II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION
of 23 June 1999
conditionally approving aid granted by France to Crédit Foncier de France

(notified under document number C(1999) 2035)

(Only the French text is authentic)

(Text with EEA relevance)

(2001/89/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular, Articles 87 and 88 thereof,

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

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

Whereas:

1. PROCEDURE

(1) By letter of 2 February 1996 the Commission requested information from the French authorities concerning the provision of an overdraft facility of some FRF 20 to 25 billion, via Caisse des Dépôts et Consignations (CDC), to meet the liquidity requirements of the specialist financial institution Crédit Foncier de France (CFF). The French authorities replied by letters of 29 February and 21 March 1996, in which they supplied some of the documentation requested and informed the Commission that the new Governor of CFF would shortly be putting forward a plan for restructuring the bank.

(2) By letter of 17 April 1996 the Commission asked the French authorities to provide the information it needed in order to complete its analysis of the public support measures for the bank. On 29 April the Minister for Economic Affairs and Finance released a statement to the press announcing support for the ailing bank and committing the Government to guaranteeing CFF's debts and restoring its solvency ratio.

(3) Taking the view that some of the planned measures for supporting CFF were liable to involve State aid within the meaning of Article 87(1) of the EC Treaty and could not, at that stage and on the basis of the information then available, be declared compatible with the common market, the Commission on 3 July 1996 initiated the procedure provided for in Article 88(2) of the EC Treaty and requested the French authorities to provide further clarifications concerning the planned aid measures.

(4) The solution to CFF's problems initially envisaged by the French authorities was based on implementation of a recovery plan, whereby the group was to reorganise and refocus its activities on medium- and long-term property lending, and on a link-up with a partner. Thanks to its credit rating, the new shareholder was to have enabled the cost of refinancing to be reduced and the bank's own funds to be restored. After the appointment of a new Governor, the bank began pursuing a resolute policy of asset disposals and divestment of non-strategic interests. An agreement was negotiated and concluded with the trade unions enabling a plan to be launched which involved 600 voluntary departures with a view to reducing CFF's workforce to 2 400 by the end of 1997.

[1] OJ C 275, 20.9.1996, p. 2.

(5) Since the initial efforts to find a buyer were not successful, the French authorities decided to nationalise CFF in order to facilitate a link-up. The plan adopted by the French Government along with its decision to nationalise CFF, called the 'Arthuis plan' and communicated to the Commission on 26 July 1996, provided for CFF to be subsequently wound up and a public institution, Caisse Nationale du Crédit Foncier de France (CNCF), created. Crédit Immobilier de France (CIF) was to have taken over CFF's branches and management of its portfolio of outstanding loans as well as some of its staff. CNCF was to have received a capital grant of FRF 2,5 to 2,6 billion from the Government in order to acquire all the mortgage bonds taken over by CDC and would have been responsible for underwriting CFF's debts and recovering its property loans with a view to winding up CFF in the long term (over a period of around ten years). Following the announcement on 9 September 1996 of a takeover bid by Caisse des Dépôts et Consignations (CDC) on behalf of the Government, CDC then controlled 90,6 % of CFF's capital, the remainder being held by the savings scheme for CFF staff (1,3 %), the pension fund for CFF staff (1,2 %) and other shareholders (6,9 %). Faced with stiff opposition to CIF among CFF staff, the plan was then abandoned by the new Government that had been in office since June 1996, which instead planned simply to sell off CFF.

(6) Not having received all the information requested, the Commission sent the French authorities a reminder by letter of 9 July 1997. The French Finance Minister replied on 17 October 1997, informing the Commission that the task of finding a reference shareholder had been entrusted by CFF, in agreement with the Government, to the bank Deutsche Morgan Grenfell, which had prepared a presentation dossier and sent letters and presentation memos to potentially interested candidates that had at least FRF 10 billion in consolidated own funds. Offers were to involve the shares in CFF held by CDC and were preferably to cover the whole of the CFF group, but it was also possible to submit partial offers or joint offers with third parties where this would still result in privatisation. By letter of 21 November 1997 the Commission asked for information on the procedure for finding a partner that had been announced, and in particular the report drawn up by Deutsche Morgan Grenfell. The Commission received that report on 18 December 1997 and in the light of its analysis asked for further information by letter of 26 January 1998 concerning any other possible government support for CFF as part of the sell-off.

(7) According to press reports, several candidates interested in CFF's commercial network came forward (the names mentioned are GE Capital, the Azur-GMF group, the French Post Office, the French savings banks and the US companies General Electric and General Motors). In particular, the solution apparently preferred was to set up a pool with minority holdings in CFF's capital around an industrial operator with an excellent credit rating. The group's financial documents were made available for consultation to the most serious candidates from 19 January to 30 April 1998. In September 1998, after several months of negotiation, the French Government broke off discussions with the sole candidate for taking over CFF, the US consortium GMAC-Bass. The reason for the failure of negotiations was GMAC-Bass' unwillingness to commit itself to taking over the whole of CFF and the extent of the guarantees it was demanding. According to the press, GMAC-Bass feared that, if it were to take over CFF's entire balance sheet (amounting at that stage to around FRF 310 billion) without any government guarantee, its own rating would be downgraded by the rating agencies. GMAC-Bass therefore requested the French Government to split CFF's balance sheet in two and to keep for itself all the outstanding liabilities covered by a public guarantee.

(8) Following the failure of discussions with GMAC-Bass for the takeover of CFF, the French Government notified the Commission by letter of 18 September 1998 that it was initiating a fresh procedure with a view to finding a definitive solution for CFF. The new plan under consideration, which was notified to the Commission by letter of 24 December 1998 and communicated in full with all the technical annexes on 23 March 1999, was a three-stage operation: financial restructuring, recapitalisation by the Government via CDC and initiation of a new procedure for linking CFF to a partner.

(9) On 24 March 1999 the French Government announced that it was recapitalising CFF by a maximum of FRF 1,85 billion via a shareholder's advance from CDC, bearing interest at a short-term market rate. The French authorities also stated that they intended to link CFF to a partner before the end of 1999. In particular, the Director of the Treasury announced by letter of 11 May 1999 that CDC would dispose of its interest in CFF (90,5 % of the capital and the shareholder's advance of FRF 1,85 billion) through an open, transparent and non-discriminatory procedure with bidding specifications.

2. **DESCRIPTION**

2.1. **Crédit Foncier de France**

(10) Crédit Foncier de France (CFF) is a medium-sized financial group. At the end of 1994 it had a balance-sheet total of FRF 377 billion and a staff of 3 400. The group was made up of 52 companies active in the spheres of finance, low-cost housing and property development. It had a national network of 145 permanent or temporary sales outlets as well as subsidiaries in France and abroad (United Kingdom, Spain, Italy and the Netherlands).

(11) CFF is a specialist financial institution within the meaning of the 1984 Banking Act. As such it is responsible for carrying out various activities which are regarded by the French authorities as public-service tasks, for example the distribution of certain loans for building low-cost housing (PLA — prêts locatifs aidés),

the organisation of the mortgage market and the payment of premiums under housing savings contracts to credit institutions. Its main public-service task was the distribution of subsidised loans for the purchase of a main residence (PAP — prêts pour l'accession à la propriété). The Government paid CFF grants enabling it to offer loans at preferential rates. CFF accounted for 75 % of the distribution and 100 % of the financing of these loans. This task was discontinued from 1 October 1995 when home-ownership funding was completely reformed.

(12) Following the French Government's decision in October 1995 that no more new PAP loans were to be granted and the reform of the PLA loans system in October 1996, total turnover in subsidised loans fell (–85 % over the period 1994 to 1996). CFF still has to manage the stock of outstanding subsidised loans, which is shrinking as loans are reimbursed (scheduled or early repayments). CFF's competitive activity, which is generally more profitable but riskier, used to be limited but has become increasingly important in recent years as a means of counterbalancing the decline in the institution's public-service tasks.

(13) Up to 1994 the bulk of CFF's capital (59 %) was widely dispersed among private investors, with the remainder being controlled by a group of national institutional shareholders (such as Caisse des Dépôts et Consignations, Assurances Générales de France and others, with approximately 15 % of the capital) and foreign institutions (UBS Asset Management, Templeton Global Investors and others, with around 22 % of the capital). CFF staff held approximately 3 % of the capital. CFF was nevertheless controlled by the Government, which appoints its Governor and Deputy Governors. The Government is also represented at the annual meeting of shareholders and appoints one of three auditors who have the task of ensuring that the articles of association are strictly applied; it is also represented by a deputy Government commissioner. By virtue of its legal status, CFF is subject to public supervision in addition to the usual checks carried out on limited companies that issue securities and on credit institutions.

2.2. **Description of the Government intervention**

(14) Unlike the commercial banks, CFF has no traditional deposit-taking activity and raises funds by issuing bonds on the domestic and international markets which are assigned a rating by the major international rating agencies. The recession on the property market in the 1990s, abolition of the PAP subsidised loans, over which CFF had a near-monopoly, and, above all, CFF's recorded or anticipated losses caused its long-term ratings to be downgraded by Moody's to Baa1 and by Standard & Poor's (S & P) to A1 [2], increasing the cost of its borrowing to the point where it was impossible for it to tap the capital markets without compromising its profitability.

(15) In early 1996 CFF was refinanced by means of an overdraft facility of FRF 20 billion, which could be increased to FRF 25 billion, granted by CDC for a period of 18 months to enable it to overcome its liquidity crisis. The accounts for 1995 showed a huge loss (FRF 10,8 billion) due to provisions of FRF 13,6 billion linked largely to a poorly conducted policy towards lending in the competitive property sector and insufficiently strict monitoring of the risks involved. The group's own funds were negative to the tune of FRF 2,4 billion. The extraordinary general meeting of 28 June 1996 reduced the registered capital to FRF 943 billion by cutting the nominal value per share from FRF 200 to FRF 25.

(16) The statutory solvency ratio having fallen to 0,5 %, the institution's survival was safeguarded by the Government itself, which stepped in and guaranteed CFF's debt and future solvency. The aid measures contemplated by the French Government were as follows:

1. an overdraft facility of FRF 20 to 25 billion granted by Caisse des Dépôts et Consignations (wholly owned by the Government) for a period of 18 months;
2. a Government guarantee that all CFF debt represented by securities would be honoured in terms of principal and interest over the whole maturity range;
3. the Government's undertaking that every necessary step would be taken to ensure that CFF could continue to carry out its activities in accordance with the prudential rules in force.

3. **COMMENTS BY INTERESTED PARTIES**

(17) In the course of these proceedings, no comments were submitted to the Commission by other interested parties within the prescribed deadline.

4. **COMMENTS BY FRANCE**

(18) As regards the terms of the loan granted by CDC to CFF, the French authorities put forward several arguments aimed at demonstrating that the intervention was of a temporary and urgent nature and that the terms of the loan were dissuasive, given its limited duration and the fact that the interest rates were progressive.

[2] Standard & Poor's rating agency uses the following scale: AAA: the issuer's capacity to reimburse is extremely strong; AA: capacity is very strong; A: capacity is still strong but the issuer is susceptible to changes in economic conditions; BBB: capacity is adequate but with great sensitivity to changes in economic conditions; BB and B: speculative characteristics and uncertainty of payment; CCC, CC and C: doubtful claim; D: already in payment default. Moody's scale for investment grade risks is as follows: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2. The two scales are not comparable on a one-to-one basis.

(19) On the duration of the loan, the French authorities stressed that it was reimbursed definitively and in full eight months after it was granted. As regards the loan guarantees, the selection of loans to local authorities provided as collateral ([3]) to CDC was made up of loans with a maturity of more than two years and of good quality, i.e. free from any arrears or risks of dispute, amounting to FRF 27,8 billion. As far as the interest rate was concerned, the average effective margin was 31 basis points, rising from 27 basis points in February to 41 basis points in August; it was therefore higher than those observed on the interbank market.

(20) The French authorities argued that the undertaking given by the Minister for Economic Affairs and Finance on 29 April 1996 and reiterated in the statement of 26 July 1996, to the effect that all CFF's debt liabilities falling due would be honoured, did not have the same legal value as a genuine government guarantee. No details were given of the technical and legal arrangements and, even if there had been a formal government guarantee, such an undertaking would have had to be written into a finance bill. The Minister's declaration was therefore, according to the French authorities, rather a political commitment to monitor CFF's situation and to reassure the financial markets.

(21) The French authorities also stated that only some of the bond issues (i.e. foreign-currency loans issued prior to 1 January 1991) were covered by a formal government guarantee. A Government guarantee was granted during the 1970s in respect of loans issued by State-owned enterprises and specialist financial institutions in order to finance the balance of payments in a context of high inflation and exchange controls. The guarantee had been withdrawn by the French Government since 18 January 1991 in view of progress in controlling inflation and the greater stability of the French franc; loans issued by CFF after 18 January 1991 were therefore not covered by a formal guarantee provided by either the Government or a public institution.

(22) Lastly, with reference to Government guarantees for CFF's assets, the public guarantee covering its mortgage loans for housing purchases stems from an Act dated 31 December 1950: the conditions of the guarantee are determined by agreement between the Government and CFF under a procedure which ensures that the Government guarantee is limited to not more than 50 % of the value of the mortgaged property (60 % since 1991) and is exercised only if the net amount collected through foreclosure on a mortgage is insufficient to cover the sum normally payable by the debtor. Since 1991 the agreement also provides for 'incentive remuneration' of CFF for optimum operation of the subsidised loans guarantee fund.

(23) By letter of 16 April 1999 the Commission requested the French authorities to clarify the reasons that had prompted the supervisory authority, the Commission Bancaire, to refrain from requiring CFF promptly to restore its own funds to the appropriate level. The French authorities replied in their letter of 30 April 1999 that they were not aware of the grounds on which the decision of the Commission Bancaire was based, but they considered it likely that the supervisory authority had preferred the approach of looking actively for a buyer while restoring CFF's viability rather than putting it into liquidation.

5. ASSESSMENT OF THE AID MEASURES CONCERNED

5.1. Involvement of State aid in the measures concerned

(24) In its appraisal of financial assistance provided by Member States, the Commission applies the 'market economy investor principle', as set out in its communication on public undertakings ([4]). That communication states that aid is involved in an operation where a private investor, operating under normal market economy conditions, would not have undertaken it.

5.1.1. *The credit line provided by CDC*

(25) Under a protocol signed on 23 January 1996, CDC granted CFF, until 31 March 1997, an overdraft facility in the form of a renewable credit line, guaranteed through the assignment of loans granted to local authorities. The credit line of FRF 20 to 25 billion granted by CDC for a period of 18 months was used for an average amount of FRF 7,9 billion between 31 January and 30 August 1996, with a maximum drawing of FRF 12,4 billion made on 2 April 1996, the date on which it was reimbursed. As regards the terms on which this overdraft facility was granted, the average effective margin was 31 basis points compared with the reference interbank rate specified in the loan terms, rising from 27 basis points in February to 41 basis points in August 1996.

(26) The credit line was intended to maintain CFF's liquidity during a transitional phase in which it was unable to borrow on the financial markets on normal commercial terms. Since the beginning of 1996 and in the second week of January 1996, CFF's 10-year bond issues were quoted on the secondary market with a record yield gap of almost 200 basis points (i.e. two percentage points of interest) above the yields on Government issues of the same duration. Faced with the deterioration in CFF's financial situation, the Government, without being a direct shareholder and through CDC (a public credit institution which at the time had an interest of approximately 4 % in CFF), was alone in assisting CFF, the private shareholders refusing to provide any support at that stage.

([3]) By CFF as security for the loan.

([4]) Commission communication to the Member States on the application of Articles 92 and 93 of the EEC Treaty and of Article 5 of Commission Directive 80/723/EEC to public undertakings in the manufacturing sector (OJ C 307, 13.11.1993, p. 2).

(27) To determine whether the overdraft facility granted by CDC should be regarded as state aid, it has to be compared with other loans normally granted on the market by credit institutions. In particular, it has to be established whether:

(a) other private institutions would have granted it; and

(b) the terms on which the loan was granted (duration, interest rate and guarantees) were in line with those prevailing on the market.

In assessing these factors, account also has to be taken of the specific conditions in which the credit line was granted, and in particular the financial situation in which CFF found itself in early 1996.

(28) Looking at CFF's situation at that time, it should first be stressed that — given its dependence on the capital markets for financing its activities — CFF was also dependent, as regards determination of the rates at which it could borrow, on the assessments of its financial soundness made by the rating agencies. The rating agencies had begun to downgrade CFF's rating in 1993, but the situation deteriorated in 1995 when Moody's gave CFF a D rating, which indicates uncertain financial soundness. That rating was revised downwards in January 1996 (to E +) to indicate very uncertain financial soundness. By contrast, CFF's long-term rating, which is the most important since it takes account not only of financial soundness but also of any form of support or protection from other parties, in particular the public authorities, remained at a proportionately higher level (Baa1), which shows that the market was anticipating government support for CFF.

(29) The fact that an institution is under the dominant influence and protection of the government, as in the case of CFF, is reflected in the abnormal evolution of its rating. Although certain institutions may be in serious financial and economic difficulty, where the government retains some form of control over them the rating assigned to their borrowings does not deteriorate. To demonstrate this process, Moody's has developed a system of bank financial strength ratings which give an assessment of the stand-alone financial soundness of an institution, i.e. without any potential outside support ([5]). The evolution of CFF's ratings are highly indicative in this respect. Its bank financial strength was downgraded by Moody's between 30 August 1995 and 1 May 1996 from C + to E (the lowest possible rating) despite the French Government's intervention to support it between January and April 1996. By contrast, Moody's did not modify CFF's long-term debt rating, which it gave as Baa1 in early 1996, and confined itself to changing its forecast from negative to positive after the statements made by the Government at the end of April.

(30) As part of the procedure the Commission assessed the information provided by the French authorities, and in particular its comments on the duration of the overdraft facility, the interest rates applied and the guarantees required.

(31) The Commission found that CFF used the credit line for only eight months in view of the penalising terms on which it was granted, which deterred use of the credit over and above the minimum necessary through premiums on the basic rates that varied with the timing of drawings ([6]). CFF took advantage of this respite in order rapidly to find solutions to its debt problem on the market and to improve its asset-liability management. The loan therefore supported the ailing institution at a critical moment in its financial restructuring, for a limited period and in respect of a limited amount.

(32) As regards the collateral for the loan, the Commission requested additional information in order to enable it to check more effectively the soundness of the loans granted by CFF to local authorities and assigned as a guarantee to CDC. The Commission found that the total value of the claims provided as collateral exceeded the total amount of the loan granted by CDC ([7]) and that the claims assigned were exclusively loans to metropolitan local authorities with a maturity of more than two years and free from any arrears or risks of dispute.

(33) The guarantee offered to CDC is in line with usual banking practice and due diligence in concluding contracts. It is standard banking practice to require as collateral claims worth more than the amount loaned: the extra amount also comprises a further guarantee for the creditor to cover the statistical risk of incomplete fulfilment of the debtor's obligations. Furthermore, the greater the risks involved in the loan, the more the guarantees provided must be readily and surely realisable. Given their high quality, the assets assigned as collateral by CFF to CDC can be regarded as a proportionate guarantee, despite the particularly high risk normally attached to a loan to an institution in difficulty, as was CFF at that time.

(34) As far as the rates applied by CDC to the loan are concerned, the Commission notes that CFF had to pay a premium over and above the average French interbank market rate. That rate is reserved for intermediaries with the best risk rating. The extent of the spread determined in line with the risk of default by the borrower, the existence of penalties linked to the amounts drawn, and the duration of the credit line are factors to be taken into account in determining whether the contractual conditions linked to the rates applied to CFF can be regarded as consistent with banking practice or whether,

([5]) See the publication *Moody's assigns bank financial strength ratings to 540 banks*, Moody's, New York, September 1995.

([6]) On average, the rates applicable were as follows: TIOP (Paris average interbank offered rate) + 0,25 % for drawings before 3 June 1996; TIOP +0,40 % for drawings between 3 June and 1 October 1996; TIOP + 0,675 % for drawings between 1 October 1996 and 31 March 1997.

([7]) The net excess was FRF 27,8 billion at 31 December 1995, excluding doubtful claims and arrears, out of total outstanding claims of FRF 37,6 billion on that date.

on the contrary, they involve preferential treatment and could possibly not be accepted as compatible with the competition rules. In view of the fact that, as a result of the spread, the total cost to CFF was approximately FRF 2 billion more than it would have been if the interbank reference rate had been applied, and that the contractual terms of the loan comprised penalties designed to prevent the overdraft facility being turned *de facto* into long-term financing, the rate conditions applied to CFF can be regarded as being in line with banking practice.

(35) By way of conclusion, the Commission has found that the conditions attached to the credit line granted by CDC to CFF were in line with banking practice for a loan in a risk category similar to that of CFF in January 1996 and comprised penalties aimed at encouraging the institution quickly to find other less costly sources of finance or solutions to its liquidity imbalance at the earliest opportunity, in particular through the assignment of claims on its portfolio of loans to local authorities. On that basis, the overdraft facility does not constitute aid.

5.1.2. *The government guarantee covering CFF's debts*

(36) On 29 April 1996 the French authorities announced that CFF had recorded a loss of FRF 10,8 billion for 1995, which placed it in an extremely serious situation, with more than FRF 2 billion of negative own funds. In a statement issued on the same date, the Minister for Economic Affairs and Finance announced that the Government had given an assurance that all CFF debt represented by securities would be honoured in terms of principal and interest over the whole maturity range. At the time, the guarantee covered approximately FRF 260 billion of CFF borrowings.

(37) The guarantee was confirmed a few months later. In his statement of 26 July 1996 the Minister further indicated that 'the institution's situation has therefore prompted the Government to intervene, in accordance with the undertakings given on 29 April, in keeping with the interests of public finances, the employees of Crédit Foncier de France, the holders of shares and bonds issued by it and the Paris stock exchange'. Being addressed to the public, the Minister's statement was therefore intended to reassure CFF's counterparties, who were concerned about the serious financial difficulties of their debtor, as to the quality of its debt; since CFF was also highly active on international markets, those counterparties were largely foreign investors. Nevertheless, the statement by the Minister for Economic Affairs and Finance did not specify the duration of the guarantee, the amount covered or any remuneration required in return.

(38) On the grounds that the Government guarantee covering all of CFF's debt could constitute restructuring aid, the Commission requested further information on the public guarantees or any other Government protection enjoyed by CFF.

(39) The Commission has assessed the comments submitted by the French authorities concerning the guarantee covering CFF's liabilities, and it takes the view that the statement by the Minister cannot be regarded — as suggested by the French authorities — simply as a non-legally binding political commitment. The arguments put forward underestimate the considerable impact of a statement of this kind by a minister responsible for economic affairs and finance.

(40) Looking not merely at the aims but, as stressed by the Court of Justice, above all at the effects [8] of Government support measures, it can only be concluded that, by reassuring creditors as to the quality of their claims, the statement in question had the effect of averting demand for reimbursement of CFF securities during a serious liquidity crisis, at a time when the institution was unable to obtain finance on the market on normal terms. The Commission considers that it also had the following effects. Firstly, it avoided the need for CFF to use the credit line granted by CDC for extraordinary transactions resulting from possible demand for reimbursement of loans from creditors anxious at the bank's financial situation, which would have diverted funds away from measures to restore its economic and financial viability. Secondly, it enabled the bank's management to draw up and subsequently implement a restructuring plan from a long-term perspective given the security afforded by the Government support. Thirdly, it enabled CFF to obtain permission from the Commission Bancaire to continue in business despite having an inadequate solvency ratio.

(41) It should be stressed that the Commission Bancaire allowed CFF to operate for a long period with a solvency ratio well below that required under the Community prudential rules. Although the Government undertook to raise the ratio to the statutory minimum, effective public involvement was not announced until March 1999. It is highly likely that, in allowing CFF to continue in business outside the prudential rules, the Commission Bancaire did not consider the forthcoming recapitalisation by the Government to be adequate but had ascertained that, if CFF's difficulties were to worsen further, the Government guarantee announced by the Minister would be called upon.

[8] According to the Court of Justice, Article 87(1) of the Treaty does not distinguish between measures of state intervention by reference to their causes or aims but defines them in relation to their effects (see in particular its judgment of 26 September 1996 in Case C-241/94 *France* v *Commission* [1996] ECR I-4551).

(42) Indirect confirmation of the awkward position in which the Commission Bancaire was placed by the uncertainty surrounding recapitalisation of CFF by the Government is given by the fact that in 1997 the Commission Bancaire apparently invited CDC, which since the take-over bid in late 1996 held more than 90 % of CFF's capital, to recapitalise CFF so that it would comply with the prudential ratios. CDC is thought to have replied that its intervention in favour of CFF was limited to granting the overdraft facility and that it controlled CFF only on behalf of the Government, and it therefore refused to provide it with fresh resources that would give it the requisite own funds.

(43) Although the Government's pledge did not specify in formal terms the technical arrangements for its support, it was nevertheless followed by concrete steps to assist CFF by the Government, which formally took control of the bank via CDC. Following the statement issued on 29 April 1996 and confirmed on 26 July 1996, CDC, which had already granted the emergency loan to CFF in January 1996, bought on the market in October 1996 on behalf of the Government 90,6 % of CFF's capital for much more than the market price at the time: until the takeover bid was announced at a price of FRF 70 per share, CFF shares were being quoted at between FRF 29 and FRF 40, although it was known that a purchaser was being sought. The fact that the Treasury bank took control of CFF, albeit temporarily with a view to subsequently selling it off, therefore confirmed in the eyes of the public that the Government was determined to ensure its survival.

(44) The Commission takes the view that, although the statement issued by the Minister in April 1996 was not legally formalised, it nevertheless had substantial effects and should therefore be deemed equivalent to a guarantee and assessed in the light of the market economy investor principle as set out by the Commission in its communication to the Member States of 13 November 1993 ([9]).

(45) When the Commission applies the market economy investor principle to government guarantees, it has to assess the existence of aid by comparing the terms of the guarantee with those which the beneficiary would have obtained on the market at the time when the decision to support it was taken and which normally depend on the assessment of the beneficiary company's financial situation and future prospects. In particular, where Government support is provided by means of a guarantee, it has to be established whether it is not subject to specific conditions. Aid is involved, for example, where the guarantee covers a firm's debts and there are no quantitative or time limits on its use by the beneficiary and/or if the remuneration is not in line with conditions prevailing on the market for similar transactions.

(46) In the case in point the Commission notes that the Government guarantee was unlimited both in time and in terms of the amount involved, and that it was in no way remunerated. The Minister's general statement related to all the bank's liabilities represented by securities, without specifying the nature or amount of those liabilities; it did not make it clear, in particular, whether this meant only debt represented by a security or also other debts, for example subordinated debts.

(47) The guarantee that all CFF's debt liabilities falling due would be honoured could have covered different types of debt. If it related only to 'debt represented by a security' as shown on the 1995 balance sheet, it covered an amount of nearly FRF 268 billion; otherwise an extra FRF 9,2 billion in subordinated loans and securities would have to be included. However, on the basis of the clarifications provided by the French authorities concerning the existence of a system of statutory guarantees, in determining the amount of the State aid the Commission has considered that the Government guarantee does not cover the total nominal amount of CFF's debt represented by securities. Given the specific status of building societies (*sociétés de crédit foncier*), loans distributed by these institutions enjoy a special privilege provided for by the Act of 28 February 1852 and confirmed by the Act of 4 January 1993, which lays down a link between financing and loans whereby the amount of outstanding loans granted in accordance with the articles of association must always be at least equal to that of the guaranteed financing. Otherwise, the building society has to redeem some of its borrowings in order to fulfil the condition. Claims arising from loans are affected to some extent by the value of the property on which the creditors have a first mortgage: the amount of property loans is at the outset equal to not more than 62 % of the value of the property or, alternatively, is covered by a guarantee granted by a public authority or a specific statutory procedure. Given the system described, then, the Government guarantee covering borrowings by building societies would appear to be additional to the special claim on the property or the guarantee granted by a public authority, which improves the liquidity of CFF's claims. CFF's creditors are thus reassured as to the reimbursement on maturity of the amounts they have loaned to it, without having to take legal action to call on the mortgage security. Moreover, if the Government has to honour the guarantee it will, thanks to the mortgage security, be likely to recover a substantial proportion of the amount paid. This is not the case of the abovementioned subordinated debts which, by definition, do not have any priority and are not much more likely to be recovered than shareholders' equity.

([9]) See footnote 4.

(48) In conclusion, as far as the terms of the guarantee are concerned it should be noted that no limit was placed on its duration and no remuneration or *quid pro quo* for the Government was stipulated. Furthermore, as already pointed out, at the time the guarantee was granted CFF's situation was so serious that it was unable to obtain a guarantee on comparable terms from a market economy investor: only the Government was prepared to provide support. The Government guarantee therefore constitute State aid. It enabled CFF to continue carrying out its activities for nearly three years in conditions in which it would normally have been impossible to grant any other institution the same authorisation to carry on banking and financial business.

(49) In order to determine the amount of the aid, an estimate can be made of the price that CFF would have had to pay if it had had to purchase the guarantee on the market. To that end it is necessary to estimate the probability of reimbursement of a financial instrument (loan, bond, guarantee) with characteristics similar to those of the government guarantee granted to CFF, and in particular indefinite duration, the probability of recovery of mortgage loans and the theoretical probability of failure of institutions with the same rating as that assigned to CFF at the time the guarantee was granted (Moody's: Baa1; S & P: A1). That probability, in conjunction with the above factors, makes it possible to calculate the premium (spread) on the risk-free rate for a banking product with the same characteristics as the guarantee in question. On this basis, the remuneration that the Government should have demanded for this support can be calculated at FRF 14,6 billion.

(50) The government guarantee in respect of CFF's debt also constitutes indirect support for the bank's creditors. Following the Government's decision to guarantee all of CFF's debt, the value of its creditors' claims rose as a result of the greater certainty of reimbursement provided by the public guarantee. Most of CFF's debt is represented by bonds that are held anonymously and can be transferred without written formality.

5.1.3. *The Government's undertaking that CFF would comply with the prudential rules*

(51) The same press statement issued on 29 April 1996 by the Minister for Economic Affairs and Finance announcing the government guarantee for CFF's debt also contained a pledge on the part of the French Government that CFF would comply with the prudential rules. As already mentioned in connection with the debt guarantee, the statement was intended to reassure CFF's counterparties. The specific objective in this case was to restore confidence among the bank's staff, who were anxious about its future and had on 22 March 1996 already sounded the alarm as they were entitled to do under the Act of 1 March 1984 on prevention of company failures.

(52) However, since an adequate level of own funds is a basic and necessary condition for carrying on banking business, the Minister's statement implied that the Government was prepared to provide the financial resources necessary for ensuring the institution's survival and viability. At the time of the Minister's statement CFF's own funds requirements were considerable: substantial losses had caused the solvency ratio to fall to 0,5 %. When proceedings were initiated under Article 88(2) of the Treaty the Commission did not have sufficient information to quantify the extent of such possible public assistance; press reports referred at the time to a minimum tier-one own funds requirement of FRF 8 billion in order to achieve a solvency ratio of 8 %.

(53) In accordance with Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions ([10]), as last amended by Directive 92/30/EEC ([11]), the banking supervisory authorities must ensure that a bank whose solvency ratio drops below 8 % takes the necessary steps to restore the ratio to the appropriate level as quickly as possible, through recapitalisation or by reducing its liabilities, failing which its banking licence is to be withdrawn and it is to cease its activity. As already stated in other Commission Decisions concerning banks, such recapitalisation operations constitute aid if they are not carried out by the Government under normal market conditions, even if the amount incurred in recapitalising the assisted institution is less than it would have cost to wind it up. The minimum solvency requirement is one of the criteria for determining the viability of a bank and at the same time ensures that there is a level playing-field since, in theory, banks can always reduce their liabilities in order to meet the solvency requirement rather than increasing their capital.

([10]) OJ L 336, 30.12.1989, p. 14.
([11]) OJ L 110, 28.4.1992, p. 52.

(54) Since the liquidation option is always open, a recapitalisation operation of this nature constitutes aid if it is not performed under normal conditions that are acceptable in terms of remuneration to a private investor. When comparing the action by the Government with the behaviour of a market economy investor, the assessment of the amount of the aid must be based on a comparison between the cost of the operation and its correctly discounted value.

(55) Since 1996, despite creative accounting and the sale of property assets, CFF was unable to comply with the prudential requirements without recapitalisation measures. By letter of 24 March 1999 the Minister for Economic Affairs and Finance informed the Commission that on the basis of the accounts for 1998 the amount of the recapitalisation had been fixed at FRF 1,85 billion. The operation was to be carried out by means of a shareholder's advance by CDC, remunerated at a short-term market rate. When CFF was sold, the advance would be repaid and then consolidated into CFF's capital by the buyer. Nevertheless, a recapitalisation limited to FRF 1,85 billion anticipates and presupposes deconsolidation of the subsidiary Crédit Logement (CLog), which has not so far been effected, and compliance with the objective set by the Commission Bancaire of a tier-one own funds ratio for CFF of at least 6 %.

(56) Expansion of CLog's business due to recovery of the housing market, combined with rapid development of the secured loans sector, caused a steep increase in the weighted total of CLog's outstanding loans which CFF, given the size of its stake in CLog (71 %), consolidates in its accounts. CLog's loans are economically more risky and therefore carry a higher prudential weighting, resulting in a greater own funds requirement for CFF. In their letter of 24 December 1998 the French authorities informed the Commission that discussions had begun with the other CLog shareholders on reducing CFF's interest in CLog from 71 % to less than 20 % in order to alleviate over the ensuing months the own funds burden carried by CFF ([12]). On the basis of the information provided by the French authorities the Commission estimates CFF's own funds requirements at between FRF 1,357 billion and FRF 5,914 billion according to various assumptions regarding the tier-one own funds ratio required by the Commission Bancaire and the extent of CFF's interest in CLog ultimately decided on.

Table 1 — Capital requirements of Crédit Foncier de France

(in FRF million)

	Stake in Crédit Logement				
Tier-one own funds solvency ratio	71 %	51 %	20 %	10 %	0 %
	(unchanged)				
4 %	1 849	1 321	1 646	1 357	1 357
5 %	3 857	3 329	1 646	1 357	1 357
6 %	5 914	5 385	1 801	1 801	1 801

Source: French authorities

(57) On the basis of the information available, the Commission concludes that the Government's pledge that CFF would comply with the prudential rules constitutes aid whose compatibility must be assessed in the light of the measures to restructure CFF. The Commission bases its assessment of the aid on the scenario of a capital increase limited to FRF 1,85 billion (FRF 1,4 billion discounted to 1996), as notified by the French authorities, assuming that the reduction of CFF's interest in CLog will be sufficient for that purpose (see Table 1).

([12]) The denominator of the solvency ratio comprises risk-adjusted assets.

(58) In conclusion, the total aid granted to CFF amounts to FRF 16 billion as set out in the following summary table.

Table 2 — Summary of aid measures (discounted to 31 December 1996)

(in FRF billion)

Measures concerned	Amount of aid
Restructuring aid	
— Government guarantee	14,6
— own funds	1,4
Total	16,0

5.2. **Effect on trade between Member States**

(59) The liberalisation of financial services and the integration of financial markets are making intra-Community trade increasingly sensitive to distortions of competition.

5.2.1. *Distortion of competition*

(60) When aid is granted to a banking group such as CFF, which supplies loans and other financial services to businesses and collects resources from a wide range of customers, it is liable to distort competition with other credit institutions. Aid to the weakest institutions has a harmful effect and contributes to downward pressures on banking margins. Aid encourages inefficiency and defeats market discipline. Protection by a government which is ready to intervene should credit institutions run into difficulties removes the incentive for creditors to monitor the behaviour of their debtors. Institutions are no longer subject to the supervision and verdict of the markets. Not only is protection of this nature unjustified and excessive, it also acts as an incentive to poor management on the part of credit institutions.

(61) In terms of the collection of resources, an area where the degree of competition is also high, the distortion of competition caused by the aid was considerable since CFF was a fairly major borrower on international financial markets. The Government guarantee conferred on CFF a substantial competitive advantage in that area.

5.2.2. *Effect on trade between Member States*

(62) Although banks can in principle offer their services freely and without restriction across frontiers, principally by taking deposits and granting loans, they encounter obstacles to their expansion abroad.

(63) These obstacles are frequently linked to the firm local rooting of domestic banks, which makes market entry more expensive for foreign competitors. Since completion of the single market has given banks the opportunity of offering their services in other Member States, any aid granted to a bank, whether it operates nationally or internationally, is liable to restrict these opportunities.

(64) Aid designed to secure the survival of banks, even operating only at local level, which would otherwise have been forced out of the market as a result of their lower profitability and their lack of competitiveness, may therefore distort competition at Community level since it makes it more difficult for foreign banks to enter the French market.

(65) Without the aid in question, CFF would probably have had to be wound up. Under such circumstances, CFF's assets could have been purchased by foreign competitors wishing to acquire a significant commercial presence in France. CFF's customers would have had to turn to another bank, possibly from another Member State.

(66) The aid to CFF must consequently be deemed to be caught by Article 87(1) of the EC Treaty since it distorts competition to an extent likely to affect intra-Community trade.

5.3. **Examination of the compatibility with the Treaty of the aid to CFF**

(67) Having established that the financial support measures granted to CFF involve State aid, the Commission has to examine whether that aid can be declared compatible with the common market in accordance with Article 87(2) and (3) of the EC Treaty.

(68) It should first be noted that the aid under examination is not aid of a social character granted to individual consumers, or aid to promote the development of certain areas of France. Neither is it aid designed to remedy a serious economic disturbance since it is intended to remedy the difficulties of a single recipient, CFF, and not those of all operators in the sector.

(69) The Commission considers that CFF's problems do not stem from a systemic banking crisis in France. CFF is not the only French credit institution in difficulty, and a number of other banks, particularly State-owned ones, are also encountering difficulties; however, the causes of CFF's losses are specific to itself and seem to be linked largely to a poorly conducted policy towards lending in the competitive property sector by its subsidiaries and insufficiently strict monitoring of the risks involved. Neither can the aid therefore be justified in the Community interest on the grounds of the development of a generalised banking crisis.

(70) Only the derogation provided for in the second part of Article 87(3)(c) can possibly be taken into consideration. The compatibility of the aid measures must be assessed on the basis of the specific rules governing rescue and restructuring aid ([13]). The general principle is that State aid to firms in difficulty is compatible if a number of conditions are met, and in particular in the case of restructuring aid:

1. full implementation of a restructuring plan based on realistic assumptions and making it possible to restore within a reasonable timescale the required minimum return on capital invested and thus to secure the firm's long-term viability;

2. provision of sufficient *quid pro quos* to offset the distortion of competition and therefore make it possible to conclude that the aid is not contrary to the common interest;

3. proportionality of the aid to the aims pursued and limitation of the amount of the aid to the minimum necessary for restructuring, to ensure that the recovery effort receives maximum support from the firm itself;

4. full implementation of the restructuring plan and compliance with any other obligation laid down by the Commission in its final decision;

5. establishment of arrangements for monitoring fulfilment of the preceding condition.

In accordance with the guidelines on restructuring aid, the Commission considers that such aid should normally be necessary once only.

5.3.1.1. Viability of the enterprise

(71) In a letter dated 21 March 1996 the French authorities informed the Commission that CFF's new Governor was preparing a restructuring and strategic redeployment plan for the bank. The plan was to place CFF on a sound footing and restore its viability with a view to linking it to a partner. The plan did not initially provide for an increase in the bank's capital by the Government, which hoped that the measures included in the plan would be sufficient to generate the necessary resources for recapitalising CFF.

(72) While it was looking for a reference shareholder, and especially from 1996 onwards, CFF embarked on an internal restructuring process based on realignment on its core business, namely loans for owner-occupied or rented housing, granted chiefly to private individuals. The business strategy hinged on five activities around which the new organisational structure was devised. The internal restructuring rationalised the organisation chart by grouping together activities of the same type with a view to clarifying responsibilities and achieving economies of scale.

([13]) Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 368, 23.12.1994, p. 12).

(73) Marketing was the priority of CFF staff and management, with significant results in terms of turnover in loans in the competitive sector, which grew from FRF 6,1 billion in 1995 to FRF 11,5 billion in 1998. Thanks to the efforts of its commercial network, CFF gained market shares in its traditional area of activity, regulated loans. It improved its commercial methods with the introduction of sales training in early 1998.

(74) The policy of restructuring and divestment in the context of refocusing on the core business helped at the same time to improve the group's liquidity and restore its own funds. In 1996 CFF sold non-strategic assets and holdings worth FRF 23 billion and finalised transactions involving the securitisation and direct sale of claims on local authorities amounting to FRF 22 billion, of which FRF 11 billion by securitisation. These transactions enabled CFF first to reimburse the advance provided by CDC and, by introducing asset-liability management tools, to refrain after the January 1996 crisis from raising funds on the capital market.

(75) CFF's cash position is now positive by a substantial margin, not only owing to the disposal of considerable amounts of local-authority loans and the sale of other assets, but above all thanks to early repayments by its customers in response to the fall in market rates. In 1996 early repayments were made in respect of nearly all outstanding loans, generating FRF 26 billion in addition to the FRF 9 billion in contractual amortisations and the FRF 21 billion from disposals of local-authority loans. This made it possible to cope with the production and redemption of maturing securities and other debts and to add FRF 10 billion to the securities portfolio. Since high levels of early repayment continued in 1997 and 1998, CFF fulfilled all its commitments until 1999 while maintaining the turnover envisaged in the business plan; if necessary the bank can carry out securitisation transactions or realise assets in its bond portfolio in order to raise funds.

(76) As regards the evolution of bad debts and provisions, the total amount of doubtful outstanding claims was lowered in parallel with the fall in total loans outstanding. Provisions for doubtful claims fell from FRF 9,7 billion in 1995 to FRF 5,2 billion in 1998, a significant improvement achieved through the strict risk selection policy pursued in connection with the grant of loans (risk management) as a direct consequence of the refocusing of the bank's activities on low-risk sectors (housing credit). As regards the system for monitoring the risks and liabilities entered into by its subsidiaries, CFF recognised that risk monitoring tools existed generally within the group, but that they had previously not been upgraded quantitatively and qualitatively in line with the needs of modern management, especially in the context of the diversification which CFF had undertaken. Since 1996, therefore, CFF has endeavoured to improve the control of the parent company over its subsidiaries: a group committee is responsible for constantly checking that the strategy pursued by subsidiaries is consistent with that of the parent company and provides a forum for discussing common problems. The monitoring of subsidiaries comprises quarterly reporting of results and of the main financial indicators of the cash position, as well as updating of the annual results forecasts. The reporting is supplemented by monitoring of the business results. As far as risk control is concerned there are two committees, one responsible for authorising commitments totalling more than FRF 5 billion by CFF subsidiaries in respect of entities outside the group, and the other for dealing with large risks of which the aggregate amount per client amounts within the group to at least FRF 5 billion.

(77) The following table gives the balance-sheet data for the CFF group from 1995 to 1998.

Table 3 — Consolidated balance sheet of the CFF Group

(in FRF billion)

	1998	1997	1996	1995
Assets (net)				
Government paper	14,4	12,4	3,1	3,7
Claims on banks	21,1	36,8	45,5	51,4
Claims on customers	193,8	228,2	257,4	299,3
Securities portfolio	33,6	16,6	15,6	9,9
Other assets	13,0	4,8	5,0	6,3
Prepayments and accrued income	10,6	10,7	14,0	11,4
Total	286,5	309,5	340,6	382,0

(in FRF billion)

	1998	1997	1996	1995
Liabilities				
Banks	39,4	44,1	47,3	60,9
Customers	5,4	5,3	4,9	5,2
Securities	194,4	215,9	241,4	266,0
Other liabilities	14,0	15,3	16,5	19,5
Accruals and deferred income	12,6	11,2	13,1	13,0
Provisions for risks	5,2	5,5	7,1	9,7
EGBR	1,3	0,9	0,7	0,7
Subordinated debt	11,7	11,2	10,3	9,2
Minority interests	0,8	0,7	0,7	0,3
Consolidated own funds	0,5	– 1,5	– 2,3	8,3
Consolidated result	1,2	0,9	0,9	– 10,8
Total	286,5	309,5	340,6	382,0
Off-balance-sheet items				
Commitments given	142,0	122,3	114,4	112,8
Commitments received	0,9	1,4	20,5	1,0
Forward foreign-exchange transactions	69,7	78,8	67,2	75,1
Transactions involving forward financial instruments	107,7	102,6	73,9	75,4

(78) Since 1996 margins have been increased in line with the objectives of the business plan. The greatest efforts have focused on structural costs, with a view to adjusting resources to the fall in the level of activity. Between 1995 and 1998 the workforce was reduced by approximately 30 % (from 3 287 to 2 371), enabling staff costs to be cut by 25 %. Total operating charges were reduced by 22 % over the same period. Since the exceptional loss sustained in 1995 the group has accumulated profits which, albeit still on a modest scale, have led to an improvement in consolidated own funds. The contraction in net receipts from banking resulting from the reduction in the overall interest margin (foreseen in the business plan) has been neutralised not only by the reduction in general operating charges but also by the capital gains realised on disposals of local-authority loans and by the reduction in value adjustments in respect of claims and financial assets (thanks to improved risk management) and in depreciation and provisions.

(79) The following table shows the evolution of the CFF group's consolidated results.

Table 4 — Profit and loss account of the CFF Group

(in FRF billion)

	1998	1997	1996	1995
Banking operating income	25,2	28,3	31,2	34,2
Banking operating charges	– 22,2	– 24,5	– 26,8	– 29,4
Other income and charges	0,5	0,3	0,1	0,1
Net receipts from banking	3,5	4,1	4,5	4,9
Operating and administrative charges including staff costs	– 2,0	– 2,3	– 2,3	– 2,8
	– 1,2	– 1,5	– 1,5	1,7
Gross operating result	1,5	1,8	2,2	2,1
Risk charges	– 0,6	– 0,9	– 1,7	– 13,6
Exceptional income/charges	– 0,1	– 0,1	0,2	1,2
Other accounts	0,4	0,1	0,2	– 0,4
Consolidated net result	1,2	0,9	0,9	– 10,7

(80) The validity of the restructuring plan implemented by CFF, which by virtue of the consolidation measures carried out generated the liquid resources the bank needed during the period of difficulty it underwent, and the resulting return to profitability, did not however suffice to restore its solvency ratio to the appropriate level. Although the French authorities initially stated that, despite the Government's pledge, they did not intend to carry out any prior recapitalisation of CFF or to give it any other support, the size of the profits made did not enable the bank's own funds to be restored to the level required by the Community prudential rules. That was to be done by the bank's buyer as part of the sell-off of CFF.

Table 5 — Own funds of the CFF Group

(in FRF million)

	1998	1997	1996	1995
Tier-one own funds	6 424,0	3 304,0	1 990,0	557,0
Additional own funds	6 424,0	3 304,0	1 990,0	557,0
Deduction	– 96,0	– 126,0	– 183,0	– 194,0
Consolidated own funds	12 752,0	6 482,0	3 797,0	920,0
Weighted risks	205 600,0	188 000,0	185 550,0	183 600,0
Solvency ratio	6,20 %	3,45 %	2,05 %	0,50 %
Solvency ratio (tier-one) [1]	3,12 %	1,76 %	1,07 %	0,30 %

[1] The tier-one ratio should normally, in accordance with the prudential rules, be at least 4 %.

(81) In September 1998, however, the discussions being held with the candidate for taking over CFF, the US consortium GMAC-Bass, were broken off as a result of the latter's unwillingness to take over the whole of CFF. According to the press, GMAC-Bass feared that, if it were to take over CFF's entire balance sheet (amounting at that stage to around FRF 310 billion) without any Government guarantee, its own rating would be downgraded by the rating agencies. GMAC-Bass therefore requested the French Government to split CFF's balance sheet in two and to keep for itself all the outstanding liabilities covered by a public guarantee.

(82) The new plan presented by the French authorities on 24 December 1998 is a three-stage operation: financial restructuring, recapitalisation and initiation of a new procedure for linking CFF to a partner.

(83) The financial restructuring is intended to solve the difficulties identified during the previous search for a partner, in particular the guaranteeing of CFF's debt, problems of corporate governance, transparency of the accounts and the increasing need for own funds. These problems were addressed, respectively, by setting up a building society as a subsidiary, giving CFF ordinary bank status, clarifying its balance sheet and reducing its holding in CLog.

(84) The mortgage bonds and corresponding assets will be transferred to a specialised subsidiary with the status of a building society (société de crédit foncier — SCF). Given the standing of these societies, this will provide CFF with a new, secure source of finance enabling the government guarantee to be withdrawn. Implementation of this plan is subject to approval by the French Parliament of the savings and financial security act, scheduled for the end of this year. The Commission is favourably disposed towards those legislative provisions and creation of the SCF by CFF, since such an organisational structure will provide a definitive solution to the problem of the government guarantee.

(85) The Commission attaches great importance to the reduction of CFF's interest in Clog, in view of the effects of consolidating CLog's accounts on the solvency ratio of the group, as shown by Table 1.

(86) Following a letter of 24 March 1999 from the Minister for Finance and Industry communicating the amount which the Government intended to provide for recapitalising CFF, the Commission requested information with a view to ascertaining that there was an industrial plan that could carry the bank's recovery to completion and establishing that the planned aid measure corresponded to the strict minimum necessary. The information requested was also to confirm the planned dates for giving CFF ordinary bank status and creating the SCF subsidiary. The Commission received the full information requested on 12 May 1999.

(87) The new plan takes the results posted for 1998 as a basis for developing future strategy and forecasting the group's future results, and forms part of the effort to find a buyer. It aims to restore the bank's profitability in the areas of highest risk and to avoid contraction of the net receipts from banking by finding other sources of income to offset the fall in traditional receipts. The plan tackles the bank's underlying problems and all aspects of its day-to-day management (staff, organisation, marketing), strategic development and financial structure (own funds, quality of claims, profitability, liquidity) with a view to enabling it to confirm its viability.

(88) The aims of the strategic plan are twofold: to complete the refocusing on mortgage lending and to develop turnover in housing credit, the sale of services and the distribution of savings products. As far as the first objective is concerned, the chief measures are concentration on loans for low-cost housing, reorganisation of the network and strengthening of the marketing function. CFF intends to continue its redeployment in three directions: loans for owner-occupied or rented housing, granted chiefly to private individuals, coupled with a strategy for marketing a corresponding range of savings products; increasing lending activity in sectors under control, such as loans to property firms and specialised loans; and developing the marketing of services with high value added, such as property valuations, administration of estates, low-cost housing and the management of property, areas in which it already has considerable professional experience.

(89) On the basis of the documents submitted, the strategic plan appears adequate on the whole; albeit optimistic in some respects. The fall in income from the assisted sector has not yet been sufficiently counterbalanced by growth of the competitive sector, in which CFF still has only a small market share. Projections regarding the growth of market share in that area appear optimistic, given that no growth of the market as a whole is forecast in the business plan. Switching to a new product line in this way is not easy for CFF, which is emerging from a deep crisis, and will demand great efforts from its staff, whose commercial skills had not been greatly developed in the past.

(90) Furthermore, although the increase in loan renegotiations and early repayments prompted by the fall in interest rates and the development of a policy of loan repurchases by banking networks has initially had a favourable impact on CFF's cash position, it can lead to a drop in banking operating income, particularly in the assisted sector, which remains at the heart of CFF's lending activities.

(91) Lastly, analysis of the evolution of these costs beyond 1999 reveals the absence of any further adjustment to take account of the fall in outstanding PAP loans and the continuing slow growth of net receipts from banking. The evolution of operating charges does not reflect a continuation of the trend observed over the last three years and the forecasts for the banking sector as a whole.

5.3.1.2. Compensatory measures

(92) It should be borne in mind first of all that, without the aid it received, CFF would have had to be put into liquidation. As stated in the guidelines on State aid for rescuing and restructuring firms in difficulty ([14]), it has to be seen whether the solution causing the least distortion of competition for competitors has been sought. If major distortion of competition is unavoidable, substantial compensatory measures, or *quid pro quos*, must be required that benefit other operators in the sector in order to mitigate the harmful effects of the aid.

([14]) See footnote 13.

(93) It should be added that, in accordance with Community policy, the *quid pro quos* should represent an additional effort on the part of the firm receiving aid in comparison with the restructuring operations strictly necessary for restoring its viability. In particular, they should first and foremost consist of measures that are not directly or indirectly financed by State aid. Where there is no closure of capacity, *quid pro quos* can take the form of divestments, provided that the activities concerned are profitable, or a reduction in the commercial presence of the company concerned.

(94) In the banking sector, the solvency constraint introduced by the banking legislation (the nucleus of tier-one own funds and own funds in the broad sense must represent 4 % and 8 % respectively of risk-adjusted assets) limits credit institutions' capacity for growth. In reality there is a capitalisation requirement 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 and immediate. It can be quantified according to the rules laid down and cannot be temporarily relaxed as part of a growth strategy pursued by a credit institution. A credit institution that only narrowly satisfies the solvency requirement does not have any room for growth until it can attract fresh capital or increase its own capital and reserves by achieving a high rate of profit. The growth of an inefficient institution is consequently held back, while a bank that is generating sizeable profits has potential for growth linked to its profitability. This restraint which the solvency requirement places on the growth of less efficient institutions illustrates very clearly the way in which prudential policy and competition policy complement one another.

(95) One result of the solvency requirement is that in the case of credit institutions it is possible to arrive at a hypothetical estimate of the distortion of competition caused by State aid ([15]). 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 EUR 1 million, or any measure with equivalent effect, would allow a bank to increase the weighted assets in its balance sheet (given the compulsory solvency ratio of 8 %) and thus to expand its activities. Such an operation would create a potential distortion of competition equivalent in terms of activity to around EUR 12,5 million (since, without the aid, the bank would not have been able to increase its weighted assets by EUR 12,5 million). This relationship also means that State aid to a credit institution exceeds the latter's 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 compensatory measures is to limit the distortion estimated very roughly in this manner.

(96) In the case under examination, as regards the information on the compensatory measures offered by CFF to competitors which the Commission requested when it initiated the Article 88(2) procedure, the French authorities submitted data on the efforts made. The Commission does not regard the reduction in net receipts from banking envisaged by the business plan as a compensatory measure since it is rather a result of the reduction of lending activity in the assisted sector which has not yet been counterbalanced by an increase in activity in the competitive sector.

(97) The Commission nevertheless takes the view that the substantial reduction in the balance sheet (from FRF 392 billion at 31 December 1995 to FRF 296 billion at 31 December 1998, i.e. a 25 % reduction) cannot be regarded merely as necessary for restoring viability and as an effect of the voluntary refocusing of the bank's activities, but that it involved substantial efforts which have mitigated the distortion of competition resulting from the Government's intervention. These efforts represent in particular a very significant contribution in relation to the distortion of competition that can be hypothetically evaluated in the case in point.

(98) In this connection the Commission regards as a positive development CFF's decision to dispose of its network abroad, particularly in view of the fact that its foreign business, albeit small, was expanding before the Government intervened (a branch had been opened in Italy).

(99) Given the amount of the aid in relation to the compensatory measures carried out, the Commission takes the view that CFF has made a significant contribution to its restructuring costs and has provided substantial *quid pro quos* enabling the distortive effect of the aid on competition to be mitigated.

([15]) See Commission Decision 98/490/EC of 20 May 1998 concerning aid granted by France to the Crédit Lyonnais group (OJ L 221, 8.8.1998, p. 72).

5.3.1.3. Proportionality of the aid and contribution of the bank to its recovery

(100) In view of the foregoing and with regard to compliance with the other conditions laid down in the guidelines on restructuring aid, the Commission considers that CFF is making a significant contribution to the restructuring costs from its own resources.

(101) Nevertheless, although CFF's recovery has already been largely achieved, the level of its own funds remains well below the statutory minimum required by the prudential rules. This problem should be solved by means of the recapitalisation notified by the French Government (limited to FRF 1,85 billion, in view of the reduction of CFF's interest in CLog [16]), the timing and details of which are still uncertain). The Commission considers that the remaining uncertainties regarding the bank's long-term viability should be dispelled once it is linked to a partner.

(102) The return on own funds achieved by CFF in 1998, determined on the basis of the ratio of the consolidated result to consolidated own funds (including the shareholder's advance) amounts to approximately 8,4 %. This figure is not yet in line with the average profitability of the banking sector or the expectations of a private shareholder and justifies linking the bank with a strong partner as envisaged in the plan for privatising the bank in the near future in order to secure its viability.

(103) The fact that the task of restoring the bank's own funds to an appropriate level and completing its recovery is entrusted to a major partner, which should enable it to implement its business plan, raises problems regarding its sale.

(104) In conjunction with its examination of the compatibility of the aid measures concerned, the Commission has taken privatisation of the bank into account. In their letter of 12 May 1999 the French authorities undertook to privatise CFF by December 1999 in accordance with an open, transparent and non-discriminatory procedure. The Commission takes note of these undertakings and recalls the general principles it applies in cases of privatisation 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) [17]. It considers that the privatisation ought to provide a definitive solution to the problem of corporate governance pointed out earlier and ensure that, in future, CFF turns to its private shareholders and to the market for any additional resources it may need.

(105) At this stage and on the basis of the information available on the privatisation of CFF, since the choice of the buyer is to be determined by reference to market criteria as far as the price and the buyer's business plan are concerned, the Commission takes the view that the privatisation procedure does not give rise to any presumption of further State aid.

(106) In evaluating the aid the Commission has not taken account of how much privatisation of the bank could bring in for the Government: at this stage, a selling price has not yet been determined for CFF and it does not have a valuation.

6. **CONCLUSIONS**

(107) In view of the foregoing and on the basis of the information available, the Commission concludes that CFF's recovery plan involves substantial State aid, in particular in the form of:

— a Government guarantee covering all CFF's debt liabilities falling due, in terms of both principal and interest,

— the Government's undertaking to take every step necessary to ensure that CFF can continue to carry out its activities in accordance with the prudential rules in force, and a capital advance to CFF.

(108) These measures have been examined in the light of Article 87(3)(c) of the EC Treaty to determine whether they can be regarded as compatible with the common market. For the reasons set out in recitals 62 to 100, the Commission takes the view that the aid granted to CFF complies with the conditions laid down in the guidelines on State aid for rescuing and restructuring firms in difficulty, provided that the conditions specified in the latest plan notified are fulfilled.

[16] See Table 1.

[17] *Twenty-third Report on Competition Policy*, point 403. The principles to which the Commission refers in order to determine whether a privatisation involves 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.

(109) It is also necessary, in view of the large amount of aid involved, for the proper implementation of the plan to be monitored, with special reference to the restructuring efforts, to ensure that the recovery plan submitted to the Commission is carried out effectively and in full. The French authorities should therefore inform the Commission, every six months following the date of approval of this Decision and until the objectives of the restructuring plan have been achieved, of progress in implementing the plan and any deviation of actual results from the forecasts. No change that could result in an increase in State aid to CFF may be made to the plan without the Commission's prior approval.

(110) The French authorities have stated that the shareholder's advance of FRF 1,85 billion is the strict minimum needed to enable CFF to comply with the prudential requirements and that the buyer will be responsible for increasing the bank's own funds to a level that secures CFF's long-term viability. In the absence of privatisation and therefore of an increase in CFF's own funds by a buyer, the French Government would probably have to carry out a further recapitalisation. If so, the Commission could consider that such an operation constituted additional aid.

(111) Under these conditions, the aid in question can be exempted from the prohibition laid down in Article 87(1) of the EC Treaty and Article 61(1) of the EEA Agreement since it can be regarded as compatible with the common market in pursuance of Article 87(3)(c) of the EC Treaty and Article 61(3)(c) of the EEA Agreement,

HAS ADOPTED THIS DECISION:

Article 1

The measures intended to consolidate, restructure and privatise Crédit Foncier de France, in particular the government guarantee covering its debts announced by the Minister for Economic Affairs and Finance on 29 April 1996 and the FRF 1,85 billion increase in its capital carried out by Caisse des Dépôts et Consignations, constitute State aid within the meaning of Article 88(1) of the EC Treaty. These operations, the value of which is estimated at FRF 16 billion, are hereby declared compatible with the common market and with the EEA Agreement pursuant to Article 87(3)(c) of the EC Treaty and Article 61(3)(c) of the EEA Agreement.

Article 2

Authorisation of the measures referred to in Article 1 is subject to France complying with the following conditions:

(a) The implementation of all the recovery measures and all aspects of the restructuring plan submitted to the Commission must be guaranteed;

(b) The conditions laid down in the restructuring plan may not be modified, after the conditions imposed by this Decision have been taken into account, without the Commission's prior agreement;

(c) Crédit Foncier de France must not be allowed to carry over tax losses in respect of the losses covered by the notified capital increase.

Article 3

France shall cooperate fully in monitoring the implementation of this Decision and shall transmit the following documents to the Commission:

(a) A detailed report by the French authorities on application of the Commission Decision, implementation of the restructuring plan and privatisation of the bank. The report shall in particular:
   — examine the viability of Crédit Foncier de France by presenting detailed results in relation to the estimates contained in the plan,
   — give details of any government assistance to Crédit Foncier de France (by way of recapitalisation, finance, guarantees, etc.),
   — analyse in detail developments in the process of selling Crédit Foncier de France.

This report shall be submitted to the Commission every six months following the date of notification of this Decision and for the last time after Crédit Foncier de France has been privatised;

(b) The balance sheets, profit and loss accounts and reports (annual and half-yearly) adopted by the Board of Directors of Crédit Foncier de France.

The Commission may request that these documents and implementation of the plan be evaluated by means of specialised audits. If so, the French authorities and Crédit Foncier de France shall cooperate in the performance of those audits.

Article 4

This Decision is addressed to the French Republic.

Done at Brussels, 23 June 1999.

For the Commission

Karel VAN MIERT

Member of the Commission