EUROPEAN COMMISSION

Brussels, 27.06.2012
C(2012) 4387 final

Subject: State Aid SA.34958 (2012/N) – Portugal
Extension of the Portuguese Guarantee Scheme

Sir,

I. PROCEDURE

1. On 29 October 2008, the Commission approved the Portuguese Guarantee Scheme until 31 December 2009 under case number NN 60/2008[1]. On 22 February 2010, the Commission approved a first prolongation of the Guarantee Scheme until 30 June 2010 under case number N 51/2010[2]. On 23 July 2010 the Commission approved a second prolongation of the Guarantee Scheme until 31 December 2010 under case number N 315/20103. On 21 January 2011 the Commission approved a third prolongation of the Guarantee Scheme until 30 June 2011 under case number SA.32158. On 30 June 2011 the Commission approved a fourth extension of the Guarantee Scheme until 31 December 2011 under case number SA. 33178[4]. On 21 December 2011 the Commission approved a fifth extension of the Guarantee Scheme until 30 June 2012 under case number SA. 34034[5].

2. On 11 June 2012, Portugal notified to the Commission a request to extend the Guarantee Scheme until 31 December 2012. Further information was provided on 14 and 15 June 2012.

3. The Portuguese authorities exceptionally accepted that the Commission decision be adopted in the English language for reasons of urgency.

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1 Commission Decision 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 of 22 February 2010 – State aid N51/2010, OJ C 96, 16.04.2010.
3 Commission Decision of 23 July 2010 – State aid N315/2010, OJ C 283, 20.10.2010.
4 Commission Decision of 30 June 2011 – State aid SA.33178, OJ C 344, 24.11.2011.
5 Commission Decision of 21 December 2011 - State aid SA.34034, OJ C 99, 03.04.2012.

S. Ex.ª o Ministro dos Negócios Estrangeiros
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II. DESCRIPTION

1. The objective of the Guarantee Scheme

4. 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 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

5. 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 which are solvent for the purposes of Portuguese law may benefit from the scheme.
6. Under the approved Order[6], the Guarantee Scheme covers the issuance of non-subordinated debt with a minimum maturity of three months and a maximum maturity up to five years. In case of guarantees on the issuance of covered bonds (on mortgages and on the public sector), the maturity can go up to seven years. This prolongation of the maturity of the guarantees constitutes a material modification of the previously approved scheme.
7. Portugal intends to extend the Guarantee Scheme until 31 December 2012.
8. The part of the guaranteed liabilities with a maturity longer than three years will not exceed one-third of the total value of the liabilities covered by the State guarantee.
9. All other conditions of the Guarantee Scheme, as approved by the Commission decisions in State aid case SA.32158, remain unchanged and continue to apply.
10. The total budget remains EUR 29.92 billion.

3. Operation of the Guarantee Scheme up to 15 April 2012

11. The Portuguese authorities submitted a report on the operation of the Guarantee Scheme on 11 June 2012.
12. According to the report submitted by Portugal, the total amount of outstanding guarantee on 15 April 2012 was EUR 16,825 million, EUR 4,300 million having already been reimbursed. Four further requests are currently being analysed.

4. Remuneration

13. For guarantees covering debt with a maturity of one year or more, the guarantee fee will as a minimum be the sum of:

    i. a basic fee of 40 basis points ("bp"); and

    ii. a risk-based fee equal to the product of 40 bp and a risk metric composed of (i) one-half of the ratio of the beneficiary's median five-year senior credit default

[6] Portaria n.º 80/2012 of 27 March 2012, *Diário da República, 1.ª série, n° 62.*

swap ("CDS") spread over the three years ending one month before the date of issue of the guaranteed bond to the median level of the iTraxx Europe Senior Financials five-year index over the same three-year period, plus (ii) one-half of the ratio of the median five-year senior CDS spread of all Member States to the median five-year senior CDS spread of the Member State granting the guarantee over the same three-year period[7].

14. For banks without CDS data or without representative CDS data, but with a credit rating, an equivalent CDS spread will be derived from the median value of five-year CDS spreads during the same sample period for the rating category of the bank concerned, based on a representative sample of large banks in the Member States. The supervisory authority will assess whether the CDS data of a bank are representative.

15. For banks without CDS data and without a credit rating, an equivalent CDS spread will be derived from the median value of five-year CDS spreads during the same sample period for the lowest rating category, based on a representative sample of large banks in the Member States. The calculated CDS spread, for that category of banks, may be adapted on the basis of a supervisory assessment.

16. For guarantees covering debt with a maturity of less than one year, as CDS spreads may not provide an adequate measure of credit risk for debt with a maturity of less than one year, the guarantee fee for such debt will as a minimum be the sum of:

(1) a basic fee of 50 bp; and

(2) a risk-based fee equal to 20 bp for banks with a rating of A+ or A, 30 bp for banks with a rating of A-, or 40 bp for banks rated below A- or without a rating.

III. POSITION OF PORTUGAL

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

18. According to the Bank of Portugal[8], there is a need to extend the scheme for a number of reasons. First, the Memorandum of Understanding ("MoU")[9] signed between the 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

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7 The formula for the guarantee fee can be written as:
Fee = 40bp x (1 + (1/2 x A/B) + (1/2 x C/D))
where A is the beneficiary's median five-year senior CDS spread, B is the median iTraxx Europe Senior Financials five-year index, C is the median five-year senior CDS spread of all Member States and D is the median five-year senior CDS spread of the Member State granting the guarantee.
The medians are calculated over the three years ending one month before the date of issue of the guaranteed bond.
In the case of guarantees for covered bonds, the guarantee fee may take into account only one-half of the risk-based fee.

8 Letter of the Bank of Portugal of 11 June 2012.

9 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

institutions in Portugal is currently almost inexistent, given the strong risk aversion for Portugal in the market. That factor continues to affect adversely the capacity of Portuguese financial institutions to manage liquidity, with no short-term perspective of improvement.

19. Under those circumstances, the Portuguese authorities consider as necessary the extension of the Guarantee Scheme until 31 December 2012.

20. 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 2012 at the latest.

21. To enable the Commission to assess the application in practice of the revised pricing applicable from 1 January 2012, Portugal provided an updated estimation of the costs applicable to banks eligible to benefit from those guarantees, based on an application of the formula using recent market data. Furthermore, Portugal commits to communicate to the Commission, within three months following each issue of guaranteed bonds, the actual guarantee fee charged in relation to each issue of guaranteed bonds.

IV. ASSESSMENT OF THE MEASURE

22. 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"). Nothing in the extended scheme alters that assessment, which is, moreover, not contested by the Portuguese authorities. In its decision of 29 October 2008, the Commission also 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.

23. The Commission observes that the extension of the Guarantee Scheme is a response to the financial difficulties that Portugal continues to experience. 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 the resulting downgrades, Portuguese banks have lost wholesale market access to fund their operations and have increasingly relied on Euro-system credit operations.

24. 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. It is also appropriate to take into account that Portuguese banks are experiencing problems stemming from the difficulties that have led Portugal to request external assistance.

25. 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 can be deemed necessary in the current situation of high instability on the financial markets as confirmed by the Bank of Portugal.

26. The 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 the MoU.

27. The Commission therefore considers that the extension of the Guarantee Scheme until 31 December 2012 is appropriate and necessary to remedy a serious disturbance of the Portuguese economy.

28. 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.

29. 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[10] and the Commission's subsequent decisional practice continue to apply. Moreover, the 2011 Prolongation Communication[11] has modified the formula for the calculation of the remuneration of guarantees. The Commission considers that the notified extension until 31 December 2012 of the Guarantee Scheme complies with those requirements and is compatible with the internal market.

30. 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.

31. The Commission also notes that Portugal has committed to respect the new guidelines on the remuneration of the guarantees, as set out in the 2011 Prolongation Communication and to communicate to the Commission, within three months following each issue of guaranteed bonds, the actual guarantee fee charged in relation to each issue.

32. As regards the combination of the Guarantee Scheme with other aid measures, as indicated in the Annex to the Restructuring Communication[12], 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.

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[10] 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.

[11] Communication from the Commission on the application, from 1 January 2011 , of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

[12] 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, p. 9.

33. 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.

34. 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 2012 and to 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.

35. On the basis of the above, the notified extension of the measure is compatible with the internal market until 31 December 2012.

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 for the period from 1 July 2012 until 31 December 2012.
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/competition/elojade/isef/index.cfm

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

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President