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WORKING LANGUAGE

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Subject: State Aid N 315/2010 – Portugal
Extension of the Portuguese Guarantee Scheme

Sir,

I. PROCEDURE

1. On 1 July 2010, Portugal pre-notified to the Commission a request to extend the Guarantee Scheme until 31 December 2010. This pre-notification was registered by the Commission under case number PN 158/2010. On 14 July 2010, Portugal submitted the notification that was registered by the Commission under case number N 315/2010.
2. The Guarantee Scheme was originally approved by the Commission on 29 October 2008 until 31 December 2009 under case number NN 60/2008[1]. On 22 February 2010, the Commission approved the first prolongation of the Guarantee Scheme until 30 June 2010 under case number N51/2010[2].

[1] Commission Decision C(2008) 8686 of 29 October 2008 – State aid NN60/2008, OJ C 9, 14.01.2009 and Corrigendum, OJ C 25, 31.01.2009.
[2] Commission Decision C(2010) 1051 of 22 February 2010 – State aid N51/2010, OJ C 96, 16.04.2010.

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II. DESCRIPTION

1. The objective of the Guarantee Scheme

3. In response to the ongoing exceptional turbulence in world financial markets, Portugal brought forward a measure designed to preserve stability in the financial system and to restore confidence in the economy. In particular, the Guarantee Scheme aims to support the access to liquidity of solvent credit institutions in Portugal in the context of the financial crisis.

2. Description of the Guarantee Scheme approved by Commission decision NN 60/2008 and N 51/2010

4. The beneficiaries of the Guarantee Scheme are all credit institutions incorporated in Portugal, including subsidiaries of foreign banks with registered office in Portugal. Only institutions with conditions of solvability according to the Portuguese law may benefit from the scheme.
5. The Guarantee Scheme covers the issuance of non-subordinated euro-denominated debt with minimum maturity of three months and maximum maturity of three years. Under exceptional circumstances, duly justified by the Bank of Portugal, the maximum maturity can be of five years.
6. The total budget of the Guarantee Scheme for 2010 is EUR 9,1462 billion.

3. Operation of the Guarantee Scheme up to 21 April 2010

7. The Portuguese authorities submitted the report on the operation of the Guarantee Scheme on 19 May 2010.
8. According to the report, no guarantees have been granted since the first prolongation of the Guarantee Scheme approved on 22 February 2010. From the total amount of EUR 4,95 billion of debt instruments issued by six beneficiaries[3], the Portuguese authorities submitted that two banks have already redeemed guarantees for a total amount of EUR 75 million[4].

4. Extension of the Guarantee Scheme

9. Portugal intends to extend the Guarantee Scheme until 31 December 2010.
10. Portugal introduces amendments to the extended Guarantee Scheme concerning pricing conditions (an increase in the guarantee fee), viability review requirements and an additional reporting obligation, which are in line with the updated compatibility conditions for the renewal of guarantee schemes[5].

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[3] The total amount can be broken down as follows: CGD - Caixa Geral de Depósitos S.A. (EUR 1250 million), Millenium - Banco Comercial Português S.A. (EUR 1500 million), BANIF – Banco International do Funchal S.A. (EUR 550 million), BES – Banco Espírito Santo S.A. (EUR 1500 million), Banco Invest S.A. (EUR 50 million) and Banco Finantia S.A. (EUR 100 million).

[4] BANIF – Banco International do Funchal S.A. redeemed the Schuldschein Loan Agreement (EUR 50 million) and Banco Invest S.A. redeemed the loan contract - *"contrato de mútuo"* (EUR 25 million).

[5] http://ec.europa.eu/competition/state_aid/studies_reports/phase_out_bank_guarantees.pdf.

11. All other conditions of the Guarantee Scheme, as approved by the Commission decisions in State aid cases NN 60/2008 and N 51/2010 remain unchanged and continue to apply.

III. POSITION OF PORTUGAL

12. In line with the previous Decisions on the Guarantee Scheme, the Portuguese authorities accept that the amended scheme contains State aid elements.

13. The Portuguese authorities note that the Guarantee Scheme has not been used in the last twelve months. However, the recent evolution of the financial markets showed high levels of tension which exacerbated the risk aversion behaviour and caused the non-regular functioning of the monetary and capital markets. This situation has affected the capacity of Portuguese financial institutions to manage liquidity. Moreover, the unpredictable conditions of financing in the international capital markets, especially for Portugal, suggest increased caution in timing of the implementation of the exit strategy from the public support. A letter sent by the Bank of Portugal dated 24 May 2010 confirms the necessity to prolong the Guarantee Scheme.

14. Under these circumstances, the Portuguese authorities consider that the extension of the Guarantee Scheme until 31 December 2010 is necessary in order to ensure the liquidity conditions and the regular financing of the economy.

15. Portugal undertakes to maintain the commitments made in the context of the original authorisation of the Guarantee Scheme and the prior prolongation and confirms that all other conditions as reflected in the Commission decisions in State aid cases NN 60/2008 and N 51/2010 remain unchanged and continue to apply.

16. Portugal undertakes to charge beneficiary banks a guarantee fee that is higher than under the pricing formula recommended by the ECB in October 2008 by

    - 20 basis points for banks with a rating of A+ or A[6],
    - 30 basis points for banks rated A-[7], and
    - 40 basis points for banks rated below A-. Banks without rating will be considered to belong to the category of banks with a BBB rating[8].

17. In this matter, Portugal will amend the legislative framework that implements the Guarantee Scheme in order to comply with the recommendations on the guarantee fees.

18. Portugal undertakes to present a viability review for every bank that is granted guarantees on new or renewed liabilities as from the date of adoption of the present decision and for which at the time of the granting of 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 and will comply with the principles set out in the Restructuring Communication[9]. In particular, it will cover the solidity of the funding capacity of the bank concerned; where

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

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

[8] 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.

[9] OJ C 195, 19.8.2009, p.11-13, point 8 in conjunction with section 2.

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 banks that are already in restructuring or obliged to present a restructuring plan or subject to a pending viability review at the time new guarantees are granted.

19. In addition to the existing commitments concerning reporting obligations, Portugal undertakes to submit to the Commission a concise mid-term review on the operation of the Guarantee Scheme by 15 October 2010 at the latest.

IV. ASSESSMENT OF THE MEASURE

20. In its decision of 29 October 2008, the Commission concluded that the Guarantee Scheme constitutes State aid within the meaning of Article 107(1) TFEU[10]. However it found that the measure was compatible with the internal market under Article 107(3)(b) TFEU, because it was apt to remedy a serious distortion of the Portuguese economy. To this end, the Commission had assessed the appropriateness, necessity and proportionality of the measure.

21. The Commission observes that the extension of the Guarantee Scheme is a response to the continuing fragility of the funding sources that the banks in Portugal, as in most Member States, continue to experience. Since the objective of the measure is to provide short- and medium-term financing to financial institutions which are unable to obtain such funds on the financial markets, it is important to ensure the availability of the guarantee scheme as long as the global financial crisis continues.

22. Although access to funding for banks has gradually improved in most funding markets over the past year and is no longer a systematic and generalised problem, markets have not yet fully returned to entirely normal functioning. Against this background and taking into account the residual fragility of recovery process and the possibility of setbacks in that process, the continuation of a guarantee scheme can be deemed necessary to ensure financial stability as confirmed by the Bank of Portugal. The Commission therefore considers that the extension of the Guarantee Scheme until 31 December 2010 is appropriate and necessary to remedy a serious disturbance of the Portuguese economy.

23. As regards the specific features of the Guarantee Scheme, in assessing the request for the extension 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.

24. The gradual stabilisation of the market situation and the resulting reduction of the risk premium for unguaranteed debt have brought about a first step towards an alignment with market conditions, whilst providing an exit incentive for the sounder institutions. Lower-rated banks for which bond issuances with a government guarantee still hold considerable economic benefits have become the prime users of guarantee schemes.

25. It is necessary to minimise distortions across banks in the internal market and avoid the risk of State aid dependence. There should therefore be an adjustment of the terms on

[10] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the Treaty on the Functioning of the European Union. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

which banks may retain for the time being the possibility of accessing government guarantees schemes.

26. 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[11] and the Commission's subsequent decisional practice continue to apply but need to be complemented by requirements aimed at achieving two objectives.

27. First, banks should be incentivised to scale down or terminate their recourse to government guarantees by means of pricing rules that bring the funding costs of beneficiary banks closer to market conditions and thereby reduce distortions of competition. This should be achieved by an increase in the guarantee fee[12] in comparison with the ECB Recommendations of October 2008 that amounts at least to 20 basis points for banks with a rating of A+ or A[13], 30 basis points for banks rated A-[14], and 40 basis points for banks rated below A-[15].

28. Second, the use of guarantee schemes should not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments. To this end, Portugal committed to present a viability review for any bank that requests new guarantees under a scheme which take or keep the total amount of the bank's outstanding guaranteed liabilities above 5% of that bank's total liabilities and above the absolute amount of EUR 500 million. That 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[16]. The viability review will either confirm the bank's long-term viability without State support or show that farther-reaching restructuring.

29. With the notification, Portugal has provided commitments to follow these new conditions. The Commission therefore considers that the notified extension until 31 December 2010 of the State Guarantee Scheme complies with the requirements set out above and is compatible with the internal market.

30. As regards the combination of this guarantee scheme with other aid measures, as indicated in the Annex to the Restructuring Communication, 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.

31. 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

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[11] '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 C 270, 25.10.2008, p. 8).

[12] For liabilities of all eligible maturities.

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

[14] Or A3, depending on the rating system employed.

[15] Banks without a rating will be considered as having a BBB rating.

[16] Except where the bank concerned is already in restructuring or subject to 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.

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 bank.

32. In addition to the above, Portugal 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 extensions of the scheme beyond 31 December 2010 and the conditions for such extensions. Any further extension will require the Commission's approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness.

V. DECISION

The Commission finds that the notified extension of the Guarantee Scheme constitutes State aid within the meaning of Article 107(1) TFEU.

Since the extension of the Guarantee Scheme fulfils the conditions for aid under Article 107(3)(b) TFEU, it is compatible with the internal market. The Commission has accordingly decided not to raise any objections to the extension of the Guarantee Scheme until 31 December 2010 included.

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http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm

Your request should be sent by registered letter or fax to:

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Yours faithfully,

Joaquín ALMUNIA
Vice-president of the Commission

[17] See point 23 of the Commission decision of 28 April 2009.