II

(Non-legislative acts)

DECISIONS

COMMISSION DECISION

of 18 July 2011

on State aid C 15/09 (ex N 196/09), which Germany implemented and is planning to implement for Hypo Real Estate

(notified under document C(2011) 5157)

(Only the German text is authentic)

(Text with EEA relevance)

(2012/118/EU)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof [1],

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

Having called on interested parties to submit their comments pursuant to those provisions [2] and having regard to their comments,

Whereas:

I. PROCEDURE

(1) On 2 October 2008 the European Commission authorised State aid to Hypo Real Estate Holding AG in the form of a State guarantee of EUR 35 billion (registered under case number N 44/08) [3] temporarily, that is for six months or until the submission of a credible and substantiated restructuring plan for the bank. Germany notified the measure on 30 September 2008.

(2) On 1 April 2009, Germany notified a restructuring plan for Hypo Real Estate Group ('HRE') (registered under case number N 196/09). By letter dated 17 April 2009 Germany supplemented the notification of the restructuring plan by informing the Commission of a capital injection of EUR 60 million and a prolongation of State guarantees of EUR 52 billion which had been granted under the approved bank support scheme [4].

(3) By letter dated 7 May 2009 [5], the Commission informed Germany that it had initiated the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union. That decision ('opening decision') was published in the *Official Journal of the European Union* [6], calling on interested parties to submit comments.

(4) On 3 June 2009 Germany notified a capital injection amounting to EUR 2,96 billion, registered under case number N 333/09.

(5) On 17 August 2009 Germany informed the Commission (registered under case number C 15/09) that it intended to again prolong guarantees previously granted by the Sonderfonds Finanzmarktstabilisierung ('SoFFin') amounting to EUR 52 billion for HRE (cf. recital 2).

[1] With effect from 1 December 2009, Articles 87 and 88 °f the EC Treaty have become Articles 107 and 108, respectively, of the TFEU. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

[2] OJ C 240, 7.10.2009, p. 11; OJ C 13, 20.1.2010, p. 58; OJ C 300, 6.11.2010, p. 6.

[3] Commission decision of 2 October 2008 (OJ C 293, 15.11.2008, p. 1).

[4] Commission decision of 12 December 2008 in case N 625/08 (OJ C 143, 24.6.2009, p. 1).

[5] Commission decision of 7 May 2009, replaced by decision of 24 July 2009 in case C 15/09 (ex N 196/09) (OJ C 240, 7.10.2009, p. 11).

[6] See footnote 5.

(6) On 20 and 21 October 2009, Germany provided another update of the restructuring plan, notified the Commission of further intended measures for HRE (creation of a winding-up institution, grant of additional guarantees) and informed the Commission about a further prolongation, i.e. the third prolongation, of the existing SoFFin guarantees of EUR 52 billion (registered under case number N 557/09).

(7) On 26 October 2009 Germany notified, under case number N 557/09, a further capital injection amounting to EUR 3,0 billion, SoFFin guarantees amounting to a total of EUR 18 billion for HRE, as well as a SoFFin guarantee amounting to EUR 2 billion for HRE's winding-up institution ([7]). The Commission did not approve the SoFFin guarantee amounting to EUR 2 billion.

(8) On 13 November 2009, the Commission extended the formal investigation procedure and temporarily approved capital injections of EUR 60 million, EUR 2,96 billion and EUR 3 billion (in cases: C 15/09, N 333/09 and N 557/09) until the Commission has taken a final decision on the restructuring plan. That decision was published in the *Official Journal of the European Union* ([8]), calling on interested parties to submit comments.

(9) On 15, 16 and 17 December 2009 (registered under case number N 694/09) the German authorities complemented the notification of 26 October 2009 by submitting further information regarding the SoFFin guarantees of EUR 18 billion.

(10) On 21 December 2009 the Commission temporarily authorised the SoFFin guarantees of EUR 18 billion for one year maximum (case number N 694/09) ([9]).

(11) On 30 April 2010 Germany notified a SoFFin capital injection of EUR 1,85 billion (case number N 161/10).

(12) On 19 May 2010 the Commission temporarily authorised the EUR 1,85 billion capital injection until the Commission has taken a final decision on the restructuring plan ([10]).

(13) On 2 September 2010 Germany notified a SoFFin liquidity guarantee amounting to EUR 20 billion (case number N 380/10).

(14) On 10 September 2010 Germany notified an impaired asset measure — i.e. the intent to transfer assets from HRE to FMS Wertmanagement AöR ([11]) ('FMS-WM') — and a capital injection of up to approximately EUR 2,13 billion, as well as an additional guarantee, i.e. a settlement guarantee of up to EUR 20 billion (case number N 380/10).

(15) On 24 September 2010 the Commission again extended the formal investigation procedure and temporarily authorised the impaired asset measure, the liquidity guarantee of EUR 20 billion and the settlement guarantee of up to EUR 20 billion. That decision was published in the *Official Journal of the European Union* ([12]), calling on interested parties to submit comments. The Commission decision of 24 September 2010 did not cover the capital injection of up to EUR 2,13 billion that was notified by Germany on 10 September 2010; i.e. that capital injection was not approved by the Commission.

(16) On 14 June 2011 Germany submitted a final update of the restructuring plan. On 15 June 2011 Germany submitted a list of related commitments, which was supplemented on 1 July 2011.

(17) On 14 June 2011, Germany clarified that the next capital injection will not amount to EUR 2,13 billion as notified on 10 September 2010, but that it will amount to EUR 2,08 billion and that the reduced amount will be made available to FMS-WM.

(18) In the course of time several meetings and telephone conferences have taken place and further correspondence has been shared between the Commission departments, Germany and HRE.

(19) The Commission received comments from interested parties, forwarded them to Germany, and received observations from Germany by letter dated 24 March 2010.

II. THE BENEFICIARY AND THE AID MEASURES

II.1. The beneficiary

(20) In October 2003 HRE was established as a spin-off of parts of the commercial real estate financing business of HVB Group. In 2007, HRE took over Dublin-based DEPFA Bank plc and extended its business to public sector and infrastructure finance. The HRE group ([13]) currently consists of Hypo Real Estate Holding AG ('HRE Holding') and its three subsidiaries pbb Deutsche Pfandbriefbank AG ('PBB'), DEPFA Bank plc and Hypo Real Estate Finance BV in Liquidation ('HRE Finance i.L.'). DEPFA Bank plc and PBB each have a number of

([7]) According to Germany, the SoFFin guarantee amounting to EUR 2 billion for HRE's winding-up institution was never formally requested by HRE or approved by SoFFin.
([8]) Commission decision of 13 November 2009 in cases C 15/09 (ex N 196/09), N 333/09 and N 557/09 (OJ C 13, 20.1.2010, p. 58).
([9]) Commission decision of 21 December 2009 in case N 694/09 (OJ C 25, 2.2.2010, p. 14).
([10]) Commission decision of 19 May 2010 in case N 161/10 (OJ C 190, 14.7.2010, p. 7).
([11]) Winding-up institution of HRE.
([12]) Commission decision of 24 September 2010 in cases C 15/09 (ex N 196/09) and N 380/10 (OJ C 300, 6.11.2010, p. 6).
([13]) For further information on the HRE group and its problems see the opening decision and the decisions on the extension of the procedure.

further subsidiaries and participations. PBB is the renamed core bank of the group and the only one of the three subsidiaries of HRE Holding which will continue to generate new business. Its sectors of activity are real estate finance and public investment finance ('PIF'). DEPFA Bank plc is in run-down and will not contract any new business as of notification of this Commission decision. Its core activities mainly included public sector finance lending businesses and budget credit and the financing of infrastructure projects (e.g. roads, bridges, tunnels and public buildings). As its name suggests, HRE Finance i.L. is a company in liquidation ([14]).

(21) FMS-WM, the winding-up institution for HRE, was established in 2010. It manages the assets and derivatives of the HRE group that it has taken over because they were either non-strategic or contained an unacceptable risk or capital burden. FMS-WM has in the course of time taken over a considerable part of HRE's assets. FMS-WM does not have a banking licence.

(22) HRE reported losses of EUR 5,5 billion for the financial year 2008, losses of EUR 2,2 billion for 2009 and losses of EUR 0,9 billion for 2010.

(23) By injecting capital amounting to approximately EUR 3,02 billion (EUR 60 million in March 2009, EUR 2,96 billion in June 2009), Germany became 90 % owner of HRE. In autumn 2009 a squeeze-out of minority shareholders took place. Germany acquired the remaining shares, paying EUR 1,30 per share, and becoming 100 % owner of HRE. A restructuring process was subsequently initiated for HRE.

II.2. **HRE's difficulties in the context of the financial crisis**

(24) At the end of September 2008, HRE faced a liquidity shortage, which put the bank on the brink of insolvency. HRE was not able to obtain short-term financing on the markets because the financial market crisis led to the collapse of some financing markets. After Lehman Brothers applied for creditor protection, the interbank market in particular came to an almost complete standstill in mid-September 2008.

(25) The business model of DEPFA Bank plc, a wholly owned subsidiary of HRE since October 2007 that was highly dependent on funding from the interbank market and other short-term unsecured funding sources, proved to be extremely fragile in the face of the liquidity crisis, and the resulting problems threatened its very existence.

([14]) HRE Finance i.L. was created in 2007 for the purpose of one specific securities transaction and has been in liquidation since 2008. It has no employees and its balance sheet total at the end of 2010 was only EUR 275 000.

(26) HRE had to cover the short-term liquidity needs of DEPFA Bank plc. However, the volume of the credit lines which became due on 30 September 2008 was too big to be supported by HRE. Furthermore, internal transactions and activities within the HRE group, such as receivables, guarantees and letters of comfort, meant that most companies in the HRE group were in the same situation. The liquidity problems therefore posed a serious threat to the existence of the HRE group.

(27) HRE's difficulties were, inter alia, also attributable to a legacy problem stemming from assets that did not show an appropriate return on investment if their actual risk profile was taken into account, and to the fact that HRE was the product of a merger of several smaller banking institutes which were using different IT systems, […] (*).

II.3. **The State aid measures**

(28) Overall, the German State has provided or will provide HRE with capital injections totalling up to approximately EUR 9,95 billion (FMS-WM has received or will receive part of that capital) and guarantees of EUR 145 billion. HRE also benefited from an asset relief measure with an aid element of approximately EUR 20 billion.

II.3.1. *Capital injections*

II.3.1.1. Capital injection of EUR 60 million

(29) As part of Germany's intention to gain full control over HRE by acquiring all its shares in several steps, on 30 March 2009 SoFFin bought 20 million new HRE shares at their nominal value of EUR 3 per share, resulting in a capital injection to HRE of EUR 60 million and giving SoFFin an 8,65 % share in the equity. That capital injection was temporarily approved by the Commission on 13 November 2009.

II.3.1.2. Capital injection of EUR 2,96 billion

(30) On 2 June 2009, HRE shareholders approved a capital injection amounting to EUR 2,96 billion into HRE by issuing new shares to be acquired by SoFFin. As a result, SoFFin held 90 % of the shares of HRE. Those newly issued shares were registered in the commercial register on 8 June 2009. This capital injection was temporarily approved by the Commission on 13 November 2009.

II.3.1.3. Capital injection of EUR 3 billion

(31) The capital injection notified on 26 October 2009, amounting to EUR 3,0 billion in total, was structured as follows:

(a) EUR 2 billion was injected into the uncommitted reserves ('*freie Rücklagen*') of HRE Holding and PBB. After the squeeze-out of minority shareholders, HRE was entirely owned by Germany/SoFFin;

(*) Confidential information.

(b) EUR 1 billion was injected as a silent participation in PBB, with a profit-dependent coupon of 10 % p.a.

(32) The contracts for that EUR 3 billion capital injection were signed on 16 November 2009. The capital injection was temporarily approved by the Commission on 13 November 2009.

II.3.1.4. Capital injection of up to EUR 1,85 billion

(33) The capital injection of up to EUR 1,85 billion, into the uncommitted reserves (*'freie Rücklagen'*) of HRE, was divided into two tranches:

(a) a capital injection of EUR 1,4 billion (that tranche was temporarily approved by the Commission on 19 May 2010 and was injected thereafter);

(b) a capital injection of up to EUR 450 million (that tranche was also temporarily approved by the Commission on 19 May 2010, contingent on the existence of certain circumstances ([15]). It has not yet been injected as those circumstances have not yet occurred).

(34) The capital injection of EUR 1,85 billion is part of a total capital need set out in the restructuring plan for HRE. EUR 1,4 billion of this capital injection was injected in order to comply with regulatory capital requirements and to have a risk buffer. The contract for that EUR 1,4 billion capital injection was signed on 20 May 2010. Germany expects the other part of the EUR 1,85 billion, i.e. EUR 450 million, to be injected in the third quarter of 2011.

II.3.1.5. Capital injection of EUR 2,08 billion

(35) On 10 September 2010 the German authorities notified a capital injection of up to EUR 2,13 billion for HRE. On 14 June 2011, Germany clarified that the capital injection would not amount to EUR 2,13 billion but to EUR 2,08 billion and that the amount would be injected into FMS-WM. According to Germany, the EUR 2,08 billion would be injected in the third quarter of 2011. SoFFin put the EUR 2,08 billion, subject to agreement by the European Commission, as a capital claim (*'Einlageanspruch'*) into the capital reserve (*'Kapitalrücklage'*) of HRE Holding. HRE Holding transferred that capital claim to FMS-WM as of 1 October 2010.

II.3.2. *Guarantees*

II.3.2.1. Guarantees of EUR 35 billion

(36) On 13 November 2008 Germany provided State guarantees of EUR 35 billion to bridge the refinancing needs of HRE. The guarantees were temporarily approved by the Commission on 2 October 2008.

(37) These guarantees were provided for a liquidity line amounting to EUR 20 billion provided by the Deutsche Bundesbank and for guaranteed notes amounting to EUR 15 billion taken up by a consortium of German financial institutions.

(38) HRE paid a guarantee premium to the State for the EUR 35 billion guarantee consisting of a basic premium and a performance-related premium. The basic premium consisted of 1 % p.a. on the so-called 'First-Loss-Guarantee-Amount' and of 0,5 % p.a. on the so-called 'Second-Loss-Guarantee-Amount'. The performance-related premium consisted of 1,25 % p.a. on the 'First-Loss-Guarantee-Amount' and of 0,25 % p.a. on the 'Second-Loss-Guarantee-Amount'.

II.3.2.2. Guarantees of EUR 52 billion

(39) Between November 2008 and February 2009 HRE received guarantees of a total amount of EUR 52 billion from SoFFin on the basis of the approved German banking rescue scheme ([16]).

(40) HRE paid a guarantee fee of 0,5 % for the parts of the guarantee actually used to cover bonds and a commitment fee of 0,1 % for parts not used.

II.3.2.3. Guarantee of EUR 8 billion

(41) The 'secured notes' expiring on 23 December 2009 were replaced by a SoFFin guarantee for EUR 8 billion. The Commission temporarily approved that guarantee on 21 December 2009.

(42) HRE paid a guarantee premium to SoFFin amounting to 0,5 % p.a. of the guaranteed sum. For parts of the guarantee that were not used, a commitment fee of 0,1 % p.a. was applicable.

II.3.2.4. Guarantee of EUR 10 billion

(43) On 21 December 2009 a SoFFin guarantee of EUR 10 billion, lasting for one year at most, was temporarily approved by the Commission, in order to ensure the liquidity needs of HRE.

(44) HRE paid a guarantee premium to SoFFin amounting to 0,5 % p.a. of the guaranteed sum. For parts of the guarantee that were not used, a commitment fee of 0,1 % p.a. was applicable.

([15]) See footnote 10.

([16]) Commission decision of 27 October 2008 in case N 512/08, Rettungspaket für Kreditinstitute in Deutschland, replaced by Commission decision of 12 December 2008 in case N 625/08, Rettungspaket für Finanzinstitute in Deutschland (OJ C 143, 24.6.2009, p. 1).

II.3.2.5. Guarantee of EUR 20 billion

(45) HRE needed an additional EUR 20 billion liquidity guarantee because of adverse developments on the capital and interest rates futures markets, which affected HRE until the assets had been transferred to the winding-up institution FMS-WM. The guarantee was temporarily approved by the Commission on 24 September 2010.

(46) HRE paid a guarantee premium of 0,8 % p.a. For the part of the guarantee not used a commitment fee of 0,1 % p.a. was applicable.

II.3.2.6. Guarantee of up to EUR 20 billion

(47) A settlement guarantee of up to EUR 20 billion was needed because of the remaining uncertainties regarding the technically complicated procedures in connection with the transfer of assets to the winding-up institution. The guarantee was temporarily approved by the Commission on 24 September 2010.

(48) HRE paid a guarantee premium to SoFFin of 0,8 % p.a. For the unused part of the guarantee a commitment fee of 0,1 % p.a. was applicable.

II.3.3. *Transfer of assets to a winding-up institution*

(49) On 10 September 2010, Germany also notified the transfer of a notional amount of about EUR 210 billion of assets and about EUR 280 billion of derivatives to the winding-up institution FMS-WM. FMS-WM was created by a board decision of 8 July 2010 in accordance with the German *Finanzmarktstabilisierungsfondsgesetz* [Financial Market Stabilisation Fund Act] (§ 8a of the FMStFG). It manages assets and derivatives of the HRE group that it has taken over because they were either non-strategic or contained an unacceptable risk and capital burden. FMS-WM acts independently of HRE and benefits from an obligation on the part of SoFFin to compensate losses (*'Verlustausgleichspflicht'*). However, FMS-WM does not have a banking licence. As a result, many of the HRE assets could only be synthetically transferred; a variety of 'transfer' mechanisms, depending on the specific circumstances, were devised to obtain a similar regulatory capital relief effect for PBB and the HRE group.

(50) The transfer was temporarily approved by the Commission on 24 September 2010. The measure transferred non-strategic and non-performing assets such as government bonds or non-performing property loans (or, as described in recital 49, only their regulatory capital usage) into a government-backed vehicle to be wound down over a number of years. The transferred non-strategic assets also included those that could not be used as collateral for covered bonds.

(51) The effective transfer date was 30 September 2010. By that time, due to amortisation, the portfolio earmarked for the transfer had a book value of EUR 173 billion. In accordance with the Communication from the Commission on the treatment of impaired assets in the Community banking sector ('Impaired Asset Communication' or 'IAC') ([17]), the Commission appointed external experts to support it in valuing the portfolio, determining the aid element and assessing whether and to what extent the value of the transfer made was above the real economic value (REV) of the portfolio. As laid down in the IAC, Germany also commissioned an external expert to perform an independent valuation.

(52) The portfolio included about EUR 30 billion of commercial real estate loans, which are geographically diversified and composed mainly of financing of office buildings and shopping centres. They are of a relatively short duration (three years) but of inferior credit quality.

(53) The non-commercial real estate part of the portfolio was composed of public sector finance or bonds and loans to public entities or utilities. Most of that business consisted of standard bonds ('plain vanilla bonds'), but it also included EUR 31 billion of 'structured credit instruments' and another EUR 30 billion of public sector loans. The quality of the assets in this part of the portfolio was significantly better than that of the commercial real estate loans. However, due to their long maturities and with the market credit spread widening since acquisition, the securities suffered from a significant discount in terms of market price.

(54) The Commission's experts found that, in contrast to some other State aid cases, the complex commercial real estate loans and structured credit assets categories (mainly consisting of student loan backed securities, public sector asset backed securities and EUR 5 billion in a total return swap investment) were overall safe. They expected only limited losses on those categories, albeit higher than estimated by Germany's experts, mainly due to the valuation of cash bonds in the Halcyon/Pegasus structures as well as the negative basis and the implicit funding cost in the total return swaps. By contrast, the 'plain vanilla' bonds were transferred at an asset swap level close to parity, considerably above their REV. In addition, they belonged to markets that were not particularly impaired, so that their REV should in fact be close to their market value. As a result, the Commission's experts concluded that the REV of that part of the portfolio would be considerably below the value at which HRE transferred it to FMS-WM.

([17]) OJ C 72, 26.3.2009, p. 1.

(55) For the derivatives portfolio, the Commission's experts largely agreed with the findings of Germany's experts. In addition, they estimated the countervalue of the credit risk to be slightly higher than the level found by Germany's experts and incorporated some findings from their sample as well as a general 'operational risk' charge, motivated by prudent assumptions surrounding shortcomings in the overall hedge effectiveness.

(56) The table below summarises the findings of the Commission's experts:

(in EUR billion)

Portfolio	Notional value	Transfer value (TV)	Δ REV–TV (Germany's figures)	Δ REV–TV (Commission's experts' figures)	Divergence (Commission v Germany)
Bonds	83,444	93,960	– 0,902	– 7,590	– 6,688
Structured Credit	31,199	30,111	– 0,765	– 1,981	– 1,216
CRE loans	26,312	23,874	– 1,211	– 2,800	– 1,589
Non-CRE loans	29,834	31,115	– 0,222	– 1,084	– 0,862
Derivatives	280,255	– 13,106	– 2,149/ – 2,531	– 2,786	– 0,255
Total	451,044	165,954	– 5,249/ – 5,631	– 16,241	– 10,610

(57) As a result, the aid amount that, in line with the IAC, is not a priori compatible with the internal market (which is defined as the difference between REV and transfer value) is determined by the experts as being about EUR 16,2 billion. The total aid amount, i.e. the difference between transfer value and market value, is difficult to establish due to the lack of easily available market prices for the loan part of the portfolio. The extreme assumption that the market value of the loan book is zero would give a total aid amount of EUR 90 billion. Assuming that the loans trade in the same way as liquid bonds of similar maturity and credit quality, the total aid would be around EUR 20 billion.

II.4. **Grounds for initiating and extending the in-depth investigation**

(58) On 7 May 2009, the Commission opened an in-depth investigation into State aid measures for HRE, mainly based on doubts regarding HRE's viability, in particular in the light of HRE's refinancing strategy and needs. The initial restructuring plan submitted to the Commission on 1 April 2009 only identified external factors as reasons for HRE's financial problems and targeted a balance sheet reduction of only 25 %, meaning that the refinancing volume would have remained high. HRE planned to reduce the group balance sheet by selling assets on the market, not by transferring them to a winding-up institution. One of the core business fields described in the restructuring plan was budget finance activities that generate low margins, and the plan contained very little information on issues that are vital to the restructuring process such as the modification and integration of the IT systems. At that stage, the Commission also had doubts that there were sufficient measures to limit distortions of competition and sufficient burden-sharing measures.

(59) The in-depth investigation was extended on 13 November 2009 because:

(a) the additional State aid measures for HRE, in the form of a capital injection of EUR 2,96 billion (cf. recital 30), a capital injection of EUR 3 billion (cf. recitals 31 and 32), a guarantee of EUR 8 billion (cf. recitals 41 and 42), a guarantee of EUR 10 billion (cf. recitals 43 and 44) and a guarantee of EUR 2 billion ([18]) for refinancing a possible winding-down solution, plus capital injections amounting to a total of EUR 4 billion (structured as follows: the capital injection of EUR 1,85 billion referred to in recitals 33 and 34 and the capital injection of EUR 2,08 billion discussed in recital 35) had to be covered; and

([18]) According to Germany, the EUR 2 billion for the winding-up institution was never formally requested by HRE or approved by SoFFin. The Commission did not approve that guarantee.

(b) the Commission had doubts that the restructuring measures were compatible with the Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules ([19]) (Restructuring Communication).

(60) On 24 September 2010 the in-depth investigation was extended once more because:

(a) the additional State aid measures for HRE, namely a guarantee of EUR 20 billion (cf. recitals 45 and 46), a further guarantee of up to EUR 20 billion (cf. recitals 47 and 48) and the transfer of assets to a winding-up institution (cf. recitals 49 to 57) had to be covered; and

(b) the Commission had doubts regarding the compatibility of the asset relief measure with the IAC, in particular with respect to transparency, valuation, burden sharing and remuneration, and had noted that the restructuring plan had shortcomings with regard to demonstrating the restoration of viability, proper burden sharing and appropriate mitigation of distortions of competition.

II.5. **Main features of the restructuring plan**

(61) On 1 April 2009 Germany notified a first draft of a restructuring plan for HRE and, after several modifications, it submitted the final update of the plan on 14 June 2011. Unless otherwise specified, all references to the restructuring plan in the remainder of this Decision are to this final version of 14 June 2011.

(62) According to the restructuring plan, HRE — having been freed from its legacy of impaired assets with a nominal value of EUR 210 billion by transferring them to the winding-up institution FMS-WM — will redesign its business activities in such a way that its core bank PBB can carry out its activities based on a stable funding approach and improved internal control systems. Its future activities will be on a considerably smaller scale than HRE's activities before the crisis, regardless of whether measured in terms of balance sheet size, volume of new business, workforce, branch network or geographical scope.

(63) Compared with the situation before the crisis, PBB's strategic balance sheet size at the end of 2011 — corrected for items that are in run-down mode or have been synthetically transferred to FMS-WM — accounts for approximately 15 % of HRE's balance sheet size at the end of 2008. New business in real estate finance will, for example, be reduced to approximately 30 % of its pre-crisis level (HRE's new business in commercial real estate finance amounted to EUR 32,1 billion in 2007). The workforce has been reduced by approximately 30 %, and all the executive board members of HRE who held office before the crisis have been replaced. More than 30 participations, one third of which are outside Europe, have already been divested or liquidated, or are in the process of liquidation. Some 26 out of 32 branches have been closed. In addition, a multi-year, group-wide transformation project called 'New Evolution' with a budget of approximately EUR 180 million has been launched to improve and integrate the IT systems.

(64) PBB will continue two strategic business lines, real estate finance (REF) and public investment finance (PIF). Both business lines target assets that are eligible for German covered bonds, either in the form of German mortgage bonds ('*Hypothekenpfandbriefe*') or in the form of German public sector bonds ('*öffentliche Pfandbriefe*'). All other activities, in particular budget finance business, infrastructure finance, capital markets and asset management activities, will be terminated.

(65) The arrangements for the two other subsidiaries of HRE Holding are as follows: DEPFA Bank plc is put into run-down as of the date of notification of this Decision and will not generate any new business. The same applies to its subsidiaries. HRE Finance is in liquidation and also not carrying out new business.

(66) Germany claims that the fundamental decision to pursue a more conservative commercial strategy and to focus on German covered bonds as the primary refinancing source ensures a qualitative improvement of the lending activities because they are subject to the legal framework of the German *Pfandbriefgesetz* [Pfandbrief Act], which has specific requirements regarding the management, monitoring and control of risks, and provides for protective measures such as limitation of the loan-to-value ratio. That funding strategy considerably reduces HRE's previous dependency on the interbank money market, which in future is only needed for the warehousing period preceding the issuance of covered bonds.

III. **COMMENTS FROM INTERESTED PARTIES**

(67) The Commission received comments from interested parties, as summarised below:

(a) Summary of comments from Verband deutscher Pfandbriefbanken (vdp) (November 2009):

— vdp is convinced that a business model which is aligned on Pfandbrief-eligible business is promising and capable of ensuring the long-term viability and profitability of a bank without State guarantees.

([19]) OJ C 195, 19.8.2009, p. 9.

(b) Summary of comments from Heisse Kursawe Eversheds (November 2009):

— Heisse Kursawe Eversheds is of the opinion that the State aid violates the rights of certain shareholders, that the planned acquisition of all HRE shares by SoFFin by excluding minority shareholders (squeeze-out) constitutes further State aid, that the squeeze-out is not appropriate aid and that it violates the principle of free movement of capital.

(c) Summary of comments from Heisse Kursawe Eversheds (February 2010):

— In its further comments, Heisse Kursawe Eversheds is of the opinion that the exclusion of the minority shareholders of HRE (squeeze-out) is State aid within the meaning of Article 107 et seq. TFEU, that such State aid violates the freedom of movement of capital, and that State aid for HRE may only be authorised if HRE will be continued on the basis of a sustainable restructuring plan.

(d) Summary of comments from Bohdan Kalwarowskyj (February 2010):

— Mr Kalwarowskyj is of the opinion that, based on the valuation documents of HRE presented in the context of the squeeze-out on 5 October 2009, it is evident that HRE will be viable and profitable, and that SoFFin in cooperation with HRE aims to manipulate the company value downwards.

IV. COMMENTS FROM GERMANY ON THE COMMENTS FROM INTERESTED PARTIES

(68) On 24 March 2010 the Commission received comments from Germany on the comments from interested parties:

(a) Summary of comments regarding Verband deutscher Pfandbriefbanken (vdp):

— According to Germany, the comments from vdp confirm that the planning of HRE's business model is based on plausible assumptions.

(b) Summary of comments regarding Heisse Kursawe Eversheds:

— Germany is of the opinion that the squeeze-out does not constitute State aid within the meaning of Article 107(1) TFEU. As the squeeze-out does not constitute State aid, the question whether there is a violation of the principle of free movement of capital (which is not the case in Germany's opinion) is not relevant to the in-depth investigation at hand.

(c) Summary of comments regarding Bohdan Kalwarowskyj:

— Germany agrees with Mr Kalwarowskyj that, on the basis of the planned restructuring measures, the long-term viability of HRE would be secured.

V. POSITION OF GERMANY

(69) Germany accepts that the measures constitute State aid within the meaning of Article 107(1) TFEU.

(70) In order to ensure that the business model set out in the restructuring plan is put into action, and to ensure that adequate burden sharing is achieved and distortions of competition are limited to the minimum necessary, on 15 June 2011 Germany submitted a number of commitments, supplemented on 1 July 2011 ([20]), which can be summarised as follows:

(a) *Implementation of the restructuring plan and the commitments:* Germany will ensure that the restructuring plan as set out in its final version and the commitments are fully implemented.

(b) *Duration of the commitments:* In principle the commitments are valid until the end of the restructuring period, i.e. 31 December 2015. However, commitments regarding DEPFA Bank plc and its subsidiaries will in principle end as soon as DEPFA Bank plc is reprivatised, if that happens sooner. In such a case, Germany would notify the Commission of the sale in advance and would not implement the sale without the Commission's approval, if it were to take place before 31 December 2013. Commitments regarding PBB will end as soon as PBB is reprivatised, but in any event not before 31 December 2013

(c) *Business lines:* Germany will ensure that only PBB will pursue new business and will do so only in two business lines, real estate finance and public investment finance. All other business lines are stopped (the budget finance portfolio will remain on the PBB balance sheet but in run-down mode) and all other entities of the HRE group will stop their business activities.

(d) *Reprivatisation of PBB:* Germany will reprivatise PBB as soon as possible, and by 31 December 2015 at the latest.

(e) *Restriction of growth of PBB:* Germany will ensure that the growth rates of PBB remain within defined limits, measured in terms of balance sheet size as well as volume of new business.

([20]) The full commitments document is annexed to this Decision.

(f) *Winding-up institution:* Germany will ensure that, after 30 September 2013, PBB will provide neither asset management services nor refinancing services for the winding-up institution FMS-WM and that, from an organisational point of view, those services can be taken over by third parties.

(g) *Market presence:* Germany will ensure that PBB will acquire new business only on the following geographic markets:

(i) Real estate finance:

— Core markets ([21]): Germany, United Kingdom, France and Spain.

— Further markets: Sweden, Poland, Czech Republic, Belgium, Netherlands, Luxembourg, Austria, Switzerland, Denmark, Finland, Norway, Slovakia and Hungary.

(ii) Public investment finance:

— Core markets: Germany, France, Spain and Italy.

— Further markets: Switzerland, Austria, Poland, Hungary, Czech Republic, Slovakia, Sweden, Norway, Denmark, Finland, Belgium, Netherlands, Luxembourg and United Kingdom.

(h) *Remuneration for using the winding-up institution:* Germany will ensure that HRE, within the limits of its abilities, pays adequate remuneration in return for using the winding-up institution FMS-WM. Specifically, Germany will ensure that the Bundesanstalt für Finanzmarktstabilisierung ('FMSA') orders HRE to pay an amount of EUR 1,59 billion to FMS-WM either directly or via its subsidiaries. Those subsidiaries of HRE which transferred assets to the winding-up institution and which have a core capital quota exceeding 15 % are in principle liable for that payment. PBB will retain and accumulate profits in order to pay back the silent participation.

(i) *Restrictions regarding coupon payments and profit distribution:* Germany will ensure that HRE and its subsidiaries refrain, within the legal limits, from coupon payments and other measures of profit distribution.

([21]) PBB has an established branch network in core markets but not in the further markets.

(j) *Restrictions regarding paybacks:* Germany will ensure that HRE and its subsidiaries refrain from paying back existing financial instruments.

(k) *Acquisition ban:* Germany will ensure that HRE and its companies do not acquire other businesses during the restructuring period.

(l) *Commitments relating to information technology of HRE/PBB:* Germany will ensure that the project set up to improve the bank's IT systems is fully implemented.

(m) *Commitment relating to RAROC:* Germany will ensure that PBB's strategic new business does not issue any new loans that have a risk-adjusted return on capital (RAROC) of less than 10 % on a transaction-by-transaction basis.

(n) *Monitoring trustee:* Germany will ensure that the restructuring plan and all commitments are correctly implemented and that the implementation is constantly monitored by a sufficiently qualified monitoring trustee.

VI. **ASSESSMENT OF THE AID**

VI.1. **Existence of State aid under Article 107(1) TFEU and potential beneficiaries**

(71) The various measures in question were provided either directly by Germany or by SoFFin, an entity set up and controlled by the German Government, and thus involve State resources. The measures provide a selective advantage to HRE, enabling it to obtain new capital and guarantees and benefit from asset relief measures on more favourable conditions than could normally have been found on the market. HRE is an internationally active bank, competing with other banks in Germany and other countries. Therefore, for the same reasons as already outlined in the previous Commission decisions on HRE ([22]), the measures constitute State aid within the meaning of Article 107(1) TFEU.

(72) Within the HRE group only PBB (and its subsidiaries) is pursuing new economic activities and is thus active on the markets. PBB can thus be regarded as the entity continuing the activities of the former HRE (albeit to a limited extent, as explained in recital 63). All other entities of the HRE group (i.e. DEPFA Bank plc and its subsidiaries and HRE Finance i.L.) are in run-down mode and their activities are limited to what is necessary to allow for an orderly run-down, but they do not generate new business.

([22]) Commission decision of 2 October 2008 (OJ C 293, 15.11.2008, p. 1); Commission decision of 7 May 2009, replaced by the decision of 24 July 2009 in case C 15/09 (ex N 196/09) (OJ C 240, 7.10.2009, p. 11); Commission decision of 13 November 2009 in cases C 15/09 (ex N 196/09), N 333/09 and N 557/09) (OJ C 13, 20.1.2010, p. 58); Commission decision of 21 December 2009 in case N 694/09 (OJ C 25, 2.2.2010, p. 14); Commission decision of 19 May 2010 in case N 161/10 (OJ C 190, 14.7.2010, p. 7); Commission decision of 24 September 2010 in cases C 15/09 (ex N 196/09) and N 380/10 (OJ C 300, 6.11.2010, p. 6).

(73) The final objective and effect of all the aid measures (irrespective of whether they were formally granted to HRE, HRE Holding, PBB or DEPFA Bank plc) is to enable PBB to continue to be active on the markets. It is thus PBB's continued existence on the markets which is distorting competition. DEPFA Bank plc can (like FMS-WM) be considered merely as a winding-up institution for assets which for various reasons were not transferred to FMS-WM (the 'bad bank'). It will realise its assets as they mature or by selling them on the market, but will not contract new business as of the date of notification of this Decision ([23]).

(74) In view of the fact that PBB is therefore the economic continuation of HRE and, in line with the Commission's decision-making practice ([24]), PBB is considered the beneficiary of the aid, the assessment of the compatibility of the aid which follows will therefore concentrate on PBB.

(75) As regards the view expressed by Heisse Kursawe Eversheds that the squeeze-out constitutes State aid, the Commission notes that, while the capital injections into HRE constitute State aid, the squeeze-out of minority shareholders (i.e. the acquisition of their shares against payment to those shareholders) does not in itself contain State aid elements because it does not provide the bank with an advantage stemming from State resources. The squeeze-out involved a payment from the State to the minority shareholders, but this had no economic effect on HRE. From HRE's perspective only its ownership structure changed. As a result, the question whether the squeeze-out infringes the Treaty provisions on free movement of capital does not need to be assessed within this Decision.

VI.2. **Compatibility of the aid with the internal market**

VI.2.1. *Application of Article 107(3)(b) TFEU*

(76) Under Article 107(3)(b) TFEU, aid may be considered to be compatible with the internal market if it remedies a serious disturbance in the economy of a Member State. As the breakdown of a systemically relevant bank can directly affect the financial markets and indirectly affect the entire economy of a Member State, the Commission currently, in the light of the ongoing fragile situation on the financial markets, bases its assessment of State aid measures in the banking sector under State aid law on that provision.

(77) The Commission has no grounds to doubt Germany's qualification of HRE as a bank of systemic relevance, in particular in the light of the position it previously held in the German Pfandbrief market, the original size of HRE's balance sheet and the amount of derivatives previously held by HRE.

(78) The Commission observes that HRE has received rescue aid which the Commission has found to be compatible with the internal market; however, that aid will now have to be assessed to determine whether it may be considered to be restructuring aid which is compatible with the internal market. Therefore the Commission must now assess the compatibility of those measures and all further restructuring measures, i.e. the guarantees of EUR 52 billion and the capital injection of EUR 2,08 billion, on the basis of the Impaired Asset Communication and the Restructuring Communication.

VI.2.2. *Assessment on the basis of the Impaired Asset Communication (IAC)*

(79) Any asset transfer to a winding-up institution must take place in accordance with the IAC. Furthermore, the Restructuring Communication clearly states that adequate remuneration of any State intervention generally is one of the most appropriate limitations of distortions of competition, as it limits the amount of State aid. A limit on the bank's expansion in certain business or geographical areas may also be required, for instance via market-oriented remedies such as specific capital requirements, where the market would be weakened by direct restrictions on expansion, or to limit moral hazard.

(80) As regards the eligibility of assets earmarked for transfer, paragraph 34 of the IAC recognises the necessity of a pragmatic and flexible approach to the selection of asset types for impaired assets measures. The Commission has applied that flexibility in other State aid cases and accepted the transfer of assets which, strictly speaking, were not distressed but were non-strategic in view of the profound change in the business model of the bank in question.

([23]) This commitment with regard to winding-up does not per se prejudice the possibility that Germany might sell parts of DEPFA Bank plc or the entire DEPFA Bank plc or any of its subsidiary companies at a later date. If such sales were to take place before the end of December 2013, they would be notified to the Commission and would not be effected before the Commission had given its approval. In a scenario in which the DEPFA Bank plc group or any of its parts were to start to recommence operations on the market, this commitment enables the Commission to examine whether any state aid from which the DEPFA Bank plc had benefited was distorting competition and — if necessary — to take appropriate measures to reduce such distortion.

([24]) See, for example, Commission decision of 31 March 2011 in case SA.32745 (2011/NN, Kommunalkredit, not yet published).

(81) As set out in paragraph 46 of the IAC, in order to facilitate the bank's focus on the restoration of viability and to prevent possible conflicts of interest, it is necessary to ensure clear functional and organisational separation between the beneficiary bank and its impaired assets. The Commission understands that when the winding-up institution was created it was not possible, in particular for technical reasons, to immediately cut the links between PBB and FMS-WM. However, that situation must be remedied as quickly as possible. On that basis, Germany has committed that PBB will establish the full organisational independence of the related services and will no longer provide them to FMS-WM after 30 September 2013.

(82) As regards valuation and burden sharing, paragraph 21 of the IAC notes that correct remuneration is an element of the burden-sharing requirement. The Commission will ensure, as noted in Annex IV to the IAC, that any pricing of the asset relief includes remuneration for the State that adequately takes account of the risks of future losses exceeding those that are projected in the determination of the REV. In line with the Commission's decision-making practice on asset relief measures ([25]), the assessment of necessary remuneration of the capital relief effect will be based on a transfer at the REV, even if that is lower than the transfer value.

(83) Paragraph 41 of the IAC states that the transfer value should correspond to the REV. Where a Member State considers it necessary — in particular to avoid technical insolvency — to use a transfer value for assets that exceeds their REV, it can only be accepted if accompanied by far-reaching restructuring and the introduction of conditions allowing the recovery of that additional aid at a later stage, for example through a claw-back mechanism.

(84) On that basis, the Commission comes to the conclusion that the difference between the REV and the transfer value, which is to be recovered at a later stage and which was established with the support of the Commission's independent experts, is at the level of EUR 16,2 billion, and calls for a particularly thorough restructuring and downsizing of the bank. No additional remuneration is required, pursuant to paragraph 21 of the IAC, because, after an a priori capital deduction of EUR 16,2 billion, the measure does not entail any further capital relief effect ([26]).

(85) The Commission observes that Germany has not explicitly provided for recovery of that amount. However, it has introduced clauses allowing for recovery as far as possible. They consist of:

(a) a contingent payment of EUR 1,59 billion from HRE to the winding-up institution;

(b) the use by PBB of retained profits to redeem the silent participation of the Federal Republic of Germany;

(c) after the payment of EUR 1,59 billion has been made in full, the DEPFA Bank plc sub-group (i.e. parent company and all subsidiaries) must pay to Germany an adequate remuneration for the State support;

(d) although HRE has been nationalised, Germany plans to reprivatise PBB, which means that Germany will receive proceeds from any subsequent reprivatisation. Due to the fact that the State has taken the bank into public ownership and now plans to reprivatise it, it can also be argued that the State will try to recuperate as much of its contribution as possible and that former shareholders have contributed adequately.

Moreover, the proposed restructuring is very far-reaching and includes a dramatic downsizing of the 'good' core bank, to approximately 15 % of HRE's size at the end of 2008. Together with commitments on growth restriction, product range limitations, corporate governance and reprivatisation through a public tender, the complete restructuring package can be considered sufficiently far-reaching within the meaning of the IAC.

(86) The Commission also observes that the doubts it raised about Germany's and HRE's willingness and ability to provide full *ex ante* transparency and disclosure of the impairments have been alleviated by the extensive data delivery from a dedicated team at the bank. In addition, partly at the Commission's request, HRE has had its data sets audited for consistency and quality, which facilitated the final assessment by the Commission's experts. Furthermore, Germany and PBB have committed to far-reaching improvements to the risk management and reporting systems in order to alleviate the Commission's concerns about potential gaps in management information systems in the future.

VI.2.3. *Compatibility with the Restructuring Communication*

(87) The Restructuring Communication sets out the State aid rules applicable to the restructuring of financial institutions in the current crisis. According to the Restructuring Communication, in order to be compatible with

([25]) Cf. Commission Decision 2010/395/EU in case C 17/09, LBBW (OJ L 188, 21.7.2010, p. 1), and Commission Decision 2010/608/EC in case C 10/09 ING (OJ L 274, 19.10.2010, p. 139).
([26]) Cf. Commission Decision 2010/395/EU.

the internal market under Article 107(3)(b) TFEU, the restructuring of a financial institution in the context of the current financial crisis must lead to the restoration of the long-term viability of the bank, include a sufficient own contribution by the beneficiary (burden sharing) and contain sufficient measures limiting the distortion of competition ([27]).

(88) The amount of capital injections already granted, the amount of capital injection still envisaged and the amount of State aid resulting from the asset transfer together represent more than 20 % of HRE's pre-crisis risk weighted assets.

VI.2.3.1. Restoration of the long-term viability of PBB

(89) In line with section 2 of the Restructuring Communication, Germany submitted a comprehensive and detailed restructuring plan which identifies the causes of the financial difficulties faced by HRE and provides detailed information about the business model.

Causes of the difficulties experienced by HRE

(90) The restructuring plan and the complementary information provided by Germany show that HRE's difficulties were mainly attributable to:

(a) the status of HRE, and in particular its subsidiary DEPFA Bank plc, as a purely wholesale financed bank without franchise funding, so that it was highly dependent on an intact interbank money market, which temporarily came to a complete standstill after the collapse of Lehman Brothers;

(b) a legacy problem stemming from assets that do not show an appropriate return on investment if their actual risk profile is taken into account; and

(c) the fact that HRE was the product of a merger of several smaller banks with different IT applications that were not integrated into a comprehensive, coordinated risk management system.

Business model

(91) As set out above, the restructuring and the planned measures, which relate primarily to the funding of the bank and internal control systems, are intended to ensure that the liquidity problems that put the bank on the brink of insolvency cannot be repeated. The restructuring plan addresses the main concerns very specifically by focusing on a more stable, Pfandbrief-based funding concept, by considerably reducing the previous dependence on the interbank money market, by improving and integrating its IT systems and by reducing the geographical scope, the branch network and the absolute size of the business. Terminating other activities and treating them as a run-down portfolio on the PBB balance sheet is the logical complement to that concept.

(92) Consequently, the two remaining business lines of PBB will only target assets which are eligible for German covered bonds, either in the form of mortgage bonds (*'Hypothekenpfandbriefe'*) or that of public sector bonds (*'öffentliche Pfandbriefe'*). The argument that a more conservative commercial strategy of that kind should lead to a qualitative improvement of the lending activities is credible, in particular in the light of the specific requirements of the German Pfandbrief Act regarding the management, monitoring and control of risks, and its protective measures such as limits to the loan-to-value ratio.

(93) In recital 92 of the extension decision of 24 September 2010 (cf. recital 15 of this Decision) the Commission expressed doubts that the bank could achieve sufficient margins with its future business activities, in particular those in the public finance sector, which is characterised by low margins. Some of HRE's former public sector finance activities, namely the PIF activities, are to be continued. However, the PIF activities will only involve financing for products linked to investments by public-sector customers. Hence they can be distinguished from budget finance activities, i.e. uncommitted financing of public authorities, which are characterised by particularly low margins. In the adjusted business model low-margin budget finance activities are terminated (they are equivalent to approximately 75 % of the former public sector finance activities) and the resulting portfolio is put in run-down mode on the PBB balance sheet, so that those concerns of the Commission are alleviated. Moreover, the commitment from Germany to ensure that PBB in its strategic new business will not contract new loans which have a RAROC of less than 10 % on a single transaction basis helps to alleviate those concerns.

(94) The Commission also notes that keeping PIF as a second business line of PBB will mitigate concerns of market players and rating agencies about the lack of diversification on the part of banks which restrict their activities to a single business line (known as 'monoline banks') and are therefore overly dependent on a single business area. Having two business lines, with potentially different business cycles, should enable PBB to secure more stable and predictable revenues and to achieve the required visibility among institutional investors.

([27]) In that regard the Commission agrees with the observations of Heisse Kursawe Eversheds that the aid to HRE can be approved only on the basis of a sustainable restructuring plan.

(95) The restructuring concept will result in a clearer organisational structure, as fringe activities such as capital markets and asset management activities are terminated and the branch network is considerably reduced. A substantial number of sales offices have already been closed; according to the more detailed and regional business model, four of those sales offices (Berlin, Hamburg, the Rhine/Ruhr area and Stockholm) will be re-opened.

(96) The restructuring plan ensures that PBB will not unduly increase its presence on the markets. New lending is capped for both business lines. On its respective core markets PBB targets market shares of 1 % to 2 % with its PIF activities and 2 % to 6 % with its REF activities.

(97) The Commission notes that the bank has started to address the weaknesses of its IT system, which was initially rather heterogeneous and seriously deficient, in particular with regard to risk-management functionality and applications. In 2009 HRE set up a multi-year, group-wide project called 'New Evolution' with a budget of approximately EUR 180 million to transform the IT landscape. The project will roll out various system improvements in six successive releases. The scope of the project covers, inter alia, operational improvements such as the consolidation of credit management systems, risk management related improvements of the IT system with respect to credit, market and liquidity risks, standardisation of front office systems, and improvements to the accuracy, detail and quality of information and data. The information provided on the content and progress of the IT transformation process suggests that the initial problems have been adequately addressed and can be resolved to the required extent during PBB's restructuring period. It is the Commission's view that the future IT system will be a functional, efficient platform for timely and prudent risk management which is appropriate to the business processes. Its full implementation is therefore crucial.

(98) Liquidity, solvency and profitability of PBB ([28]) are taken as the main indicators of the viability of the bank, assessed under both a base case and a stress case scenario ([29]).

Liquidity

(99) According to the restructuring plan, PBB will no longer benefit from State guarantees on its refinancing. PBB nevertheless remains a wholesale funded institution without franchise funding. That situation is mitigated by PBB's strategy to significantly reduce the amount of unsecured funding required and instead to issue covered bonds, considered to be a more stable source of funding.

(100) As an acute liquidity shortage was one of the main causes of HRE's problems that ultimately led to the need for State support, the restructuring plan provides for an adequate cash and liquidity reserve, taking into account effects that might result from Basel III requirements. That reserve is greatest at the beginning of the restructuring period and will gradually decrease over time. In the base case scenario the cash and liquidity reserve would be approximately [12–17] % of PBB's balance sheet by the end of 2011 and reach a level of approximately [7–17] % by the end of 2015. In the stress case scenario the cash and liquidity reserve would exceed [7–10] % of PBB's balance sheet by the end of 2011, and reach a level of approximately [7–10] % by the end of 2015. In the Commission's view, the liquidity situation seems to be appropriate in both a base case and a stress case scenario.

Solvency

(101) With a core capital ratio (calculated on the Basel II internal ratings-based approach) projected at 12,9 % at the end of 2011 in the base case scenario or 10,5 % in the stress test scenario, PBB is sufficiently capitalised and will meet minimum capital requirements over the restructuring period. According to the assumptions used in the restructuring plan, the core capital ratio at the end of 2015 will be 12,4 % in the base case scenario or 11,3 % in the stress case scenario. However, the decline in the core capital ratio in the base case scenario is due mainly to the projected increase in risk-weighted assets resulting from the planned growth and not to losses (in the base case scenario, PBB shows a positive result after tax between 2011 and 2015; only in the stress case scenario would PBB show a loss after tax in 2011 and 2012).

Profitability

(102) The profitability of PBB is expected to improve over the restructuring period. According to the restructuring plan, in the base case scenario PBB's profit after taxes will amount to EUR [110–150] million in 2011 and to EUR [280-320] million in 2015. In 2011 that result would correspond to a return on equity (after taxes) of just [3–6] %, but at the end of the restructuring period in 2015 it would correspond to a return on equity (after taxes) of [8–11] %. The targeted profitability in the base case can hence be considered satisfactory for a bank pursuing the business targeted in the restructuring plan, both from a viability point of view and in the light of the planned reprivatisation of PBB. According to Germany, for PBB profits after tax will be offset by losses from previous years. In view of the losses carried forward, this means that PBB will record balance sheet losses ('*Bilanzverluste*') until 201[…] but will not do so in 201[…], in the context of the redemption of the silent participation.

([28]) In line with case practice the viability of parts of the group that are in run-down mode, such as DEPFA Bank plc, is not assessed.

([29]) The stress case scenario basically assumes a sovereign shock as in the CEBS stress test of 2010 and a 'double dip' scenario, affecting provisions for contingent loan losses, the amount of RWAs and prolongation rates.

(103) Table 1: PBB profit and loss forecast, International Financial Reporting Standards (IFRS) (base case scenario), according to the restructuring plan

		2011	2012	2013	2014	2015
Net interest income and similar earnings	EUR million	[…]	[…]	[…]	[…]	[…]
Net commission income	EUR million	[…]	[…]	[…]	[…]	[…]
Operating income	**EUR million**	**[…]**	**[…]**	**[…]**	**[…]**	**[…]**
Loan loss provisions	EUR million	[…]	[…]	[…]	[…]	[…]
Administrative expenses	EUR million	[…]	[…]	[…]	[…]	[…]
Balance of other income/expenses	EUR million	[…]	[…]	[…]	[…]	[…]
Pre-tax profit/loss	**EUR million**	**[…]**	**[…]**	**[…]**	**[…]**	**[…]**
Taxes	EUR million	[…]	[…]	[…]	[…]	[…]
Profit/loss after taxes	**EUR million**	**[110-150]**	**[140-160]**	**[170-220]**	**[240-270]**	**[280-320]**

(104) Assessing PBB's main profitability drivers, two sources of profitability can be identified: first, PBB's revenues stemming from its commercial activities will increase and, second, operating costs will decrease.

(105) As regards the increase of revenues, the restructuring plan assumes that the average margin on loans can be improved, in particular by underwriting new and more profitable business. With regard to the REF business line, net margins calculated for the current portfolios are assumed to improve from [85–100] bps (basis points) to [105–120] bps in 2011, [105–110] bps in 2012 and [95-100] bps thereafter. The PIF business line will generate a net margin of [27-35] bps during the whole restructuring period, which is a considerable improvement on the net margin of [6–12] bps calculated for the existing portfolio of public sector finance activities ([30]). That improvement is largely due to the fact that budget finance activities, which are characterised by particularly low margins, will no longer be pursued.

(106) Given the importance of securing sufficiently high margins, Germany's commitment that PBB's strategic new business will not contract new loans with a RAROC of less than 10 % on a transaction-by-transaction basis is appropriate and necessary.

(107) In 2011 and 2012, fees generated from asset management services provided for FMS-WM (HRE's 'bad bank') represent an important source of income for PBB. As set out in the IAC, in order to facilitate the bank's focus on the restoration of viability and to prevent possible conflicts of interest, it is necessary to ensure a clear functional and organisational separation between the beneficiary bank and its impaired assets. The Commission understands that when the winding-up institution was created it was not possible, in particular for technical reasons, to immediately cut the links between PBB and FMS-WM. However, that situation needs to be remedied as quickly as possible. On that basis, Germany has committed that PBB will establish full organisational independence of the related services and will no longer provide those services to FMS-WM after 30 September 2013. The same applies to the refinancing of FMS-WM. That commitment also helps to ensure that in the medium term PBB's profitability is self contained and no longer based on fee income related to the transfer of impaired assets.

(108) The Commission notes that PBB intends to reduce its operating costs considerably. Over the restructuring period, the cost-income ratio will improve significantly from [64–79] % in 2011 to [32–42] % in 2015 in the base case scenario.

(109) PBB has adopted some decisive restructuring measures that affect its cost base. It has closed a considerable number of sales offices and reduced its workforce by approximately 30 % (1 366 employees at the end of 2010, compared with 2 000 employees at the end of 2007) ([31]). While those measures will have a positive impact on operating expenses in the medium and long term, the restructuring process brings about extraordinary expenses in the short term, in particular for redundancy and early retirement payments, fees for lawyers and consultants, etc. In the Commission's view, the assumption that operating costs will stabilise at a considerably lower level once the restructuring process has been completed therefore seems credible.

([30]) That portfolio does not contain the assets that have been transferred to the winding-up institution FMS-WM.

([31]) Certain persons (e.g. executive board members, supervisory board members) are not included in those figures.

(110) After the transfer of impaired assets to FMS-WM, resulting in a significant reduction of the balance sheet, the base case scenario shows that PBB's loan loss provisions are stable for the restructuring period.

(111) The Commission considers that the targeted profitability of PBB is also sufficiently robust against the assumptions made in the stress case scenario, as neither the viability of the bank nor the prospects of reprivatising PBB are put at risk. According to the restructuring plan, in the stress case scenario PBB would record losses of EUR [100–125] million in 2011, yet at the end of the restructuring period in 2015 PBB is expected to show profits of EUR [270-310] million. The return on equity (after taxes) would be negative in 2011 (– [2,8–3,8] %) and in 2012, but in that scenario the expected return on equity in 2015 would be nearly [9–12] %.

(112) Table 2: PBB profit and loss forecasts, International Financial Reporting Standards (IFRS) (stress case scenario), according to the restructuring plan

		2011	2012	2013	2014	2015
Net interest income and similar earnings	EUR million	[…]	[…]	[…]	[…]	[…]
Net commission income	EUR million	[…]	[…]	[…]	[…]	[…]
Operating income	**EUR million**	**[…]**	**[…]**	**[…]**	**[…]**	**[…]**
Loan loss provisions	EUR million	[…]	[…]	[…]	[…]	[…]
Administrative expenses	EUR million	[…]	[…]	[…]	[…]	[…]
Balance of other income/expenses	EUR million	[…]	[…]	[…]	[…]	[…]
Pre-tax profit/loss	**EUR million**	**[…]**	**[…]**	**[…]**	**[…]**	**[…]**
Taxes	EUR million	[…]	[…]	[…]	[…]	[…]
Profit/loss after taxes	**EUR million**	**– [100-125]**	**– [75-90]**	**[230-290]**	**[250-290]**	**[270-310]**

(113) In the light of the improvements to the business model, the technical infrastructure and the organisational set-up, and their impact on PBB's situation as to expected liquidity, solvency and profitability, the Commission considers that the restructuring plan fulfils the requirements of the Restructuring Communication with regard to the restoration of long-term viability.

VI.2.3.2. Own contribution/burden sharing

(114) The Restructuring Communication stipulates that the beneficiary must make an appropriate contribution to the restructuring costs. The principles are laid down as follows in Section 3 of the Restructuring Communication:

(a) Restructuring aid should be limited to covering costs which are necessary for the restoration of viability.

(b) In order to limit the aid amount to the minimum necessary, the beneficiary bank should first use its own resources to finance restructuring, for example, through the sale of assets.

(c) The costs associated with the restructuring should not be borne solely by the State but should also be borne by those who invested in the bank by absorbing losses with available capital and by paying an adequate remuneration for State interventions. The objective of burden sharing is twofold: to limit distortions of competition and to address moral hazard ([32]).

(115) The Commission's doubts as to whether the aid is limited to the minimum necessary to restore the long-term viability of PBB have been allayed. Altogether Germany has invested or will invest nearly EUR 10 billion in HRE. Part of those capital injections, i.e. EUR 2,08 billion, will be used to recapitalise the winding-up institution FMS-WM, while another EUR 1,59 billion will be transferred to FMS-WM in the course of the restructuring. Approximately 63 % of the capital of nearly EUR 10 billion remains within the HRE group.

([32]) See point 22 of the Restructuring Communication.

(116) PBB is the only entity within the HRE group that will undertake new business in future and hence actively participate in competition. In the base case scenario its core capital ratios (based on the Basel II RBA method) are projected to be 12,9 % at the end of 2011, declining slightly over the restructuring period to reach 12,4 % by the end of 2015. The restructuring plan does not raise doubts that the bank will meet minimum capital requirements over the restructuring period. The projected core capital ratio is strong, yet in line with capital ratios of competitors. In reaction to the financial crisis, banks are now generally expected to show higher capital ratios than before the crisis. It also needs to be borne in mind that PBB, due to its problems within the crisis, needs a strong capital base in order to convince market players that it is a reliable business partner. In the Commission's view, the amount of capital provided and the resulting capital ratios are therefore deemed to be adequate and limited to the minimum necessary.

(117) HRE has furthermore benefited from the provision of guarantees amounting to EUR 145 billion in total, of which EUR 124 billion have actually been used. Those guarantees were necessary in order to enable the continued operation of the bank when it faced insolvency, at least until HRE was in a position to transfer its impaired assets to FMS-WM. All the guarantees that were used by the HRE group, amounting to a total of EUR 124 billion, were transferred to FMS-WM with effect from 1 October 2010. The operation of PBB therefore no longer relies on State guarantees. That transfer helped to ensure that the aid in the form of guarantees was limited to the minimum period necessary.

(118) As stated in the Restructuring Communication, beneficiary banks should first use their own resources to finance their restructuring, which is typically done by selling assets. HRE has hived off a considerable part of its assets by transferring a notional amount of about EUR 210 billion of assets as well as about EUR 280 billion of derivatives to the winding-up institution FMS-WM, thereby effectively cutting its balance sheet in half. However, that transaction has not created any accounting surplus that could have contributed to the financing of the restructuring costs. Rather, the transfer should be classified as a State aid measure itself, as the price that HRE received for the assets exceeded the REV of the assets by some EUR 16,2 billion. Nevertheless, the company has sold and is in the process of selling several participations in companies (e.g. Arsago ACM GmbH (Frankfurt), Arsago Holding AG (Switzerland), DEPFA First Albany Securities LLC (New York) and Collineo Asset Management GmbH).

(119) HRE has paid interest to SoFFin on all guarantees given by Germany, the respective interest rates ranging from 0,5 % to 0,8 % per annum. It has thus, in line with the Commission communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ([33]) ('Banking Communication'), adequately remunerated that part of the State aid. By contrast, up to now the bank has remunerated neither the capital received nor the capital relief arising from the asset relief measure, and is not capable of ensuring an adequate claw-back mechanism for the aid element received in the form of a transfer value of the assets which was higher than their REV.

(120) In the light of the overall economic situation of HRE, it can be concluded that the bank was simply not in a position to make any meaningful further own contribution to the restructuring costs ([34]). Therefore the lack of own contribution has to be compensated for by particularly far-reaching structural measures in the restructuring plan, in order to ensure that the bank and its shareholders adequately share the burden of the rescue of the bank. Overall, the Commission considers that the amount of downsizing laid down in the restructuring plan in terms of organisational size, market presence, scope of activities and balance sheet size is, given the specific circumstances of this case, an adequate substitute for the lack of adequate own contribution.

(121) It should also be borne in mind that the bank was taken into public ownership and that the compensation received by its former shareholders was based on the value of the company without State support ([35]). That outcome is a positive element from a State aid point of view and means that the former shareholders have been wiped out and thus can be considered as having sufficiently contributed to the costs of the restructuring of HRE.

(122) Furthermore, as regards HRE's subordinated debt holders, Germany has provided a commitment that HRE will not make discretionary payments on profit-related financial instruments to third parties, thereby ensuring that Tier 2 capital holders will get little or no compensation for their investment and will thus participate in the burden sharing in the same way as Tier 1 capital holders.

([33]) OJ C 270, 25.10.2008, p. 8.

([34]) That highly distressed status of the bank in the past can also be seen as the reason why Germany decided to take the bank into state ownership.

([35]) In general, the Commission considers that the purchase of existing shares and the takeover of assets do not favour a company inasmuch as they amount to a mere change of ownership. The compensation paid to the minority shareholder does not therefore constitute state aid to HRE within the meaning of Article 107(1) TFEU, since it does not provide the company with an advantage stemming from state resources. See also Commission decision of 16 February 2009 in case N 61/09, Change of ownership of Anglo-Irish Bank Corporation plc (OJ C 177, 30.7.2009, p. 2), and Commission decision of 2 April 2008 in case C 14/08 Northern Rock (OJ C 135, 3.6.2008, p. 21).

(123) The Commission therefore concludes that HRE's shareholders have adequately contributed to the restructuring costs and that as a consequence the risk of moral hazard is adequately addressed.

VI.2.3.3. Measures limiting the distortion of competition

(124) As regards the measures limiting the distortion of competition, the Restructuring Communication sets out that the Commission has to take into account, in its assessment the amount of aid, the degree of burden sharing and the position the financial institution will have on the market after the restructuring. On the basis of that analysis, suitable measures should be put into place.

(125) The distortions of competition caused by HRE are significant. Overall, the German State has provided or will provide for HRE capital injections totalling up to approximately EUR 9,95 billion (FMS-WM is the recipient of part of that capital) and guarantees of EUR 145 billion. HRE also benefited from an asset relief measure with an aid element of about EUR 20 billion. In view of that considerable State support, a deep restructuring of HRE must be carried out.

(126) HRE's successor, PBB, will be well funded and relieved of the burden of the risky lending made by HRE in the past. A large amount of aid has been necessary in order to keep PBB in business and to facilitate the split-up. However, PBB will be a much smaller bank, and sufficient measures limiting any distortion of competition have been put in place by Germany.

(127) First, PBB will be an economic entity that is rather different from the former HRE. It has been taken into public ownership and is currently undergoing in-depth restructuring. As a result, PBB is a much smaller bank than HRE was. After the transfer of a series of assets to FMS-WM, PBB's strategic balance sheet size — which does not take into consideration those balance sheet items which are in run-down mode or have been synthetically transferred to FMS-WM — is around 15 % of HRE's balance sheet at the end of 2008.

(128) Second, Germany has provided the Commission with several commitments aimed at limiting PBB's market presence, which have been described in more detail in Section V. PBB will only pursue new business in two business lines, REF and PIF. Those two business lines have only limited room for growth during the restructuring period because new business, the balance sheet and portfolio sizes must all stay within defined boundaries, effectively restricting PBB's ability to expand on the market and thus distort competition. Those caps on growth will remain in place until at least 31 December 2013 and potentially longer if PBB is not reprivatised by then. All other entities of the HRE group must stop business and run down their portfolios, in particular infrastructure finance, capital markets and asset management, and activities related to budget finance.

(129) Third, in order to allay the Commission's concerns that PBB might harm competition and competitors through overly aggressive pricing strategies, Germany has given a commitment that PBB's strategic new business will not issue new loans with a RAROC of less than 10 % on a transaction-by-transaction basis. In the Commission's view, that commitment will be another effective measure against undue distortions of competition.

(130) Fourth, PBB's activities will be limited by behavioural constraints which include an acquisition ban and a ban on invoking State support in its advertising.

(131) Finally, Germany has committed to reprivatise PBB as soon as possible, i.e. by 31 December 2015 at the latest. The sale of PBB will allow the Federal Republic of Germany to recover (part of) the funds invested in HRE. In addition, the Commission notes that timely reprivatisation can ensure that third parties have the opportunity to acquire PBB.

VII. **MONITORING**

(132) Germany has committed that the implementation of the HRE restructuring plan and the implementation of the commitments will be monitored by a monitoring trustee, who will submit reports to the Commission on a quarterly basis.

VIII. **CONCLUSION**

(133) The Commission concludes that the measures analysed above constitute State aid pursuant to Article 107(1) TFEU.

(134) The Commission further concludes that the restructuring aid is compatible with the internal market pursuant to Article 107(3)(b) TFEU subject to the implementation of the restructuring plan which was finally updated on 14 June 2011 and subject to the fulfilment of the commitments set out in the Annex to this Decision,

HAS ADOPTED THIS DECISION:

Article 1

The State aid which Germany implemented and is planning to implement in favour of Hypo Real Estate Group, consisting of:

— capital injection of EUR 60 million, notified on 17 April 2009,

— capital injection of EUR 2,96 billion, notified on 3 June 2009,

— capital injection of EUR 3 billion, notified on 26 October 2009,

— capital injection of EUR 1,85 billion, notified on 30 April 2010, of which EUR 450 million is contingent on the existence of certain circumstances,

— capital injection of EUR 2,08 billion, notified on 10 September 2010,

— guarantees of EUR 35 billion, notified on 30 September 2008,

— guarantees of EUR 52 billion, notified on 17 April 2009,

— guarantee of EUR 8 billion, notified on 26 October 2009,

— guarantee of EUR 10 billion, notified on 26 October 2009,

— liquidity guarantee of EUR 20 billion, notified on 2 September 2010,

— settlement guarantee of EUR 20 billion, notified on 10 September 2010 and

— assets transfer to the winding-up institution FMS Wertmanagement AöR, notified on 10 September 2010,

is compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union in the light of the commitments set out in the Annex to this Decision.

Article 2

Germany shall ensure that, from the notification of this Decision, detailed quarterly reports are submitted to the Commission on the measures taken to comply with it, in line with the time schedule set out in the Annex to the commitments.

Article 3

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 18 July 2011.

For the Commission

Joaquín ALMUNIA

Vice-President

ANNEX

COMMITMENTS DOCUMENT IN STATE AID PROCEEDINGS SA.28264 (C 15/09) HYPO REAL ESTATE — GERMANY

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1. **General**

(i) The Federal Republic of Germany ('Germany') will ensure that the restructuring plan submitted on 1 April 2009 and updated on 14 June 2011 ('restructuring plan') for Hypo Real Estate Konzernverbund ('HRE') including the commitments set out below ('commitments') is implemented in full within the periods specified ('periods') in each case.

(ii) The purpose of this Commitments Document is to enable the European Commission to take a decision under procedure SA.28264 (C 15/09) which approves the State aid notified by Germany, in particular the implementation of recapitalisation measures and guarantees and all measures associated with the establishment, staffing and servicing of the winding-up institution 'FMS-Wertmanagement' ('winding-up institution') by HRE companies.

(iii) On reprivatisation of Deutsche Pfandbriefbank AG ('PBB'), DEPFA BANK plc ('DEPFA plc') and of the participations held by DEPFA plc in Hypo Public Finance Bank plc ('HPFB'), Hypo Pfandbrief Bank International SA ('HPBI') and DEPFA ACS Bank plc ('ACS'), all obligations arising from this Commitments Document will cease to apply to the reprivatised company. For the PBB sub-group only, this will apply from 31 December 2013 at the earliest. Reprivatisation will be considered to have been successful if Germany cannot directly or indirectly exercise sole or joint control within the meaning of Article 3 of the Merger Regulation (EC) No 139/2004 over the company in question ('reprivatisation').

2. **Restriction of new business to the PBB sub-group**

Germany will ensure that, as of notification of the final Commission decision on the compatibility of the State aid implemented for HRE with the common market ('decision') at the latest, HRE restricts its new business to the PBB sub-group. Germany will ensure that all other HRE companies conduct no new business but allow their existing business to run down. The PBB sub-group will become active as a specialised commercial bank for Pfandbrief-eligible real estate finance and Pfandbrief-eligible public investment finance in the countries referred to in paragraph 8.4:

(i) In the business line of real estate finance all activities of the PBB sub-group in commercial real estate finance will be associated with professional real estate clients.

(ii) The business line of public investment finance will comprise exclusively medium- or long-term financing of public projects which are either in the public interest or serve to safeguard the productivity potential, including services which are closely linked with such financing.

(a) The product catalogue of the PBB sub-group will therefore be limited to investment financing of the following activities:

(I) public sector facilities (administrative and special-purpose facilities, educational and cultural establishments, and sports facilities);

(II) construction of local authority housing (social housing, housing associations, student housing);

(III) utility supply and waste disposal (energy generation, water collection and supply, waste water disposal and processing, refuse disposal and recycling);

(IV) essential infrastructure (networks and facilities for road, waterway, rail and air transport, transport and equipment fleets for local and long-distance transport, and systems and facilities for intelligence and defence);

(V) health and age care (medical health and care facilities and administrative and insurance facilities).

(b) With regard to customers within the public sector, the PBB sub-group will restrict itself to:

(I) financing which is concluded directly with a public-sector borrower that is recognised as eligible for cover under the German Pfandbrief Act on the basis of a specific restricted use commitment, in accordance with the above product catalogue;

(II) financing for companies with a public or private legal status and financial basis which are secured by a public guarantee within the meaning of the Pfandbrief Act (transport and utility companies, public utility companies, special-purpose associations, management companies, non-profit businesses, associations);

(III) financing for special-purpose companies secured by a public guarantee within the meaning of the Pfandbrief Act (special-purpose companies for PPP/PFI projects, investment companies for buildings and facilities, capital goods covered by an export credit guarantee/ECA).

(c) With regard to the financing structures, these activities will take account of the cash flows generated by the project/object and/or a public guarantee or other public safeguard within the meaning of the Pfandbrief Act. A report on expenditure of funds will be obtained for all new public investment financing. Public investment financing by the PBB sub-group will not include financing of purely budgetary resources, liquidity bridging, short-term lending and advances on current accounts for day-to-day operation.

(iii) The PBB sub-group can undertake restructuring and prolongation of existing assets in so far as this is necessary in order to maintain value and for efficient management of the cover pools.

(iv) In so far as is necessary for regulatory or other legal reasons (e.g. requirements under Basel III, MaRisk, EBA/CEBS or the Pfandbrief Act which can only be guaranteed by government bonds which are fungible or required by the regulator), the PBB sub-group may, notwithstanding the suspension of the budget financing business, continue to acquire, hold and sell approved securities for management of the cover pools of the PBB sub-group and for liquidity management. This does not include any budget finance business as a strategic business activity.

3. **Reprivatisation of the PBB sub-group**

(i) Germany will ensure that reprivatisation of the PBB sub-group in accordance with the terms and conditions of sale set out in paragraph 11 takes place without delay, but by 31 December 2014 at the latest, under economically sustainable conditions, namely by sale to one or more purchasers which are independent of Germany and the HRE, if necessary by means of flotation. A purchaser is independent of Germany if, at the time of reprivatisation, Germany cannot directly or indirectly exercise sole or joint control within the meaning of Article 3 of the Merger Regulation (EC) No 139/2004 over the purchaser. A purchaser is independent of HRE if, at the time of reprivatisation, HRE holds no direct or indirect shares in the purchaser and also has no other links with the purchaser under company law. The purchaser must be approved by the Commission.

(ii) Economically sustainable conditions for reprivatisation exist if the proceeds of the reprivatisation represent:

(a) up to 31 December 2013, not less than [80–100] %; or

(b) up to 31 December 2014, not less than [80–100] %

of the sum of all payments, amounting to a maximum of EUR 10,23 billion, which the Sonderfonds Finanzmarktstabilisierung ('SoFFin') has paid or has yet to pay in accordance with the decision of the European Commission:

(a) to third parties for the purchase of shares in HRE; and

(b) to HRE in the context of carrying out recapitalisation measures.

If reprivatisation has not taken place by 31 December 2014, it will be effected by 31 December 2015 irrespective of the proceeds achievable. If reprivatisation has not taken place by 31 December 2015, a Divestiture Trustee will be appointed with the remit of completing reprivatisation irrespective of the proceeds achievable. The appointment, duties, responsibilities and discharge of the Divestiture Trustee must follow the procedures set out in the 'Trustees' annex.

4. **Restriction of growth of the PBB sub-group**

(i) Germany will ensure that the cumulative book values of the interest-bearing assets ('interest-bearing assets') in the PBB sub-group's strategic business lines of real estate finance and public investment finance, which at 31 December 2010 together amounted to EUR 34,3 billion, do not exceed EUR [30–50] billion at 31 December 2011, EUR [40–60] billion at 31 December 2012, EUR [40–60] billion at 31 December 2013, EUR [40-60] billion at 31 December 2014 and EUR [60–90] billion at 31 December 2015. The interest-bearing assets of the two strategic business lines may be subdivided as follows:

(a) Real estate finance business line EUR [20–40] billion up to 31 December 2011, EUR [20–40] billion up to 31 December 2012, EUR [20–40] billion up to 31 December 2013, EUR [30–50] billion up to 31 December 2014 and EUR [30–50] billion up to 31 December 2015.

(b) Public investment finance business line EUR [10–25] billion up to 31 December 2011, EUR [10–25] billion up to 31 December 2012, EUR [10–25] billion up to 31 December 2013, EUR [10–25] billion up to 31 December 2014 and EUR [10–25] billion up to 31 December 2015.

(ii) The cumulative book values of the interest-bearing assets in the PBB sub-group's strategic business lines of real estate finance and public investment finance are based on new business as follows:

(a) In the real estate finance business line the annual new business is limited to EUR [9–15] billion in 2011, EUR [9–15] billion in 2012, EUR [7-16] billion in 2013, EUR [5–16] billion in 2014 and EUR [5-16] billion in 2015.

(b) In the public investment finance business line the annual new business is limited to EUR [1–5] billion in 2011, EUR [1–5] billion in 2012, EUR [1-6] billion in 2013, EUR [1–7] billion in 2014 and EUR [1–7] billion in 2015.

If the upper limits for the volume of new business as set out in 4(ii)a) and 4(ii)b) are not reached, this new business can be made up in the following years.

(iii) Compliance with the upper limits as set out in paragraph 4(i) and paragraph 4(ii) is obligatory. Deviations from those limits are permissible as described below:

(a) Within the limits for the total amount of interest-bearing assets for both of the PBB sub-group's strategic business lines as set out in paragraph 4(i) and for new business as set out in paragraph 4(ii), PBB may offset growth that has not been achieved in one business line with additional growth in the other business line. The precondition for utilisation of this option is that, in the public investment finance business line, annual new business amounting to a minimum of EUR [1–4] billion and a maximum of EUR [1–4] billion must have been concluded in the years 2011 to 2013 and a minimum of EUR [1–4] billion and a maximum of EUR [1–4] billion in the years 2014 and 2015.

(b) If the asset portfolios in one of the business lines are run down to a greater extent than was originally planned, the difference may be compensated for by new business of that magnitude, provided that the cumulative book values for interest-bearing assets in the relevant business line, as set out in paragraph 4(i), continue to be maintained and provided that the values for new business as set out in paragraph 4(ii) are exceeded by not more than a maximum of [7–11] % per year.

(iv) Germany will ensure that the PBB sub-group's corrected IFRS group balance sheet ('corrected IFRS group balance sheet'), which amounted to EUR 112,6 billion at 31 December 2010, does not exceed EUR 107,0 billion at 31 December 2011, EUR 105,0 billion at 31 December 2012, EUR 105,0 billion at 31 December 2013, EUR 103,0 billion at 31 December 2014 and EUR 107,0 billion at 31 December 2015.

(v) Germany will ensure that the PBB sub-group's corrected strategic IFRS balance sheet ('corrected strategic IFRS group balance sheet'), which amounted to EUR 64,7 billion at 31 December 2010, does not exceed EUR 67,0 billion at 31 December 2011, EUR 71,0 billion at 31 December 2012, EUR 75,0 billion at 31 December 2013, EUR 79,0 billion at 31 December 2014 and EUR 86,0 billion at 31 December 2015.

(vi) The new business of the PBB sub-group will encompass all newly concluded nominal volumes (without prolongation or restructuring) in interest-bearing assets in the strategic business lines of real estate finance and public investment finance. Syndications, which must normally be effected/transferred within six months, can only be initiated with the part which remains the property of PBB.

(vii) The corrected IFRS group balance sheet corresponds to the IFRS group balance sheet of the PBB sub-group, corrected for the one-off and pass-through effects stemming from the transfer of non-strategic assets to the winding-up institution FMS-WM. This relates, for instance, to ECB funding of the winding-up institution or upgrades to the transfer channels which have not yet been implemented, e.g. back-to-back instead of novation for derivatives. In addition to the assets required for proper running of the bank, the PBB sub-group's corrected IFRS group balance sheet contains:

(a) the interest-bearing assets of the strategically relevant portfolio (real estate finance, public investment finance) (paragraph 4(i));

(b) the interest-bearing assets of the non-strategic budget finance portfolio which runs off onto the balance sheet; and

(c) the assets which were transferred to the winding-up institution synthetically, but without transfer of beneficial ownership and therefore without derecognition from the PBB balance sheet, which are entered in PBB's mortgage cover pool.

(viii) The corrected strategic IFRS group balance sheet corresponds to the corrected IFRS group balance sheet (paragraph 4(vii)), minus

(a) the interest-bearing assets of the non-strategic budget finance portfolio which runs off onto PBB's balance sheet (paragraph 4(vii)(b)); and

(b) the assets which were transferred to the winding-up institution synthetically but without transfer of beneficial ownership and therefore without derecognition from the PBB balance sheet, which are entered in PBB's mortgage cover pool (paragraph 4(vii)(c)).

(ix) Germany will ensure that the PBB sub-group has suitable accounting or financial reporting structures to enable compliance with these commitments to be monitored.

(x) The figures in paragraphs 4(i), 4(iv) and 4(v) may be corrected for non-taxable effects such as changes to the valuation standards. The balance sheet figures may also be adjusted for foreign currency effects and the trend in the market values of derivatives, if this trend is different from the trend described in the restructuring plan and the difference is not attributable to an increase in the notional values of the derivatives.

5. **Active reduction of the business activities of the DEPFA plc sub-group**

5.1. *Business activities of the DEPFA plc sub-group*

Germany will ensure that HRE separates itself completely from the business activities of the DEPFA plc sub-group,

(i) by foregoing new business in the DEPFA plc sub-group (balance sheet of EUR 248 billion at 31 December 2008) as of the date of notification of the decision at the latest. The following are not 'new business' within the meaning of this Commitment Document:

(a) restructuring of existing loans in order to maintain value, provided that those loans fall under the management of problem loans;

(b) transactions which are necessary in the context of liquidity management of the DEPFA plc sub-group or the winding-up institution, e.g. central bank transactions;

(c) management of the cover pools of HPBI and ACS;

(d) prolongations which are necessary in order to avoid losses, provided that a prolongation offers significantly better prospects of final realisation;

(e) derivative transactions which are necessary in order to manage interest rate, currency and credit risks in the existing portfolio, e.g. asset swaps, provided that they have the effect of reducing the overall market risk position of the DEPFA plc sub-group;

(f) business which was fully consolidated in the group financial statement of DEPFA plc or business for which the commercial opportunities and risks already lay predominantly with the DEPFA sub-group;

(g) all business which is necessary for regulatory or other legal reasons, including the acquisition, holding and sale of approved securities for management of the cover pools of the DEPFA plc sub-group and for liquidity management of the DEPFA plc sub-group (cf. paragraph 2(iv)); this does not include any budget finance business as a strategic business activity;

(h) all business that DEPFA plc and its subsidiary companies conclude for the purpose of refinancing, including new issues and buying back of debt;

if 'necessity' is a requirement of paragraphs 5.1(i)(b), 5.1(i)(d), 5.1(i)(e) and 5.1(i)(g), this means that the measure in question must be capable of achieving the objective that it serves under economically viable and sustainable conditions;

(ii) and by

(a) the reprivatisation of DEPFA plc and the participations held by DEPFA plc (HPFB, HPBI and ACS) in accordance with paragraph 5.2; or

(b) the sale of other credit portfolios and other assets in accordance with paragraph 5.3; or

(c) use of a winding-up institution, as has already taken place, in accordance with paragraph 6.

5.2. *Sale of DEPFA plc or participations held by DEPFA plc (HPFB, HPBI and ACS)*

(i) If and in so far as the sale of individual assets of HPFB, HPBI, ACS or DEPFA plc does not represent the more cost-effective form of active run-down (paragraph 5.3), Germany will ensure that HRE effects the reprivatisation of HPFB, HPBI, ACS or DEPFA plc as a sub-group without delay, but by 31 December 2014 at the latest, in accordance with the terms and conditions of sale as set out in paragraph 11. At the same time, Germany will ensure that the necessary sales procedures are introduced sufficiently promptly so as to enable reprivatisation of HPFB, HPBI, ACS or DEPFA plc as a sub-group to be effected by 31 December 2014.

(ii) Reprivatisation of HPFB, HPBI, ACS or DEPFA plc as a sub-group must, in each case, take place only if and in so far as the following conditions are met with regard to the company in question:

(a) taking into account all contractual obligations and assuming that the underlying financial and balance-sheet-relevant legal conditions are essentially unchanged, the minimum sale proceeds realised are […]; and

(b) the purchaser in each case undertakes to redeem all of HPFB, HPBI, ACS or DEPFA plc's refinancing liabilities with respect to HRE, its subsidiaries and the winding-up institution so that refinancing which is independent of HRE and the winding-up institution can be put in place.

(iii) If the DEPFA plc sub-group is being wound up and therefore withdraws from the market, no problems which are related to State aid will arise as long as the DEPFA plc sub-group does not contract any new business. Germany undertakes to notify the European Commission promptly in advance of any sale of DEPFA plc or subsidiaries of DEPFA plc to third parties, and a sale will not take place before 31 December 2013 unless it has been approved by the Commission in advance. The Commission will make every effort to complete the relevant investigation as quickly as possible. This commitment does not apply to asset-only sales from DEPFA and/or its subsidiaries.

5.3. *Sale of credit portfolios*

(i) Germany will ensure that other credit portfolios held by DEPFA plc, in so far as they are not covered by paragraph 5.2, are sold to one or more suitable, independent purchasers by 31 December 2014.

(ii) A sale must take place only if and in so far as, taking into account all contractual obligations and assuming that the underlying financial and balance-sheet-relevant legal conditions are essentially unchanged, the minimum sale proceeds realised are […].

6. **Winding-up institution**

(i) Germany commits that, after 30 September 2013, the PBB sub-group will no longer provide services associated with servicing of the winding-up institution FMS-WM. Short-term follow-up work and supervision of the handover process to a new service provider which is independent of the HRE group will remain unaffected.

(ii) Germany commits that, after 30 September 2013, HRE will no longer provide refinancing services to the winding-up institution.

(iii) Germany commits that — subject to paragraph 6(i) — there will be a clear organisational separation between the winding-up institution and HRE/PBB.

7. **Active reduction and run-down of business lines**

(i) Germany will ensure that HRE actively reduces the business lines of infrastructure finance and capital markets/asset management. Therefore Germany will ensure in particular that, as of the date of notification of the decision at the latest, HRE does not conclude any more new business in the business lines of infrastructure finance and capital markets/asset management. Paragraph 5.1(i) will apply *mutatis mutandis*.

(ii) Germany will ensure that the PBB sub-group allows the budget finance business line on its balance sheet to run down and, as of the date of notification of the decision at the latest, does not conclude any more new business in the budget finance business line. The budget finance business line includes budgetary lending to State authorities such as central and federal governments, local authorities and regional governments which is used for general, uncommitted financing of the budget and is therefore not tied to a specific purpose with the character of an asset and/or investment.

8. **Reduction in market presence**

8.1. *Reduction in market presence in the public investment finance and budget finance business lines*

At 31 December 2010 HRE had closed the 15 sites listed below in the public investment finance and budget finance business lines:

(i) Amsterdam;

(ii) Athens;

(iii) Bucharest;

(iv) Chicago;

(v) Frankfurt am Main;

(vi) Hong Kong;

(vii) Istanbul;

(viii) Copenhagen;

(ix) Milan (sales section of the site);

(x) Mexico City;

(xi) Mumbai;

(xii) Nicosia;

(xiii) São Paulo;

(xiv) Sacramento; and

(xv) Warsaw.

8.2. *Reduction in market presence in the real estate finance business line*

At 31 December 2010 HRE had closed the 12 sites listed below in the real estate finance business line:

(i) Berlin (sales section of the site);

(ii) Dortmund;

(iii) Hamburg;

(iv) Hong Kong;

(v) Copenhagen;

(vi) Lisbon;

(vii) Milan (sales section of the site);

(viii) Manchester;

(ix) Mumbai;

(x) Singapore;

(xi) Stockholm; and

(xii) Tel Aviv.

8.3. *Reactivation of branches or sales offices*

The PBB sub-group is at liberty to re-open three branches or sales offices in Germany (Berlin, Hamburg, Rhine-Ruhr area) and one branch in Stockholm. Germany will ensure that HRE/PBB does not open any further branches, sales offices or sites.

8.4. *Restriction of the countries with new business activity*

Germany will ensure that the PBB sub-group only concludes new business in the following countries:

(i) Real estate finance:

(a) Core markets: Germany, United Kingdom, France, Spain.

(b) Further markets: Sweden, Poland, Czech Republic, Belgium, Netherlands, Luxembourg, Austria, Switzerland, Denmark, Finland, Norway, Slovakia, Hungary.

(ii) Public investment finance:

(a) Core markets: Germany, France, Spain, Italy.

(b) Further markets: Switzerland, Austria, Poland, Hungary, Czech Republic, Slovakia, Sweden, Norway, Denmark, Finland, Belgium, Netherlands, Luxembourg, United Kingdom.

9. **Own contribution**

9.1. *Remuneration for using the winding-up institution*

(i) Germany will ensure that HRE, within the limits of its abilities, pays remuneration in return for using the winding-up institution FMS-WM. Thus Germany will ensure that the Federal Agency for Financial Market Stabilisation ('FMSA') sets the payment obligations pursuant to § 8a(4)(8) of the Financial Market Stabilisation Fund Act (FMStFG) amounting to EUR 1,59 billion ('payment obligation') at the full level and that the HRE subsidiaries, to which the payment obligation is addressed, pay the payment obligation in full in accordance with the contractual conditions specified therein, if necessary on a phased basis. The payment will be made to FMS-WM, with the result that the capital of FMS-WM will increase accordingly on payment. In accordance with the payment obligation, those HRE subsidiaries which have transferred assets to the winding-up institution are liable to pay, provided that they have a core capital quota exceeding 15 % and also comply with certain regulatory and other requirements. On the basis of the data collected at 31 March 2011, this would apply solely to subsidiaries of the DEPFA sub-group; depending on future developments, a payment could also be required from subsidiaries of the PBB sub-group.

(ii) Germany will ensure that PBB, within the limits of its abilities, pays appropriate remuneration to Germany in return for the State support measures. This will be achieved by skimming off all the profits of Deutsche Pfandbriefbank AG (HGB unconsolidated financial statement). Profits will be skimmed off by means of the following measures:

(a) the full amount of the relevant annual net profit after tax will be offset against the net loss;

(b) until reprivatisation of PBB, no decision will be taken which offsets the net loss against the uncommitted reserves, with the aim of establishing profit distribution capability;

(c) this profit distribution capability will be restored only in the context of reprivatisation, with the result that profits will be retained by appropriation to Germany's silent participation and subsequent repayment of the silent participation;

(d) until full repayment of the silent participation, no dividend payments and no coupon payments which are not required by law will be made.

(iii) As of the time when the payment obligation outlined in paragraph 9.1(i) is paid in full, Germany will ensure that the DEPFA plc sub-group (i.e. parent company and all subsidiary companies), within the limits of its abilities, pays appropriate remuneration to Germany in return for the State support measures. This remuneration represents an expenditure on the profit and loss account and its annual level corresponds to the amount that the sub-group can pay without recording losses and without being legally obliged to pay interest to the providers of hybrid capital. The remuneration will be contractually structured between the Federal Republic of Germany or SoFFin, for the one part, and DEPFA plc, for the other part, such that it is not a profit-related remuneration but a consideration in return for the State aid implemented (indirectly) by the Federal Republic of Germany and approved by the European Union in order to stabilise the DEPFA plc sub-group.

9.2. *Restrictions regarding coupon payments and profit distributions*

Germany will ensure that, during the implementation of the restructuring plan and until 31 December 2015 at the latest, HRE and its subsidiaries are only obliged to pay to third parties which are external to the group, by the end of the financial year for the previous financial year, coupons and profit distributions on the core capital instruments, silent participations, participation rights and participation certificates with a share in the loss pursuant to § 10(5) of the German Banking Act (KWG) and any other profit-related own capital financial instruments (e.g. hybrid capital instruments, participation certificates) (excluding shares) existing in HRE at 30 September 2010 provided that they have not been guaranteed by SoFFin ('other own capital instruments') if and in so far as HRE or the subsidiary companies in question are legally obliged to do so without releasing reserves or the special item pursuant to § 340g of the German Commercial Code (HGB).

9.3. *Restrictions regarding paybacks*

(i) Germany will ensure that, during the implementation of the restructuring plan, and until 31 December 2015 at the latest, HRE and its subsidiaries are obliged to make no repayments of other own capital instruments (e.g. hybrid capital instruments, participation certificates) unless they are required by law while silent participations or other SoFFin own capital instruments which have been contributed or may yet be contributed by SoFFin have not been repaid in full and the book value of the SoFFin own capital instruments is reduced and/or any cumulative profit distributions or coupons on the SoFFin own capital instruments have not been paid in full.

(ii) Payback also includes the repayment or acquisition of instruments which have been issued specifically for the financing of other own capital instruments, and the repayment or acquisition of which results financially in a payback or repurchase or other reduction in other own capital instruments.

(iii) With the approval of SoFFin and after consultation with and approval of the Commission, the following items are not excluded:

(a) the exercising of cancellation rights or any other payback or termination of other own capital instruments due to the expiry of recognition of the instrument in question as a component of the own capital category of HRE or of an entity subject to registration for which it was created;

(b) replacing an existing other own capital instrument with a new instrument of at least the same own capital category, level and duration, although replacing an other own capital instrument with the SoFFin own capital instruments is not permitted; and

(c) repurchase of other own capital instruments at significantly less than the issue price.

Germany will ensure that HRE Holding does not pay any dividends for the financial years 2010 and 2011.

10. **Other commitments**

10.1. *Sound, prudent business policy, taking into account the borrowing requirement of the EU economy*

During the implementation of the restructuring plan, but until 31 December 2015 at the latest, Germany will ensure that the PBB sub-group:

(i) pursues a prudent, sound business policy which is focused towards the principle of sustainability;

(ii) examines the appropriateness of its internal incentive systems in the context of the legal and regulatory requirements and works towards ensuring that they do not provide any temptation to take unacceptable risks and are transparent and focused on long-term, sustainable goals; and

(iii) takes account of the borrowing requirement of the German and EU economies through economically sustainable conditions which are customary on the market.

10.2. *Ban on advertising with State support*

Germany will ensure that HRE does not advertise itself with the State support measures implemented or advertise itself in any other way on the basis of the competitive advantages arising from the State support measures. The exception to this requirement is legally binding or customary market information about those State support measures, e.g. in the annual or quarter-end accounts, communications that are compulsory under capital market law, securities prospectuses or information memoranda.

10.3. *Acquisition ban*

(i) Germany will ensure that, during the implementation of the restructuring plan but until reprivatisation at the latest, although not before 31 December 2013, HRE acquires no participations in businesses except with the prior approval of the Commission, for instance because such an acquisition is necessary in order to safeguard the stability of the financial market.

(ii) Acquisition of businesses within the meaning of this commitment includes the partial or full acquisition of businesses by means of transfer of shares in companies and assets and the concluding of other transactions which serve the purpose of acquisition, such as the concluding of futures and options transactions.

(iii) Restructuring within the HRE group is not affected by this commitment.

(iv) The acquisition of businesses in the case of so-called 'bail-out purchases' during restructuring of credit commitments and the acquisition of project companies or acquisition for other reasons resulting from operational activity in accordance with the business model of the bank are also unaffected by this commitment, provided that such acquisitions do not exceed a maximum total purchase price of EUR [10–80] million until 31 December 2015.

10.4. *Commitments relating to information technology of HRE/PBB*

Germany will ensure that HRE achieves the outstanding milestones in the 'New Evolution' IT project according to the project schedule — having regard to the usual uncertainties associated with the implementation of a project of this size. The outstanding milestones are Releases N3–N4/5. The project schedule is attached to the Commitments Document as an Annex.

Notwithstanding the above, Germany will in particular ensure that the methodological integration of market risk management and reporting functionalities is completed by the end of the fourth quarter of 2012. This will include consolidation of market risk methodologies and front office systems in the PBB sub-group and […].

10.5. *Commitment relating to RAROC*

Germany will ensure that PBB's strategic new business does not issue any new loans that have a RAROC (risk adjusted return on capital) of less than 10 % on a transaction-by-transaction basis.

The RAROC will be calculated as the ratio between the net margin after tax and the economic capital. This commitment applies to new business without taking into account prolongations and restructuring.

Within the meaning of this Commitment Document,

(i) the gross margin is the difference between the margin invoiced to the customer (expressed in basis points above the IBOR reference rate) and PBB's refinancing costs (expressed in basis points above the IBOR reference rate) represented by the internal transfer price, plus annualised fees;

(ii) the internal transfer price will reflect the estimated cost of PBB's new refinancing from borrowed and own capital, taking account of the characteristics (maturity, currency, etc.) of the loans to customers;

(iii) the net margin is equal to the gross margin minus:

(a) additional costs of all kinds (overheads, salary costs, operating costs, amortisation and depreciation, etc.) estimated on the basis of the observation of the actual total costs of lending to customers;

(b) cost of average risk calculated for each transaction in accordance with the Basel II methodology (or any banking regulation applicable thereafter) and a tax charge;

(iv) the economic capital (capital adequacy requirements according to the Basel Committee on Banking Supervision Pillar 1) is calculated in accordance with the relevant Basel II methodology (or any applicable banking regulation applicable thereafter).

11. **Terms and conditions of divestiture**

(i) Germany will ensure that the necessary sale procedures are initiated without delay in order to ensure that the deadlines relating to reprivatisation/divestiture are met.

(ii) As far is legally permissible and possible without breach of business confidentiality, reprivatisation will take place in an open, transparent and non-discriminatory procedure. This does not preclude the holding of negotiations with interested parties who are addressed in a targeted manner before or during such a procedure. As far as is reasonable, the sale procedure will be announced through publication in at least one international newspaper or periodical. The terms and conditions of sale may not include any clause which unreasonably limits the number of potentially interested parties or is tailored specifically to certain interested parties. The terms and conditions of sale may refer to the redemption obligation set out in paragraph 5.2(ii)(b). As far as is reasonable and legally permissible, potential purchasers will, after signature of standard non-disclosure agreements, also be granted direct access to all information necessary to conduct due diligence investigations.

12. **Monitoring Trustee**

(i) Germany will ensure that the full and correct implementation of the HRE restructuring plan of 14 June 2011 and the full and correct implementation of all commitments within this Commitments Document are continuously monitored by an independent, sufficiently qualified Monitoring Trustee who is obliged to maintain confidentiality.

(ii) The appointment, duties, obligations and discharge of the Monitoring Trustee must follow the procedures set out in the 'Trustees' annex.

(iii) Germany will ensure that, during the implementation of the decision, the Commission has unrestricted access to all information which is necessary for monitoring of the implementation of this decision. The Commission may ask the HRE for explanations and clarification. Germany and HRE will cooperate fully with the Commission and the Monitoring Trustee acting on behalf of the Commission with regard to all enquiries associated with monitoring of the implementation of this decision.

ANNEX

THE TRUSTEE

A. **Appointment**

(i) Germany undertakes to ensure that:

(a) HRE will appoint a Monitoring Trustee to carry out the duties of a Monitoring Trustee as set out in paragraph B(ii) of this Annex; and

(b) if the reprivatisation of PBB has not been effected by 31 December 2015, HRE will appoint a Divestiture Trustee to carry out the duties of a Divestiture Trustee as set out in paragraph B(iii) of this Annex.

(ii) Both the Monitoring Trustee and the Divestiture Trustee ('Trustee(s)') must be independent of HRE. The Trustee must possess the specialised knowledge that is required in order to carry out its mandate, for example as an investment bank, consultant or auditor, and must at no time be exposed to any conflict of interest. The Trustee will be remunerated by HRE in a way that must not impede the independent and effective fulfilment of its mandate. The cost of the Trustee will, as far as is legally permissible, be borne by HRE, otherwise it will be borne by Germany.

(iii) Germany undertakes to ensure that:

(a) not later than four weeks after notification of the decision, HRE will submit the names of two or more persons to the Commission for approval as Monitoring Trustee; and

(b) as soon as it becomes clear that reprivatisation of PBB cannot be completed by 31 December 2015, and not later than 30 September 2015, HRE will submit the names of one or more persons to the Commission for approval as Divestiture Trustee.

(iv) These proposals must contain sufficient information about those persons to enable the Commission to verify whether the proposed Trustee fulfils the requirements set out in paragraph A(ii), and must in particular include the following:

(a) the full terms of the proposed mandate with all the provisions which are necessary to enable the Trustee to fulfil its duties;

(b) the draft of a work plan which describes how the Trustee intends to carry out its assigned duties.

(v) The Commission has the discretion to approve or reject the proposed trustees and to approve the proposed mandate subject to any modifications that it deems necessary in order to enable the Trustee to fulfil its obligations. If only one name is approved, HRE will appoint the person or institution concerned as Trustee or cause that person or institution to be appointed, in accordance with the mandate approved by the Commission. If more than one name is approved, HRE is free to decide which of the approved persons should be appointed as Trustee. The Trustee will be appointed within one week of the Commission's approval, in accordance with the mandate approved by the Commission.

(vi) If all the proposed Trustees are rejected, Germany undertakes to ensure that HRE submits the names of at least two further persons or institutions within two weeks of being informed of the rejection, in accordance with the requirements and procedure set out in paragraphs A(i) and A(iv).

(vii) If all further proposed Trustees are also rejected by the Commission, the Commission will nominate a Trustee which HRE will appoint or cause to be appointed, in accordance with a trustee mandate approved by the Commission.

B. **Duties and obligations of Trustees**

(i) The duty of the Trustee is to guarantee full and correct compliance with the obligations set out in the commitments and full and correct implementation of the HRE restructuring plan of 14 June 2011. The Commission may, on its own initiative or at the request of the Trustee, give any orders or instructions to the Trustee or HRE in order to ensure compliance with the commitments attached to the decision.

(ii) The Monitoring Trustee will:

(a) propose in its first report to the Commission a detailed work plan describing how it intends to monitor compliance with the commitments attached to the decision;

(b) oversee the management of PBB's transactions in order to ensure that its economic viability, saleability and competitiveness continue to be guaranteed, and monitor HRE's compliance with the conditions and constraints attached to the decision. To this end, the Monitoring Trustee has the duty:

(I) to ensure that PBB's economic viability, saleability and competitiveness are maintained and that management of PBB is organisationally separate from the companies remaining with HRE;

(II) to verify that PBB is managed as an organisationally distinct, divestable business;

(III) after consultation with HRE, to specify all necessary precautions to ensure that, from the date of notification of the decision, HRE obtains no business secrets, know-how, business information or other confidential or proprietary information about PBB unless such information is necessary to execution of the sale or management of the group by HRE or disclosure to HRE is required by law, and thereby to strive in particular to ensure that the integration of PBB into the central IT network is completed as far as possible and economically feasible without endangering the viability of PBB, and to decide whether such information may be disclosed to HRE because its disclosure may reasonably be considered necessary to the execution of the sale or management of the group by HRE, or its disclosure is required by law;

(IV) to monitor distribution of the assets and personnel between PBB and HRE or the affiliated companies; dual mandates and secondment remain permissible;

(c) monitor compliance with all other commitments;

(d) assume the other functions assigned to the Monitoring Trustee in the Commitments attached to the decision;

(e) monitor the full and correct implementation of the HRE restructuring plan of 14 June 2011;

(f) propose to HRE such measures as the Monitoring Trustee considers necessary to ensure HRE's compliance with the commitments attached to the decision, in particular maintaining the full economic viability, saleability and competitiveness of PBB, continuation of PBB as a separate entity and maintaining the confidentiality of information that is relevant to competition;

(g) review the progress of the reprivatisation process, assess potential purchasers and verify that, dependent on the stage of the reprivatisation process:

(I) potential purchasers receive sufficient information relating to the business to be sold and its personnel, in particular by reviewing (if available) the data room documentation, the information memorandum and the due diligence process; and

(II) potential purchasers are granted reasonable access to the personnel;

(h) submit a draft written report to the Commission, Germany and HRE within 30 days after the end of each quarter. The Commission, Germany and HRE can submit comments on the draft within five working days. Within five working days of receipt of the comments, the Trustee will prepare a final report, incorporating the comments to the extent possible and at its discretion, and submit it to the Commission. The Trustee will also send a copy of the final report to Germany and HRE. If the draft report or the final report contains any information that must not be disclosed to HRE, HRE will only receive a non-confidential version of the draft report and the final report. Under no circumstances will the Trustee submit any version of the report to Germany and/or HRE before submitting it to the Commission. The subject of the report will be fulfilment of the duties set out in the mandate by the Monitoring Trustee and compliance with the obligations by HRE, thus enabling the Commission to assess whether HRE is being managed in accordance with the obligations and to form a picture of the status of the reprivatisation process and of potential purchasers. If necessary, the Commission may specify the scope of the report in more detail. In addition to these reports, the Monitoring Trustee will promptly report in writing to the Commission if it has reason to suppose that HRE is failing to comply with these obligations, sending a non-confidential version to HRE at the same time.

(iii) If reprivatisation of PBB has not been completed by 31 December 2015, the Divestiture Trustee will sell PBB to a purchaser without specifying a minimum price provided that the Commission has approved both the purchaser and the final binding purchase agreement. The Divestiture Trustee will include in the purchase agreement such terms and conditions as it considers appropriate for an expedient sale. The Divestiture Trustee may include in the purchase agreement such customary provisions relating to representation, warranties and indemnification as are reasonably required to effect the sale. The Divestiture Trustee will protect the legitimate financial interests of Germany and HRE.

(iv) Until the completion of reprivatisation, the Divestiture Trustee will provide the Commission with comprehensive monthly reports in German on the progress of the divestiture process. These reports will be submitted within 15 days after the end of every month, with a simultaneous copy to the Monitoring Trustee and a non-confidential version to HRE.

C. **Duties and obligations of HRE**

(i) Germany undertakes to ensure that HRE will provide and require its advisors to provide any cooperation, assistance and information that the Trustee may reasonably require in performing its duties. The Trustee will have unrestricted access to any of HRE's books, records, documents, management or other personnel, facilities, sites and technical information that are necessary to fulfilling the Trustee's duties under the commitments. HRE will provide the Trustee, on request, with copies of documents. HRE will make available to the Trustee one or more offices at its business premises and will be available for meetings with the Trustee in order to provide the Trustee with all information necessary for the performance of its duties.

(ii) HRE will provide the Monitoring Trustee, on request, with the information sent to potential purchasers and will grant and require its advisors to grant the Trustee, in particular, the same access to data room documentation and all other information that was granted to potential purchasers during the due diligence procedure. HRE will inform the Monitoring Trustee about potential purchasers, provide the Monitoring Trustee with a list of potential purchasers, and keep the Monitoring Trustee informed of all developments in the reprivatisation process.

(iii) Germany undertakes to ensure that HRE will grant and require its affiliated companies to grant the Divestiture Trustee comprehensive powers of attorney, duly executed — subject to that which is legally permissible, in particular under supervisory and company law — to effect the reprivatisation, transfer and all actions and declarations which the Divestiture Trustee considers necessary or appropriate for the reprivatisation and transfer, including the appointment of advisors to assist with the reprivatisation process. At the request of the Divestiture Trustee, HRE will ensure that the documents required for effecting the reprivatisation and transfer are duly executed. Germany undertakes to ensure that HRE will indemnify the Trustee and its employees and agents ('Indemnified Parties') and hold the Indemnified Parties harmless against, and hereby declares that the Indemnified Parties will have no liability to, HRE for any liabilities arising out of the performance of the Trustee's duties under the obligations, except to the extent that such liabilities result from the wilful default, recklessness, gross negligence or bad faith of the Trustee, its employees, agents or advisors.

(iv) At the expense of HRE, the Trustee may appoint advisors (in particular for corporate finance or legal advice), subject to HRE's approval (this approval not to be unreasonably withheld or delayed) if the Trustee considers the appointment of such advisors necessary or appropriate for the performance of its duties and obligations under the mandate, provided that any fees and other expenses incurred by the Trustee are reasonable. Should HRE refuse to approve the advisors proposed by the Trustee, the Commission may approve the appointment of such advisors instead, after having heard HRE. Only the Trustee will be entitled to issue instructions to the advisors. Paragraph C(iii) will apply *mutatis mutandis*. The Divestiture Trustee may use advisors who served HRE during the divestiture period if the Divestiture Trustee considers this to be in the best interest of an expedient sale.

D. **Replacement, discharge and reappointment of the Trustee**

(i) If the Trustee does not fulfil its functions under the commitments or for any other good cause, including the exposure of the Trustee to a conflict of interest:

(a) the Commission may, after hearing the Trustee, require HRE to replace the Trustee; or

(b) HRE, with the approval of the Commission, may replace the Trustee.

(ii) If the Trustee is removed according to paragraph D(i), the Trustee may be required to continue in its function until a new Trustee is in place to whom the Trustee has effected a full handover of all relevant information. The new Trustee will be appointed in accordance with the procedure referred to in paragraphs A(i) to A(vi).

(iii) Beside the removal according to paragraph D(i), the Trustee will cease to act as a Trustee only after the Commission has discharged it from its duties. This discharge will take place when all the obligations with which the Trustee has been entrusted have been implemented. However, the Commission may at any time require the reappointment of the Monitoring Trustee if it is subsequently found that the relevant remedies have not been fully and properly implemented.