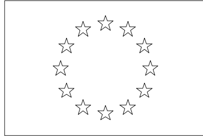

EUROPEAN COMMISSION

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PUBLIC VERSION

WORKING LANGUAGE

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Subject: State Aid N336/2009 – Spain
Prolongation of the Guarantee Scheme for credit institutions in Spain

Sir,

I. PROCEDURE

1. On 8 October 2008, Spain notified a scheme for the creation of a debt guarantee scheme (hereafter "**the Scheme**"), which was approved on 23 December 2008, in State aid case NN54b/2008 (hereafter "**the original Decision**").
2. On 31 March 2009, Spain notified changes to the Scheme, which were approved on 16 April 2009.
3. On 23 April 2009, a corrigendum to the original Decision was published in order to correct some translation and stylistic mistakes.
4. On 27 May 2009, Spain notified the Commission a request to prolong and amend the Scheme.

II. DESCRIPTION

1. The objective of the Scheme

5. In response to the ongoing exceptional turbulence in world financial markets, Spain brought forward a measure designed to preserve stability to the financial system and to remedy a serious disturbance to the economy in Spain. In particular, the measure aimed at

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limiting the risks and re-establishing confidence in the financing mechanism of credit institutions and contribute to foster lending to businesses and households.

2. Description of the original Scheme.

6. The institutions eligible for the Scheme are credit institutions, consolidated groups of credit institutions and pools of credit institutions. Subsidiaries of foreign credit institutions are also included subject to the same requirements than Spanish credit institutions (hereinafter "**the Beneficiary**" and together as "**the Beneficiaries**"). Branches of foreign credit institutions are excluded from the scheme.

7. The debt instruments to be guaranteed comprise emissions of notes (*pagarés*), bonds (*bonos*) and obligations (*obligaciones*) admitted to the official secondary markets in Spain. These instruments must not be covered by other types of guarantees. Securitization notes and subordinated debt are not eligible instruments.

8. The interest rate of the debt instruments issued can be fixed or variable and must be placed within the market yield of emissions and issuers with similar characteristics, as well as in line with prior emissions (pre crisis) of the same issuer. The principal needs to be re-paid in one payment. The minimum nominal value of each emission has to be at least of €10 million.

9. The Minister for Economic Affairs and Finance allocated for each Beneficiary, the maximum amount that can be guaranteed in direct proportion to its market share[1].

10. The Beneficiary must pay a fee on the guarantee based on the recommendations of the European Central Bank[2].

11. The maturity of the debt instruments are between three months and three years. In exceptional circumstances, instruments may be guaranteed with a maturity of five years, subject to a report from the Bank of Spain. The Spanish authorities committed to notify individually to the Commission the cases in which the financial instruments have a maturity exceeding 3 years.

12. The Scheme provides for State guarantees covering new issuance of debt instruments up to an amount of €100 billion, which can be increased, if the Spanish authorities consider it necessary given market conditions, up to €200 billion, distributed equally over the annual budget of 2008 and 2009.

3. The modification to the Scheme of 16.04.09.

13. The Spanish authorities, based on the Commission Communication on the "recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition"[3], requested on 31 March 2009, that some behavioural constraints included in the original Decision in the form of a limitation of the expansion of the balance sheet of the

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[1] Ministerial Order EHA/3748/2008 of 23 December modifying Ministerial Order EHA/3364/2008.

[2] Recommendations on Government Guarantees on Bank Debt of the European Central Bank of 20 October 2008.

[3] Official Journal C10, 15.01.2009, pages 2-10.

Beneficiaries be removed from the Scheme. The Commission accepted such amendment on 16 April 2009, since there are no indications that the absence of such limitations leads to undue distortions of flows of funds between Member States.

4. Operation of the Scheme up to June 2009.

14. In its notification of 8 October 2008, Spain undertook to present reports every six months on the operation of the Scheme. The first such report was received by the Commission on 27 May 2009.

15. According to the Spanish authorities the Scheme has contributed positively to the easing of the impact of the crisis in the Beneficiaries` funding and the financial system as a whole. By reducing risk premium, the Scheme has provided the Beneficiaries with a funding mechanism at a significant lower cost than would otherwise be available to them at the current juncture. To date, every guarantee requested under the Scheme has been granted.

16. As of 27 May 2009 (hereinafter "**the Reporting Date**"), twenty-one Beneficiaries applied and issued debt instruments under the Scheme for a total of €29.6 billion, with a take-up rate of 46% of the global ceiling budgeted for 2008[4]. Almost 99% of the total debt issued under the Scheme had a maturity between one and three years with the rest maturing within one year. Up to the Reporting Date, all debt instruments issued under the Scheme have been Euro-denominated. No debt instrument issued under the Scheme had a maturity above three years.

17. To the Reporting Date, the Beneficiaries have respected the behavioural commitments agreed by the Spanish authorities. There have not been solvency issues with the Beneficiaries and no guarantee has been called upon.

18. Furthermore, the report provides information in support of an extension of the maturity of the debt instruments issued under the Scheme up to five years. A longer issuance window up to five years will allow banks to source their funding from a wider variety of investors, thus giving them the flexibility of using both short and medium term maturities to suit their requirements and market appetite. Additionally, the proposed five-year extension will avoid an excessive concentration over the existing three-year period.

5. Description of the proposed prolongation and modifications to the Scheme.

19. The Spanish authorities are planning to extend the window for issuing new debt instruments under the Scheme as from 1 July 2009 to 31 December 2009.

20. Spain is also planning to extend the guarantee to debt with maturities up to five years. In this respect, the Commission notes that the amount of debt with maturities exceeding three years and up to five years (made possible by this measure), is limited to an aggregate maximum of one third of the total budget that can be guaranteed under the Scheme.

[4] Total take up rate can be broken down as follows: 33% of debt securities issued, 1% of debt securities authorised but not yet issued and 12% requested but for which authorisation is pending.

21. The Minister for Economic Affairs and Finance will continue to allocate the maximum amount that can be guaranteed for each Beneficiary under the Scheme, in direct proportion to its market share[5] and in compliance with the limitation set out above.

22. All other conditions of the amended Scheme remain unchanged.

III. POSITION OF SPAIN.

23. In line with the original Decision, the Spanish authorities accept that the amended scheme contains State aid elements.

24. The Spanish authorities note and the report[6] submitted by the Bank of Spain confirms that the Beneficiaries´ access to market funding is still affected by the international financial crisis and that it is thus necessary to prolong the Scheme with the above-mentioned modifications. Difficulties in Beneficiaries' access to market funding have already caused repercussions for households' and firms' ability to refinance their own obligations. In order to avoid strengthening the negative feedback loop between the real economy and the financial sector, it is imperative that the Scheme will be prolonged.

25. The Spanish authorities submit that the Scheme needs to include medium-term funding with maturity up to five years, in addition to current three-year maturity. In the situation, where companies and enterprises increasingly turn to the beneficiaries for loans as they do not get funding from capital and securities markets, there is a discrepancy if Beneficiaries cannot grant longer-term loans to their customers if the Beneficiaries' own funding is based solely on short term debt. In addition, extending maturities up to five years would avoid maturities concentration in short periods of time, easing hence the exit strategy of the scheme.

26. Furthermore, a longer issuance window up to five years will allow banks to source their funding from a wider variety of investors, thus giving them the flexibility of using both short and medium term maturities to suit their requirements and market appetite. Additionally, the proposed five year extension will avoid an excessive concentration over the existing three-year period. Moreover, according to the Spanish authorities, banks have expressed the need to align the scheme to other national schemes which have a maximum maturity of five years, in order to avoid creating a competitive disadvantage against credit institutions of those Member States.

IV. ASSESSMENT

1. State aid character of the prolonged Guarantee Scheme

27. As set out in Article 87(1) EC, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

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[5] As set out in Article 6 of Ministerial Order EHA/3364/2008 of 21 November (as amended).

[6] Letter of Mr. Javier Alonso Director General for Operations, Markets and Settlement Systems of the Bank of Spain dated 12 June 2009 attaching a copy of the Financial Stability Report issued by the Bank of Spain on May 2009.

28. Similar to the original scheme, the Commission agrees with the position of Spain that the prolonged scheme for eligible institutions constitutes aid to the institutions concerned pursuant to Article 87 (1) EC.

29. The guarantee on the newly issued debt allows the Beneficiaries to refinance at advantageous conditions. This gives an economic advantage and strengthens the position of the Beneficiaries compared to their competitors in Spain and other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. The advantage is selective since it only benefits the Beneficiaries of the Scheme and is provided through State resources.

30. In particular, the Commission is convinced that in the current circumstances of financial crisis no private investor would have granted such a significant guarantee to the Beneficiaries.

2. Compatibility of the Prolonged Guarantee Scheme

a) Application of Article 87(3)(b) EC.

31. The Banking Communication[7] acknowledges that Article 87(3)(b) may be available as a legal basis for aid measures undertaken to address the current systemic crisis. It lays down conditions which have to be complied with all the aid measures. Paragraph 1.5 therein provides that: "*all general support measures have to be:*

- *well-targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy;*
- *proportionate to the challenge faced, not going beyond what is required to attain this effect, and*
- *designed in such a way as to minimize negative spill-over effects on competitors, other sector and other member States"*

32. For the reasons indicated in the original Decision and its amendment, the Commission found the Scheme to be compatible with the common market under Article 87(3)(b) of the Treaty, as the Scheme met the criteria of appropriateness, necessity and proportionality laid down in the Banking Communication[8].

33. Given that the notified amendments would not substantially change the Scheme, and that the situation on the financial markets has not improved sufficiently, it is only necessary to assess whether the finding of compatibility holds true also in view of the notified prolongation and amendment.

b) Assessment of the proposed prolongation to the Scheme.

34. The Commission observes that the extension of the scheme is a response to the continuing financial difficulties that most Member States continue to experience. Since the objective of the measure is to address the current problems of lack of liquidity and lack of confidence, it is important to ensure the availability of the Scheme as long as the global

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[7] Commission Communication on the application of State aid rules to measures taken in relation to financial institution, in the contest of the current global financial crisis (2008/C270/02), p. 10.

[8] Communication from the Commission "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis" (OJ 270, 25.10.2008, p. 8).

financial crisis remains. As the markets are likely not to have returned to normal functioning by the end of June 2009, the Commission considers that the prolongation of the Scheme until 31 December 2009 is appropriate and necessary to remedy the disturbance of the Spanish economy.

35. Indeed, as far as the appropriateness is concerned, the extension of the Scheme aims at providing liquidity to the Beneficiaries and at promoting lending to business and households. Since the extension of the Scheme is targeted at filling the ongoing funding gap in Spain, the aid is therefore well targeted.

36. As regards proportionality, the extended Scheme is proportionate to addressing the funding problems facing the Spanish financial institutions. The Commission accepts that medium-term liquidity conditions remain challenging. The Commission takes note of the report issued by the Bank of Spain in this regard[9].

37. Regarding the duration of the extension itself, the proposed measure will be temporary in nature, lasting until 31 December 2009, which limits the potential distortion of competition.

38. Regarding the minimisation of negative spill-over effects on competitors and other Member States, the Commission observes that all other conditions of the original scheme aiming at ensuring that aid is limited to the minimum necessary and does not unduly distort competition remain unchanged.

39. As regards the lending commitments, it is appropriate that banks accessing the measures are committed to continuing lending to the real economy.

c) Assessment of the Proposed Modifications to the Scheme.

40. With the proposed amendment, the Scheme would also cover debt instruments with a maturity of up to five years, whereas it previously covered maturities of up to three years. In the existing Scheme debt instruments with longer maturities (up to five years) could only be guaranteed in exceptional circumstances upon individual notification to the Commission. This increase in scope does not affect the Scheme's appropriateness as a tool to remedy the serious disturbance in the Spanish economy. In this respect, the Commission notes that the amount of debt with maturities exceeding three years and up to five years is limited to an aggregate maximum of one third of the total budget that can be guaranteed under the Scheme.

41. Furthermore Spanish Authorities will continue to allocate the maximum amount that can be guaranteed for each Beneficiary under the Scheme, in direct proportion to its market share[10] and in compliance with the limitation mentioned above.

42. In view of this and in line with earlier decisions[11], the Commission considers that this limitation provides a sufficient safeguard that any distortion of competition that the proposed extension may generate will remain proportionate to its purpose. The Commission can therefore agree to the notified amendment.

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9 Financial Stability Report of May 2009 issued by the Bank of Spain.

10 As set out in Article 6 of Ministerial Order EHA/3364/2008 of 21 November (as amended).

11 See Commission Decision of 12 December 2008 in case N 531/2008 *Guarantee scheme for credit institutions in Slovenia* and of 12 February 2009 in state aid N 664/2008 *Support measures for the baking industry in Hungary.*

43. On the basis of the above, the amended scheme of Spain can be considered compatible with the Common market.

V. DECISION

The Commission concludes that notified amended scheme is compatible with the Common market and has accordingly decided not to raise objections against it, since it fulfils the conditions to be considered compatible with the EC Treaty.

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Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission