EUROPEAN COMMISSION

Brussels, 28.06.2010
C(2010)4401 final

Subject: State Aid N 263/2010 – Spain
Extension 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. On 23 April 2009, a corrigendum to the original Decision was published in order to correct some translation and stylistic mistakes.

3. On 27 May 2009, Spain notified the Commission a request to prolong and amend the Scheme, which was approved on 26 June 2009 (State Aid N336/2009). On 26 October 2009, Spain notified a request to prolong the Scheme for an additional period of six months. The second extension of the Scheme was approved on 1 December 2009 (State Aid N588/2009). Finally, on 18 June 2010, Spain notified to the Commission a request to prolong the Scheme for an additional period of six months.

4. The Commission notes that for reasons of urgency, Spain exceptionally accepts the adoption of the decision in the English language.

II. DESCRIPTION

1. The objective of the Scheme

5. In response to exceptional turbulences in the financial markets, Spain brought forward a measure designed to preserve stability of its financial system and to remedy a serious disturbance to its economy. In particular, the Scheme aimed at limiting the risks and re-establishing confidence in the financing mechanism of

Excmo. Sr. Don Miguel Ángel MORATINOS
Ministro de Asuntos Exteriores
Plaza de la Provincia 1
E-28012 MADRID

credit institutions and fostering lending to businesses and households. The exact details of the Scheme are explained in the Commission's earlier decisions.

6. The Spanish legislation implementing the Scheme was amended[1] in order to cater for the wave of consolidation undergone by the Spanish credit institutions since its recapitalisation scheme was approved in January 2010[2]. The amendments enacted allow merging credit institutions benefiting from the Scheme ("**the Beneficiaries**") to keep utilising the Scheme if they have not exhausted their rights under it.

2. Operation of the Scheme up to June 2010

7. In the original notification of the Scheme of 8 October 2008, Spain undertook to present reports every six months on the operations of the Scheme. The requisite reports were submitted on 27 May and 17 November 2009 and 18 June 2010.

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

9. As of 2 June 2010 (hereinafter "**the Reporting Date**"), the Beneficiaries applied for and issued debt instruments under the Scheme for a total of EUR 54.2 billion, with an aggregate take-up rate of 37% of the global ceiling (EUR 146 billion) of the State guarantees pre-approved for 2008 and 2009[3].

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

III. POSITION OF SPAIN

11. In line with the previous Decisions on the Scheme[4], the Spanish authorities accept that the Scheme contains State aid elements.

12. The Spanish authorities note, and the letter submitted by the Bank of Spain[5] 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 modifications described below. While an increasing number of Beneficiaries have obtained term financing outside the Scheme, this might not be the case for medium-to-small credit institutions which continue to make significant use of it. Moreover, Spanish authorities report that the latest bond issue outside the Scheme took place more than one month before the Reporting Date.

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1 Ministerial Orders of 29 December 2008 and 30 September 2009 implementing Royal Decree-law 7/2008.

2 Decision N 28/2010 of 28 January 2010 on the recapitalisation measures in favour of the banking sector in Spain.

3 Updated information on the issuers may be found at: http://www.tesoro.es/EN/Avales/EmisionesAvaladasyenProceso_2008_EN.asp

4 Decision NN 54b/2008 of 23.12.08, Decision N 336/09 of 26.06.09 and Decision N 588/09 of 1.12.2009.

5 Letter from the Director General for Operations, Markets and Settlement Systems of the Bank of Spain dated 28.05.10.

13. The Spanish authorities are planning to extend the window for issuing new debt instruments under the Scheme for a further six-month period as from 1 July 2010. However, the proposed extension of the Scheme does not involve an increase in the Scheme's overall budget already approved. Furthermore, extending the Scheme for an additional six-month period would permit both a higher take-up rate and a better distribution of issuances over time.

14. In addition, Spain undertakes to charge the Beneficiaries a guarantee fee[6] higher than the pricing formula recommended by the ECB in October 2008 by:

- 20 basis points for Beneficiaries with a rating of A+ or A[7],
- 30 basis points for Beneficiaries rated A-[8], and
- 40 basis points for Beneficiaries rated below A-.

Beneficiaries without rating will be considered to belong to the category of Beneficiaries with a BBB rating[9].

15. Spain undertakes to present a viability review for every Beneficiary that is granted guarantees on new or renewed liabilities as from 1 July 2010 and for which at the time of the granting of the new guarantees the total outstanding guaranteed liabilities (including guarantees accorded before 1 July 2010), exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. The viability review will be communicated to the Commission within three months of the granting of guarantees under the Scheme and shall comply with the principles set out in the Restructuring Communication10. In particular, it will cover the solidity of the funding capacity of the Beneficiary concerned; where necessary and in any event where requested by the Commission in case of doubt, a liquidity stress test will be carried out. No separate viability review has to be presented for Beneficiaries which are undergoing restructuring or obliged to present a restructuring plan or subject to a pending viability review at the time new guarantees are granted.

16. In addition to the existing reporting obligations mentioned in paragraph 15 above, Spain undertakes to submit to the Commission a concise mid-term review on the operation of the Scheme by 15 October 2010, at the latest.

17. Spain undertakes to maintain the commitments made since the introduction of the Scheme and upheld in the context of its last extension. All other conditions of the amended Scheme remain unchanged.

IV. ASSESSMENT OF THE SCHEME

18. In its decision of 23 December 2008, the Commission concluded that the Scheme constituted State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"). However, it found it compatible with the internal market under Article 107(3)(b) TFEU, because it was apt to remedy a

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[6] The new pricing is set out in detail in the notification.

[7] Or A1 and A2 depending on the rating system employed.

[8] Or A3 depending on the rating system employed.

[9] In the case of divergent assessments by different rating agencies the relevant rating for the calculation of the fee increase should be the higher rating. The material time for the rating in the determination of the guarantee fee is the day on which the guarantee is granted in relation to a specific bond issuance by the beneficiary.

[10] OJ C 195, 19.8.2009, p.11, point 8 in conjunction with section 2.

serious distortion of the Spanish economy. To this end, the Commission had assessed the appropriateness, necessity and proportionality of the Scheme.

19. The Commission observes that the extension of the Scheme is a response to the continuing financial difficulties that Spain, as most Member States, continues to experience. Since the objective of the measure is to provide short- and medium-term financing to credit institutions which are unable to obtain funds on the financial markets, it is important to ensure the availability of the Scheme as long as the global financial crisis continues.

20. Although access to funding for credit institutions has gradually improved in most funding markets over the past year, markets have not yet returned to normal functioning. Against this background and taking into account the fragility of recovery process and the recent setbacks in that process observed in Spain, the continuation of the Scheme can be deemed necessary to ensure financial stability as confirmed by the Central Bank of Spain. The Commission, therefore, considers that the extension of the Scheme for a further six months is appropriate and necessary to remedy a disturbance of the Spanish economy.

21. On the basis of the above, the notified extension of the Scheme does not alter the Commission's previous assessment in the decision of 23 December 2008 and the prolongation decisions of 26 June and 1 December 2009.

22. As regards the specific features of the Scheme in assessing the request for the prolongation, the Commission has to balance its positive effects for financial stability with the distortions of competition and the delay in the return to a normal functioning of the financial markets that the extension entails. Guarantee schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States.

23. According to the information submitted by Spain, market conditions have changed so that lower-rated credit institutions have become the prime users of the Scheme, whereas a gradual alignment with market conditions has provided an exit incentive for sounder institutions..

24. The necessity to minimise distortions across banks in the internal market and avoid the risk of State aid dependence, requires an adjustment of the terms on which banks should retain for the time being the possibility of accessing government guarantees schemes to these altered conditions.

25. On the basis of these considerations, the prerequisites for the compatibility of guarantee schemes with Article 107 (3) (b) TFEU that have been established by the Banking Communication and the Commission's subsequent decisional practice continue to apply but need to be complemented by requirements aimed at achieving two objectives.

26. First, credit institutions should be incentivised to scale down or terminate their recourse to government guarantees by means of pricing rules that bring the funding costs of the Beneficiaries closer to market conditions and thereby reduce distortions of competition. This should be achieved by an increase in the guarantee fee[11] in

[11] For liabilities of all eligible maturities.

comparison with the ECB Recommendation of October 2008 that amounts at least to 20 basis points for banks with a rating of A+ or A[12], 30 basis points for banks rated A-[13], and 40 basis points for banks rated below A-[14].

27. Second, the use of guarantee schemes should not enable the Beneficiaries with structural weaknesses in their business models to postpone or avoid the necessary adjustments. To this end, Spain should present a viability review for any Beneficiary that requests new guarantees under the Scheme which take or keep the total amount of the Beneficiary's outstanding guaranteed liabilities above 5% its total liabilities and above the absolute amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication within three months of the granting of the guarantees[15]. The viability review will either confirm the Beneficiary's long-term viability without State support or show that farther-reaching restructuring is required.

28. The Commission considers that the notified extension until 31 December 2010 of the Scheme complies with the requirements set out above and is compatible with the internal market.

29. As regards the combination of the Scheme with other aid measures, as indicated in the Annex to the Restructuring Communication[16], any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To this end, an individual ex ante notification is necessary.

30. Furthermore, the Commission recalls that based on point 16 of the Restructuring Communication, if aid not initially foreseen in a notified restructuring plan is necessary for the restoration of viability, this additional aid cannot be granted under an approved Scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission’s final decision on that credit institution.

31. Spain agrees to provide the Commission with a concise mid-term review of the operation of the Scheme by 15 October 2010, in addition to the pre-existing reporting requirements and to complement its future reports on the operation of the Scheme with updated available data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances[17.] This will allow the Commission to assess the appropriateness, necessity and proportionality of possible further prolongations of the Scheme beyond 31 December 2010, and the

12 Or A1 and A2, depending on the rating system employed.

13 Or A3, depending on the rating system employed.

14 Banks without rating will be considered as having a BBB rating.

15 Except where the bank concerned is already in restructuring or subject a pending viability review on the basis of a restructuring or viability plan; in those circumstances the award of additional State aid will be assessed within the framework of the ongoing restructuring/viability review process.

16 OJ C 195, 19.08.2009.

17 See point 23 of the Commission decision of 12 December 2008.

conditions for such prolongations. Any further prolongation will require the Commission's approval and will be based on a review of the developments in financial markets and the Scheme's effectiveness.

V. DECISION

The Commission finds that the notified six-month extension of the Scheme until 31 December 2010 is compatible with the internal market and the Commission has, accordingly, decided not to raise objections to the extension of the Scheme until 31 December 2010 included.

The Commission notes that for reason for urgency Spain exceptionally accepts the adoption of the decision in the English language.

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Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
Rue Joseph II 70
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-president of the Commission