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**Subject: C 33/2009 (ex NN 57/2009 ex CP 191/2009) - Portugal
Restructuring of Banco Privado Português**

Sir,

The Commission wishes to inform Portugal that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in relation to the State guarantee in favour of Banco Privado Português (hereafter "BPP").

The Commission also wishes to inform Portugal that it has decided to enjoin Portugal pursuant to Article 10(3) of Council Regulation (EC) No 659/1999 to submit the restructuring plan for Banco Privado Português.

1. PROCEDURE

- (1) On 13 March 2009 the Commission approved a State guarantee underwriting a € 450 million loan granted to BPP by six Portuguese banks on 5 December 2008. The measure was authorised for a period of six months on the basis of Article 87(3)(b) EC, subject inter alia to the submission of a restructuring plan. On 23 June 2009 Portugal informed the Commission that the State guarantee had been prolonged for a further period of six months.

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- (2) On 15 July 2009 the Commission invited the Portuguese authorities to urgently submit the restructuring plan for BPP. Since the requested plan was not submitted, by letter dated 6 October 2009 the Commission sent an official reminder pursuant to Article 5(2) of Council Regulation (EC) No 659/1999.

2. DESCRIPTION

2.1. The beneficiary

- (3) BPP is a financial institution based in Portugal providing private banking, corporate advisor and private equity services. BPP's clients are private and institutional depositors, including five "Caixas de Crédito Agrícola Mutuo", one "Caixa Economica", several pension funds, insurance companies and others. BPP is present in Portugal, Spain and to a lesser extent in Brazil and in South Africa.
- (4) BPP's shares are not listed in a stock exchange and, hence, the market price of the shares is not observable. As of 30 June 2008, total assets on the balance sheet of BPP amounted to EUR 2.9 billion, representing less than 1% of the total assets of the Portuguese banking sector. BPP is 100% held by the group Privado Holding SGPS (sociedade gestora de participações sociais) S.A. As of 30 June 2008, the majority of the shares of this holding (51.5%) were held by 12 shareholders.

2.2. Financial difficulties of the bank

- (5) According to the Portuguese authorities, BPP came into liquidity difficulties due to the deterioration of the global economic situation, which significantly reduced the bank's ability to manage its liquidity.
- (6) On 24 November 2008 BPP informed the Portuguese Central Bank ("Bank of Portugal") that it risked being unable to meet its payment obligations. On 5 December 2008 BPP received a EUR 450 million loan assisted by a State guarantee, as specified hereafter. The loan and the guarantee only cover BPP's liabilities as registered in the balance sheet on 24 November 2008 and the loan will only be used to reimburse depositors and other creditors and not to cover liabilities of other entities of the group. Since 5 December 2008, BPP is no longer providing banking services and has been allowed to suspend all its payments as from the 1st December 2008.

2.3. The emergency aid measure

- (7) On 5 December 2008 BPP signed a loan contract, assisted by a State guarantee, for EUR 450 million with 6 major Portuguese banks (Banco Comercial Português, S.A., Caixa Geral de Depósitos, S.A., Banco Espírito Santo, S.A., Banco BPI, S.A., Banco Santander Totta, S.A., Caixa Central – Caixa Central de Crédito Agrícola Mútuo CRL). The loan had a maturity of 6 months renewable up to two years and bore an interest rate of EURIBOR + 100 basis points. The remuneration for the loan was determined on the basis of the cost of funding for the creditor banks, at the time of the transaction.

- (8) According to Portugal, without a State guarantee no lender was willing to finance BPP at a reasonable rate, given its difficult financial situation. The State guarantee that assists the loan was granted in accordance with Law n.º112/97, i.e. outside the Portuguese guarantee scheme (Law 60-A/2008) approved by Commission on 29 October 2008¹. In particular, the Portuguese authorities stated that the general guarantee scheme, which is reserved to solvent banks, was an inappropriate framework for the State intervention in favour of BPP, taking into consideration the increasing financial deterioration of the bank and the specific risks linked to this transaction.
- (9) The remuneration for the State guarantee was fixed at 20 basis points, in consideration of the collaterals presented by BPP. The collaterals consist of: (i) first right of pledge on several assets as specified in a contract concluded by Portugal, BPP and Bank of Portugal; (ii) first mortgage on immovable assets owned by BPP. These collaterals are estimated to be worth around EUR 672 million. The provision of collateral is regulated by an "Agreement" subscribed by the Treasury, BPP and the Bank of Portugal, in which the latter was appointed as custodian and collateral manager on behalf of the Treasury.
- (10) During the period of validity of the loan covered by the State guarantee, BPP commits not to sell, provide as collateral or otherwise dispose of its present and future assets.
- (11) The Commission approved the measure for a period of six months from the granting of the State guarantee, i.e. until 5 June 2009.
- (12) In order to prolong the validity of the guarantee beyond the initial period of 6 months (i.e. beyond 5 June 2009), the Portuguese authorities committed to submit a specific notification to the Commission.

2.4. Prolongation of the emergency aid measure

- (13) By e-mail dated 23 June 2009 Portugal informed the Commission that it has taken a decision to prolong the State guarantee for a further period of six months (Despacho N°13364-A/2009 of the Ministry of Finance of 5 June 2009). However, Portugal neither notified the extension nor sought the approval of the Commission.
- (14) Since the Commission decision only approved this aid for a period of six months (i.e. until 5 June 2009), the rescue aid became unlawful on 6 June 2009.

2.5. The delay in submitting the restructuring plan.

- (15) In the context of the Commission's examination of the emergency aid measure, Portugal committed to provide a restructuring plan for BPP within six months of the State intervention (i.e. by 5 June 2009). In its decision of March 2009 approving the measure, the Commission considered the submission of the restructuring plan as an unavoidable requirement given the exceptionally low level of remuneration.

¹ Decision of 29/10/2008 in case NN 60/2008- *Guarantee scheme for credit institutions in Portugal*

- (16) Portugal has not fulfilled the above-mentioned commitment.
- (17) A recovery plan was submitted to the Bank of Portugal by BPP's administrators on 24 April 2009.
- (18) By letter dated 5 June 2009 the Portuguese authorities explained to the Commission that the delay in submitting a restructuring plan for BPP was due to the fact that the recovery plan proposed by BPP had not been accepted by the Bank of Portugal.
- (19) On 9 June 2009 the Ministry of Finance and Public Administration published a document which stated that the recovery and restructuring plan submitted on 24 April 2009 by BPP to the Bank of Portugal proposed, among other things, a capitalisation with State contribution of € 200 million in the form of ordinary shares, preferential shares and supplementary obligations with no return.
- (20) The government judged that solution unworkable. The above-mentioned document also stated that *"Due to its size, market share and business model, which is based essentially on wealth management, BPP does not amount to relevant systemic risk that constitutes a public interest and justifies the use of public money, as requested in the plan, especially considering the national and international financial system's current constraints. Also, the Recovery Plan proposed by BPP does not comply with recapitalisation regulations defined in Law no. 63-A/2008, nor the guidance on this topic from the European Union regarding EU competition regulation compliance, now that the situation has required intervention from the State"*.
- (21) The government's document also reported that a large number of BPP's clients placed their savings under the management of the bank, which invested them in financial instruments spread over a wide number of vehicle companies based in offshore jurisdictions. Despite the risk inherent in these products, BPP stated a remuneration rate and guaranteed all the capital invested by these clients upon maturity ('Absolute Return' instrument). This guarantee of return was never communicated to the supervisory authorities nor was it included and recorded on the bank's balance sheet. By concealing this liability, the bank's shareholders were spared from having to inject more capital to meet the legal and regulatory requirements in force. Additionally, the investigation by the Portuguese Securities and Exchange Regulator and the Bank of Portugal found serious irregularities that amount to criminal practice on the part of BPP.
- (22) From the same document issued on 9 June, the Commission has learnt that the Portuguese government is not insensitive to the concerns of BPP's clients holding Absolute Return instruments and whose investments are jeopardised and has consequently worked with the supervisory authorities to identify a solution to minimise losses. The solution envisaged by the government would have, among other features, the following ones: 1) The creation of a new financial instrument, representative of the current indirect Absolute Return portfolio that replaces the current investors' positions; 2) The financial instrument would be issued and managed by an entity that is independent of BPP and owned and managed by national banking institutions.

- (23) On 15 July 2009 the Commission invited the Portuguese authorities to urgently submit the restructuring plan for BPP, even in a provisional form, recalling that the rescue aid had become unlawful since 6 June 2009. Portugal has not yet submitted the requested plan.
- (24) In a letter dated 31 August 2009 the Portuguese authorities informed the Commission that a special investment fund will be constituted in the short term in order to safeguard the interests of BPP's clients and that this solution will not involve any State resources.

3. ASSESSMENT OF THE AID

3.1 Existence of aid

- (25) As stated 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, save as otherwise provided in the Treaty.
- (26) The Commission recalls that it has already established in the rescue aid decision that the State guarantee constitutes State aid. The Commission considers at this stage that the prolongation of the guarantee also constitutes State aid. The guarantee arrangement allows in fact BPP to get financing in a situation where it would still be unable to find adequate funding on the market. This gives an economic advantage to BPP and potentially strengthens its position compared to that of its competitors in Portugal and other Member States that are not benefitting from public support. The measure must therefore be kept on being regarded as potentially distorting competition and affecting trade between Member States. The advantage is provided through State resources and is selective since it only benefits one bank.
- (27) The Commission notes that BPP has been involved in cross-border and international activities, so that any advantage from State resources would affect competition in the banking sector and have an impact on intra-Community trade.

3.2 Compatibility of aid

3.2.1 Application of Article 87(3)(b) EC

- (28) Portugal claims that the aid element in the guarantee should be assessed on the basis of Article 87(3)(b) EC. Article 87(3)(b) EC enables the Commission to declare aid compatible with the common market, if it is aimed at remedying "a serious disturbance in the economy of a Member State". The Commission recalls that the Court of First Instance has stressed that Article 87(3)(b) EC needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State².

² Cf. See, in principle, Joined Cases T-132/96 and T-143/96 *Freistaat Sachsen and Volkswagen AG Commission* [1999] ECR II-3663, para. 167. Followed in Commission Decision in case C 47/1996, *Crédit Lyonnais*, OJ 1998

- (29) On 13 October 2008 the Commission adopted a Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ("Banking Communication")³. In the Banking Communication the Commission acknowledges that, in light of the severity of the current crisis in the financial markets and of its possible impact on the overall economy of Member States, Article 87(3)(b) EC is, in the present circumstances, available as a legal basis for aid measures undertaken to address this systemic crisis.
- (30) As regards the case at stake, the Commission also notes that in its decision approving the emergency aid it assessed the applicability of Article 87(3)(b) EC and considered that the aid could be found compatible on the basis of Article 87(3)(b) EC after 5 June 2009 subject to the re-notification of the measure, provided that Portugal submitted a credible and substantiated restructuring plan for the bank.

3.2.2 *Compatibility under Article 87(3)(b) EC*

- (31) The initial measure, approved by the Commission on 13 March 2009, was considered compatible subject to the submission of the restructuring plan. Since the latter has not been submitted, the measure has become unlawful.
- (32) The renewal of the guarantee without Commission approval is clearly illegal. At this stage it is not clear whether the aid can be considered compatible or not.
- (33) First, in the 13 March 2009 decision authorising the granting of the guarantee, the Commission accepted the arguments provided by the Bank of Portugal that in a country like Portugal the default of even a bank of moderate size like BPP could have had a domino effect over several financial institutions, representing a serious disturbance of the Portuguese economy.
- (34) It is not clear whether this argument is still valid. Indeed, in the document issued on 9 June 2009 recalled above (see paragraph 19), the Portuguese government stated that the situation of BPP does not amount to relevant systemic risk that constitutes a public interest and justifies the use of public money.
- (35) Second, in relation to the pricing of the guarantee, the Commission observed that the fee of 20 basis points was below the level resulting from the application of the ECB's recommendation of 20 October 2008.
- (36) In the decision of 13 March 2009 approving the initial rescue measure, the Commission clearly stated that this level of remuneration is subject to the submission of the

L 221/28, point 10.1, Commission Decision in Case C28/2002 *Bankgesellschaft Berlin*, OJ 2005 L 116, page 1, points 153 *et seq* and Commission Decision in Case C50/2006 *BAWAG*, not yet published, points 166. See Commission Decision of 5 December 2007 in case NN 70/2007, *Northern Rock*, OJ C 43 of 16.2.2008, p. 1, Commission Decision of 30 April 2008 in case NN 25/2008, *Rescue aid to WestLB*, OJ C 189 of 26.7.2008, p. 3, Commission Decision of 4 June 2008 in Case C9/2008 *SachsenLB*, not yet published.

³ Commission Communication on "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 of 25.10.2008, p. 8.

restructuring plan and that the costs of public intervention in favour of BPP should, in the longer term, be reflected in the restructuring plan, which will also take account of the competitive impact of the support in compensatory measures.

- (37) The restructuring plan should be in line with the Commission Communication on the return to viability and the assessment of restructuring measures⁴ and should address, inter alia, the following issues:
- presentation and analysis of the bank's strategy and business model to consider its long-term viability in a reasonable timeframe so that it might continue to meet the credit needs of the economy thereby underpinning economic recovery;
 - minimisation of State aid, including ensuring the contribution of the bank to any restructuring costs that arise;
 - minimisation of competition distortions as a consequence of the State investment;
 - management changes;
 - commercial conduct restrictions in relation, inter alia, to the following: (i) reduction in the size of the bank's balance sheet and (ii) restrictions on new lending pending the restructuring of the bank.
 - commitment that the bank will refrain from advertisement or promotion invoking the recapitalisation measure as an advantage in competitive terms;
- (38) Third, as regards the limitation in time, the Commission noted positively that the aid measure had a duration limited to six months and clearly stated that a prolongation of the guarantee beyond the initial period of six months would have to be notified to the Commission for approval.
- (39) In view of the fact that the pricing of the guarantee was below the level normally required pursuant to the Banking Communication and considering that the Commission only authorised such level of pricing subject to Portugal submitting a restructuring plan which would, in the longer term, adequately address this advantage, in the absence of such a plan, the Commission has doubts that the guarantee provided by Portugal on 5 December 2008 as well as its prolongation after 5 June 2009 are compatible with the common market in relation to both the duration and the pricing of the measure.

Conclusion

- (40) On the basis of the above the Commission has at this stage doubts that the State guarantee in favour of BPP can be found compatible with the common market.
- (41) Furthermore the Commission decides to enjoin Portugal pursuant to Article 10(3) of Council Regulation (EC) No 659/1999 to submit the restructuring plan for BPP within a period of 30 working days.

⁴ 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, 19.8.2009, p. 9

(42) The formal investigation procedure does not prejudice the conclusions that may be reached afterwards with regards to the new financial instrument that Portugal intends to create in order to minimise the losses of BPP's clients.

4. DECISION

In the light of the foregoing considerations, the Commission has decided to initiate the procedure laid down in Article 88(2) of the EC Treaty for the State guarantee in favour of BPP.

Furthermore, pursuant to Article 10(3) of Council Regulation (EC) No. 659/1999, the Commission has decided to issue an information injunction to request the submission of the restructuring plan within 30 working days of the date of receipt of this letter.

In particular, the Commission would wish to receive comments on all the points on which it raised doubts.

Portugal is requested to forward a copy of this letter to the recipient of the aid immediately.

The Commission wishes to remind Portugal that Article 88(3) of the EC Treaty has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No. 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Portugal that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Communities. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

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For the Commission

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