in the period 1996-2000 from 2 100 to 1 750, i.e. a reduction of some 17 %. On the basis, however, of information forwarded by CL to the Commission's consultant bank, it would seem that the total number of CL outlets in its French network should fall from 2 298 at the end of 1996 to 2 146 at the end of 2000, i.e. a reduction of only 6,6 %. The difference between the data supplied in July to the Commission and those sent by CL appears to be due to the scope of the commitments which, in CL's presentation, includes all CL's outlets in France, including the parent company and subsidiaries.

Together, these measures should help to improve profits in the French network. The bank's aim is to increase the net result of DCAF (central directorate for activities in France) from FRF 1 billion to FRF 4,3 billion by 2000. If it succeeds, CL will not only have restored the French network's contribution to the result, in proportion to the turnover produced, it will have made the activity in France one of the most profitable of the group.

*Table 12:*

**Development of agency network, France**

| Branches | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|
| Authorities' plan — July 97 | | | 2 100 | | | | 1 750 |
| % change since 1996 | | | | | | | −16,7 % |
| Data from CL | 2 475 | 2 385 | 2 298 | 2 248 | 2 146 | 2 146 | 2 146 |
| % change since 1996 | | | | | | | −6,6 % |
| Breakdown: | | | | | | | |
| Personal | 2 063 | 2 010 | 1 954 | 1 924 | 1 899 | 1 899 | 1 899 |
| Business | 215 | 215 | 201 | 181 | 136 | 136 | 136 |
| Business and corporate centres | 197 | 160 | 143 | 143 | 111 | 111 | 111 |

*Source:* French authorities and data supplied by CL to the Commission's consultant bank.

A sensitivity analysis conducted by CL showed that, if consumer credit were to grow twice as slowly as forecast, if the new measures to finance the NRB (for the DCAF) were to contribute twice as little as expected and the reduction in the provisioning rate was not as large as predicted, the contribution of the French network to the result would be reduced by half, but would still be positive.

(ii) *neutralization of the loan to EPFR*

The various sections of the 1995 CL rescue plan included a plan for CL to finance the hive-off by granting a soft loan of FRF 145 billion to EPFR. This below-market rate would thus enable the State, which would ultimately bear the final cost of the CDR debt write-off through EPFR, to reduce the financing cost of carrying the CL assets transferred to CDR.

As stated above, the plan provided that the CL loan to EPFR would be remunerated at 7 % in 1995 and then at 85 % of MMR (short-term money market rate) from 1996. The State benefited from this: for EPFR the benefit can be estimated annually on the basis of the differential between the short-term rate for the CL loan and the long-term rate for the refinancing it would have to obtain without the CL loan, i.e. currently some 2,5-3 % annually on the loan outstanding. In 1997, the benefit of the special scheme set up by the State was worth, in respect of the amount outstanding, some FRF 2,8-3,3 billion to EPFR. From CL's standpoint, however, the loan, which is partially secured with refinancing liabilities contracted at a higher rate and which preceded the 1995 hive-off, is penalizing and makes a negative contribution to its operating result, amounting to the differential between the borrowing rates for its loan refinancing liability and the lending rate for the loan. As a large part of CL's refinancing liabilities are fixed-rate liabilities, any cut in rates, taking account of the definition of the rate for the loan to EPFR, results in an increase in the net loan-carrying costs.

According to CL, from September 1995 to the end of 1996, it set up an instrument providing partial cover for the rate risk it was incurring on account of the structure of its loan refinancing liabilities. These 'swap' type hedging derivatives enabled the bank, it claims, to limit its carrying costs in 1995-96 to some FRF 670 million (i.e. only very partial cover for the rate risk incurred, as is clear from the amount of the neutralization subsequently necessary), which it took into account in calculating the cost of the rate for the emergency aid (relating to the loan to EPFR) for 1996, i.e. 5,84 %. In view of these considerations, and the very partial rate risk cover set up in 1995, it is clear however, that CL expected interest rates to develop differently, thus reducing its costs. Hence, the higher losses incurred by the bank on the loan granted to the hive-off are attributable to it in part, to the extent of the risk rate it contracted. At the end of 1997, the French authorities commissioned an independent firm to audit the transactions connected with the loan to EPFR, but they have not forwarded the results to the Commission.

As far as the Commission is aware, the bank has not had recourse to any methods of covering the rate risk on the loan to EPFR since the end of 1996, largely rendered meaningless by the fall in rates of more than two points since the adoption of Decision 95/547/EC.

In September 1996, when the emergency aid was notified, the French authorities asked for the complete neutralization of the effects of the CL loan to EPFR until 2014 through an increase in the interest rate from 85 % of MMR to a rate corresponding to the cost of refinancing CL (it was subsequently established in work done by the Commission's consultant bank that the rate would fluctuate between MMR + 2,5 at the start of the period to MMR + 0,2 at the end of the period). The request was confirmed in the plan presented to the Commission in July 1997. According to the French authorities, this measure should make it possible to draw a line below the past, as CL would no longer be penalized for the financial consequences of the expansion strategy that led it to the crisis of 1993-95.

In the view of the Commission, however, it in fact amounts to 'over-neutralization', as the proposed increase in the rate takes it above the market rate and also compensates for initial errors in the cover against the rate risk on the CL loan to EPFR. On the basis of a scenario involving repayment of the loan and 'rate spread' data (the gap between the asset rate for the EPFR loan and the weighted average of the rates applicable to the refinancing liabilities) submitted by CL to the Commission's consultant bank, this component of the aid can be estimated at FRF 20,2 billion in the period 1997-2014 (by discounting future flows at the money market rate used to define the rate spreads in this scenario, i.e. 3,19 %). It is worth noting that the bank and the French authorities, using a long-term discounting rate, arrive at a different figure for the discounted aid relating to the neutralization, which they estimate at some FRF 17,2 billion over the period 1997-2014, using the same method (apart from the

discounting rate applied), which was validated by the Commission's consultant bank. It should also be noted that, if the conventional hypotheses underlying that calculation were to change substantially, in particular the timetable for repayment of the CL loan to EPFR, the calculation of the neutralization aid would be invalid and would have to be revised on new bases. The Commission is not aware at the date of this Decision of any such changes and notes that the French authorities have retained their estimate based on similar underlying hypotheses.

At the request of the consultant bank, CL carried out a study on the sensitivity of the neutralization value of the CL-EPFR loan to an increase in interest rates. All other things being equal, the study shows that in the event of a 1 % rise in short-term rates (and of a 0,5 % increase in long-term rates), the cost of neutralizing the loan would vary by FRF 500 million from the FRF 17,2 billion calculated by the bank. The Commission therefore concludes, in view of the 0,3 % increase in MMR between mid-1997 and this Decision, that the conditions on the basis of which it estimated the cost of neutralizing the loan at FRF 20,2 billion at the end of 1997 are still valid.

In their letter of 31 March 1998, the French authorities propose to alter the mechanism by totally neutralizing the loan until 2000 (as in their preceding notification) and, from 2001 to 2014, by neutralizing it at a short-term rate (not specified, but possibly the PIBOR which, depending on market conditions, ranges from MMR to MMR + 0,2 %). The Commission has assessed the economic effects of the new proposal from the French authorities. The difference is small, i.e. (discounted to 31 December 1997) FRF 2,3 billion, the aid falling from FRF 20,2 billion to FRF 17,9 billion. The minimal difference is explained by the fact that CL incurs carrying costs on the loan to EPFR in respect of the portion exceeding MMR, chiefly in the period 1997-2001.

*Table 13:*

**Financial impact of 'neutralization'**

*(FRF billion)*

| | 1997 estim. | 1997 actual | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Financial impact of neutralization | 3,3 | | 3,0 | 2,7 | 2,4 |
| Net result (before clause) | | | | | |
| — without neutralization | 0,1 | − 1,4 (1) | 0,5 | 1,8 | 4,6 |
| — with neutralization | 3,4 | 1,9 | 3,5 | 4,5 | 7,0 |

*NB:* The data used to draw up this table were submitted in March 1998 to the Commission by the French authorities. They are based on the July 1997 plan, although certain items have been updated.

(1) estimated.

In support of their proposal, the French authorities considered that if the carrying costs of the loan to EPFR were not neutralized, the bank's viability could be jeopardized owing to the possible reactions of its customers, the compensating measures and the rating agencies which could downgrade CL's rating. The French authorities also justified the measure on the ground that it should help to bring new shareholders to the bank.

The plan submitted by the French authorities to the Commission in July 1997 also considered another possibility: instead of the annual neutralization of the carrying costs of the EPFR loan, CL would be repaid in advance and would receive an adjustment for the discounted difference between the cost of the liabilities securing the EPFR refinancing (13) until they are extinguished and the cost of refinancing short-term liabilities. However, in subsequent discussions with the Commission, the French authorities made no further reference to that option. It is worth noting

(13) Liabilities not transferred to the hive-off described above.

that, as stated above, the existing mechanism was relatively advantageous to the French Government as, throughout the period of the loan (potentially until 2014), it financed long-term applications (the carrying by EPFR of the participating loan to CDR) with resources obtained at a lower rate, i.e. at a short-term rate. The neutralization option has the advantage of being less expensive for EPFR than early repayment of the loan coupled with a long-term borrowing: in view of the gradual restructuring of the CL liabilities backing the loan, the rate of the loan after neutralization should gradually fall until it reaches PIBOR in 2004 or 2005. As the reference rate for the loan is still MMR, the State could thus continue, although the terms would not be as good, to bear the carrying costs of the hive-off at a rate similar to the short-term rate.

### 6.2 **Measures presented by the French authorities in exchange for aid to CL**

In addition to the restructuring of the French network, which includes branch closures described by the French authorities as compensating measures for aid to CL, the July 1997 plan includes the sale of most retail operations in Europe, including CL's largest subsidiary, Bank für Gemeinwirtschaft (BfG, Germany, of which it owns 50 % plus one share). The plan earmarks major provisions (FRF 4,4 billion) for the financial years 1998 and 1999 in anticipation of the negative impact, forecast in 1997, of the sale of BfG at a loss in 2000. The French authorities also proposed that the rigid timetable imposed in 1995 for completion of the compensating measures in the first aid plan (i.e. the sale of 50 % of the bank's assets in Europe by 31 December 1998) should be relaxed to avoid CL having to call on its shareholder to finance the erosion of own funds resulting from the sales. Strategic disinvestments would be staggered until 2000, sales being decided as and when financial circumstances permitted.

*Table 14:*

**Impact of the strategic disinvestments proposed by the French authorities**

**Reallocation of establishments outside France**

| | | 1996 | 1997 | 1998 | 1999 | 2000 | Variation 1996/2000 |
|---|---|---|---|---|---|---|---|
| Net receipts from banking (FRF billion) | | | | | | | |
| | DCAE | [...] | [...] | [...] | [...] | [...] | [...] |
| | DCAI | [...] | [...] | [...] | [...] | [...] | [...] |
| | DCMC | [...] | [...] | [...] | [...] | [...] | [...] |
| Staff | | | | | | | |
| | DCAE | [...] | [...] | [...] | [...] | [...] | [...] |
| | DCAI | [...] | [...] | [...] | [...] | [...] | [...] |
| | DCMC | [...] | [...] | [...] | [...] | [...] | [...] |
| Number of establishments | | | | | | | |
| | Europe | 728 | | | | 270 | − 62,9 % |
| | Rest of the world | 292 | | | | 250 | − 14,4 % |
| | Total | 1 020 | | | | 520 | − 49,0 % |

DCAE: Central Directorate for European Affairs
DCAI: Central Directorate for International Affairs
DCMC: Central Directorate for Capital Markets

The French authorities took the view that CL's decision to sell its subsidiaries before the introduction of the Euro deprived it of the opportunities afforded by a more integrated personal banking market in Europe and therefore constituted a substantial effort which released market shares for its competitors in Europe.

Outside France, once the bank had pulled out of retail banking in Europe, its strategy would be to refocus on the functions of credit for large firms, structured financing and financing of projects, capital markets, asset and flow management, private management and international trading. These would in future be organized as 'world lines' in order to provide better support for the bank's customers in their international transactions. The refocusing would reflect CL's move away from the 'universal' bank strategy abroad.

## 7. ASSESSMENT OF ADDITIONAL AID TO THAT APPROVED BY THE COMMISSION IN 1995

### 7.1 Uncertainty concerning the total amount of aid

The Commission having placed a ceiling of FRF 45 billion on the amount of aid approved in 1995, it is necessary to assess the amount of additional aid before determining its compatibility with the Treaty. It will be recalled that, in addition to the FRF 45 billion authorized in 1995, the Commission also authorized some FRF 4 billion in emergency aid in September 1996.

The costs incurred by the State and included in the total aid to CL are as follows:

— the recapitalization of CL in 1994 (i.e. FRF 4,9 billion), to which the French authorities envisaged, in the plan submitted to the Commission in July 1997, possibly adding a second recapitalization for an unspecified amount;

— the discounted losses of CDR borne by EPFR, which abandoned claims (with activation of guarantees) in respect of the participating loan of FRF 145 billion (of which FRF 10 billion were converted into a guarantee for CDR borrowings from third parties);

— the discounted carrying costs of the CL loan of FRF 135 billion to EPFR; these costs might rise if the CL loan is neutralized between 1997 and 2014, giving a discounted cost of some FRF 20 billion;

— the extra discounted carrying costs if EPFR exercises its right to draw on additional credit of FRF 10 billion which CL undertook to grant it from 1 January 1998;

— the extra discounted carrying costs which EPFR could incur if, in view of its cash flow, it had to borrow on the market in addition to its loan from CL.

All the hive-off costs are to be settled by the State by recapitalizing EPFR through budget allocations, whose amounts and timetable are not known at this stage but which are likely to be spread over the period of the CL loan to EPFR, until it matures in 2014, and through receipts from the better fortunes clause ([14]) and from the privatization of CL.

First of all, as is clear from the aid calculation set out below, some of the aid in question, especially the neutralization of the CL loan to EPFR for 1995-96 (approved by the Commission in September 1996 as part of the CL emergency measures) and its neutralization from 1997 (proposed by the French authorities), are an integral part of the costs of carrying the loan from CL to EPFR. The Commission nevertheless regards the neutralization of the loan as a specific aid: it is additional in relation to the plan approved in 1995, and its implementation would mean that CL would be relieved of a cost with an estimated discounted value of some FRF 20 billion over the period from 1997 (inclusive) to 2014. 'Neutralization', as the French authorities interpret it, means that CL would be relieved of the net charges connected with the EPFR loan and that the discounted value of the bank would be immediately increased by the correction in proportion ([15]) to the discounted amount of the neutralization. The bank would thus benefit immediately from the future effects of the neutralization. The Commission therefore considers that the discounted value of the neutralization throughout the period 1997-2014 must be taken directly into account in full, as fresh aid to the bank. The Commission notes that the French authorities, in a letter dated 3 April 1998, appear to take the same approach to this point, and include the total value of the neutralization in their estimate of the amount of aid to CL.

There are further difficulties in assessing the amount of aid to CL owing to the specificities of the hive-off plan drawn up by the French authorities and to a number of uncertainties not clarified by the French authorities in the plan submitted to the Commission in July 1997.

The losses eventually borne by the hive-off and hence by the State are not yet known. The potential losses include one component, the losses of CDR, estimated at 31 December 1996 at FRF 100,2 billion. It is pointed out

([14]) Provided it is retained.
([15]) Subject to a difference due to taxation of the results.

that the latter figure, presented on 1 July 1997 in the EPFR report to the Minister for Economic, Financial and Industrial Affairs and to the French Parliament, is not certified by the auditors of CDR. The French authorities, questioned on this matter by the Commission, indicated that they would be unable, in view of the specificity of the hive-off, to produce certified accounts for CDR. Only the losses already recorded by CDR and charged to EPFR by activating the guarantee on the participating loan, i.e. some FRF 45 billion at the end of 1996, could at the beginning of 1998, before the closure of the 1997 accounts, be regarded as certain, on the basis of the information available. At meetings held at the beginning of May 1998, the French authorities informed the Commission that the estimated additional losses of CDR in 1997 amounted to a further FRF 3 billion, i.e. a total loss of FRF 48 billion at end 1997. In view of the remaining assets (about FRF 80 billion, assets of FRF 110 billion having already been sold or wound up), the French authorities conclude that losses cannot be more than FRF 128 billion. The Commission agrees that part of the residual risk to EPFR in respect of CDR (the portion relating to its assets) diminishes as the asset sell-off plan progresses: by the end of 1997, 58 % of the gross assets transferred to CDR at 1 January 1995 had been sold.

The French authorities were unable, however, to make any undertaking concerning the maximum losses that might be incurred by CDR. The French Parliament had not put a ceiling on the nominal risk borne by EPFR, which granted a participating loan of FRF 145 billion to CDR (of which the latter used FRF 123,5 billion, plus FRF 10 billion taken from the loan facility and transformed into a guarantee), so that it covers all CDR losses, even if they reach or even exceed the amount of the participating loan, i.e. FRF 145 billion.

The risk borne by EPFR in respect of CDR exceeds its exposure to the assets initially transferred to the hive-off, for several reasons. Firstly, the 'backup' capital investments in the hived-off assets, the merits of which are not questioned by the Commission at this stage, increase CDR's exposure in respect of the recapitalized assets and hence the exposure of EPFR to CDR and the risk of losses by the hive-off ([16]). In spite of repeated requests to the French authorities, the Commission so far has only a very limited picture of these transactions ([17]). Even if, as the French authorities claim, the investments have the effect of cutting the hive-off losses, at this stage they mean an increase in the risk relating to the State guarantee. In addition, a number of off-balance sheet risks were transferred from CL to CDR in the form of guarantees on its subsidiaries or on assets not transferred to CDR when it was set up. Furthermore, CDR's consolidation limits were extended in 1996, the Commission being unable at that stage to determine whether the expansion significantly increased the risk exposure of CDR and EPFR: the extension of the consolidation limits in 1996 must be examined in the light of the risks to CDR of the new assets before their incorporation in the form of assets within the hive-off vehicle. Further losses have also emerged and could continue to increase, chiefly as a result of the rise in the number of legal proceedings initiated. By mid-1997, there were 75 such proceedings, of which 52 in France and 23 abroad. Several will probably result in damages being awarded to CDR and a consequent reduction in the cost of the hive-off. Others, however, in the event of an unfavourable outcome for CDR, will result in major off-balance sheet risks that are hard to forecast and may alter considerably over time. Furthermore, legal proceedings have a negative effect inasmuch as they make it more difficult to wind up or sell assets in dispute, by slowing up or indeed interrupting transactions.

Any slippage in the timetable for the sale of CDR's assets in relation to the original timetable for their transfer to the hive-off vehicle (sale of 50 % in three years and 80% in five years) increases management costs and operating losses for CDR. In addition, CDR's repayments to EPFR were slowed down owing to the fact that certain third-party liabilities (out of the liabilities of some FRF 60 billion transferred to CDR, in addition to the EPFR participating loan) were repaid by CDR more rapidly than the original five-year period, some of the liabilities having become due following the withdrawal of licences from its banking subsidiaries. In addition, there is the growing complexity of cases (the easiest assets to sell having already been disposed of), which will slow down foreseeable hive-off transactions and heighten the risk of capital losses. Furthermore, the abandonment in December 1997, when CDR was reformed, of the liquidation rationale may also have prolonged the hive-off management costs and hence the losses charged to the State via EPFR. The delays in selling CDR's assets do not directly affect its losses (apart from the increase in its operating costs

([16]) As stated in the CDR management report for 1996, capital increases in covered subsidiaries constitute a claim on EPFR which will become due only when the securities of the subsidiaries concerned are liquidated or sold.

([17]) The Commission initiated the Article 93(2) procedure in respect of two transactions: the recapitalization and sale of SDBO (OJ C 346, 16. 11. 1996 and OJ C 207, 8. 7. 1997) and the recapitalization and sale of Stardust Marine (OJ C 111, 9. 4. 1998).

charged as losses) but do, however, have the effect of prolonging uncertainty and increasing the nominal carrying costs of the hive-off as regards EPFR. Experience with this type of hive-off tends to show that, over time, the assets remaining in portfolio are of less good quality and become increasingly difficult to realize. Furthermore, the hived-off companies can incur heavy losses that will be charged to hive-off losses irrespective of the asset value of those companies.

Despite two letters sent to the French authorities on the subject (on 1 December 1997 and 5 February 1998), the Commission has not received any reply concerning a possible timetable for recapitalizations of EPFR by the State which would help to reduce the balance of the loan from CL to EPFR. It is pointed out that, according to a timetable based on conservative hypotheses presented by CL to the Commission's consultant bank, the balance of the loan could remain in the region of FRF 100 billion until the loan matures in 2014.

The carrying costs are not included in the calculation of CDR's losses. They too will be charged to EPFR and hence ultimately to the national budget. The costs to EPFR of carrying the hive-off will rise in proportion to delays in CDR's repayments to EPFR. In nominal terms ([18]), assuming that the loan-carrying costs cover the entire period in accordance with the timetable submitted by CL to the Commission's consultant bank (and excluding any further assumptions concerning EPFR's borrowings), and taking account of the neutralization of the loan planned by the French authorities, the carrying costs would, for the entire period of the scheme (1995-2014) amount altogether to almost FRF 100 billion, of which FRF 78 billion from 1 January 1997. The nominal costs would in the end be borne by the national budget and the taxpayer, like all the hive-off losses. Furthermore, the nominal value of the carrying costs is also sensitive to changing rates: a 1 % increase in MMR would also result in a nominal increase of FRF 13 billion. Such nominal sensitivity to rate trends would have benefited EPFR since 1995, due to the drop in short-term rates, if the CL loan had not been neutralized in 1995-96. But it could again have the opposite effect if rates harden (unless the loan is neutralized). The uncertainty concerning the amount of the carrying costs can nonetheless be partly eased by a discounting calculation which includes the discounted carrying costs and losses (see below).

The carrying costs have already risen in relation to the original estimates of 1995 as a result of two factors: first, CDR has carried out only a fraction of the participating loan repayments to EPFR originally provided for, so that EPFR has not been able to repay its loan from CL as soon as expected and current interest rates are higher than planned. Second, the State's recapitalizations of EPFR have been inadequate, so that the latter has accumulated interest arrears on its payments to CL which are charged as higher nominal carrying costs. Thus not only might EPFR fail to repay the principal of its loan from CL for several years, but its debts might rise if, as in the last two years, interest arrears accumulate owing to late or inadequate recapitalizations by the State. In its 1997 report ([19]), EPFR rings the alarm, pointing out that, if it receives only the repayments on its participating loan to CDR and payments from the State solely to cover interest arrears, it will have to run into debt to pay the interest on the loan from CL (because the interest is not capitalizable with the underlying loan). According to EPFR, its borrowing capacity for interest payments, capped at FRF 50 billion by the Law of 28 November 1995, could be used in full by 2002-04. It concludes that, in any event, it would be advisable to avoid financing irrecoverable losses by contracting a debt which would only add to the final bill ([20]).

It is clear that it is possible for the hive-off costs to spiral significantly, not only as regards CDR and its asset losses and off-balance sheet risks, but also as regards EPFR and its rising carrying costs. In its 1997 report, EPFR describes it as a 'snowball' effect which could result in the State bearing not only the 'primary' interest costs (those of the CL loan to EPFR) but also the interest on the additional loans contracted to pay the interest on the principal loan. If the fears of EPFR come about and it is compelled to borrow the necessary resources to service the CL loan, the carrying costs for the entire mechanism could spiral again. This could continue for as long as the State's recapitalizations of EPFR are insufficient, and especially if the loans to EPFR have to be concluded at medium- and long-term rates (about 4,5-5,5 % at the beginning of 1998) considerably higher than the service rate for the loan from CL (85 % of MMR, i.e. about 3 % at the beginning of 1998). For example, if in 2003 the amount outstanding on new loans contracted by EPFR totalled FRF 50 billion, the annual carrying cost of the hive-off could surge from FRF 2,9 billion (current estimated servicing of CL loan, excluding neutralization) to some FRF 4,4-5,5 billion, depending on whether EPFR refinances at short- or long-term rates.

([18]) The nominal data given below have not been discounted. For the discounted value, refer infra. to the calculation of the estimated cost of the operation to the State.

([19]) EPFR Report, page 27.
([20]) Op. cit., page 29.

In addition, the State now plans, following the decision to transfer to EPFR the stake in the holding company Artemis originally hived off to CDR, to give EPFR an asset-carrying role not originally provided for in the plan submitted to the Commission in 1995. The accounting or transfer losses could be attributed to EPFR. Accordingly, such capital losses would no longer be borne by CDR so that its estimated losses would be reduced by the amount of provisions in respect of Artemis; thus the transfer should not affect the hive-off as a whole.

The French authorities also intimated in the plan submitted in July 1997 that they might recapitalize CL afresh, without specifying the amount involved. If necessary, the Commission would have added such a recapitalization to its calculation of the total amount of aid in question. However, no further action was taken.

In Decision 95/547/EC, a number of factors were deducted from the total aid. The carrying cost of the zero-coupon bond was deducted and cannot be deducted from the new assessment of aid to CL, the French authorities having clearly confirmed by letter dated 31 March 1998 from the Minister for Economic, Financial and Industrial Affairs to Mr Van Miert that they planned to abolish the obligation to finance a zero-coupon bond. This accordingly increases by FRF 7,8 billion, compared with the 1995 plan, the estimated aid to CL, the latter being relieved of that obligation. Another factor, the discounted value of the receipts generated by the better fortunes clause, was deducted, as was the net book value of CL (after deduction of the clause). By letters dated 31 March and 3 May 1998 to Mr Van Miert, the Minister for Economic, Financial and Industrial Affairs formally stated that France undertook to transfer CL to the private sector before the end of 1999, and that the clause would be 'terminated'. In view of that undertaking and the approaching deadline, the Commission considers that the value of the State's holding in the bank (some 82 %) should be deducted from the gross aid rather than, as it did in 1995, deducting the sum of the clause and the net book value of the bank.

The French authorities, unlike the Commission which had calculated in 1995 that possible aid to CL totalled FRF 45 billion, took the view at the time that the financial rescue package would be self-financed from the better fortunes receipts, the privatization of CL and the capitalization of the interest on the zero-coupon bond originally provided for, i.e. the net budget effect for the State would be zero and the taxpayer would not incur any costs. In its report of 1 July 1997 ([21]) to the Minister for Economic, Financial and Industrial Affairs and to Parliament, EPFR concluded that, at the financial level, the results already recorded and the trend of forecast future losses ruled out the possibility of attaining the financial equilibrium originally forecast for the period in question. However, the French authorities and the Commission disagree as to the nature and amount of aid concerned by this Decision.

In particular, the Commission having concluded that all CDR losses should be regarded as aid to CL, the French authorities rejected such a comprehensive approach in contacts with the Commission and in two notes dated 25 November 1997 and 3 April 1998 on the ground that, since the transfer to the hive-off of the ring-fenced assets, CL, which is not represented on any of the organs of CDR had, in accordance with Decision 95/547/EC, shed all involvement in management decisions concerning the sale or liquidation of those assets. In addition, the accounting rules applicable to hived-off assets differ from those applicable to assets that contribute to the operation of the bank. The rules applying in the event of continued operation lapse in part; this accelerates the depreciation of the goodwill, which inflates the losses of CDR. According to the French authorities, the increase of about FRF 40 billion in the losses of the hive-off (up from the FRF 60 billion projected in 1995 to an estimated FRF 100,2 billion at 31 December 1996) could not be charged to CL for that reason. Thus the aid to CL taken into account in the total calculation is limited to the losses initially transferred to the hive-off. By letter dated 3 April 1998, however, the French authorities suggested another possible method, consisting in taking account of CDR's actual losses at 1 January 1997, i.e. FRF 64,3 billion and discounting them inclusive of carrying costs at a long-term rate, giving a value of FRF 59 billion, i.e. virtually the same amount as that obtained by the first method.

The Commission cannot agree with the arguments of the French authorities. The sole justification for the entire hive-off in 1995 and thereafter is the CL rescue plan, without which the bank would have had to be wound up. If it was possible simply to set up a hive-off vehicle in order to cut all links between a firm divested of its bad assets and the ability to charge all or part of the losses of that structure to the assisted firm, the obligations arising out of Article 92 of the Treaty could be circumvented by using such financial vehicles to evade the Treaty. In the case in point, the cause of the hive-off losses is taken to

([21]) Op. cit, page 29.

be, save evidence to the contrary in specific cases yet to be identified, the transfer in 1995 of CL's doubtful assets to CDR, a wholly-owned CL subsidiary (although not consolidated for accounting purposes because its losses are charged to EPFR and not to its parent). The cost of creating the hive-off, which includes the goodwill referred to by the French authorities (shift from a going concern to a liquidation rationale) is, in the opinion of the Commission, one of the specific costs of the operation to assist the bank and must be taken into account as a form of 'badwill' attached to the setting-up of the hive-off. The only way the Commission can conclude that the hive-off losses are not chargeable to CL, as the recipient, is if it can be shown that CDR did not act like a prudent manager seeking the best price for the hived-off assets or their liquidation, and with due regard for the financial consequences of such decisions. As the French authorities have not put forward any such arguments, the Commission must conclude, provisionally, that all the losses of the hive-off constitute aid to CL.

It is pointed out that the possibility of an increase in the aid relating to the hive-off costs, in relation to the amount initially approved, was expressly provided for in Article 2(c) of Decision 95/547/EC which states that, if the costs of the scheme are exceeded, the Commission will re-examine the scale of the compensating measures taken into account in that Decision. The Commission notes that the French authorities have not challenged that provision of Decision 95/547/EC and that they therefore have no grounds for presenting a different argument at this juncture. It also notes that the 'scheme' referred to in Decision 95/547/EC is clearly the entire CL hive-off and cannot be interpreted narrowly as simply part of it, as suggested by the French authorities' proposal to take account of the higher carrying costs relating to the neutralization of the loan, and exclude the overall increase in the other carrying costs and hive-off losses.

In view of the foregoing, the Commission is justified in taking account of all the hive-off losses, i.e. those of CDR and any additional ones which may emerge in regard to EPFR, principally in the form of higher carrying costs. In view of the above-mentioned factors, and the great uncertainty still remaining as to the final cost to the State of rescuing CL, the Commission will assess a very wide range of aid, adding to the likely costs at this stage (low value in the range) those which may emerge as a result of the hazards of the hive-off scheme.

7.2 **Range used to estimate the cost of the measures to assist CL**

The scheme set up by the French authorities consists in financing the budgetary cost of the operation over a long period, potentially until 2014, using a system of borrowings (by EPFR from CL) at rates based on the short-term money market rate, as well as possible large borrowings by EPFR at market rates if the State recapitalizations do not cover its immediate cash flow needs and allow it to honour its interest payments on the CL loan. Without prejudging future budget choices, the French authorities have retained considerable flexibility in the scheme as regards the rate at which the costs of the transaction will be repaid. In order to simplify the scheme and the calculation of its cost, it can be assumed that, provided the hive-off has ended, the State has the choice each year of paying a compensatory amount in final settlement to EPFR, allowing the latter to repay the balance of the loan from CL, or of allowing the loan to continue, on the basis of the short-term financing rates defined in 1995.

To the extent that CDR's repayments are not sufficient to reimburse the interest annuities on the loan from CL, the State should recapitalize EPFR in order to maintain its cash flow and prevent it from having to pay annuities on arrears. If, on the other hand, the State fails, as in 1995 and 1996, to provide EPFR with such minimum financing, EPFR will be compelled to contract massive debts on the financial market, as the above-mentioned EPFR report of 1996 warns. Furthermore, the need for future recapitalizations from the State's budget has grown appreciably since the abandonment of the zero-coupon bond that EPFR was to have subscribed, through a drawdown of FRF 10 billion on the CL loan.

The flows that do take place in the near or distant future will depend on the State's decisions regarding the recapitalization of EPFR: this means that the nominal costs of carrying the loan to EPFR or the losses incurred by CDR should be discounted to take account, at the moment each flow is recorded, of the value of the payment, in accordance with this Decision, as at 31 December 1997. If the State had financed the hive-off with a long-term loan, for instance in the form of 10 or 15-year government bonds, it would be necessary to discount future loan repayment flows and the nominal total loss incurred by CDR using a long-term rate. As the scheme in question provides for short-term financing of the hive-off based on MMR, the discounting rate taken into account by the Commission for the hive-off losses and their carrying

costs is a short-term rate. The fact that the Commission is using a short-term interest rate to discount future flows means that the assessment of carrying costs is virtually independent of rate trends. Thus the Commission's assessment range does not take account of hypothetical short-term interest rates and the calculation of the total cost of the operation produces identical amounts in 1997 and 2014. Nor is a rate-risk sensitivity scenario, used to evaluate the nominal cost, necessary under the present hypotheses for an assessment of the discounted cost of the hive-off [22] (despite the factors referred to above at section 6.1 concerning the sensitivity of neutralization costs to a variation in the calculation rates). Table 15 is based on a presentation of the cost discounted to 31 December 1997 as it would result from the obligation, at 31 December 1997, to settle the losses of the operation with a once-and-for-all budgetary payment.

On that basis, the gross aid to CL can, without prejudice to possible deductions, be calculated (at constant prices at 31 December 1997) on the basis of CDR's losses, carrying costs, neutralization of the loan to EPFR and the State recapitalization in 1994 (already included in the aid of FRF 45 billion approved in 1995). This method produces similar results to those that would be obtained by discounting the sum of the State's recapitalizations of CL and EPFR, for which data on the exact amount and future timetable could not be obtained for the reasons given above, and from which EPFR income should be deducted (on the assumption, principally, that the better fortunes clause is transferred and the proceeds from the privatization of CL are allocated to EPFR).

The uncertainty as to the losses of CDR which should be taken into consideration introduces the first unknown into the assessment of the aid. The losses were estimated at 31 December 1996 by CDR at FRF 100,2 billion. As the Commission has no update for that figure at 31 December 1997, it must use the 1996 figure and include it at the lower end of the aid range. As stated above, CDR's losses are borne by EPFR via the participating loan it granted to CDR, the latter not repaying any losses it incurs. The guarantee given by EPFR to CDR, however, exceeds the amount of the participating loan, FRF 145 billion (including the additional tranche of FRF 10 billion which was ultimately not drawn down by CDR but was converted into an EPFR guarantee for CDR's external borrowings of FRF 10 billion) and covers in particular all the off-balance sheet items, notably the court case risks tied to the many disputes concerning the hived-off assets. Thus the final estimate of the losses incurred by CDR is particularly uncertain.

The Commission, in calculating the aid to CL, must take account of a possible unforeseen increase in CDR's losses compared with the FRF 100,2 billion estimated at 31 December 1996. Despite the reduction in residual risk as the disposal programme advances, and in order to take account of additional losses which may emerge, as stated above, it seems prudent at this stage to take the risk relating to the entire participating loan as the basis for calculating the estimated upper range of losses incurred by CDR. For that reason, in view of the number of errors made by the French authorities in the past in estimating the amount concerned, and in order to retain an adequate margin of error, the Commission considers that a range of FRF 100,2-145 billion should be used to calculate the total aid regarding the possible losses of CDR.

The carrying costs set out below are discounted to 31 December 1997. EPFR also plans, in order to facilitate its cash-flow management, to contract from 1 January 1998 an additional loan of FRF 10 billion from CL. The increase in hive-off losses makes fresh capital from the State more urgent than ever if EPFR is to service its loan from CL. In the absence of precise details from the French authorities on future recapitalizations, and in view of the cash-flow difficulties encountered by EPFR which have compelled it to delay interest payments (thus incurring penalties) to CL, the Commission would normally apply the high value in the range, on the assumption that EPFR will obtain a further loan of FRF 10 billion from CL, for which a protocol exists between CL and EPFR. In view of the pessimistic forecast made by EPFR in its 1997 report, its outstanding borrowings on the market could reach the statutory maximum of FRF 50 billion by 2003 (EPFR indicates a possible horizon of 2002-04) if the State does not provide the necessary capital. Under the Law of 28 November 1995 setting up EPFR [23], the latter is authorized to borrow a maximum of FRF 50 billion to pay the interest on the loan granted to it by CL.

[22] On the other hand, as stated above, CL is sensitive to the risk of a fall in rates, which would mean a possible rise in loan-carrying costs.

[23] See Article 3 of Law 95-1251 of 28 November concerning State action in connection with the recovery plans for Crédit Lyonnais and the Comptoir des Entrepreneurs, Journal Officiel de la République Française, 30 November 1995.

However, on the basis of the undertaking given by the French authorities to privatize CL in 1999, the Commission has not included the risk of excess costs in its assessment of additional aid to CL: if CL is privatized in 1999, EPFR will immediately receive the value of the State's holding, which will inject some oxygen into its cash-flow, obviate the need for further indebtedness and even help to reduce the balance of its loan from CL by repaying some of the principal. If the State sells 72 % of the bank's capital and retains 10 % (it currently holds 82 %), EPFR would receive an injection of some FRF 25 billion following the privatization in 1999 ([24]). As this would not suffice to service the loan for a sufficiently long period, it is essential for the State to continue to recapitalize EPFR regularly to ensure that the scenario described by EPFR in its report does not become reality.

In practice, the French authorities will probably allocate funds to EPFR over time to allow it to pay both its interest annuities on the loan from CL and some of the principal to avoid a single repayment of principal in 2014 and spread the burden over several years (they could not, however, give undertakings on this matter without prejudicing the authority of the French Parliament in budgetary matters). Provided that EPFR is regularly provided with sufficient capital to satisfy its cash-flow requirements and obviate the need to borrow, the determination of aid is not dependent on an exact timetable for recapitalization by the State. The present figures are calculated on that basis.

It must be pointed out that the two assessment scenarios set out below in Table 15 are based on necessarily simplifying hypotheses: the Commission does not have the data needed to simulate a forecast of resources and expenditure for EPFR which alone would provide a relatively accurate estimate of the total cost of the operation. The Commission considers, however, that the very broad range used to assess the cost of the hive-off as set out below provides the most objective picture possible at this stage of the range within which the final overall cost to the State will be situated.

*Table 15:*

**Estimated range of aid to CL**

**(Total aid provided for in the July 1997 plan, including aid authorized in 1995-96)**

*(FRF billion)*

| | Aid 1995 | Addit. Aid Low 95-98 | Total aid ([1]) Low 95-98 | Addit. aid High 95-98 | Total Aid High 95-98 |
|---|---|---|---|---|---|
| 1. **Additional CDR losses**<br>Increase from FRF 60 to 100-145 bill. | | 40,2 | | 85 | |
| 2. **Surplus carrying costs**<br>From 1995 to 1997, in relation to the 1995 plan | | 4,6 | | 4,6 | |
| 3. **Neutralization requested**<br>Discounted amount 1997-2014 | | 20,3 | | 20,3 | |
| 4. **15 % MMR burden for CL**<br>Discounted amount 1997-2014 | | −7,2 | | −7,2 | |
| 5. **Receipts from the clause**<br>FRF 1 billion paid in 1995-97 | | −1 | | −1 | |
| 6. **Variation in value of CL** ([2])<br>Increase of FRF 4 billion | | −4 | | −4 | |
| 7. **Zero coupon**<br>Amount deducted from aid in 1995 | | 7,8 | | 7,8 | |
| **Total, net amount of aid** | **41** | **61** | **102** | **106** | **147** |

([24]) On the basis of a valuation of CL at about FRF 35 billion.

*(FRF billion)*

| | Aid 1995 | Addit. Aid Low 95-98 | Total aid (1) Low 95-98 | Addit. aid High 95-98 | Total Aid High 95-98 |
|---|---|---|---|---|---|
| **Gross amount of aid (excluding amount deducted from the State's holding in CL)** | | | **130** | | **175** |
| **Amount authorized in 1995** | **45** | | | | |
| **Amount authorized in 1996 (emergency aid)** | **4** | | | | |
| **Total amount of authorized aid** | **49** | | | | |
| **Amount of supplementary aid in relation to aid authorized in 1995-96** | | **53** low | | **98** high | |

*Calculation:* European Commission.

(1) Under the present calculation of total aid, supplementary aid discounted to 31.12.1997 is added to the aid as evaluated by the Commission in 1995. This calculation, which is essentially designed to identify supplementary, unauthorized aid to CL, does not take the discounting to 31.12.1997 of aid estimated in 1995 into account. A comprehensive discounting calculation for aid apparently results in a slightly higher total amount (the difference is between FRF 3 and 4 billion), which does not affect the estimate made of supplementary aid.

(2) figure indicated, — FRF 4 billion, corresponds, by difference deducted, to an increase from 1995 to 1998 in the value of CL deducted from the aid.

On the basis of these two scenarios (high and low), the amount of aid resulting from the July 1997 plan, expressed as a gross figure (i.e. before any deduction of income from the better fortunes clause and from privatization), pertaining to the hiving-off mechanism (added to the discounted cost of the 1994 recapitalization) can be estimated at a discounted value of between FRF 130 and 175 billion.

Taking account of the very specific hive-off arrangements, under which the bank privatization proceeds will be allocated to EPFR, the Commission has deducted the value of the State interest in CL from the gross amount of the aid. At end 1997, the Commission's consultant bank estimated CL's value at between FRF 34 and 35 billion on the basis of the plan submitted in July 1997 and information provided by CL at the end of that year. The Commission has also examined more recent estimates made by independent sources in April 1998 which put a significantly higher figure on the bank's value (around an average of FRF 46 billion). However, a number of these estimates were made on the basis of unchanged consolidation limits and on the assumption that the loan will be neutralized in full. These estimates were made before the additional asset sales were decided on to offset the aid examined under this Decision. According to the revised business plan submitted by the bank to the Commission at the beginning of May 1998, these sales will have a considerable impact on the bank's business activity and results, with the probable impact by 1999 of a reduction in net receipts from banking of between FRF 7 and 10 billion and a reduction in the gross operating result (25) of between FRF 3,3 and 6 billion, as compared with the forecasts in the July 1997 plan. In so far as a company's value is primarily the discounted amount of its cash flows, this results in a significant correction in the bank's value which, at this stage and in the light of the latest developments, has not been properly taken into account, either in the latest assessments of various sources realized by the bank or by the market.

On that basis, and notwithstanding a substantial margin of uncertainty, the Commission must, as a precautionary measure, restrict itself in this Decision to the assessment carried out by its consultant bank at the end of 1997. Assuming that the value of the State's holding (82 %) in CL is deducted in full from the gross amount of aid, i.e. a deduction of approximately FRF 28 billion, the net cost to the State of the CL aid operation would be reduced to a range between FRF 102 and 147 billion. In any event, however substantial the income from privatization, the amount of the supplementary aid in question will continue to be considerable.

The expanded range for the final aid applied by the Commission is therefore, in view of the uncertainties of the hiving-off mechanism and the exact amount of the proceeds from the privatization of CL, located in a very broad range of between FRF 102 and 147 billion, which is roughly equivalent to two and three times the amount of the aid approved in 1995 and 1996 respectively.

In their letter to the Commission dated 3 April 1998, the French authorities presented a different calculation for the aid which resulted in a range of FRF 52,4 to 71,2 billion. Applying an error margin of 10 % to the upper amount of the range, as had the Commission in Decision 95/547/EC, they reached the conclusion that total aid to CL could be estimated at no more than FRF 80 billion.

(25) Reduction range contingent on the assumptions that the loan will be 'neutralized' in 1999. See section 10.4.

The Commission cannot accept this estimate for the following reasons:

(i) First, as indicated above, the French authorities do not regard all hive-off losses as aid to CL but merely those losses which were evaluated when hived-off assets and liabilities were transferred to CDR in 1995. As a result, the losses are some FRF 40 billion lower than the value of CDR's losses calculated by the Commission as constituting the lower end of the range for CDR's estimated losses. For the reasons set out above, the Commission cannot accept that only some of CDR's losses should be included, this being the main point of divergence between the French authorities' calculation and its own calculation. At the meetings held with representatives of CL and the French authorities towards the end of 1997, and in particular at a meeting held on 28 November 1997, the Commission clearly stated that, at that stage, the total increase in CDR's losses should be regarded as aid to CL. The Commission representatives reiterated this position to the authorities at a meeting held in Brussels early in May 1998.

(ii) The second major point of divergence concerns the calculation of the risks inherent in the hive-off system. The Commission takes the view that the guarantee given by EPFR to CDR (i.e. FRF 145 billion) could be activated up to an amount considerably in excess of the estimated losses of FRF 100,2 billion, since CDR's loss spiral noted to date could continue. As a result, the upper range of the aid estimate should take account of the whole risk associated with the loan (in theory, it is even higher, since the State guarantee is unlimited). In that scenario, CDR's spiralling losses could go hand in hand with spiralling additional carrying costs for EPFR, which could force EPFR to make use of the market borrowing options legally available to it. This second major point of divergence implies that the top of the range will be FRF 45 billion higher than the amount put forward by the authorities. The Commission follows a more comprehensive method than the French authorities with the aim of identifying all possible EPFR losses associated with hiving-off.

(iii) Third, the French authorities discount losses and carrying costs (the loan's basic carrying costs and the costs associated with its neutralization) using a long-term rate, namely that of 10-year government bonds (fungible treasury bonds), i.e. about 5,7 %. The Commission agrees with the French authorities as to the method, which consists in discounting the total amount of losses and carrying costs. However, it has pointed out that the long-term discounting rate results in a discounted figure for losses and carrying costs in the year 2014 which is lower than the nominal amount of those losses in 1997 (or, according to the method used, in 1995) because carrying costs are determined by a short-term rate (85 % of MMR), which is more than two points lower than the long-term discounting rate applied by the French authorities. Such a discount calculation using long-term rates, on which the French authorities' estimate is based, applied to a mechanism over such a long period (1995-2014), in the light of the scale of the losses and the outstanding loan, has a significant quantitative impact and results in the discounted losses associated with hiving-off being reduced by more than FRF 25 billion, assuming that the loss is realized in 2014. This calculation implicitly assumes that the State is able to transform a resource at 85 % of MMR into a long-term application at 5,7 %, i.e. bearing, at the current rate, 2,7 % more in interest. If the State were a lender in structural terms, it would be able to benefit from converting borrowings at short-term rates into loans at long-term rates (but in that case the present round of hiving-off would not have been necessary). However, the State is actually a borrower in structural terms and, as such, is not in a position to take advantage of the conversion options that would have been associated with the CL loan, which has been allocated in full to CDR and has only produced losses. An attempt to benefit from the conversion of short-term rates into long-term rates, the zero coupon, which was initially envisaged in 1995, failed on an amount of only FRF 10 billion, which is considerably less than the losses in question (which, moreover, had to be financed by CL and not by the State); the Commission cannot therefore conclude that the State can benefit from the possibility of converting the rates created by the loan to CL into short-term rates, up to the total amount of losses (at least FRF 100 billion).

If that were the case, the State would have been able to allocate a budget provision to the tune of several dozen billion francs to EPFR, knowing that the loss was then estimated at FRF 100 billion. EPFR could have reinvested this budget provision in the long term at a rate of 5,7 % until 2014 with a view to benefiting from the short-term/long-term rate differential. Accordingly, the Commission cannot follow a discounting logic based on a long-term rate which results in a reduction in hive-off costs which is unrelated to the reality of the mechanism in question. It also notes on a secondary basis that, even if the State were in a position to take advantage of such rate conversion options, a rate risk would remain (the risk

of short-term rates rising to the level of long-term rates, for instance in the event of cyclical overheating), which it would have to take into account in its estimates to ensure that they were comparable.

(iv) Fourth, as indicated above, the Commission did not, in the previous calculation, take account of the risks of spiralling carrying costs referred to in the EPFR 1997 report. On the basis of such risks, the upper end of the Commission's valuation range should be increased by the servicing of the debt which EPFR could enter into with CL (tranche of an additional FRF 10 billion) and the market (statutory authorization to borrow FRF 50 billion).

In view of these various divergences, the Commission rejects the estimated amount of aid to CL put forward by the French authorities.

### 7.3 Additional aid to CL over and above the amount authorized by the Commission in 1995

In conclusion, the additional aid over and above the amount authorized by the Commission in Decision 95/547/EC comprises:

— CDR's additional losses borne by the State via the mechanism of EPFR's participating loan to CDR;

— EPFR's supplementary carrying costs, in particular the neutralization of CL's loan to EPFR from 1995 to 2014;

— the abandonment of the zero-coupon bond provided for in the 1995 business plan and Decision 95/547/EC, of which the discounted receipts had been deducted from the approved aid.

The Commission points out that, in Article 2(c) of Decision 95/547/EC, it stipulated that 'if the costs of the scheme, estimated at FRF 45 billion, are exceeded, it will be necessary to re-examine the scale of the reduction in the commercial operations of CL' as accepted by the French authorities. As a result of the above, if the authorized ceiling of FRF 45 billion is exceeded, a re-examination must be carried out pursuant to the present decision with a view to determining whether the additional aid in question is compatible with the common market.

Compared with the amount of aid approved in 1995 and 1996, the estimated additional aid is, in any event, substantial. On the basis of an extended aid range of FRF 102 to 147 billion as per the previous calculation, the nominal additional aid consists of between FRF 53 and 98 billion over and above the total amount of FRF 49 billion authorized by the Commission in 1995 and 1996. An increase of that size, which would result in total aid without precedent in the Community, can be approved only on the basis of very substantial compensating measures.

## 8. STATE AID CHARATER OF THE PUBLIC SUPPORT MEASURES FOR CL

In accordance with the market economy investor principle, and in so far as the measures in question affect trade and distort or threaten to distort competition, the Commission indicated, in the aforementioned 1993 communication [26] to the Member States, that capital injections in public undertakings contain elements of State aid if, in similar circumstances, a private investor would not have carried out the capital injection in question because this would not have resulted in a sufficient return.

First, it should be noted that the unprecedented total amount mobilized in this aid operation, which is the largest ever in the history of the Community concerning a single undertaking, indicates the State as the sole player which could have mobilized such amounts in view of its virtually unlimited ability to raise finance via tax or borrowing on the market. No private group in Europe or (probably) anywhere else in the world would have had sufficient financial capacity to mobilize such a huge amount of aid.

Second, the mobilized funds, the discounted gross amount of which is (minimum) FRF 130 billion, will only produce a modest return which is disproportionate to the financial input. The State's return on the invested amounts will consist solely of the combined value of the better fortunes clause and the proceeds from the privatization of CL. Since the State does not recoup its investment, the return on the public funds allocated to rescue CL is strongly negative and can under no circumstances be compared with the return that a private operator would expect on a high-risk financial transaction, which was estimated in 1995 in Decision 95/547/EC to amount to an annual rate of 12 % of the invested capital. Since the market economy investor principle is not met, one is bound to reach the conclusion that the rescue and restructuring measures for the bank in question constitute aid.

[26] OJ C 307, 13. 11. 1993, p. 3.

After the first recapitalization of CL in 1994 the French authorities invoked the obligation to comply with the own funds requirement introduced by Council Directive 89/647/EC of 18 December 1989 on a solvency ratio for credit institutions ([27]). Indeed, they informed the Commission when notifying the emergency aid in 1996 that, unless such aid was provided, CL might find itself unable to comply with the minimum solvency ratio required by the Directive. The Commission, as it indicated in Decision 95/547/EC, would emphasize in that connection that the fact that a bank solvency requirement has been introduced by a Community Directive does not mean that injections of public funds or equivalent measures, designed to comply with the Directive, would not be regarded as aid if, in similar circumstances, a private investor would not have deemed the investment to offer him a normal return. Compliance with the Community Directive refers solely to operating continuity and the maintenance of the recapitalized company's banking licence. Under no circumstances does the Directive prohibit the liquidation of a credit institution if an injection of supplementary own funds does not satisfy the abovementioned market economy investor principle and thus constitutes State aid mobilizing public funds, the compatibility of which with the common interest should be examined in compliance with the Treaty rules in the same way as any other aid measure. In brief, the authorities cannot use the Community Directive on a solvency ratio for credit institutions as a justification for non-compliance with Article 92 of the Treaty.

It should also be noted that the Commission concluded in Decision 95/547/EC that the measures in question, which it had evaluated at a net amount of FRF 45 billion at the time, did constitute aid, and that this applied both to the first capital increase of May 1994 and to the State's underwriting of the first two hive-off operations. Since the present decision is concerned with the losses and carrying costs of the hive-off operation (including the neutralization of CL's loan to EPFR) and the abandonment of the zero-coupon bond deducted from the aid in Decision 95/547/EC, the measures concerned are essentially the same as the previous ones, reflecting spiralling costs. The aid measures concerned here are the increase in the value of aid measures estimated by the Commission in its previous decision: in other words, they constitute State aid on the same basis as the aid measures initially estimated by the Commission in 1995.

In particular, the Commission has examined the provisions of Article 52 of the Banking Law of 24 January 1984 whereby the Governor of the Bank of France was authorized to invite the shareholders and members of credit institutions to offer him the necessary support if the situation so merited. The Commission notes that, in several recent cases, the private shareholders of credit institutions in difficulties refused to respond to the invitation of the Governor of the Bank of France to provide fresh capital contributions, even though the financial amounts involved were considerably lower than in the present case ([28]). It takes the view that this call on shareholder solidarity is not binding, and that it is legitimate for shareholders to assess whether new funds should be provided on the basis of the likely return on any new capital injection or equivalent measure in the light of the recovery plan put forward by the credit institution in question and in accordance with the market investor principle referred to above. This was the interpretation of the Paris Court of Appeal, which handed down a judgment on 13 January 1998 ([29]) stipulating that Article 52 could not be interpreted as coercive. In other words, the State as shareholder could not, on the basis of Article 52, take the view that it was required by law to bail out the bank irrespective of the Treaty rules.

The possibility of credit institutions which are structurally non-viable being penalized and, where appropriate, expelled from the market by being put into liquidation, is a fundamental element in ensuring the confidence of economic operators. Maintaining credit institutions with insufficient profit margins in business artificially results in serious distortions of competition, a morally hazardous enterprise which ultimately may weaken the rest of the banking system. It also leads to major distortions in the allocation of funds and consequently to disfunctioning in the economy as a whole. The Commission shares the view of the French Commission Bancaire, which notes in its 1995 report that an orderly restructuring of the French banking system implies that credit institutions, which are companies like any others and, as such, should not be protected from market forces, can go out of business ([30]). In other words, the disappearance of banking institutions should not be regarded as indicative of the inadequacy of existing supervisory mechanisms, but as a sign that market forces are at work and that banks are no more protected than any other enterprise. The Commission notes that the objectives of competition policy and those of prudential banking policy cannot be mutually incompatible, since both are designed to achieve a common end, namely the development of a competitive, healthy

([27]) OJ L 336, 3. 12. 1989, p. 14.

([28]) In other cases, private shareholders intervening at the invitation of the monetary authorities protected themselves from the legal risks but did not act with a view to obtaining an adequate return on their capital contributions.

([29]) BTP case.

([30]) 1995 report of the Commission Bancaire, p. 13.

banking sector. This implies that the banking supervisory authorities should make provision for policies to facilitate the disappearance of uncompetitive banks.

When the emergency transitional measures were notified in September 1996, the representatives of the French authorities reported, in the course of meetings with the Commission, that, should the bank prove insolvent, there was a risk of a crisis spreading throughout the financial system and into the whole economy, depending on the accompanying measures to any liquidation process that the French authorities might take. At the time, the Commission was not in a position quickly to rule out the insolvency risk, and it is not able to exclude the risk of the CL crisis spreading throughout the financial sector. The Commission does not dispute the possible existence of such a risk, which it took into account when it approved the emergency measures notified to it at the time, pending an assessment of the whole case, including a new restructuring plan, as provided for by the Commission guidelines on aid for rescue and restructuring. However, the Commission notes that the State cannot constantly invoke the risk of a crisis of that type to avoid the consequences of Article 92 of the Treaty.

As it noted in Decision 95/547/EC, the Commission takes the view that the unprecedented scale of the losses incurred by the rescue of CL can largely be explained by the lack of supervision of the company by the State as shareholder and by the delay in taking the initial major restructuring measures. These costs reflect conduct which is not that of a prudent shareholder and demonstrate a serious lack of corporate governance, which led to numerous errors characterized by the irresponsibility of the decisions taken by the bank's previous management, a lack of transparency in management and in the company's accounts and a decision-making procedure which did not incorporate the risk assessment which is normally at the heart of a bank's decision-making process. The lack of internal and external controls, which went hand in hand with a strategy of forced expansion at the end of the 1980s and the beginning of the 1990s, explains the unprecedented scale of CL's financial problems. The Commission points out that these management failings were accentuated by confusion between the roles of the state as shareholder, the state as entrepreneur, the welfare state and the state as legislator, a confusion which resulted in the state as shareholder allowing a situation of unprecedented gravity to degenerate further, contrary to its asset-related interests.

As the Commission noted in Decision 95/547/EC, it does not have data establishing that the combined costs to the State budget of the 1994 recapitalization and the anticipated costs of hiving off CL are greater than the costs that the State would have incurred if another sale or liquidation solution had been chosen. In any event, the cost would have been less if the State had intervened before the crisis arose.

In particular, the Commission has noted instances of French case-law relating to previous cases in which the State's liability for liquidation debts was deemed to extend beyond its capital contribution to the company in question. In similar precedents ([31]), the Commission and the Court of Justice have rejected the argument whereby the liability of the State as shareholder for liquidation debts extended beyond its capital contribution on the grounds that extending liability in that way amalgamated the roles of the shareholder State and the welfare state. The case-law of the courts in no way alters the fact that such operations constitute aid: as a shareholder, the State, which was aware of this case-law based on the 1985 Law on Company Rehabilitation and Liquidation ([32]), should have taken, long before the measures currently being examined, measures to strengthen risk monitoring during the bank's expansionary phase and then restructuring and liquidation measures when the crisis broke. In other words, it did not behave as a prudent shareholder or market economy investor in compliance with the aforementioned principle. Leaving that matter aside, the Commission considers that the French authorities have failed to provide proof, as required by the 1985 Law, that the State as shareholder was equivalent to an *ipso jure* or *de facto* manager of the company. In that case, the ipso jure or de facto managers are liable for the company's liquidation debts in the event of management errors up to the financial amounts which these errors represent. Lastly, the Commission notes that, even were such proof to be provided, the provisions would not enable the French State to claim exemption from implementing Article 92 of the Treaty without flouting the principle of law that arguments cannot be based on one's own faults.

Accordingly, even though liquidation of CL would have had direct or indirect costs far in excess of those for the measures taken by the French authorities, this situation, which is the result of the failings over many years of the

([31]) See in particular Commission Decision 94/1073/EC (Bull), OJ L 386, 31. 12. 1994, p. 5 and Joined Cases C-278/92, C-279/92 and C-280/92 Spain v Commission [1994] ECR I-4103, paragraph 22.

([32]) Law of 25 January 1985 on the relief and liquidation of companies, Articles 179 and 180, Cf. French Official Gazette of 26 January 1985.

State as shareholder, cannot be invoked to argue that the measures in question do not constitute aid. The upshot of all these factors is that the aid character of the rescue and restructuring measures for the bank cannot be disputed by saying that liquidation would possibly entail far higher costs, even in a context of financial and systemic crisis.

## 9. DISTORTION OF TRADE BETWEEN MEMBER STATES

The liberalization of financial services and the integration of financial markets have made intra-Community trade increasingly sensitive to distortions of competition. Economic and monetary union has made this trend more pronounced ([33]). With the launch of the single currency, trade within the Community will be able to develop without any exchange risk or exchange costs. Although, in principle, financial institutions are able to operate on a cross-border basis, there are obstacles preventing them from expanding abroad. These obstacles are often related to arrangements protecting domestic institutions from the effects of competition, which makes it less advantageous for foreign competitors to enter the market. Aid designed to enable financial institutions to survive against a background of lower profits and reduced ability to meet the challenges posed by competition, such as the aid granted to CL, may therefore distort competition at Community level because it makes it harder for foreign financial institutions to access the domestic market.

Without the aid in question, CL would have to be wound up or sold, in one or more parts, to one or more stronger institutions, possibly as part of judicial proceedings. In the event of that happening, the institution or its activities might be taken over by a foreign competitor wishing to set up or boost its business presence in France. This procedure would make it easier to disperse CL's assets and market shares between a high number of potential buyers. It should be noted that the plan submitted by the French authorities in July 1997 does not provide for the separate sell-off of each of CL's French and foreign subsidiaries, but merely for the floatation of CL as a whole.

In addition, aid to an institution with an international dimension like CL which provides a wide range of financial products to companies competing on international markets and offers financial services to individual customers in competition with other European financial institutions, while also expanding its activities abroad via its branch network outside France, is likely to have a distorting effect on intra-Community trade. In particular, the aid in question could enable CL *inter alia* to restructure a number of its activities abroad on markets where it is competing with other financial institutions in the Community.

It should be noted that, in 1997, CL's international activities accounted for FRF 810 billion, or 54 % of the bank's total assets. European activities accounted for 32 % of the bank's total assets at the end of 1997, representing an amount of about FRF 474 billion.

Accordingly, the public intervention in question must be deemed to be covered by Article 92(1) of the Treaty, since it constitutes State aid which distorts competition to an extent likely to affect intra-Community trade.

## 10. ASSESSMENT OF THE COMPATIBILITY OF AID TO CL

### 10.1 Legal framework, criteria and method for assessing the compatibility of aid to CL

Having established that the measures in question constitute State aid pursuant to Article 92(1) of the Treaty, the Commission must determine whether such aid can be deemed compatible with the common market within the meaning of Article 92(2) and (3).

It should be borne in mind that the aid in question is neither social aid granted to individual consumers nor aid likely to facilitate the development of certain French regions (and granted for that purpose). Nor is it aid designed to remedy serious economic disruption, since its purpose is to resolve the problems of a single recipient, CL, as opposed to the acute problems facing all operators in the industry. As a result, the aid cannot be considered as in the common European interest either. Only the derogation provided for in Article 92(3)(c) may be taken into account. This article gives the Commission the power to authorize '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.' In assessing whether the aid is compatible with the common interest, the Commission takes account of the extent to which competition has been distorted, the offsetting measures provided for with a view to limiting such distortions, the restriction of aid to what is strictly necessary and the viability of the recipient.

([33]) See section 10.2.

The Commission set out the implementing conditions for this derogation in the Community guidelines on State aid for rescuing and restructuring firms in difficulty ([34]). The guidelines state that 'aid for restructuring raises particular competition concerns as it can shift an unfair share of the burden of structural adjustment and the attendant social and industrial problems on to other producers who are managing without aid and to other Member States.' The Commission takes the view that aid for restructuring may contribute to the development of economic activities without affecting trade to an extent contrary to the Community interest where the following conditions are met:

(1) a restructuring plan based on realistic assumptions which enables a minimum return on the invested capital to be generated within a reasonable time-span and the firm's long-term viability to be guaranteed;

(2) the provision of sufficient *quid pro quos* to offset the distorting effect of aid on competition so that the aid can be regarded as not contrary to the common interest;

(3) aid should be proportional to the objectives in question and the amount of aid should be limited to the strict minimum needed for restructuring so that the recipient company itself makes a maximum contribution to the recovery plan;

(4) the full implementation of the restructuring plan and observance of any other obligation laid down by the Commission's final decision;

(5) setting-up of a monitoring system for the previous condition.

In accordance with the guidelines on aid for restructuring, such aid should normally have to be provided only once. Since in the present instance, the aid in question is to be provided in addition to that approved in 1995 and 1996, and given its scale and distorting effect, a particularly rigorous and detailed assessment should be carried out to ensure that the aforementioned conditions are complied with.

### 10.2 Competitive background to CL's activities and the distorting effect of aid

The European banking industry, and the French banking industry in particular, is currently undergoing a process of adjustment characterized by very severe competition. This development is fuelled by the liberalization of capital markets, rapid technological change and the launch of the single currency. The definitive opening-up of markets and the loss of commission on exchange transactions between the currencies of the countries forming the EMU will increase competitive pressure within the Community. This will probably result in an accelerated integration of supply, with banks or, more broadly, financial institutions merging, largely as a result of existing complementarity between banking and insurance (in recent years banking networks have become one of the main retailers of insurance products). This integration of supply will inevitably give rise to further restructuring to enable the new groups to derive full benefit from the synergies created and to shed any dead wood resulting from the merger operations.

So CL is carrying on its financial business against a background of acute competition. Like wholesale banks and investment banks, retail banks are subject to considerable competitive pressure. The impact of competition on commercial banking activities in Europe is to squeeze financial intermediation margins, which have been steadily eroded over the last ten years. Banks are attempting to counteract this loss of added value by developing commission-generating services, whose share of net receipts from banking (NRB) is growing, taking French financial institutions as a whole.

As explained above, State aid to CL became necessary for several reasons: excessive, uncontrolled exposure to real estate, an imprudent policy of expansion abroad, but also an ineffective monitoring system on the part of the shareholder, which was unable to put an end in time to the high-risk behaviour of the bank's managers. In other words, the CL's overall system of corporate governance proved inadequate.

In view of CL's delay in responding to the cyclical downturn and to the difficulties it faced (rents and purchase prices have been falling uninterruptedly on the real estate market since 1990), coupled with the slow pace of the recovery process, it seems clear that its current substantial aid requirement is partly a result of the confidence its managers have placed in the State as shareholder, which was obliged to cover past errors, as is demonstrated by the French authorities' arguments regarding the cost of alternative solutions. Obviously, CL is not the only group to have rushed into a highly speculative policy, but only public institutions have been able to count on State aid, whereas private institutions have been forced by the markets to undergo drastic restructuring or to enter into a composition with their creditors. The result is an imbalance in the conditions of competition between public and private banking institutions which constitutes a serious distortion of normal market conditions. In the case in point, there are grounds for believing that, if CL had not enjoyed the total and permanent implicit or explicit backing of the State, it would not have embarked on its risky policy in the first place, or at the very least it would have undergone restructuring earlier and with greater determination.

([34]) OJ C 368, 23. 12. 1994, p. 12.

Public support, which ultimately means a lifeline for failing institutions, as was emphasized by the French Senate's information report No 52 ([35]), also has the effect of protecting their creditors. However, it also removes any incentive for creditors to monitor their debtors' behaviour, with the result that financial institutions are no longer subject to the supervision and penalties of the markets. Such protection is not just inappropriate and excessive, it also has the consequence 'of encouraging the unsound management of credit institutions' — as the European Parliament and the Council of the European Union stated in Directive 94/19/EC ([36]) of 30 May 1994 on deposit-guarantee schemes. The effect of the shareholder's support, which in turn made market support possible, was to delay the necessary restructuring and to increase the final amount of State aid. As a result, and in accordance with the statements of the Council and the European Parliament, the Commission fully subscribes to the argument which has been established in academic circles and in the wake of banking crises in several countries that this perverse effect or moral hazard problem played an important part in the CL crisis.

It should also be noted that the distorting effect of aid on competition does not merely concern the previous policy of CL and nationalized banks which have received aid, but that it may also create expectations for the future. As the UK authorities pointed out in the comments they submitted as part of the present proceedings, if aid is granted more than once, the bank's management may expect further aid to be forthcoming in future, which can have an additional distorting effect on competition. In addition, State aid to the weakest institutions plays a negative role and helps to squeeze margins in the industry as a whole. State aid is tantamount to rewarding inefficiency and undermines market discipline, especially where it is granted repeatedly, as in the case of CL. For that reason, the guidelines on State aid for rescuing and restructuring firms in difficulty specify that aid should normally be necessary only once.

Quasi-systematic state support for nationalized institutions in difficulty (CL, GAN-CIC, Crédit Foncier de France, Marseillaise de Crédit, Comptoir des Entrepreneurs), coupled with the fact that most of these rescue operations were carried out more than once, has had the effect of exacerbating the conditions of competition faced by French and European banks in France. It has worsened the difficulties of the financial industry as a whole and has had a particularly negative impact on the profit levels of private banks, which represents a serious distortion of competition; this also applies to banks from the other Member States operating in France or which face obstacles to the development of their activities in France as a result of this situation. As was pointed out in a report from the French planning authorities ('Commissariat Général au Plan') ([37]), the resulting imbalance in the conditions governing entry to, and exit from, the banking industry is such as to create an artificial blockage of the French banking system, whereas the normal counterpart of unfettered entry to the industry should be unfettered exit. This imbalance is one of the main causes, if not the main cause, of the difficulties of the French banking industry ([38]). According to the aforementioned report of the Senate Finance Committee, by systematically rejecting the liquidation and sale option, governments have merely made their remaining options more costly, once relief has been shown to be inefficient. Unfortunately, CL illustrates this fact: the cost of procrastination is high ([39]).

*Table 16:*

**Aid to nationalized French banking groups**

| Recipient | Number of aid schemes since 1992 | Total aid, not discounted (1992-1998) (FRF billion) |
|---|---|---|
| Crédit Lyonnais | 4 | 102 (minimum) |
| Société Marseillaise de Crédit ([1]) | 4 | 2,1 |
| Comptoir des entrepreneurs | 4 | 15,2 |
| GAN-CIC | 2 | 23,76 |
| Crédit Foncier de France ([2]) | 1 | 25 |
| Total | | 168 |

([1]) A further contribution, of an unquantified amount, is planned for 1998.

([2]) FRF 25 billion corresponds to the amount of the short-term facility granted by the State; other, unquantifiable components are planned (unlimited State guarantee and State undertaking to take all necessary measures to ensure that CFF can continue to operate after 31 July 1996).

([35]) See French Senate, *Banques:* votre *santé nous intéresse;* report by Mr Alain Lambert on behalf of the Finance, Budgetary Control and Accounts Committee on the situation and prospects of the French banking system, (Report No 52, 1996-97).

([36]) OJ L 135, 31. 5. 1994, p. 5.

([37]) '*Le système bancaire* français', October 1996, contribution by the planning authorities to the Senate Finance Committee's finance working party, see p. 86 of Report No 52 of the Senate Finance Committee.

([38]) See the Lambert Report, op. cit., p. 56.

([39]) See the Lambert Report, op. cit., p. 60.

Accordingly, any lasting solution for CL and the nationalized banking system in France must entail a reform of the corporate governance of the group and its institutions and a solution to the moral hazard problem engendered by the State's ultimate willingness to provide support. In the case in point, the Commission takes the view that the undertakings entered into by the French Government to privatize and radically trim the group will provide a lasting solution to the corporate governance failings noted in the past.

It should be noted that the interpretation given in numerous cases to Article 52 of the 1984 Banking Law by the French authorities (see section 9 above) results in an additional distorting element to the conditions of competition obtaining in the French banking industry. According to the French authorities, shareholders are obliged to lend support to a failing institution if the monetary authorities call on them to do so. It should be noted that this creates an uneven playing field between private and nationalized banks, whose shareholder has access to unlimited resources, and that, as a result of this interpretation, funds are allocated in an economically irrational way and the normal functioning of the market and of the conditions of competition obtaining in the French banking industry is distorted. There is no doubt that this coercive interpretation of the Banking Law, which was recently rejected by a judgment of the Paris Court of Appeal, has made a lasting contribution to the imprudent conduct of the managers of French nationalized banks, which have relied on their shareholder for virtually automatic support. By giving rise to such expectations, it aggravated existing distortions of competition. The fact that the French authorities are still invoking what they regard as the coercive nature of Article 52 in numerous cases of banks in difficulty, shows that the shareholder state has still not fully learned the lessons of the series of crises in the nationalized banking sector and that it is still capable of repeating certain past errors.

Instead of virtually unconditional support, particularly when the French authorities themselves make use of the argument that there is a risk of a systemic crisis spreading to the rest of the financial sector in the case of major banks like CL (the *'too big to fail'* argument), the Commission believes that the French authorities should, in the common interest, follow a different strategy for resolving crises in the banking sector so as to minimize their distorting effect on competition. The policy it advocates is designed to encourage responsible behaviour on the part of the managers of both nationalized and private banks. To that end, it is important not just for the competent authorities to state clearly and publicly that credit institutions will normally be subject to market forces and that banks are no more protected from liquidation than any other enterprises (as the French Commission Bancaire stated in its aforementioned 1995 report), but also that the State as shareholder will act accordingly when dealing with banking crises and will do so without discriminating between nationalized banks and private banks. This policy should be accompanied by protection measures for small investors in the form of instruments such as deposit-guarantee funds ([40]). It also needs accompanying strategies for the ordered liquidation of failing banks with a view to avoiding crises and preventing them from spreading to the rest of the financial industry and the economy as a whole. The Commission takes the view that the Member States have instruments, such as temporary liability guarantees, enabling them to provide a framework for the ordered liquidation of companies and to prevent a systemic crisis developing. The Commission has consulted a group of 'wise men' consisting of ex-governors of the Member States' central banks which concurs with this approach.

### 10.3 Assessment of the viability of CL on the basis of the assumptions contained in the plan submitted to the Commission in July 1997

It should be noted that the general principle of the guidelines on restructuring aid should be that aid is to be authorized only where it is in the interest of the Community to do so. The Commission began by analysing, with the assistance of its consulting bank, the plan submitted by the French authorities to determine the internal cohesion of the assumptions on which it was based. This preliminary examination is without prejudice to any changes which may be made to it with reference to Community policy on State aid, with the result that these assumptions are not regarded as intangible by the Commission.

According to the French authorities' plan, if the CL loan were 'totally neutralized', the bank's profits would register continuous growth, rising from FRF 0,2 billion in 1996 to FRF 3,2 billion in the year 2000 (net result, group share, after distribution of the clause). After the year 2000, according to the Commission's consulting bank, in the light of the high outturn, they would stabilize and grow at a more modest rate.

([40]) Directive 94/14/EC of the European Parliament and of the Council on deposit-guarantee schemes provides for the Member States to establish such instruments, OJ L 135, 31. 5. 1994, p. 5.

*Table 17:*

**Trend of CL's results according to the July 1997 plan**

*(FRF billion)*

| | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Financial impact of neutralization | 3,0 | 3,3 | 3,0 | 2,7 | 2,4 |
| With neutralization | | | | | |
| Net result (group share) (after better fortunes clause) | 0,2 | 1,0 | 1,7 | 2,2 | 3,2 |

*NB:* 1996 and 1997 refer to actual results. The rediscounted figures for 1998-2000 were submitted by the French authorities in March 1998. These figures were subsequently rediscounted in May 1998 (see Table 19).

Following the restructuring of the French network, the main source of CL's post-plan margins are expected to be in France itself, which should account for about 57 % of CL's net result ([41]) from the year 2000 onwards.

The work carried out by the Commission's consulting bank, which is based on the objectives set by CL (gradual floating of the company's capital by the year 2000, universal bank strategy in France and corporate bank strategy in the rest of the world), gives rise to several conclusions.

As regards France (DCAF), CL's projections seem reasonable to the Commission's consulting bank. These projections are based on an explicit strategy designed to defend existing market shares and to cut operating costs. The plan is based on the success of the cost-cutting programme and improvements to the quality of assets. In so far as CL does not aim to win back market shares (except as regards the consumer credit facilities offered in partnership with Cetelem), these objectives would seem to be within its grasp. The Commission's consulting bank has carried out a sensitivity analysis showing that, even if CL reduced its overheads and operating ratio at a far slower rate than anticipated, its profitability would not be undermined. However, growth in own funds would be far slower and the tier one solvency ratio would not rise above the 5 % mark until the year 2000. A 20 % increase in the level of provisioning in the plan would have a lesser impact on the result and the own funds ratio. The Commission's consulting bank took the view that, since the business plan's assumptions regarding turnover and net receipts from banking were on the conservative side, an analysis of sensitivity to a fall in NRB was not necessary.

([41]) DCAF and DCAF subsidiaries.

The Commission's consulting bank examined the other transactions effected by CL. It emphasized that CL's performance in Europe during the time-span of the plan, depended to a large extent on that of BfG (which, according to the plan, is not due to be sold off until the year 2000). BfG's results should stabilize following restructuring and the introduction of new strategic guidelines. Given that the plan provides for major sales in Europe, the bank's performance in Europe will be affected by extraordinary elements depending on whether the sell-offs result in capital losses or gains. The Commission's consulting bank noted that, following CL's withdrawal from its retail banking activities in the rest of the world, and the current integration of its market and corporate banking activities, major synergies made it possible to improve the overall cover of the bank's large-scale customers and meant that the bank was well-placed to achieve its objectives. In particular, Crédit Lyonnais Americas, which is one of the few banks in the United States to enjoy the status of a commercial bank and a corporate bank, and Crédit Lyonnais Asia, which is highly specialized in brokerage activities, formed two of the group's pivotal points. These two solid pillars underwrote the bank's international strategy and financial projections.

On the basis of the work carried out by its consulting bank, the Commission concluded that the business plan submitted to it in July 1997 was broadly realistic in terms of the assumptions made, which forecast reasonable growth and eschewed excessively ambitious objectives which could have led CL to adopt an aggressive pricing policy. This plan, which is structurally consistent, points to the emergence of adequate profit levels by the year 2000, so that CL is viable in the long-term according to the aid and *quid pro quo* assumptions presented by the French authorities in July 1997. CL's 1997 results would appear broadly to support this analysis. CL's NRB in 1997 was greater than the 1996 figure, even though the plan forecast a significant downturn in NRB.

These conclusions must be qualified by various considerations. CL's performance should be set against that of the institutions which are most directly comparable to it. In view of the variety of CL's functions, such comparisons are complex and require a substantial number of institutions and markets to be assessed using multiple criteria concerning the size, structure, organization, profitability, distribution and presence on the domestic and international market, etc. This examination was carried out by the Commission's consulting bank with reference not just to the French banks closest to CL, such as Société Générale and BNP, but also in the light of current trends on the other banking markets in Europe and in the rest of the world.

The analysis shows that the restructuring work begun by CL is substantial but not yet complete. CL still has a large staff and a high number of branches, reflected in substantial overheads. The hiving-off of assets to the tune of FRF 190 billion improved the portfolio's gross return (measured by the ratios of interest margins to average assets and gross operating result to average assets), but CL's net return ratios (return on assets and on own funds) are still considerably below those of comparable competitors. CL's operating ratio (76 % in 1997) is still too high in relation to that of its French competitors (approximately 70 %), not to mention its foreign competitors (approximately 60 %).

In the lead-up to the final stage of economic and monetary union, it seems very likely that further reductions in this ratio will be necessary for most European banks and all the more so for CL. In terms of asset quality, the hive-off has certainly enabled a considerable improvement to be made, and today cover for doubtful debts has been brought back to a more appropriate level. However, given that risk monitoring was the critical factor underlying most of CL's problems, it remains to be seen whether, in the medium term, the new risk management systems will enable the bank to anticipate, prevent and manage major risks in the medium term and also to face unforeseen circumstances with its own resources.

Lastly, it should be noted that, compared with the strategy of geographical expansion and expansion into new fields, the size of CL and, in particular, the size of its weighted commitments, involve a lower level of capitalization than those of its competitors, which entails *inter alia* higher financing costs on markets because of its low rating and restricts its potential growth margin. Without the aid made available to CL, it would have been obliged substantially to reduce its market shares in France, which are still close to those of its main competitors. CL will not be able to resume a growth strategy in absolute terms and in terms of market shares until it has accumulated own funds which are substantially in excess of the funds available to it at present. Unless recapitalization takes place, this would entail a series of positive results over several years.

The above brings us to the conclusion, on the basis of the notified plan, that CL is viable, but that it still has to make considerable efforts to consolidate the current recovery. In its conclusions as to CL's viability, the Commission should also take account of the very substantial changes to the plan needed in view of the requirement to minimize aid and the measures to offset distortions of competition as provided for in the Community competition rules (see sections 10.4 and 10.5 below).

### 10.4 Aid in proportion to the costs and benefits of restructuring; changes to the forecasts in the notified plan

The Community guidelines on State aid for rescuing and restructuring firms in difficulty state that 'to limit the distortive effect, the form in which the aid is granted must be such as to avoid providing the company with surplus cash which could be used for aggressive, market-distorting activities not linked to the restructuring process'. In order to assess whether the aid is in proportion to the objective, and whether CL is contributing, to the maximum extent possible, from its own resources to the restructuring plan submitted to the Commission, as the guidelines require, the Commission draws a distinction between aid arising out of the increase in CDR's losses and aid arising out of a change in the terms of the loan from CL to EPFR.

The aid to CL in respect of CDR's and EPFR's losses is a product essentially of the same cause that motivated the hive-off in 1995; it would be difficult for the authorities to vary the amount of aid without calling into question the principles that underlay the hive-off in the first place and in particular the arrangement by which CDR's losses were to be borne by EPFR. In origin these losses are CL's, as CDR took over CL's poor-quality assets and liabilities; any losses due to bad management on CDR's part would have to be substantiated case by case. Because CDR is a subsidiary of CL which is outside CL's consolidated accounts, and over which CL no longer has any control, as required by Commission Decision 95/547/EEC, these losses do not affect CL's financial position: the State takes up the cost by recapitalizing EPFR.

But the rate of interest charged on the loan from CL to EPFR has a direct impact on CL's profitability. It will be seen from Table 13 that the neutralization of the net cost of carrying this loan has a very significant effect on CL's results. This is a variable which is open to state action; indeed the State has already acted upon it, by granting emergency aid in 1995 and 1996 with a view to improving CL's financial situation. For this reason the Commission has examined the proportionality between the objectives being pursued and the additional aid represented by the neutralization of the EPFR loan and the cancellation of the zero-coupon bond, which together constitute a major increase in the carrying cost of the transaction to EPFR, an increase which has to be borne by the State.

The neutralization of the loan to EPFR can be considered necessary only if CL would be unable by itself to finance the charges it has to bear in respect of the loan to EPFR, over and above its return, which is 85 % of MMR. It should be borne in mind that this arrangement is a form of contribution by CL to the recovery plan, and helps to limit the volume of aid. It should also be pointed out that the neutralization operation is not the equivalent of a State-aided investment that would figure in CL's balance sheet, but rather an item that would show in its profit-and-loss account. The necessity for it has therefore to be assessed in the light of CL's financial position.

At the beginning of May 1998 CL drew up new profit-and-loss forecasts on the basis of the asset sales required as a *quid pro quo* in this Decision. The revised figures show that the underlying assumptions in the plan change drastically, and that from 1997 to 1999 CL will be unable to show positive results unless the loan is neutralized: for each of these years the effect of neutralizing the loan is greater than CL's profit before application of the better fortunes clause. The adjustment is particularly big in 1999, when CL expects a net profit that falls short of the July 1997 forecast by FRF 2 billion. Given CL's poor rating, and the fact that it has been placed under surveillance by Moody's rating agency since the beginning of 1998, the Commission can accept that if the loan to EPFR is not neutralized from 1997 to 1999 there could be losses serious enough to compromise the restructuring operation in progress. The Commission acknowledges that the costs of restructuring provided for in the closure and sell-off plan to which the French Government has committed itself bear heavily on the years 1998 and 1999, which are two strategic years in the life of the group, as its privatization is to be completed in October 1999.

*Table 18:*

**Revised assumptions 1996-2000**

*(FRF billion)*

| | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|
| Financial impact of neutralization | 3,3 | 3,0 | 2,7 | 2,4 |
| Net profit, group share (before clause), with neutralization: | | | | |
| — New estimates | 1,9 | [...] | [...] | 3,6 |
| — July 1997 plan | 2,3 | 2,7 | 4,5 | 6,6 |
| Shortfall by comparison with July '97 plan | −0,4 | [...] | [...] | −3,0 |

*NB:* This table was drawn up on the basis of data which CL submitted to the Commission in May 1998. They are based on the outturn for 1996 and 1997 and on CL's forecasts, updated in May to reflect the impact of the asset sales on CL's turnover and profits.

At a meeting on 7 May 1998 representatives of CL indicated that from the year 2000 onward, when the restructuring linked to the asset sales had been completed, CL expected to be able to finance its own development without the total neutralization of the loan which had initially been proposed by the French authorities in July 1997. It should be pointed out that the many factors linked to the restructuring operations which are to follow this Decision will not recur beyond the year 2000, as the asset sales are all to be complete by 31 December 2000. This means that when CL is privatized, in 1999, its medium-term prospects should be very much better, provided it continues the internal restructuring effort it has undertaken especially in order to bring its operating ratio (the ratio of its overheads to its net receipts from banking) down to about 70 %.

The Commission is of the opinion that the privatization of CL and the end of the uncertainty surrounding the aid plan will profoundly modify the conditions in which CL has to work. The bank will find it easier to go to the market for fresh capital. It should see a gradual fall in the cost of its borrowing, which because of its poor credit rating is currently more expensive than that of its competitors. This should bring its rate margins back to the same level as those of its main competitors. An improvement in these would strengthen the recovery which has already got under way with the reduction in its operating ratio. Following privatization, then, there should be a basis for a lasting improvement. The Commission would note here that CL's difficulties became particularly acute during an economic downturn in 1992 and 1993. A bank is especially vulnerable to cyclical swings, not only because its growth reflects them directly (though CL's growth should remain weak in the medium term, as a result of the continuing restraining mechanism), but also because the risks run by its customers and therefore the rate of default on its claims are a great deal lower when the macroeconomic situation is good. As the medium-term outlook for the European economy is encouraging, owing to the context of growth and stability created by economic and monetary union, the Commission is of the opinion that CL should be able to pursue its recovery in a favourable environment, which will allow it to complete the restructuring already begun and drastically to reduce its balance sheet in accordance with this Decision, even taking account of the limitations that the Decision imposes on its growth. On the basis of the initial plan in 1997 the Commission came to the conclusion that CL was viable, and in the light of the new estimates put forward by CL, therefore, the Commission considers that that conclusion continues to hold good.

The Commission concludes that the complete neutralization of the loan may be allowed for the years 1997, 1998 and 1999, and that thereafter CL will be in a position to bear the cost of refinancing the long-term liabilities backing the EPFR loan without endangering its own viability.

This limitation does not affect the amount of State aid to CL calculated on the basis of the complete neutralization of the loan. As a result of the variation in the value of CL, the State will lose as much as it gains from the reduction in the volume of aid, so that in terms of the State's portfolio the impact on the net amount of aid will be negligible (see Table 15) ([42]).

On this basis, the value of the additional aid examined in this Decision, over and above that approved by the Commission in 1995 and 1997, can be estimated at between FRF 53 billion and FRF 98 billion.

The Commission and the French Government have also agreed that a financial mechanism may be established which produces the same restraining effect as the obligation on CL to finance the loan to EPFR at 85 % of MMR, i. e. at less than its refinancing rate, which is MMR. The alternative mechanism, in accordance with the private investor principle already referred to, would not comprise any fresh State aid to CL (see section 10.6 below), and would increase the rate for servicing the loan to EPFR to 100 % of MMR.

The loan of FRF 10 billion from CL to EPFR which was intended to finance the subscription by EPFR of a zero-coupon bond will not now be granted; this constitutes a loss of revenue to the State, which the Commission has taken into account in its calculation of the aid and the *quid pro quo* it necessitates, as EPFR is deprived of the possibility of transforming a resource bearing a short-term rate of interest into an application bearing a long-term rate; but it has no direct effect on CL, which is simply relieved of an obligation to borrow and lend a sum of FRF 10 billion at MMR, without any effect on its profit-and-loss account or its solvency ratio ([43]).

### 10.5 *A quid pro quo* in proportion to the distortion of competition caused by the aid

When the Commission is examining a measure to assist the restructuring of a firm in difficulty, its overall assessment has to consider whether the common interest is served by the maintenance of the firm in business, given the competition that exists in the industry and the way competition will be affected by the aid. The distortion of competition can be reduced by limiting the aid to what is strictly necessary, but also by requiring a *quid pro quo* on the part of the firm. If the Commission can secure a substantial reduction in the distortion of competition the aid may be declared compatible with the common market, provided the other tests laid down in the guidelines on restructuring aid are satisfied.

([42]) On conventional assumptions supposing that the fiscal impact of a variation in operating revenues is offset by a marginal multiplier between the value of the bank and the value of its own funds.

([43]) Loans to the State bear zero risk and are not included in CL's solvency ratio: the effect on the weighted assets is nil.

*(a) Factors in the assessment of the distortion of competition*

It should be borne in mind, first of all, that without the State aid it has received CL would have had to be put into liquidation. Under the Community guidelines on State aid for rescuing and restructuring firms in difficulty [44], the purpose of requiring the recipient firm to give up capacity as a *quid pro quo* for the aid is to reduce the distortion of competition caused by the aid on the main markets where the recipient is competing with similar firms. The capacities or market shares left free provide a form of compensation for competitors, serving to offset as far as possible the distortion of competition caused by the aid.

If the *quid pro quo* takes the form of asset sales to reduce the size of CL's balance sheet, along the lines followed by the French authorities in connection with the earlier Decision 95/547/EC, CL will be able to use the proceeds of the sale to finance the restructuring, so that the recipient will be made to contribute, to the maximum extent possible, to the restructuring process. In this case, then, a substantial *quid pro quo* on the part of the recipient can also help to keep the State aid to a strict minimum. The Commission is nevertheless aware that in some cases market constraints may make it difficult to secure full value for the assets sold off by CL.

European banking legislation has introduced a solvency constraint: the nucleus of tier-one own funds must be at least 4 % of weighted assets, and own funds in the broader sense must amount to at least 8 %; this limits credit institutions' capacity for growth. In reality there is a capitalization constraint of this kind which applies to any form of enterprise in the medium and long term; but in the banking sector the constraint is permanent, immediate and directly quantifiable, and cannot be set aside temporarily if a credit institution wishes to pursue a growth strategy. A credit institution that barely satisfies the solvency requirement has no margin for growth unless it can attract fresh capital or increase its own capital and reserves by achieving a high rate of profit. An inefficient bank will see its growth restrained by the solvency requirement, while a bank making large profits will have a margin of growth that reflects its profitability. The restraint which the solvency requirement places on the growth of less effective institutions illustrates very clearly the way in which prudential policy and competition policy complement one another. In considering the *quid pro quo* suggested by the French authorities, the Commission has also taken account of the undertakings given by the Government regarding a mechanism to restrain CL's growth, which likewise helps to offset the distortive effect of the aid (see section 10.6).

One result of the solvency requirement is that in the case of credit establishments it is possible to arrive at a very rough theoretical estimate of the distortion of competition caused by State aid. If the aid can be equated with a capital injection, the distortion of competition can be assessed in terms of weighted assets. A capital injection of FRF 1 billion, or any measure whose effect is equivalent, allows a bank to increase the weighted assets in its balance sheet above what is required by the compulsory solvency ratio of 4 % to 8 %, and thus to expand its activities. The operation under consideration here brings with it a potential distortion of competition equivalent to between FRF 12,5 and 25 billion: CL has been able to increase its weighted assets by between FRF 12,5 and 25 billion, and would not have been able to do so without the aid. This relationship also means that if State aid to a credit institution exceeds its own funds, the distortion of competition caused would be greater than the whole of the weighted assets. In such a situation the role of the *quid pro quo* is to limit the distortion very roughly estimated here.

CL has received State aid equal to at least twice and possibly even three times its current own funds, which amounted to FRF 44 billion in 1997, so that the theoretical distortion of competition measured in terms of balance-sheet assets by the rough method outlined above is equal to its entire weighted assets (it cannot exceed that amount). Thus the aid has not only enabled CL to avoid liquidation and survive, but also to maintain a level of activity which the solvency requirement would have forced it to cut back substantially, going far beyond the reductions made so far, if the aid had been less generous; it certainly would not have been able to stabilize its market shares in France as it has done in the last two years (see Table 5 in section 3). The curb on growth imposed by the solvency requirement has not had anything like the constraining effect it would have had if no aid or only a part of the aid had been granted.

Given the volume of aid, then, CL's French and European competitors have suffered an exceptionally high level of distortion of competition. If the aid is to be approved, it is important for the common interest that a very substantial *quid pro quo* be put forward by the French authorities which provides sufficient compensation to competitors for the distortion they have suffered as a result of those authorities' refusal to allow market mechanisms to take their course.

[44] OJ C 368, 23. 12. 1994, p. 12.

*(b) Compensating measures in Europe and in the world*

As a *quid pro quo* for the 1995 aid plan, with an approved net volume of State aid of FRF 45 billion, the French authorities undertook to take substantial compensating measures. It has already been indicated (section 4) that in a letter sent to the Commission on 18 July 1995 Mr Madelin, the Minister for Economic and Financial Affairs, said that CL would reduce its commercial presence outside France by 35 % in balance-sheet terms, equivalent to about 50 % of CL's assets in Europe outside France. CL's international assets were valued at a total of FRF 959 billion at 31 December 1994, so that that reduction amounted to about FRF 335 billion, including FRF 310 billion in Europe. CL was to have until 31 December 1998 to dispose of assets so as to comply with the obligation. By the end of October 1997 CL had sold off international assets worth about FRF 171 billion, including FRF 136 billion in Europe; this was about half the reduction it had undertaken to carry out, being equal to 17,9 % of the group's international assets at 31 December 1994. To comply with Decision 95/547/EC it still had to dispose of assets of FRF 174 billion in Europe by 31 December 1998.

In the plan presented by the French authorities in July 1997 the compensating measures which were to be taken to offset the aid additional to what the Commission had approved in 1995 fell far short of what was needed. The French authorities proposed to sell off 'those subsidiaries of CL the bulk of whose business is in retail banking outside France'. They also asked for a less stringent timetable than the one imposed by Decision 95/547/EC, according to which all the sales of international assets required to offset the effects of the aid had to be carried out by 31 December 1998. They proposed that this deadline be put back to the year 2000, so that strategic disinvestment could take place over the entire duration of the plan. By letter dated 2 April 1998, Mr Van Miert informed Mr Strauss-Kahn that the Commission took the view that the conditions laid down in Decision 95/547/EC had to be complied with, and that all the compensating measures provided for in 1995 would have to be taken by the planned date in accordance with the Decision.

According to information supplied by CL, retail banking business in Europe outside France accounted for assets of FRF 438 billion, or about 45 % of CL's international assets and 70 % of its business in Europe outside France, as measured in terms of the balance sheet at 31 December 1994, which was the basis taken by the Commission for evaluating the compensating measures in the 1995 plan. In 1995 the French authorities undertook to ensure that 35 % of CL's international assets were disposed of, worth about FRF 335 billion; this was to consist essentially of sell-offs in retail banking in Europe. The new compensating measures which the French authorities proposed in July 1997 consequently amounted to at best 30 % more than those of 1995, being the percentage corresponding to the difference of about FRF 100 billion between the previous level of asset sales (FRF 335 billion) and the new one as estimated on the basis of the July 1997 plan (total sales of FRF 438 billion), whereas the total amount of aid to CL, on the higher assumptions outlined above, was over three times greater than the volume approved in 1995. In addition, the French authorities left some doubt as to what was meant by the expression 'those subsidiaries of CL the bulk of whose business is in retail banking outside France': in particular, it was not clear whether they intended this undertaking to include CL Belgium, which with total assets of FRF 70 billion at the end of 1997 was CL's main subsidiary in Europe apart from BfG. If CL Belgium was not included, the new *quid pro quo* to offset the increase in aid was practically non-existent, and would amount only to a few tens of billions in retail banking in Europe.

In the July 1997 plan the French authorities indicated that the deadline for the main compensating measure offered, namely the sale of BfG, which alone accounted for almost FRF 220 billion ([45]), might possibly be changed. CL has a stake of 50 % plus one share in BfG. The other shareholders are Aachener & Münchener, the second-largest insurance group in Germany, which holds 25 % plus one share, and a trade-union-owned financial services company, which holds 25 % minus two shares. When CL acquired its majority holding in BfG it gave the other shareholders an option to sell their holding at a price set in advance, an option they could exercise up to the end of 1999, and it guaranteed payment of a minimum level of dividends. BfG's profitability has been poor; following the replacement of its managers, restructuring measures were taken at the end of 1997, the main objective of which was to preserve its margins despite an expected fall in its net receipts from banking. These measures seem already to have borne fruit, as its profits improved in 1997. BfG represents about 35 % of CL's assets in Europe outside France (as defined at the end of 1994), so that its sale would be a compensating measure which made a very important contribution to reducing the size of the group. But in view of these uncertainties it was not clear that when the plan expired at the end of the year 2000 the compensating measures to offset the aid granted under the 1995 and 1997 plans would have been taken.

([45]) As in the case of the other compensating measures this figure is expressed on the basis of CL's balance sheet at 31. 12. 1994.

In view of the considerable increase in the volume of aid, the Commission could not approve the plan submitted in July 1997 on the basis of so loose a timetable and so small an increase in the *quid pro quo*.

The Commission has examined other possible criteria for assessing and defining the *quid pro quo* required of CL under this Decision, but has concluded that now as in 1995 the most reliable criterion for determining the nature and scale of the main steps required is a sale of assets such as subsidiaries or branches, or equivalent closures; this would mean a reduction in the balance sheet and in CL's effective commercial operations.

The Commission considers that in the common interest the main compensating measures offsetting the planned aid to CL should be taken in Europe, whether in wholesale or retail banking, because it is in these lines of business that CL competes most directly with other banks in the Community, including other French banks who wish to expand their activities in Europe. A large proportion of CL's capital dealings inside the Community is with its subsidiaries and branches. It will be remembered that during CL's rapid expansion at the end of the 1980s and into the early 1990s its growth strategy hinged on its international network, and especially the network it was building up in Europe. Thus its European banking network plays a central role in the distortion of trade caused by the granting of State aid.

Given the unparalleled scale of the aid involved, the Commission takes the view that all of CL's activities in Europe outside France should be sold off: this would amount to FRF 620 billion on the basis of CL's balance sheet at 31 December 1994, the reference date. Decision 95/547/EC already required compensating measures to be taken in Europe worth FRF 310 billion, equal to 50 % of CL's European assets, so that CL would now have to dispose of further assets worth another FRF 310 billion (like the compensating measures required by Decision 95/547/95, these would be identified on the basis of CL's balance sheet at 31 December 1994). In his letter to Mr Strauss-Kahn on 2 April, Mr Van Miert accepted that out of this FRF 310 billion figure assets of about FRF 80 billion could be disposed of outside Europe, for example in North America or Asia, but said that a *quid pro quo* on this scale was indispensable if the aid to CL was to be declared compatible with the Treaty.

In this valuation of the sales of international assets to be required as a *quid pro quo* to offset the aid, the Commission has arrived at a figure lower than that which would have been produced by:

— observing strict proportion to the *quid pro quo* required in 1995; assuming the high value for the estimated aid, this would have called for more far-reaching compensating measures;

— the rough estimate of the theoretical distortion of competition, based on the bank's solvency ratio constraint, which, if the amount of aid exceeded CL's own funds, would mean the distortion of competition would exceed CL's balance sheet total.

The Commission takes the view that the level of compensating measures described above is an incompressible minimum if the aid is to be declared compatible with the common market. The *quid pro quo* thus defined is nevertheless a substantial one, and will reduce the distortion of competition very significantly.

*Table 19:*

**Compensating measures: sale or closure of international assets**

| Compensating measures | Value on balance sheet at 31. 12. 1997 (FRF billion) |
|---|---|
| 1. **Compensating measures Europe 1995** | 310 |
| Already carried out (end 1997): | 136,1 |
| Woodchester | 15,9 |
| Credito Bergamasco (+CLIAM Italy) | 41,0 |
| Crédit Lyonnais Greece | n.s. |
| CL Bank Sverige | 0,5 |
| BPI | 0,6 |
| Iberagentes | 0,1 |
| CL Bank Netherlands | 76,6 |
| Bankhaus Wölbern | 1,5 |
| Still to be carried out in Europe under 1995 Decision | 173,9 |
| 2. **New compensating measures called for** [1] | 310 |

[1] Including FRF 12,4 billion in Latin America; other sales in Latin America are required by the 1995 Decision.

Société Générale (see section 5.1) has submitted that the Commission ought to require the sale of all CL's foreign assets and part of its business and network in France; the Commission cannot accept this. If that course were to be followed, CL would not be viable at the end of the restructuring process. The Commission is of the opinion that the distortion of competition observed can be very significantly reduced by compensating measures on the scale specified here, without the need to resort to so extreme a solution.

Meetings between the Commission and the French authorities took place at the beginning of May 1998, and on 3 and 13 May Mr Strauss-Kahn sent Mr Van Miert letters setting out the new compensating measures that France was prepared to propose with a view to this Decision. The measures related to Europe and to the rest of the world, and took the form of sales or closures of subsidiaries or branches:

— closures and sales in Europe amounting to FRF 556 billion, made up of FRF 529 billion outside France and FRF 27 billion in sales inside France (not including the branch network), and

— closures and sales in the rest of the world comprising assets worth FRF 64 billion.

The French authorities provided a confidential list of these undertakings by letter to Mr Van Miert dated 13 May.

The bulk of the sales linked to the additional aid is to be completed by the time CL is privatized, that is to say by 1 October 1999. Sales which have not taken place by then, as a result of market factors duly substantiated and acknowledged by the Commission, will in any event be completed before October 2000.

Closures of branches or subsidiaries, like sales of assets, have the effect of reducing CL's commercial presence, and can be accepted as compensating measures. In total, CL would be complying with the figure of FRF 620 billion in sales or closures called for by the Commission (FRF 645 billion including an additional FRF 25 billion in the rest of the world provided for in 1995). Together with the compensating measures to be taken under Decision 95/547/EC, this *quid pro quo* would reduce CL's balance sheet as it stood at 31 December 1994 by more than one third. The closures and sales would free market shares which could be taken up by CL's competitors. Of the total compensating measures in this form proposed in 1995 and 1998, 86 % of the Government's undertakings relate to Europe, including 82 % outside France, which is in line with the common interest.

Subject to the other factors that have to be considered in this Decision, then, the Commission is of the opinion that the *quid pro quo* proposed by the French authorities will allow the distortion caused by the aid to be reduced very significantly.

*(c) Additional compensating measures relating to the network of branches in France*

This aid comes in addition to what was approved before, and the amount of aid involved this time is potentially very much greater than the amount approved in 1995; so that CL must be asked to make a further effort in respect of its network in France, in order to free market share for its competitors in France, which are affected particularly badly by the distortion of competition caused by the aid. On the basis of information supplied by CL to the Commission's consulting bank, the plan presented in July 1997 called for a reduction in the number of outlets in France to 2 146 in the year 2000 (all branches included; personal, business and corporate functions alike); this was a reduction of 6,6 % by comparison with the number of outlets in 1996. In his letter to Mr Strauss-Kahn of 2 April, Mr Van Miert asked for a further effort on CL's part, to reduce the number of outlets in France to 1 850 by the year 2000, which the Commission's consulting bank judged compatible with the requirement that CL be viable. This further reduction of about 300 outlets is a substantial *quid pro quo* to compensate CL's competitors, and would mean that CL's French network would have been reduced by about 20 % by comparison with 1996.

The Commission has taken note of comments submitted by Société Générale in the course of these proceedings (see section 5.1) according to which some measures that would increase CL's profitability and improve its competitiveness cannot be considered to offset the distorting effect of the aid. The Commission would point out that the additional compensating measures now being asked of CL, especially with respect to its network in France but also with respect to its international business, go far beyond the restructuring measures which CL projected in the July 1997 plan.

In his letter of 3 May to Mr Van Miert, Mr Strauss-Kahn undertook to reduce the number of branches in France to 1 850, as the Commission had asked.

On this basis the Commission is of the opinion that the compensating measures to be taken in France, in addition to the planned FRF 27 billion in the form of asset sales, should encompass all the group's branches in France (personal, business and corporate banking alike). By re-

ducing CL's commercial presence they will provide a very significant *quid pro quo* to compensate CL's competitors, both French and European, by allowing them to develop their business on the French market. The closures are to take place by 31 December 2000.

10.6 **The restraining mechanism**

The better fortunes clause which the French authorities introduced in 1995 tends to restrain CL's growth by acting as a drain on its profits, and hence its own funds, given the solvency requirement already discussed. In the plan submitted in July 1997 the French authorities indicated that they proposed to reconsider the clause, and envisaged replacing it with an alternative that they did not specify at that time. In their letter of 31 March 1998 they proposed that CL be allowed to redeem the clause in exchange for a share issue reserved to the State.

The Commission acknowledges that maintaining a better fortunes clause which apportions up to 60 % of CL's profits to the State until the year 2014, at a time when CL is due to be privatized, is difficult to reconcile with the requirements of the new private shareholders. But in order to minimize the cost to the State and the amount of aid, CL should buy back the clause at a market price, on the basis of an independent valuation, so that the State receives the discounted value of the proceeds of the clause up to 2014, and the transaction does not comprise any further State aid to CL. The valuation is to be submitted to the Commission for its approval.

In May 1998 the French authorities also told the Commission that they wanted to change the mechanism of the loan from CL to EPFR, while maintaining the restraining effect at present exercised on CL by the interest rate carried by the loan (85 % of MMR). The French authorities proposed that, for the period 2000-2014, CL should convert into another form the current value of the disadvantage it suffers as a result of the low rate it collects on the EPFR loan, a value which the Commission has put at FRF 7,2 billion over the period 1997-2000 and has deducted from the total aid granted (see Table 15). This would be done by redrafting the better fortunes clause: the proportion of profits withdrawn would be increased in such a way that, given the increase in the value of the clause ([46]) and of the residual value of the State's holding in CL, the effect on the State's assets would be equal to the discounted value of the extra 15 % of MMR to be paid by EPFR on the outstanding portion of the loan from CL; this discounted value would be about FRF 5,5 billion for the period 2000-2014, according to the Commission's figures.

The better fortunes clause, whose value would now have increased, would then be redeemed by CL by means of a share issue reserved to the State, to be subscribed by EPFR. EPFR would sell these shares in the course of the privatization process, so that the effect on the State's assets of the two transactions — the change in the value of the clause and the sale of the clause — would at worst be neutral, given that the State would have foregone the 15 % of MMR interest concession on the loan to EPFR and would have lost its revenues under the better fortunes clause. On this basis the State aid to CL, after deduction of the proceeds of privatization, would not be affected by the changes to the hive-off mechanism.

Alongside this transaction, in order to maintain the restraining effect on CL, the French authorities have given the following undertakings:

(i) 58 % of CL's net profits up to and including 2003 will be distributed as dividends;

(ii) the carryover of losses for tax purposes will come to an end as soon as the better fortunes clause is redeemed;

(iii) the growth in CL's consolidated balance sheet, assuming constant consolidation limits and exchange rates, will be subject to a ceiling of 3,2 % per annum between the end of 1998 and the end of 2001, and until 2014 its solvency ratios will be maintained at no less than their level at the end of 2001 ([47]), save in exceptional circumstances duly substantiated to the Commission and acknowledged by it.

The Commission can accept the overall mechanism for increasing the rate of servicing of the loan from 85 % of MMR to 100 % from 2000 to 2014, the change in the drafting of the clause, the sale of the clause, and the alternative mechanism for restraining CL's growth, provided that the following conditions are satisfied:

— the estimate of the discounted value of the refinancing burden on CL as a result of its loan to EPFR at 15 % below the money market rate from 2000 to 2014, the redrafting of the clause, and the value put on the clause are to be based on a valuation by an independent valuer;

([46]) The value of the clause would increase as a result of two factors: the improvement of CL's profits by 15 % of MMR on the outstanding portion of the loan, and the change in the volume of profits withdrawn under the clause.

([47]) The Commission interprets this undertaking as referring to the ratio of tier-one own funds and the Cooke solvency ratio.

— the valuer's report is to be forwarded to the Commission, which must approve its conclusions before any change in the value of the clause and before the planned issue of shares in CL reserved for the State;

— the Commission may oppose the operation if it takes the view that the better fortunes clause and the refinancing burden on CL are not being given their full values, so that new aid components may be appearing.

Provided it can satisfy itself fully on these points, the Commission can conclude that the restraining mechanism does not comprise any additional aid component, and that it will continue to act as an appreciable restraint on CL beyond the end of the restructuring plan.

10.7 **Privatization undertakings given by the French authorities**

In conjunction with its examination of the compatibility of the aid at issue, the Commission takes note of the undertakings given by the Government with respect to the privatization of CL, following on from the objectives set when Decision 95/547/EC was adopted. In a letter dated 13 May 1998, the Minister for Economic, Financial and Industrial Affairs undertook to privatize CL by the end of October 1999 in accordance with an open, transparent and non-discriminatory procedure. The State would lose any role as lead shareholder, and its holding would fall to less than 10 % of the capital. A privatization order would be made by the end of 1998, and the sell-off would begin on 1 March 1999.

The Commission takes note of these undertakings, and recalls the general principles it applies in cases of privatization in order to determine whether there is any element of State aid, principles it set out in its *Twenty-third Report on Competition Policy* (1993) ([48]). It considers that the privatization ought to put an end to the problem of corporate governance pointed out earlier, and ensure that, in future, CL turns to its private shareholders and to the market for any additional resources it may need.

10.8 **Other conditions to be complied with if the aid is to be compatible**

(i) The Commission emphasizes that the sales of subsidiaries and branches must be such as to reduce the scope of CL's consolidated accounts net of previous sell-offs, and must be irrevocable. They must be carried out in accordance with transparent procedures which are open to any potential buyer, French or foreign. The conditions must not include any clause which might impose unacceptable limitations on the number of potential candidates or which is tailored to one or other potential candidate. The choice of buyer must be made with a view to maximizing revenue from the sale. The proceeds of the sale must be used entirely for the financing of CL's restructuring plan.

(ii) *Compliance with this Decision*

(a) The French authorities are to submit a progress report every three months until 31 December 2000. The report is to give a detailed account of the sales and closures agreed in connection with this Decision, showing the date of the sale, the book value of the assets at 1994, the price paid, and any capital gain or loss. The first such report is to be submitted on 1 October 1998. Subsequent reports will be due on 1 January 1999, 1 April 1999, 1 July 1999, and so on. The three-monthly progress reports for the year 1999 are to provide a precise account of the progress of privatization.

(b) CL's six-monthly and annual reports are to be supplied to the Commission immediately they are approved by the board of directors of the bank, together with a review of progress with the bank's business plan.

(c) The Commission is to have unlimited access to information. It may with the consent of the French authorities seek explanations and clarification from CL direct. The French authorities and CL are to lend their full cooperation in any enquiries that may be requested by the Commission or by a consultant acting for it.

(d) The Commission is to be kept constantly informed of the steps taken to privatize CL. The authorities are to send it in advance any information which might help to establish that the privatization is being carried out in accordance with open, transparent and non-discriminatory procedures. The Commission will examine the procedures in the light of the privatization principles already referred to.

(iii) *Decision 95/547/EC*

The French authorities are to comply with the undertakings set out in Article 4 of Decision 95/547/EC until the end of the hive-off operation.

([48]) *Twenty-third Report on Competition Policy,* point 403. The principles to which the Commission refers in order to determine whether a privatization comprises State aid had earlier been indicated to the French authorities in a letter from the Commission's Director-General for Competition dated 14 July 1993.

## 11. CONCLUSIONS

### 11.1 Compatibility of the aid additional to the aid already approved

The Commission concludes that the measures considered in these proceedings in respect of the increase in CDR's losses and EPFR's carrying costs, and the abandonment of the requirement that CL finance the subscription of a zero-coupon issue by EPFR, comprise aid additional to the aid authorized by Commission Decision 95/547/EC, which amounted to FRF 45 billion, and the Commission Decision of 25 September 1996, which amounted to FRF 4 billion. The Commission estimates the additional aid at FRF 53-98 billion, discounted ([49]).

The Commission accordingly concludes as follows:

(i) The restructuring plan submitted by the French authorities has shown that CL can be viable. This is confirmed by the conclusions of the Commission's consulting bank and by the new business plan submitted by the French authorities in May 1998.

(ii) Despite its unparalleled volume, the aid is confined to what is strictly necessary for the viability of CL, provided that the neutralization of the EPFR loan is confined to the period 1997-99.

(iii) The very far-reaching programme of sales and closures to which the French authorities have committed themselves and the fact that the aid is confined to what is strictly necessary mean that CL will be financing a substantial proportion of the restructuring plan to the maximum extent allowed by the resources available to it.

(iv) The French authorities have put forward compensating measures concerning which it can be concluded, first of all, that CL will be reducing its commercial presence considerably, in the common interest, so that its balance sheet at the end of the restructuring plan will have been reduced by one third by comparison with 31 December 1994; and second, that the compensating measures linked to the additional aid, consisting of further closures and sales of assets worth FRF 310 billion and the reduction of CL's network of branches in France to 1 850 in the year 2000, will prevent excessive distortion of competition.

(v) An equivalent restraining mechanism may be substituted for the burden of 15 % of the money market rate on the EPFR loan, and the drain on profits and own funds caused by the better fortunes clause, on condition that the change does not comprise any further aid to CL.

This set of undertakings was confirmed in three letters dated 13 May 1998.

The Commission can conclude, then, in accordance with the Community guidelines on State aid for rescuing and restructuring firms in difficulty, that provided the French authorities comply with the undertakings set out in Article 1(2) below, and with the conditions the Commission imposes in Article 1(3), the additional aid qualifies for exemption under the beginning of the first sentence in Article 92(3)(c) of the Treaty, and is compatible with the common market.

### 11.2 Aid authorized by Commission Decision 95/547/EC

The aid which the Commission authorized in Decision 95/547/EC continues to be compatible with the Treaty, always provided the French authorities and CL comply fully with the obligations imposed by that Decision, except where a change is authorized in this Decision.

The Commission would point out in particular that Decision 95/547/EC requires the French authorities and CL to ensure that the *quid pro quo* provided for in the Decision is fully implemented, that is to say that CL's commercial presence outside France is reduced by 35 % in balance sheet terms, equal to 50% of its assets in Europe outside France. The reduction is to be assessed in proportion to the proportion of CL's total assets accounted for by the asset on 31 December 1994, and is to be complete by 31 December 1998,

HAS ADOPTED THIS DECISION:

*Article 1*

(1) The measures submitted to the Commission in September 1996 and the measures in the Crédit Lyonnais restructuring plan which was laid before the Commission in July 1997, taking the form of a neutralization of the loan to EPFR, a decision not to proceed with the zero-coupon bond, and the coverage by the State of additional losses made by CDR and EPFR, as amended by the French authorities in accordance with this Decision, constitute State aid caught by Article 92(1) of the EC Treaty and Article 61(1) of the EEA Agreement. The aid, which is additional to the aid authorized by the Commission in Decision 95/547/EC and the Commission decision of 25 September 1996, has a value between FRF 53 and 98 billion. This additional aid may be declared

([49]) See Table 15.

compatible with the common market under Article 92(3)(c) of the EC Treaty and with the EEA Agreement under Article 61(3)(c) of the Agreement, provided that France complies with the undertakings set out in paragraph 2 and the conditions set out in paragraph 3.

(2) France gives the following undertakings:

(a) France undertakes to transfer Crédit Lyonnais to the private sector no later than October 1999, in accordance with an open, transparent and non-discriminatory procedure. The process can begin in 1998, when a privatization order will be made, and will take place in several stages. It will in any event be launched before 1 March 1999. The State's holding in the capital of Crédit Lyonnais will be reduced to no more than 10 %, and the State will no longer be Crédit Lyonnais's lead shareholder.

(b) As a *quid pro quo* to offset the aid, Crédit Lyonnais will sell off or liquidate assets worth FRF 620 billion on its balance sheet at 31 December 1994. The reduction will be spread over the whole of its assets in Europe outside France, with the exception in particular of its business in London, Luxembourg, Frankfurt and Switzerland. Crédit Lyonnais will be entitled to manage accounts for the purpose of supplying payment and disbursement services in the euro zone. The preservation of these strategic businesses will be offset by other assets in France and in the world. This undertaking supplements the undertaking given on 18 July 1995, which called for a worldwide reduction of 35 %, equivalent to 50 % in Europe; that undertaking is confirmed. The balance of those sales is to be completed by 31 December 1998. The worldwide reduction of FRF 620 billion must have taken place by the time of privatization. Either or both of these dates may be postponed by a year as a result of market factors duly substantiated to the Commission.

(c) Crédit Lyonnais will reduce its network in France, which will not exceed 1 850 commercial outlets in the year 2000 for the parent company and its retail banking subsidiaries. This number includes outlets for personal, business and corporate customers.

(d) To ensure successful privatization within the time allowed, the better fortunes clause and the effect of the partial neutralization of the loan after 1999 will be valued by an independent valuer, and sold to the market indirectly via an issue of Crédit Lyonnais shares to be subscribed by EPFR, which will then sell them in the course of the privatization process. Before the share issue the valuation will be forwarded to the Commission.

(e) In order to maintain the restraining effects on Crédit Lyonnais's growth potential of the better fortunes clause and of the difference in rates of interest on the loan to EPFR, and to ensure that Crédit Lyonnais's development is controlled by comparison with those of its competitors, (i) 58 % of its net profits up to and including the financial year 2003 will be distributed as dividends; (ii) the carryover of losses for tax purposes will come to an end as soon as the better fortunes clause is redeemed; (iii) the growth in its consolidated balance sheet, at constant consolidation limits and constant exchange rates, will be subject to a ceiling of 3,2 % per annum between the end of 1998 and the end of 2001, and until 2014 its solvency ratios will be maintained at no less than their level at the end of 2001, save in exceptional circumstances duly substantiated to the Commission and acknowledged by it.

(f) The performance of all the undertakings set out in points (a) to (e) may be verified by an independent expert each year until the completion of the asset sales. The French authorities will send the Commission a quarterly progress report and a detailed six-monthly report on the application of the plan.

France has sent the Commission a confidential list of the sales and closures referred to in point (b), by letter dated 13 May 1998.

(3) To ensure that the aid is compatible with the common market the French Government shall ensure that the following conditions are complied with:

(a) Implementation

All the undertakings and other measures provided for in this Decision and the measures provided for in Decision 95/547/EC which have not been changed in this Decision must be implemented; they may not be changed without the Commission's prior consent.

(b) Procedure for the sale of assets

Sales of Crédit Lyonnais subsidiaries and branches shall be such as to reduce the scope of Crédit Lyonnais's consolidated accounts net of previous sell-offs, and shall be irrevocable. They shall be carried out in accordance with transparent procedures which are open to any potential buyer, French or foreign. The conditions may not include any clause which might impose unacceptable limitations on the number of potential candidates or which is tailored to one or other potential candidate. The choice of buyers shall be made with a view to maximizing revenue from the sale. The proceeds of the sale shall be used entirely to finance Crédit Lyonnais's restructuring plan.

(c) Redefinition and operation of the mechanism to restrain Crédit Lyonnais

The valuation of the discounted value of the burden of refinancing on Crédit Lyonnais from 2000 to 2014 in respect of the loan it has given EPFR at 15 % below the money market rate, the redrafting of the better fortunes clause, and the valuation of the clause shall be carried out by an independent valuer; the valuer's report shall be forwarded to the Commission, and the Commission must approve its conclusions before any change in the value of the clause and before Crédit Lyonnais issues the shares reserved for the State.

(d) Monitoring of this Decision

(i) The French authorities shall submit a progress report every three months until 31 December 2000. The report shall give a detailed account of the sales and closures agreed in connection with this Decision, showing the date of the sale, the book value of the assets at 31 December 1994, the price paid, and any capital gain or loss. The first report shall be due on 1 October 1998. The subsequent deadlines shall be 1 January 1999, 1 April 1999 and 1 July 1999.

(ii) Crédit Lyonnais's six-monthly and annual reports shall be sent to the Commission immediately they are approved by the board of directors of the bank, along with a review of progress with the bank's business plan.

(iii) The Commission shall have unrestricted access to information throughout the duration of the plan. It may with the consent of the French authorities seek explanations and clarification from Crédit Lyonnais direct. The French authorities and Crédit Lyonnais shall lend their full cooperation in any enquiries that may be requested by the Commission or by a consultant acting for it.

(iv) The Commission shall be kept constantly informed of the steps taken to privatize Crédit Lyonnais. The authorities shall send it in advance any information which might help to establish that the privatization is being carried out in accordance with open, transparent and non-discriminatory procedures.

(v) Any postponement of the dates of sales and closures to be carried out in accordance with the mechanisms set out above in the undertakings of the French authorities at point 2(b) in this Article must have been approved in advance by the Commission. These undertakings refer exclusively to the dates of sales and closures of assets, and leave unchanged the undertaking to privatize Crédit Lyonnais, which must have been completed in any event by October 1999 at the latest.

(e) Decision 95/547/EC

The French authorities shall comply with the undertakings in Article 4 of Decision 95/547/EC until the end of the hive-off operation.

*Article 2*

Within two months of the date of notification of this Decision, France shall inform the Commission of the measures taken to comply with it.

*Article 3*

This Decision is addressed to the French Republic.

Done at Brussels, 20 May 1998.

*For the Commission*

Karel VAN MIERT

*Member of the Commission*