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WORKING LANGUAGE

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Subject: State aid NN 71/2008 – Portugal
State aid to Banco Privado Português-BPP

Sir,

PROCEDURE

(1) On 5 December 2008 the Portuguese authorities notified to the Commission a public support measure in favour of Banco Privado Português (hereafter BPP), which was granted on the same day. The Portuguese authorities submitted additional information and clarifications on 14 January, 5 February and 20 February 2009.

DESCRIPTION OF THE MEASURES

The Beneficiary and the events triggering the measure

(2) 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 Agricola 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.

(3) 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.

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(4) 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.

(5) On 13 November 2008 the rating agency Moody's downgraded the ratings of BPP[1] to reflect the increased challenges the bank was facing to maintain a business model that was highly dependent on developments in the capital markets. According to the Portuguese authorities this triggered a significant withdrawal of funds, resulting in a situation of serious financial imbalance of the bank.

(6) On 24 November BPP informed the Portuguese Central Bank that it risked being unable to meet its payment obligations. On 5 December 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.

The Measures

(7) On 5 December 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 Agricola Mútuo CRL). The loan has a maturity of 6 months renewable up to two years, and bears 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), which was approved by Commission on 29/10/2008[2]. 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.

(10) The collaterals consist of: (i) first right of pledge on several assets as specified in a contract concluded by Portugal, BPP and the Portuguese Central Bank; (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, the BPP and the Portuguese Central Bank, in

[1] The bank financial strength rating was downgraded to D from D+, the long-term local and foreign currency bank deposit ratings to Ba2 from Baa3 and the short-term deposit rating to Not prime from Prime-3.

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

which the latter was appointed as custodian and collateral manager on behalf of the Treasury.

(11) The "Agreement" also regulates the monitoring of the value of the collaterals: in practice, the value of securities is updated on a daily basis while the value of buildings is fixed and may only be updated if a new evaluation is requested. According to the rules set in the "Agreement", collaterals may be withdrawn or replaced by other collaterals provided that the overall value does not fall below the value of the outstanding debt (including accrued interest) plus 25%. Whenever the value of the collateral falls below this level, additional collateral has to be delivered by BPP. The Portuguese Central Bank submits to the Treasury collateral monitoring reports on a monthly basis.

(12) 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.

(13) The continuation of the guarantee beyond the initial period of 6 months will be the object of a specific notification to the Commission.

(14) The Portuguese Central Bank has requested BPP to present a restructuring plan. Portugal committed to transmit this plan to the Commission within six months from the date of the granting of the guarantee.

Behavioural constraints

(15) According to the terms of the loan agreement, BPP cannot use the amount received for other purposes than facing its liabilities as registered in the balance sheet on 24 November 2008.

(16) In addition, BPP is not allowed to grant loans and to distribute dividends to its shareholders without prior authorisation from the six creditor banks.

POSITION OF PORTUGAL

(17) The Portuguese authorities seek an urgent approval of rescue aid to BPP. The Portuguese authorities underlined the urgency of the measure in order to prevent harmful spillover effects on the Portuguese financial system and the Portuguese economy as a whole. Portugal argues that by 24 November 2008 BPP was in a situation where it risked being unable to meet its payment obligations, which would have entailed a risk for the stability of Portugal's financial system.

(18) Despite the relatively small size of the institution, the Portuguese Central Bank confirms in an opinion addressed to the Portuguese State on the merit of the guarantee that a payment default by BPP on its liabilities as registered in the balance sheet on 24 November 2008 could, given the current unstable market conditions, lead to a deterioration of confidence in the Portuguese banking system, including at the international level, entailing serious disruptions of the financial system.

(19) The Portuguese authorities accept that the guarantee on the loan constitutes State aid.

(20) The Portuguese authorities consider that the measure can be declared compatible with the common market to remedy a serious disturbance in the Portuguese economy pursuant to Article 87(3)(b) EC.

ASSESSMENT

Existence of State Aid

(21) As set out 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.

(22) Given that BPP is active in the financial sector, which is open to intense international competition any advantage from state resources to BPP would have the potential to affect intra-Community trade and to distort competition.

(23) The Commission agrees with the position of Portugal that the guarantee on the loan constitute aid to BPP pursuant to Article 87 (1) EC.

(24) The guarantee arrangement allows BPP to get financing in a situation where it was unable to find adequate funding on the market. This gives an economic advantage to BPP and 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 regarded as distorting competition and affecting trade between Member States. The advantage is provided through State resources and is selective since it only benefits one bank.

Compatibility of the Financial Support Measures

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

(25) The Commission considers that it may be acceptable to examine the State measure directly under the Treaty rules and in particular under Article 87 (3) (b) EC.

(26) Article 87 (3) (b) EC enables the Commission to declare aid compatible with the Common Market if it is "to remedy 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 State.[3]

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

(27) The Commission considers that the present measure concerns a Portuguese bank being part of the Portuguese financial sector and thus the Portuguese economy.

(28) The Commission agrees that the turmoil on the financial markets and in particular the mutual distrust between financial institutions, which has led to an almost total drying-up of interbank lending, has created exceptional circumstances in which the failure of one bank may have detrimental effects on the financial system at large.

(29) This may be the case even of a bank of moderate size, in particular when – as BPP– it has counterparts amongst institutional investors[4] and depositors which would be affected by a default on its payments. The Commission accepts the arguments provided by the Portuguese Central Bank, that in a country like Portugal, the default of BPP could have had a domino effect over several financial institutions and thus undermine the confidence in the Portuguese financial system. Given the great uncertainty due to the financial crisis and the necessity of external funding of the Portuguese economy, a lack of confidence in the Portuguese financial system would severely affect the whole Portuguese economy.

(30) The Commission therefore accepts that the failure of BPP would have entailed a serious disturbance of the Portuguese economy. Article 87(3) (b) of the Treaty can therefore be applied.

b) Conditions for compatibility under Article 87 (3) (b)

(31) In line with the 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" (hereinafter "the Communication"), in order for such aid to be compatible, any aid or aid scheme must comply with general criteria for compatibility under Article 87 (3) EC, viewed in the light of the general objectives of the Treaty and in particular Articles 3 (1) (a) and 4 (2) EC, which imply compliance with the following conditions:[5]

a. *Appropriateness*: The aid has to be well targeted to its objective, i.e. in this case to remedy a serious disturbance in the entire economy. This would not be the case if the disturbance would also disappear in the absence of the measure or if the measure is not appropriate to remedy the disturbance.

b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. That implies that it must be of the minimum amount necessary to reach the objective, and take the form most appropriate to remedy the disturbance. In other words, if a lesser amount of aid or a measure in a less distortive form were sufficient to remedy a serious disturbance in the entire economy, the measures in question would not be necessary. This is confirmed by settled case law of the Court of Justice.[6]

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[4] See point (3) of the present decision.

[5] Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, not yet published, at point 41.

[6] Cf. Case 730/79, *Philip Morris* [1980] ECR 2671. This line of authority has recently been reaffirmed by the Court of Justice in. Case C-390/06, *Nuova Agricast v Ministero delle Attività Produttive* of 15 April 2008, where the Court held that, "As is clear from Case 730/79 […], aid which improves the financial situation of

c. *Proportionality*: The positive effects of the measures must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measures' objectives. This follows from Article 3 (1) g EC and Article 4 (1) and (2) EC, which provide that the Community shall ensure the proper functioning of an internal market with free competition. Therefore, Article 87 (1) EC prohibits all selective public measures that are capable of distorting trade between Member States. Any derogation under Article 87 (3)(b) EC which authorises State aid must ensure that such aid must be limited to that necessary to achieve its stated objective, limiting to a minimum consequential distortions of competition.

(32) The third chapter of the Communication then translates these general principles into conditions specific for guarantees and the fourth chapter for recapitalisation schemes. The principles contained therein apply *mutatis mutandis* also to individual cases. In the next paragraphs, the Commission will therefore assess the compatibility of the notified measure with these criteria.

c) Assessment of the state guarantee on the loan

(33) The Commission understands that urgent measures were needed to keep the bank afloat and to prevent spillover effects into the Portuguese financial sector and beyond. In particular, the objective of granting a state guarantee on the loan is to enable the bank to continue its activities and to ensure that BPP has sufficient liquidity so as to face its liabilities.

(34) According to the Portuguese authorities, no bank would have granted the loan to BPP without a State guarantee, given BPP's difficult financial situation and the present financial turmoil. The State guarantee can thus be considered as an appropriate measure to keep the bank afloat. The Commission's current assessment is without prejudice to the assessment it would make if the measure was needed beyond 6 months.

(35) As regards necessity, the Commission considers that the measure are limited to the minimum necessary in scope and time.

(36) In relation to the scope of the guarantee, the Commission takes note of the limitation of the guarantee to a loan of EUR 450 million.

(37) In addition, the price paid for the state guarantee and the price for the loan constitute a sufficiently high remuneration to ensure that BPP did not draw on the state assistance to a greater extent than strictly necessary.

(38) In relation to the pricing of the guarantee, the Commission observes that the fee of 20 basis points is below the level resulting from the application of the European Central Bank's recommendation of 20 October 2008, which indicates a flat fee of 50 basis points for guarantees of less than one year when the guarantee is granted to solvent banks. In this case, the Commission takes account of the fact that the State guarantee is assisted by collaterals that are estimated to be worth around EUR 672 million, i.e. around 150% of the value of the loan. The Commission also acknowledges that the

the recipient undertaking without being necessary for the attainment of the objectives specified in Article 87(3) EC cannot be considered compatible with the common market […]."

value of the collateral is verified by the Portuguese Central Bank on a regular basis and a reduction in its value would require BPP to provide additional collaterals, as indicated in point 11.

(39) Notwithstanding the high level of collateralisation, the remuneration for the State guarantee remains considerable lower than would generally be considered as adequate for distressed banks. The Commission considers that this remuneration may, exceptionally, be appropriate in order to keep the bank afloat, although only for the short term of the rescue phase. This level of remuneration is furthermore subject to the submission of the restructuring plan. The Commission anticipates that the costs of public intervention in favour of BPP will, in the longer term, be reflected in the restructuring plan for the restoration of the bank's viability and to take account of the competitive impact of the support given to them in compensatory measures. In this context, the Commission also recalls and notes positively the commitment of the Portuguese authorities to present a restructuring plan within 6 months from the granting of the measure to the bank, i.e. by 5 June 2009.

(40) It can therefore be concluded that, in consideration of the value of the collaterals, which is constantly monitored by the Portuguese Central Bank, the price for the guarantee is in line with other cases and can be justified.

(41) As regards limitation in time, the Commission notes positively that the aid measure has a duration limited to six months. A prolongation of the guarantee beyond the initial period of six months will be notified to the Commission for approval.

(42) As regards proportionality, the distortions of competition are minimised by a number of behavioural safeguards. Adequate safeguards inter alia need to ensure that the State must, despite the current market conditions, obtain an adequate minimum return on its investment[7] in order to limit distortions of competition.

(43) Furthermore, the measure is combined with several behavioural constraints which help to ensure that the bank does not expand its activities while aided by the State[8]. This comprises a limitation in the use of the amount received. Notably, BPP cannot use the amount received for other purposes than facing its liabilities as registered in the balance sheet on 24 November 2008 and it is not allowed to grant loans and to distribute dividends to its shareholders without prior authorisation from the six creditor banks.

(44) Finally, the Commission takes note of the commitment provided by the Portuguese authorities to submit to the Commission a restructuring plan within 6 months of granting of the State aid measure. The Commission considers that follow-up adjustment measures in the context of a restructuring or liquidation plan are a good safeguard to avoid distortions of competition to the maximum extent possible.[9]

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7 See Joined Cases T-228/99 and T-233/99 *Westdeutsche Landesbank Girozentrale* [2003] ECR II-435, paragraph 314.

8 A similar principle is contained in point 44 of the R&R guidelines.

9 See also mutadis mutandis §28 and 29of the Banking communication.

(45) On the basis of the above, the described measure can be considered compatible with the Common market based on Article 87 (3) (b) EC, for a period of six months.

DECISION

The Commission finds that the abovementioned measures are compatible with the Common market and has accordingly decided not to raise objections.

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Yours faithfully,

For the Commission

Neelie KROES
Member of the Commission