STATE AIDS (BANKING): THE WESTLB CASE

Subject:	State aids
Industry:	Banking
Parties:	WestLB
Source:	Commission Statement IP/03/335, dated 6 March 2003, based on a judgment of the Court of First Instance (not yet reported)

(Note. While awaiting the text of the Court's judgment in this case, we reproduce below the Commission's observations on the importance of the case, not least in resolving other similar cases involving German regional banks. At first sight, it is not obvious from the Commission's observations that the Court did in fact annul the Commission's original decision. If the Court's judgment reveals matters calling for a further report, this will appear in due course.)

The Court of First Instance (CFI) delivered judgment on 6 March 2003 in the WestLB case, bringing about a long-awaited clarification of some major policy issues in the field of State aid. The Commission has taken note of this important judgment and, in the light of the judgment, is planning to adopt as quickly as possible a new decision in the case originally coming before it. The Court's ruling also opens the way for the Commission to resolve the six other provincial bank capital transfer cases that are still pending. Overall, the CFI judgment shows the way forward. The CFI confirmed the Commission's analysis that capital injections by the State in favour of public undertakings must be remunerated at market rates to avoid distortions of competition. This holds true even if the beneficiary is not an undertaking facing financial difficulties. In its appeal WestLB had strenuously contested this point. The ruling reinforces the Commission's determination to ensure a level playing field in the German banking sector. It will now carry on with its proceedings against similar capital transfers to six other German regional banks and will start work on a new WestLB decision after a careful examination of the CFI ruling.

As the Commission points out, the distortion of competition is all the greater if the beneficiary is a healthy undertaking, as there is then absolutely no reason for the State to forego a normal return on the invested capital.

The Court's ruling does not affect the abolition of the public sector guarantees, which will take effect from 19 July 2005. The landmark agreement with the German authorities, reached in 2001 and 2002, to abolish these guarantees is, in the Commission's view, by far the most important policy achievement of the present Commission with respect to the German public sector banks; and the CFI's judgment does not have any impact on that agreement.

The Court's ruling comes against the background of a significant increase in the breadth and sophistication of the Commission's State aid policy in the financial services sector. While in the early 1990s the Commission dealt mostly with ad hoc rescue and restructuring operations in favour of ailing banks, it was soon confronted with investment aid in the form of capital injections into banks that were not in distress. The WestLB decision is the most prominent example of investment aid to a bank which is not in distress. Nevertheless, the capital transferred allowed this bank to reinforce its equity capital and, in consequence, increase its commercial activities. In a further step the Commission extended its attention to less visible forms of State support, such as state guarantees in favour of public sector banks. It is this latter least visible category of aid which procures the banks the most significant economic advantages.

In December 1991, the parliament of the Province of North-Rhine-Westphalia voted a law under which funds were transferred to WestLB, thereby increasing the latter's solvency ratio. The Province received a remuneration of 0.6% after tax for the funds transferred to it. While the funds remained earmarked for general interest activities, they also increased WestLB's equity base allowing the bank to increase its commercial activities.

In 1994 the association of German private sector banks, the Bundesverband deutscher Banken (BdB), complained about the remuneration paid by WestLB and other public sector banks in Germany for the capital transferred to them by the regional entities. According to the BdB, this remuneration was significantly below the rate a private bank would have had to pay for its equity capital.

The Commission initiated State aid proceedings in October 1997 and decided in July 1999 that WestLB did indeed benefit from State aid. According to the Commission's assessment the economic advantage in the form of a below market cost of equity - amounted to €807.7 million for the period from 1992 through 1998. This advantage needed to be neutralised by recovering this amount plus interest.

The Commission notes that the fundamental issue involving the WestLB has meanwhile been tackled with the legal split between the commercial bank and the public sector bank, which is a result of the Commission's action against a distorting system of state bank guarantees. For the future this split will ensure a transparent distribution of tasks between the commercial and the public sector activities and will limit the State guarantee to the public sector bank that does not carry out commercial or competitive activities. However, a new decision is required in the WestLB case to neutralise the competitive advantage the bank enjoyed with respect to its purely commercial activities in the past.

The Court's ruling is also important for the ongoing proceedings with respect to capital injections benefiting six further public sector banks. In total seven regional authorities transferred capital to the public sector banks in their region against a very low level of remuneration. Proceedings with respect to the six other banks were initiated in July and November 2002. Nevertheless, individual cases may call for some differentiation in the Commission's analysis. ■