How the German banks forced the government to nationalize Hypo Real Estate

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16 July 2009

Seventeen pages of text dealing with meetings at the end of September of 2008 between leading German bankers, regulatory authorities and government representatives make clear the extent of the crisis confronting the German banking system following the collapse of US-based Lehman Brothers.

According to the chairman of Deutsche Bank, Josef Ackermann, who attended the meetings and played a pivotal role in dictating the terms of the government rescue of Hypo Real Estate (HRE), the entire German banking system was within a hair’s breadth of total collapse.

The minutes of meetings held September 27 and 28 were released a week ago by the German banking regulatory authority, BaFin. The feeding of the protocol to the press is undoubtedly bound up with the German government’s current campaign to pressure the banks to free up capital to the German business community. But irrespective of the motives of BaFin in releasing the document, the text is a devastating exposure of the government’s capitulation to the demands of the banks.

Prior to the eruption of the financial crisis last year, HRE was one of Germany’s leading banks, a member of the select DAX group of companies on the German stock market, with a balance sheet of €400 billion.

In October 2007, the chairman of HRE, Georg Funke, finalised the takeover of Ireland’s Depfa bank, which had specialised in providing loans to governments for the purpose of financing infrastructure projects. To cover its long-term loans, Depfa was heavily dependent on short-term interbank credit, which came to a virtual standstill following the collapse of Lehman Brothers on September 15. Credit rating agencies downgraded Depfa, with dramatic repercussions for its new parent company, HRE.

A week after the Lehman collapse, the chairman of HRE’s supervisory board, Kurt Viemetz, wrote a letter to German Finance Minister Peer Steinbrück requesting that the government make €15 billion available to prevent the imminent collapse of Depfa.

When the government failed to quickly free up the €15 billion, Germany’s leading bankers, headed by Ackermann, met Saturday, September 27 with officials from BaFin. From the outset, the standpoint of the assembled bankers was to deny that they bore any responsibility for the crisis and to demand that the government (i.e., the German taxpayer) bear the burden of a bailout of HRE.

On Sunday, September 28, the head of the German state bank (Bundesbank), Axel Weber, rang the German finance minister to demand that the government nationalise HRE and assume full responsibility for the stricken bank. The initial response of Steinbrück was to reject the proposal, and late Sunday afternoon senior finance ministry officials, led by State Secretary Jörg Asmussen, joined the talks to represent the government.

Asmussen made clear that the government was prepared to intervene to help bail out HRE, but pointed out that due to budget laws any involvement by the German government was restricted to providing less than 50 percent of the guarantees needed for a rescue package.

The response of the bankers was furious and prompt. Ackermann stormed out of the meeting, saying he would have to prepare his co-workers for a collapse of the interbank trading system within hours.

The intimidation tactics used by the bankers quickly bore fruit, and Ackermann returned to the meeting a short time later when the government improved its offer and agreed to act as swiftly as possible to guarantee 40 percent of a HRE bailout. The deal was sealed in a personal telephone call between Ackermann and German Chancellor Angela Merkel in the early hours of Monday morning, just hours prior to the opening of major stock markets in the Far East.

The protocol released by Bafin reveals the manner in which leading German banks and finance houses dictate policy to the German government. Following the leaking of the HRE protocol, representatives of the German government, in particular Finance Minister Steinbrück, have attempted to defend their role by arguing that they were not prepared to agree to the initial ultimatums laid down by the banking community.

In fact, since last September the government has conceded to all of the demands made by Ackermann and the banks.

Instead of the initially requested €15 billion for HRE, the federal government awarded the bank a €50 billion emergency cash injection the following month. HRE became the first bank to tap into a €500 billion bank bailout package which was rushed through the German parliament (Bundestag) with the approval of all of the Bundestag parties.

As HRE gradually revealed the full extent of its losses, the government stepped up its involvement, investing a total of more than €102 billion ($143 billion) in taxpayer funds to rescue the bank. Finally, in March of this year, the central demand of the bankers was fulfilled and the government nationalised HRE, taking over more than 90 percent of its stock.

This is the biggest nationalisation of any German company in the history of the federal republic. It was carried out entirely in accordance with the demands laid down by Ackermann and the banking community. So far, not a single member of the HRE board of directors has been called to account for his actions, and the government and finance ministry are currently blocking attempts to hold a parliamentary investigation into the background of the HRE rescue plan.

Since its bailout of HRE, the government has continued its operation to prop up the banks, passing legislation in May that allows the creation of a series of so-called "bad banks" for the purpose of assisting German banks in clearing their accounts of hundreds of billions of euros in "toxic assets."

Due to its generosity to the banks, the federal government will have to borrow €86 billion ($120 billion) in the coming year, as opposed to the €6 billion ($8.4 billion) figure that was planned before the crisis. At the same time, the German banks have been able to acquire cheap loans through a European Central Bank (ECB) financial package totalling €442 billion ($619 billion). They are paying a meagre 1 percent in interest.

Having pumped billions into the banking system and built up levels of debt that will burden the German population for decades to come, the government was recently forced to acknowledge that the banks are unwilling to hold to their part of the bargain, i.e., by easing their credit squeeze and providing loans to businesses and industry.

A recent article in *Der Spiegel* magazine comments: "Politicians, as well as central bankers, business owners and, most of all, citizens, expect something in return: a functioning financial system—and low-interest loans."

However, instead of investing in companies and providing low interest loans, the German banks prefer to restore their balance sheets by investing in secure German bonds and charging customers exorbitant interest on loans and overdrafts.

For its part, Deutsche Bank was able to post profits for the first quarter of 2009—double the expectations of market analysts—and much of its increased turnover came from trading in government bonds freed up by the bank bailout and stimulus programs.

The reluctance of the banks to release funds to Germany's ailing businesses has provoked Finance Minister Steinbrück and even Bundesbank Chairman Weber to issue unprecedented appeals. With a federal election looming, the government is fearful that a new wave of corporate bankruptcies and layoffs could ruin their chances of re-election. Just a week ago, the Bundesbank chief pleaded with the banks to pass on interest rate reductions. Otherwise, Weber warned, "central banks will be forced to circumvent the banks and take direct measures to support the economy."

Nevertheless, based on recent experience—in particular, the role played by leading bankers in the rescue of HRE—the financial community realises that it is sitting in the driver's seat and is able to dictate its terms to the government. The banks also know they can rely on the German parliament to turn a blind eye to its tactics of intimidation and bullying.

All of the major political parties, including the opposition Greens, the Left Party and the pro-market Free Democratic Party, have accepted the argument of the government that, as "system relevant" institutions, the banks should receive all the money they want. At the same time, the parliament has given huge powers to non-elected officials to conduct business in its name.

Describing the close collaboration between the banks and a handful of state secretaries, a recent article in *Der Spiegel* noted: "A discrete circle of top officials directed the rescue program for the financial and economic crisis. The officials have control over hundreds of billions of euros and decide the fate of entire branches of industry. Parliament has barely anything to say."

The article concludes: "Never in the history of the German Republic have officials possessed such a degree of power. Never have elected members of government delegated so much power to decide to co-workers in their ministries. And never has there been such concern over the fact that the decisions taken by a group of state secretaries so one-sidedly serve the interests of the financial industry."