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Germany SoFFin Capital Injections¹

Priya Sankar²

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Abstract

The insolvency of Lehman Brothers in September 2008 and the subsequent global liquidity crisis spurred the German state to pass the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz, “FMStFG”) establishing the Federal Agency for Financial Market Supervision (Bundesanstalt für Finanzmarktstabilisierung), or FMSA. Created in October 2008, it provided government support to ailing financial institutions. The FMSA supported German banks and maintained the stability of the German banking system, in part by establishing the Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung), or SoFFin. SoFFin could provide capital injections and risk shield measures of €80 billion and also possessed a guarantee provision of up to €400 billion. The actual recapitalizations peaked at €29.4 billion in late 2010. Capital injections rescued overcapitalized banks and assisted in the government takeover of and restructuring of HRE Gruppe. SoFFin was supposed to accept applications until late 2009, but this was extended several times until 2010. SoFFin was later reopened in 2012, finally closing in 2015. Germany has since passed a Restructuring Act that acts as a framework for winding up banks that are “too big to fail,” making systemic risk support operations a permanent pillar of German banking regulations. Though this law facilitates the resolution of systemically relevant banks, it does not sufficiently clarify interagency coordination, nor does it establish a resolution for other systemically important nonbank financial institutions. As of the end of 2018, SoFFin has €14.6 billion outstanding from capital injections.

Keywords: Capital injections, Germany, SoFFin

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¹ This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering broad-based capital injection programs. Cases are available from the Journal of Financial Crises at https://elischolar.library.yale.edu/journal-of-financial-crisis/.

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At a Glance

European liquidity crises and exposure to the subprime mortgage market in the United States created pressure affecting the German banking sector. The failure of Lehman created interbank liquidity shortages throughout Europe. In a bid to restore confidence in the financial system, European leaders met on October 12, 2008 and decided on a comprehensive framework to preserve financial stability and support banks.

Consequently, the German Parliament passed the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz, “FMStFG”) on October 17, 2008. It created a Federal Agency for Financial Market Stabilization (Bundesanstalt für Finanzmarktstabilisierung, “FMSA”), which created and administered the new Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung “SoFFin”). SoFFin contained provisions for guarantees, capital injections, asset purchases, and nationalization of distressed financial institutions in Germany.

The recapitalization program was limited to €80 billion, of which a maximum of €29.4 billion was outstanding at the end of 2010. Solvent financial institutions with Tier 1 capital over 7% and meeting Basel II regulatory capital requirements plus 2% were eligible if they agreed to limit risk and suspend dividends after recapitalization.

The European Commission approved SoFFin and its recapitalizations scheme in accordance with Article 87 (3)(b) of the EC Treaty, exempting SoFFin from the state aid rules due to serious economic disturbances in Germany. As of December 2018, €14.6 billion was outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former
WestLB) with no clear exit strategy. Applications for recapitalization aid under SoFFin were initially due in December 2009, later extended to December 2010. SoFFin was reopened in 2012, with a closure date in 2014, but ultimately extended until 2015.

**Summary Evaluation**

SoFFin is generally assessed positively. It was a necessity to maintain financial stability in Germany. It bolstered the capital structure of German financial institutions, easing some pressure from interbank liquidity shortages, and later, the sovereign debt crisis. It limited the vulnerability of German financial institutions to systemic risk. However, critics had concerns about the stigma associated with seeking aid, and the extensions of the eligibility window as potential issues limiting SoFFin’s effectiveness.
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I. Overview

Background

The financial tensions in Germany stemming from the Global Financial Crisis (GFC) were exacerbated dramatically in 2008, amidst global turbulence. Germany's financial market was globally integrated and suffered from exposure to the American subprime mortgage markets and the subsequent disruptions in international money, interbank lending, and capital markets. These created uncertainties in the market with respect to price developments, transparency of information, and confidence amongst market participants. Market forces were unable to stabilize the financial system and restore confidence in the financial market.

To combat the liquidity crises in Europe, Eurozone countries assembled on October 12, 2008, and created a comprehensive plan of action to restore the confidence and proper functioning of European economies. A crucial part of this plan was “providing financial institutions with additional capital resources so as to continue to ensure the proper financing of the economy” and “allowing for an efficient recapitalization of distressed banks” (Summit of Euro Area Countries 2008). It also involved credit lines and guarantees.

Germany shortly thereafter passed the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz “FMStFG”) which established a Federal Agency for Financial Market Stabilization (Bundesanstalt für Finanzmarktstabilisierung “FMSA”). The FMSA administered the Financial Market Stabilization Fund (Sonderfonds Finanzmarktstabilisierung “SoFFin”) (FMStFG 2008). In 2008, Commerzbank was undercapitalized, and was recapitalized by SoFFin. By 2009, HRE Gruppe, Aareal Bank, and Portigon (former WestLB) had also sought recapitalization (FMSA 2019). HRE Gruppe was eventually nationalized by SoFFin.

Program Description

The Financial Market Stabilization Fund, or SoFFin, was a German federal fund to stabilize the financial market, overcoming liquidity shortages and creating the framework conditions for a strengthening of the capital base of financial institutions. FMStFG had a tripartite strategy for stabilization using SoFFin including guarantees, recapitalization, and risk shields. The FMStFG limited total guarantees to €400 billion, and total recapitalization and risk shield funds to €80 billion. The objective of this recapitalization scheme was to ensure that existing solvent German financial institutions were sufficiently capitalized so that they could withstand potential losses and restore confidence in the German economy (European Commission 2008a).

Eligible institutions included a comprehensive list of financial institutions including insurance undertakings, pension funds, investment companies, operators of stock and futures exchanges and their parent companies, financial holding companies, insurance
holding companies, and private-law entrusted owners of Landesbanken (state owned regional banks) organized under public law (FMStFG 2008). Each individual institution needed to be solvent, with a Tier 1 ratio of at least 7%, or a commitment to reaching this ratio within three months. They must also adhere to the requirement of minimum regulatory capital in Basel II plus two percentage points (European Commission 2008b). Each institution could apply for a maximum of €10 billion of recapitalization aid before the deadline of December 31, 2009 (Petrovic and Tutsch 2009).

The Federal Ministry of Finance could decide on the participation of SoFFin in a recapitalization scheme when there was a substantial interest on the part of the Federation and the purpose sought by the Federation could not better and more economically be achieved by other means. SoFFin could participate in the recapitalization of a financial-sector enterprise by acquiring shares or silent participations against a contribution and assuming other components of the funds of these companies. Institutions receiving capital injections from SoFFin had to pay interest at a rate that averaged from 7-9%, unless SoFFin recapitalized with significant contributions from the private sector (Petrovic and Tutsch 2009). The Federal Government could issue ordinances with more detailed provisions of the conditions of the recapitalization, upper limits for the participation in own fund items of individual organizations as well as particular types of fund items, and any other conditions required to safeguard the purpose of the Act under the context of recapitalization (FMStFG 2008).

Financial institutions seeking to utilize one of the stabilization measures in SoFFin had to guarantee a sustainable business policy and reduce or abandon any risky activities. Recapitalized entities were not allowed to pay dividends unless there existed sufficient incentives to repay the State, and compensation for individual management members was limited to €500,000 per annum. Bonuses were disallowed while state capital remained in use, and dividends were distributable only to the Government. Recapitalized institutions were also obligated to provide loans to SMEs (Petrovic and Tutsch 2009). The Federal Government was empowered to issue additional requirements to these organizations on business strategy, use of monies received, and other conditions surrounding recapitalization funds (FMStFG 2008).

SoFFin was funded through mandated contributions from individual German states and by issuing debt securities up to a maximum of €100 billion (Mayer Brown 2009). The Federal Ministry of Finance was empowered to issue up to €70 billion of total aid within SoFFin’s risk acquisition and recapitalization provisions, with a possible extension of €10 billion with the consent of the Budget Committee of the Deutscher Bundestag. Applications for SoFFin’s stabilization measures were initially due on December 31, 2009, at which time they were no longer accepted, though subsequent policies extended this deadline first to 2010, then it was reopened in 2012 with a deadline in 2014, and finally extended to 2015 (European Commission 2010; Bundesrepublik Deutschland 2019). As of December 2018, €14.6 billion are outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former WestLB) (FMSA 2019). There are no clear exit strategies for these involvements.
Though the European Committee Treaty Article 87(1) disallows State Aid to domestic businesses in a manner that affects competition in the EU, the EC approved SoFFin. This was justified by EC Treaty Article 87(3)(b), permitting the recapitalizations, guarantees, and risk assumptions because of economic disturbances in Germany (European Commission 2008a).

Outcomes

Of a maximum of €80 billion, actual recapitalizations peaked at €29.4 billion in late 2010 (International Monetary Fund 2011). Capital injections occurred throughout 2009 and 2010, much of which were directed to HRE Gruppe, later nationalized. The European Commission approved extensions of SoFFin deadlines that made this possible (European Commission 2011a). The initial deadline was December 31, 2009, presuming the crisis lasted that long, but Germany successfully appealed to have it extended first to June 3, 2010, and later to December 31, 2010 (European Commission 2010).

As of December 31, 2018, €14.6 billion remains outstanding from recapitalization under SoFFin. Substantial amounts of this funding went to HRE Gruppe, peaking at €9.8 billion in late 2011; Commerzbank, peaking at €18.2 billion in late 2010; Portigon (former WestLB) peaking at €3 billion in December 2010; and Aareal Bank, peaking at €500 million in 2009 (FMSA 2019). Aareal Bank has repaid SoFFin’s contributions while Commerzbank has €5.1 billion outstanding, HRE Gruppe has €7.6 billion outstanding, and Portigon has €2 billion outstanding.

II. Key Design Decisions

1. The SoFFin capital injections scheme was introduced as part of a package in FMStFG, which also included guarantee and risk-shield provisions.

The German government passed the Financial Market Stabilization Fund Act (Finanzmarktstabilisierungsfondsgesetz “FMStFG”), a package of crisis response measures that created the Financial Market Stabilization Agency (FMSA). FMSA was responsible for managing the fund in SoFFin. FMStFG also established SoFFin, which was to be used for three financial stability strategies: capital injections, guarantees, and risk shields (FMStFG 2008). Section 7 of the FMStFG authorized the recapitalization scheme in particular. Borrowing by the fund was financed by issuing debt up to a maximum of €100 billion (European Commission 2008a).

2. The Fund has no legal capacity. The legal basis of the recapitalization scheme was the passage of FMStFG, the act which created SoFFin.

The Deutsche Bundesbank is responsible for the general jurisdiction of the Fund, which may act, sue, and be sued in its own name. No other measures of compulsory execution against the Fund may be attached (FMStFG 2008).
3. The European Commission approved the SoFFin capital injections scheme under Article 87(3)(b) of the EC Treaty.

The European Commission bans “state aid,” or government interventions that privilege a specific company, industry, or region in a way that distorts trade or competition. Capital injections would normally be considered such a privilege (European Commission 2019). However, the European Commission (EC) permitted capital injections from SoFFin due to Article 87(3)(b) of the EC Treaty, which permits state aid to “remedy a serious disturbance in the economy of a Member State” (European Commission 2008a).

4. SoFFin and its capital injections schemes were managed by the FMSA, initially under the purview of the Bundesbank, but later assigned to the Federal Ministry of Finance in July 2009.

The Federal Ministry of Finance controls FMSA, a public-law federal agency. It is managed by a three-member Management Committee appointed by the Ministry of Finance in consultation with the Bundesbank. An inter-ministerial Steering Committee decides on agency proposals, though the Federal Ministry of Finance is responsible for the actual administration of the Fund. The Steering Committee is composed of one member each from the Federal Chancellery, Ministry of Finance, Ministry of Justice, Ministry of Economics and Technology, and one member proposed by the Länder. The Federal Government has the capacity to create guidelines that govern administration of the SoFFin fund, and does not required consent of the Bundesrat to do so (FMStFG 2008). As of January 1, 2018, SoFFin has been managed by the Federal Ministry of Finance, which has been funding it since its inception in 2008 (Bundesrepublik Deutschland 2019).

5. Total funding for SoFFin and its capital injections and risk-shield strategies, was capped at €80 billion.

The Federal Ministry of Finance could take loans of up to €70 billion in order to fund SoFFin and the three strategies for which it is responsible. There was a possible extension of 10 billion additional Euros with the consent of the Budget Committee of the Deutscher Bundestag. Each individual institution was eligible for a maximum of €10 billion of recapitalization funds prior to the deadline of December 31, 2009 (FMStFG 2008).

6. Eligible institutions for capital injections under SoFFin included banks and nonbank institutions listed here.

The Federal Ministry of Finance would decide on the participation of SoFFin in a recapitalization scheme when there was a substantial interest on the part of the Federation and the purpose sought by the Federation could not better and more economically be achieved by other means (FMStFG 2008). The institutions receiving recapitalization aid from SoFFin were Aareal Bank, Commerzbank, Hypo Real Estate Gruppe (HRE), and Portigon (former West Landesbank).
SoFFin was meant to strengthen the capital base of institutions under section 1(1b) of the Banking Act, of insurance undertakings and pension funds under section 1(1) numbers 1 and 2 of the Insurance Supervision Act, of investment companies under the Investment Act, as well as of the operators of stock and futures exchanges and their respective parent enterprises, insofar as these financial holding companies, mixed financial holding companies, insurance holding companies or mixed insurance holding companies, and the abovementioned enterprises have their seat in Germany (financial-sector enterprises). Private-law-entrusted owners of Landesbanken organized under public law, even where the owners are not financial holding companies, were also considered to be financial-sector enterprises within the meaning of the first sentence above (FMStFG 2008).

These institutions needed to have a Tier 1 ratio of at least 7%, which was the threshold for solvency. If they did not meet this criterion, they were still eligible to apply for capital injections under SoFFin if they committed to reaching it within three months. This is in contrast to the Basel II Tier 1 ratio requirement of 4% of risk-weighted assets (Basel 2004). There was also a requirement to hold minimum regulatory capital under Basel II (8%) plus two percentage points (European Commission 2008b). This requirement indicates that SoFFin's provision to inject capital was targeted towards solvent financial institutions in order to strengthen their capital base so that they could better withstand potential losses caused by liquidity crises in Europe and exposure to the U.S. housing market. It was also an attempt to restore confidence in the German economy (European Commission 2008a).

7. **SoFFin could participate in the recapitalization of a financial-sector enterprise by acquiring shares or silent participations against a contribution and assuming other components of the funds of these companies. SoFFin then became the shareholder of acquisitions from capital injections.**

Capital injections to Commerzbank were announced on December 19, 2008. SoFFin made a silent participation of €8.2 billion in one tranche as of December 31, 2008, with annual interest of 9% paid on the silent participation (Commerzbank 2008a). Silent participation aid did not dilute shareholder control and gave the Federal Republic no direct influence on the operations of a bank (Mitchell 2016). In case of insolvency and liquidation, the debt was subordinate to all existing debt, pari passu with future hybrid offerings, and senior to shareholders. The silent participation is perpetual and could be terminated by Commerzbank with approval from the Ministry of Finance. It would be redeemed at nominal value (Commerzbank 2008b). There would not be a dividend for the first year, but in years with dividend payments, the interest rate applicable for the silent participation would increase. For each €4.4 million of dividend, one basis point would be added (Commerzbank 2008a). The first €4.1 billion of the contribution had an interest rate of 8.5% and the second €4.1 billion had an interest rate of 5.5% (Levitin 2008). To avoid legal limits on state aid to individual banks, Commerzbank and Dresdner Bank separately sought additional aid in early 2009, prior to Commerzbank’s planned acquisition of Dresdner Bank. The state refused this request, but eventually acquiesced to a €10 billion contribution to Commerzbank after threats of abandoning the merger. Dresdner Bank was struggling due to its real estate investments and would have otherwise required
nationalization to save it, which the German state sought to avoid. Of the €10 billion the state contributed, €8.2 billion was an additional silent participation, but €1.8 billion consisted of ordinary shares amounting to a 25% stake (Clark 2011). This was the first time SoFFin had taken a direct position in a financial institution, and its contributions secured it veto power over decisions at Commerzbank. It also received three seats on the bank board, though it did not intend to influence any decision-making, or dilute ownership control by private shareholders (Mitchell 2016). Commerzbank had nine members on its board in 2009 (Commerzbank 2009).

Aareal Bank had sufficient cash and capital base throughout the 2009 financial year, and sought SoFFin support to strengthen it against further turbulence in financial markets. SoFFin injections to Aareal bank in 2009 amounted to €525 million with 9% annual interest (Aareal 2009b). To expedite the repayment of the silent participation, Aareal bank did not issue dividends in 2008 or 2009 (Aareal 2009a).

In 2009, WestLB, a major Landesbank with €288.1 Billion of assets at year-end 2008, was large enough to be considered a systemic risk (European Commission 2009b). Its exposure to American subprime assets was a problem first realized in losses of €2.5 billion on its subprime portfolio (Mitchell 2016). In November 2009, shareholders along with the German government agreed to establish a bad bank, Erste Abwicklungsanstalt. It took over a portfolio of risk positions and risky assets that would have otherwise negatively impacted the performance of WestLB. The capital injection from SoFFin to WestLB amounted to €3 billion in three installments. First, €672 million was injected on December 23, 2009; €1.5 billion was injected on January 4, 2010; and €828 million was injected on April 30, 2010. The capital injection was in the form of a non-callable silent participation, which was optionally convertible into ordinary shares after July 1, 2010 (European Commission 2011b). The terms dictated that SoFFin cannot become a majority shareholder of the company. If WestLB showed a sufficient year-end profit, the terms of the silent participation provided for a 10% remuneration per annum. In the case of loss, the silent participation would participate pari passu in the losses and forgo remuneration.

Hypo Real Estate (HRE) was nationalized by SoFFin. A credit line was extended to it in 2008, and SoFFin subsequently made a public takeover bid to acquire all shares in HRE. Though SoFFin could have nationalized HRE by law had its bid been unsuccessful, it acquired 38.65% of shares in the bid. This gave SoFFin 47.31% stake in HRE, and due to low shareholder attendance in the general assembly, SoFFin had de facto control of HRE (European Commission 2009a). In April 2009, SoFFin submitted an offer to HRE shareholders to purchase shares at €1.39 per share:

The Management Board and Supervisory Board of Hypo Real Estate Holding AG have resolved to propose an increase of the registered share capital against cash contributions, excluding shareholders’ pre-emptive subscription rights, pursuant to sections 182 et seq. AktG in conjunction with section 7 FMStFG, to an Extraordinary General Meeting on June 2, 2009. To strengthen the Company’s capital base in a sustained manner, it is proposed to increase the Company’s registered share capital

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(Grundkapital) of € 693,253,560 by cash contributions of up to € 5,639,282,040 to a total of up to € 6,332,535,600, through the issuance of up to 1,879,760,680 new no-par value bearer shares. (Hypo Real Estate 2009)

SoFFin would subscribe new shares at the lowest price to obtain a 90% stake in the company. SoFFin intended to increase HRE equity from €700 million to around €6.3 billion, diluting the stake of existing shareholders (DW 2009). In October of 2009, SoFFin squeezed out remaining minority shareholders by forcing an offer of €1.30 a share, fully nationalizing HRE. Minority shareholder firm JC Flowers, along with other shareholders, took legal action against the full nationalization of HRE Gruppe, and filed a complaint with the European Union (Reuters 2009). However, the complainants lost this challenge, and the 2011 decision of the Munich courts was that Germany had a legal basis for the forced nationalization of HRE Gruppe (Wilson 2011).

As of December 2018, €14.6 billion are outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former WestLB) (FMSA 2019). SoFFin has no clear exit strategy for these involvements.

8. The Federal Government could issue ordinances with more detailed provisions of the conditions of the recapitalization.

These included the consideration of the recapitalization, upper limits for the participation in own-fund items of individual organizations as well as particular types of fund items, the conditions under which the Fund could resell its participation in the own-fund items, and any other conditions required to safeguard the purpose of the Act under the context of recapitalization (FMStFG 2008). Financial enterprises seeking to utilize one of the stabilization measures in SoFFin had to guarantee a prudent business policy. (Petrovic and Tutsch 2009)

Each applicant to the recapitalization measure in SoFFin had to prove that their business activities were sustainable and that their risky activities were limited or abandoned. They were obligated to provide loans to SMEs. They were not allowed to pay dividends to any shareholders before the State, and individuals managing each firm were limited to €500,000 in annual compensation. They were not allowed to receive bonuses. (Petrovic and Tutsch 2009)

The Federal Government was empowered to issue additional requirements to these organizations on business strategy, use of monies received, remuneration of their bodies and employees, the level of their own funds, distribution of dividends, the period within which to fulfill requirements, measures to avoid distortions of competition, the way in which account was to be rendered to the Fund, an undertaking on compliance with the above enumerated requirements to be given by the authorized representative body with the consent of the supervisory body and to be published, and any other conditions required to safeguard the purpose of the FMStFG (FMStFG 2008).
9. **SoFFin's stabilization measures were initially available until December 31, 2009, but were subject to several extensions.**

The initial deadline for applications for recapitalization funds was December 31, 2009, provided the crisis lasted that long (European Commission 2008b). However, with approval from the European Commission, Germany successfully appealed to have the deadline extended three times to December 31, 2010. SoFFin was reopened in 2012 with a final closure in 2015 (Bundesrepublik Deutschland 2019; European Commission 2010).

10. **There are no clear exit strategies for SoFFin's recapitalization involvement.**

As of December 2018, €14.6 billion were outstanding in Commerzbank, Hypo Real Estate (since nationalized) and Portigon (former WestLB). SoFFin has announced no clear plans to exit these capital injections, nor does FMStFG delineate clear exit strategies.

11. **Germany has new legislation concerning government interventions in the case of financial crisis.**

Germany passed the Bank Restructuring Act in January 2011. This act strengthened the coordination of various German federal agencies and European agencies in order to better deal with distressed systemically important banks. It creates procedures to recover struggling banks and reorganize insolvent ones by the Federal Financial Supervisory Authority (BaFin), the successor to FMSA. These measures will be funded by a Restructuring Fund to which all banks are required to contribute (Deutsche Bundesbank 2011).

### III. Evaluation

Assessments of SoFFin’s overall effectiveness are generally positive in nature and agree that it contributed to maintaining financial stability and limiting losses in Germany during the global financial crisis. It also created mechanisms for resolving problem banks with better interagency coordination and strengthened the broader crisis management framework in Germany. SoFFin created mechanisms to combat short term issues of liquidity and confidence, but also helped achieve some long-term goals like encouraging executive responsibility by restricting compensation while using SoFFin funds. However, it did not adequately address the issues of lack of transparency regarding bank assets and performance. In addition, it did not address long-term issues of bank concentration or executive liabilities for losses (Bleuel 2009). SoFFin also did not have a clear exit strategy, and this is particularly an issue for the recapitalization funds of which €14.6 billion remain outstanding. In addition, the relationship between SoFFin’s restructuring fund and the deposit insurance schemes and mutual protection schemes must be clarified. (International Monetary Fund 2011) SoFFin was not constructed to coordinate with other European and German institutions to comprehensively address failing banks. Germany has since passed a Restructuring Act that finances its recapitalization fund by collecting dues from
systemically important banks. This Act also contains provisions to recover and restructure illiquid or insolvent banks in coordination with other German and European agencies, especially if the bank operates across borders (Deutsche Bundesbank 2011).

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V. Key Program Documents

Summary of Program

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Legal/Regulatory Guidance

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**Reports/Assessments**

*Paper providing context for the Global Financial Crisis in Germany and analyzing policy responses, including SoFFin.*


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