EUROPEAN COMMISSION

Brussels, 30.6.2011
C(2011) 4716 final

Subject: State Aid SA. 33178 (2011/N) – Portugal
Fourth extension of the Portuguese Guarantee Scheme

Sir,

I. PROCEDURE

1. On 29 October 2008, the Commission originally approved the Portuguese Guarantee Scheme 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 N 51/2010[2]. On 23 July 2010 the Commission approved the second prolongation of the Guarantee Scheme until 31 December 2010 under case number N 315/2010[3]. On 21 January 2011 the Commission approved a third prolongation of the Guarantee Scheme until 30 June 2011 under case number SA.32158 (2011/N)[4].
2. On 14 June 2011, Portugal notified to the Commission a request to prolong the Guarantee Scheme until 31 December 2011. On 22 June 2011, the Portuguese authorities exceptionally accepted that the Commission decision be adopted in the English language.

II. DESCRIPTION

1. The objective of the Guarantee Scheme

3. In response to the ongoing exceptional turbulence in the global financial markets, Portugal brought forward a measure designed to preserve the stability of the financial system and to restore the confidence in the economy. In particular, the Guarantee Scheme

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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.
3 Commission Decision C(2010) 5126 of 23 July 2010 – State aid N315/2010, OJ C 283, 20.10.2010.
4 Commission Decision C(2011) 323 of 21 January 2011 – State aid SA.32158, OJ C 111, 09 April 2011

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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

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 five years.

6. The total budget of the Guarantee Scheme for 2010 approved by the Commission was EUR 9.1462 billion.

3. Operation of the Guarantee Scheme up to 21 April 2011

7. The Portuguese authorities submitted a report on the operation of the Guarantee Scheme on 14 June 2011.

8. According to the report, no guarantees have been granted since April 2009. From the total amount of EUR 4.95 billion of debt instruments issued by six beneficiaries before that date[5], the Portuguese authorities stated that two banks have already redeemed guarantees for a total amount of EUR 75 million[6].

4. Extension of the Guarantee Scheme

9. Portugal intends to prolong the Guarantee Scheme until 31 December 2011.

10. The total budget will be increased from EUR 9.1462 billion to EUR 20.18 billion on the basis of law (Lei do Orçamento do Estado para 2011), until the adoption of an amended law in Portugal that will further increase the budget to EUR 35 billion. All other conditions of the Guarantee Scheme, as approved by the Commission decisions in State aid cases NN 60/2008, N 51/2010, N 315/2010 and SA.32158 remain unchanged and continue to apply.

III. POSITION OF PORTUGAL

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

12. According to the Bank of Portugal[7], there is a need to prolong the scheme for a number of reasons. First, the Memorandum of Understanding ("MoU")[8] signed between the

[5] 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).

[6] 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).

[7] Letter of Bank of Portugal dated 1 June 2011.

Portuguese Government on the one hand, and the International Monetary Fund, the European Commission and the European Central Bank on the other hand, foresees measures for the banking sector which include the maintenance and the reinforcement of the scheme. Second, access to market capital by financial institutions in Portugal is currently almost inexistent, with no short-term perspective of improvement. Third, some credit institutions have recently requested to be able to issue government-guaranteed debt.

13. Under those circumstances, the Portuguese authorities consider as necessary the extension of the Guarantee Scheme until 31 December 2011.

14. 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 2011 at the latest.

IV. ASSESSMENT OF THE MEASURE

15. In its decision of 29 October 2008, the Commission concluded that the Guarantee Scheme constitutes State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"). However it found that the measure was compatible with the internal market under Article 107(3)(b) TFEU, because it is to remedy a serious distortion of the Portuguese economy. To that end, the Commission had assessed the appropriateness, necessity and proportionality of the measure.

16. The Commission observes that the extension of the Guarantee Scheme is a response to the continuing financial difficulties that Portugal continues 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.

17. Although access to funding for banks has gradually improved in most European markets over the past year and is no longer a systematic and generalised problem, markets have not yet fully returned to entirely normal functioning and Portuguese banks are experiencing problems stemming from the difficulties that have led Portugal to request external assistance.

18. Against that background and taking into account the residual fragility of the recovery process, as well as the possibility of setbacks in that process, the continuation of the Guarantee Scheme and the increase of the budget can be deemed necessary in the current situation of high instability on the financial markets as confirmed by the Bank of Portugal and by the recent applications of some credit institutions to issue government-guaranteed debt.

19. The Commission notes that the Portuguese banking system is currently facing severe funding problems. Banks' liquidity remains under high pressure and non-performing loans are increasing due to the highly indebted economy with weak growth prospects. As a result of the sovereign situation and recent downgrades, Portuguese banks have lost wholesale market access to fund their operations and have increasingly relied on Euro-system credit operations.

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8 Portugal, " Memorandum Of Understanding On Specific Economic Policy Conditionality", 17 May 2011, http://ec.europa.eu/economy_finance/eu_borrower/mou/2011-05-18-mou-portugal_en.pdf

20. The increased budget of the scheme should provide an adequate buffer to address liquidity requirements taking into account the need to reduce reliance on Euro-system funding and to continue to support the productive sectors of the domestic economy, as is acknowledged also in point 2.1 of the MoU.

21. The Commission therefore considers that the extension of the Guarantee Scheme until 31 December 2011 is appropriate and necessary to remedy a serious disturbance of the Portuguese economy.

22. 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, the distortions of competition that the extension entails and the delay in the return to a normal functioning of the financial markets. Guarantee schemes should contain 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. The Commission considers that the conditions of the Guarantee Scheme comply with those requirements.

23. On the basis of those considerations, the prerequisites for the compatibility of guarantee schemes with Article 107(3)(b) TFEU that have been established by the Banking Communication[9] and the Commission's subsequent decisional practice continue to apply. The Commission considers that the notified extension until 31 December 2011 of the Guarantee Scheme complies with the requirements set out above and is compatible with the internal market.

24. The Commission notes that Portugal confirms that all the commitments made in relation to the Guarantee Scheme will continue to apply, including those related to presenting every six months a report on the operation of the scheme. Portugal will have to notify any modification of the conditions of the notified scheme, which may be introduced once the new national legal basis is enacted.

25. As regards the combination of the Guarantee Scheme with other aid measures, as indicated in the Annex to the Restructuring Communication[10], 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). It means that, as soon as 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 that end an individual *ex ante* notification is necessary.

26. 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, that 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 bank.

27. In addition to the above, Portugal agrees to provide the Commission with a concise mid-term review of the operation of the Guarantee Scheme by 15 October 2011 and to

[9] 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

[10] Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.08.2009

complement its future reports on the operation of the scheme with updated data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances[11].

28. On the basis of the above, the notified extension of the measure remains compatible with the internal market until 31 December 2011.

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 2011 included.

The Commission notes that Portugal has exceptionally accepted that the decision be adopted in the English language.

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

Your request 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

[11] See point 21 of the Commission decision of 29 October 2008