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WORKING LANGUAGE

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Subject: State Aid N328 /2009 – Italy
Prolongation of the Italian Guarantee Scheme

Sir,

I. PROCEDURE

1. On 29 May 2009 Italy notified a request to prolong its guarantee scheme for banks. The original measures notified on 11 November 2008, were approved on 13 November 2008 in State aid case N520a/2008[1].

II. DESCRIPTION

1. The objective of the scheme

2. In response to the exceptional turbulence in global financial markets, Italy brought forward a guarantee scheme designed to reinforce banks' capitalisation and sustain the liquidity of the banking system.[2]

3. The Italian authorities indicated that, although the Italian banking system has a low exposure to US subprime mortgages and its operations in the market of structured financial instruments are relatively limited, the strains in international capital markets have had a significant impact on the channels and the cost of Italian banks' funding.

4. In particular the Scheme aims at sustaining the medium and long-term financing of the banks and providing the banks with assets eligible for refinancing with the Eurosystem, by means of State guarantee and swaps transactions with the Ministry of Economy and Finance (MEF).

[1] State Aid Case N520a/2008, OJ C/29/2009, p.2.

[2] Decree-law n. 155/08 converted into Law n.190 of 4/12/2008 and implementing decree n. 287 of 27/11/08.

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2. Description of main features of the Scheme

5. The three measures covered by the request for prolongation are:

a) State guarantee on new banks' liabilities

6. A State guarantee can be provided on liabilities of Italian banks issued after 13 October 2008. The purpose is to enhance the capacity of banks to place debt instruments in the market.

7. The State guarantee covers financial debt instruments issued by banks with a residual maturity of no less than three months and no more than five years.

8. The debt instruments eligible for the guarantee must provide for the repayment of the principal amount in a single instalment at maturity; they must be at a fixed rate and be denominated in euro. Subordinated debt, guaranteed bank bonds (art. 7-bis of Law n. 130 of 30 April 1999) , structured instruments or complex products, or products with a derivative component are explicitly excluded from the eligibility for the guarantee, and so is regulatory capital.

9. The part of the guaranteed liabilities of a bank with a maturity longer than 3 years cannot exceed 25% of the total value of the liabilities covered by the State guarantee, in addition to the limit of the *patrimonio di vigilanza* (see point 19 below).

10. The terms of the guarantee follow the European Central Bank recommendation of 20 October 2008. For the guarantee of duration longer than two years, the fee is increased by 0.50 percentage points starting after the 24 months from the granting of the guarantee.

b) Swaps between State securities and liabilities of Italian banks

11. The MEF is authorised to carry out temporary exchange between government bonds and financial instruments owned by Italian banks or liabilities issued by Italian banks after 13 October 2008.

12. The measure consists in the subscription by the MEF of banks' newly issued liabilities in exchange for Treasury notes; it is partially complementary and partially substitutable to the guarantee above and its purpose is to make available to Italian banks Treasury bonds that can be used to get refinancing through operations with the Eurosystem and the interbank market. The swaps will last a maximum of 6 months.

13. The liabilities eligible for the swap must provide for the repayment of the principle amount in a single instalment at maturity; must be denominated in euro and must provide the same financial characteristics in terms of maturity and interest rate and ensure the same cash flows as the Government bonds against which they are exchanged.

14. The commission to be paid by the beneficiary bank is fixed at 1 %. The fee shall be payable on an annual basis on the nominal value of the Government bonds exchanged with bank's liabilities.

c) State guarantee in favour of non banking institutions willing to lend high quality bonds to Italian banks for refinancing operations with the Eurosystem

15. The MEF can provide a guarantee in favour of non banks institutions (such as insurance companies or pension funds) willing to lend against remuneration bonds that can be used by the banks as collateral to get refinancing in the Eurosystem.

16. The guarantee can be granted on temporary loans of a duration of less than three years and for an amount equal to the total value in Euro of the lent bonds, the latter being the market value of the bonds. The total value of each operation should not be lower than € 500.000.

17. The financial conditions for these transactions are exactly those foreseen for State guarantee on new banks' liabilities, including the add-on fee of 50 basis points in case the guarantee exceeds 24 months.

Eligibility

18. The institutions eligible for all the three measures are Italian banks, meaning banks incorporated in Italy, which includes Italian subsidiaries of foreign banks.

19. Only solvent banks are eligible for the measures. Banca d'Italia assesses ex ante, before the MEF approves a transaction, whether the bank's capitalisation is sufficient, and whether the bank is able to meet the obligations.

Ceiling per bank

20. Each beneficiary bank cannot benefit from the various measures for an amount higher than its capital for supervisory purposes *(patrimonio di vigilanza)* including its Tier 3. Banca d'Italia will monitor the respect of this limit and communicate its result to the MEF which will in turn communicate them to the Commission.

Conditions relating to the commercial conduct of covered banks

21. The beneficiary banks must conduct their activity in such a way as not to abuse the assistance received and not benefit from any undue advantage, in particular as regards commercial communication with the public. Banca d'Italia will verify the respect of these conditions.

22. In addition, the Italian authorities have committed to monitor and review the expansion of the activities of the credit institutions benefitting from the measures at stake to ensure that their aggregate growth in balance sheet volume does not exceed the higher of the following values:

    - the annual rate of growth of Italian nominal GDP in the preceding year, or
    - the average historical growth of the balance sheets in the Italian banking sector during the period 1987-2007, or
    - the average growth rate of the balance sheet volume in the banking sector in the EU in the preceding six months.

23. In case these conditions are not respected, the MEF, having heard Banca d'Italia, can exclude the banks from the measures. The exclusion will be communicated to the Commission.

Review

24. The Italian authorities confirmed that the measures are subject to 6-monthly review by the MEF, with the support of Banca d'Italia, in particular as regards their limitation to the minimum necessary to remedy a serious disturbance of the economy, their effects on the economy, the necessity of their maintenance and their possible modifications. The Italian authorities committed to communicate to the European Commission the results of such review, which will be submitted within six months from the date of this decision and in any case in advance of a further request for prolongation.

3. Operation of the Scheme up to April 2009

25. Up to May 2009, no bank applied for a measure under the Scheme. According to the Italian authorities, this is explained by the following elements:

- The better credit's profile of Italian banks in comparison to many European Banks
- The high price of guarantee
- The different sovereign spread of Italy in comparison to other countries

26. Nevertheless, the Italian authorities remark that this instrument has been conceived to be operational in case of a deterioration of the banks' risk profile. For this reason it is important that these measures remain potentially available for further 6 months. The existence of the Scheme represents in itself an element contributing to the path to normal banking market conditions.

III. POSITION OF ITALY

27. The Italian authorities accept that the Scheme contains State aid elements.

28. The Italian authorities claim that the scheme is compatible with the common market because it is necessary to remedy a serious disturbance in the Italian economy pursuant to Article 87(3)(b) of the EC Treaty.

29. In its report of May 2009 related to the functioning of the Scheme, Banca d'Italia confirms that the current financial situation plead in favour of the prolongation of the Scheme.

30. No amendment to the three measures under the scheme approved on 13 November 2008 is proposed.

IV. ASSESSMENT

1. State aid character of scheme

31. 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.

32. As indicated in its decision of 13th November 2008, the Commission agrees with the position of Italy that the measures by the MEF constitute aid to the institutions concerned pursuant to Article 87 (1) EC.

33. The prolongation of the scheme does not modify the nature of the measures and therefore constitutes aid pursuant to article 87(1) EC.

2. Compatibility

34. In its decision of 13th November 2008, the Commission considers the notified measures compatible with the common market under Article 87(3)(b).

35. The Commission considers that the exceptional circumstances at the origin of the notified measures still persist and therefore recognises the need for the prolongation of the scheme. This is confirmed by Banca d'Italia (see point 29 above).

36. The prolongation of the scheme does not contain any modification of the measures already approved, and therefore does not change the assessed compatibility with the common market.

37. The Commission therefore does not object to the prolongation of the three measures under the scheme for a period of six months from the date of this decision.

V. DECISION

The Commission has decided not to raise objections against the prolongation, since it fulfils the conditions to be considered compatible with the EC Treaty.

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European Commission
Directorate-General for Competition
State Aid Greffe
Rue de la Loi/Wetstraat, 200
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission