



EUROPEAN COMMISSION

Brussels, 13.XI.2008
C (2008) 6989 corr

In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].

PUBLIC VERSION

WORKING LANGUAGE

**This document is made available for
information purposes only.**

Subject: State aid N 520a /2008, Italy
Urgent measures to guarantee the stability of the Italian banking system

Sir,

I. PROCEDURE

1. On 9th October 2008, Italian government adopted a Decree-law No 155 on "Urgent measures to guarantee the stability of the credit system and the continued availability of credit to enterprises and consumers in the current crisis on international financial markets". On the 13th October 2008 Italy adopted a Decree-Law No 157 on further urgent measures to guarantee the stability of the credit system.¹
2. Italy formally notified the Decree-Law No 155 and the Decree-Law No 157 on 17th October 2008. On the same day, the Commission sent questions to the Italian authorities.
3. Further information on the measures under the Decree-law No 157 was sent to the Commission between 21st October and 7 November. The Commission addressed further questions to Italy on 22nd and 24th October. Conference calls between the Commission and the Italian authorities took place between 20th October and 7 November. The text of the implementing decree of Decree-Law No 157 was formally notified to the Commission on 11 November.
4. The present decisions concerns exclusively measures under the Decree-law No 157 of 13th October 2008 as implemented by implementing decree to be adopted and is without prejudice to the Commission assessment of measures under the Decree-law No 155 of 9th

¹ Both decrees enter into force the day of their publication in the "Gazzetta Ufficiale della Repubblica italiana" and will have to be converted into law within 60 days.

October 2008, or any other measures taken to guarantee the stability of the Italian financial system.

II. DESCRIPTION

1. Objective of the measures

5. 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. These negative developments are affecting even solvent banks, whose availability of funds has been severely harmed. Incentives for banks to hoard liquid assets have increased, further contributing to freeze the interbank market and slow down the credit to the economy.
6. In this context and in the framework of the coordinated approach of the EU Member States, the government has adopted two Decree-Laws which aim at strengthening the capitalisation of the banks (Decree-Law 9 October 2008, n° 155) and sustaining the liquidity of the banking system (Decree-Law 13 October 2008, n° 157). Both Decree-Laws require implementing provisions in the form of ministerial decrees to be adopted by the Ministry of economy and finance after consulting Banca d'Italia.
7. Priority has been given to the implementation of measures of Decree-Law n° 157/2008 aimed at sustaining 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 Minister of Economy and Finance (hereafter MEF). Banca d'Italia has also adopted on 13 October, in combination with the adoption by the government of Decree-Law 157, measures to increase the liquidity of the banking system.

2. Decree-law No 157 of 13th October 2008

8. Decree-law No 157 of 13th October 2008 authorised the MEF to undertake until 31 December 2009 a number of measures to guarantee the stability of the banking system and in particular:
 - to grant a State guarantee, on market terms, for the liabilities of Italian banks with a maturity of up to five years issued after the date of entry into force of this Decree-law' (Article 1(1));
 - to carry out temporary swaps between State securities and financial instruments held by counterparty Italian banks or liabilities of counterparty Italian banks with a maturity of up to five years issued after the entry into force of this Decree-law (Article 1(2));

- to grant a State guarantee, on market terms, for transactions concluded by Italian banks in order to obtain the temporary disposal of securities that can be used for refinancing operations with the Eurosystem (Article 1(3)).
9. The implementing ministerial decree (hereafter the implementing decree) to be adopted determines the criteria, mechanisms and terms of the three transactions types mentioned above; it also assigns to its Treasury department (Dipartimento del Tesoro) certain of the tasks defined in Decree-law n° 157².

Eligibility

10. The institutions eligible for all three measures are Italian banks, meaning banks incorporated in Italy, which includes Italian subsidiaries of foreign banks. As far as branches of foreign banks are concerned, Italy clarified to the Commission, and submitted relevant information, that only around 8% of the total assets owned by banks in Italy are owned by branches of foreign banks, all of them except one (with a 2% market share) having a market share below 1%. Italy also explained that the measures at stake, basically guarantees on new liabilities³ issued by banks and associated swaps, are only relevant for banks incorporated in Italy, since it is not reasonable that they could be issued by a foreign branch
11. Only solvent banks are eligible for the measures under the implementing decree. 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 it is assuming. In particular, the beneficiary bank should meet both following criteria (Article 7(3) and 8(3) of the Implementing decree):
- core capital and total capital ratios no lower than the regulatory ratios, at the time of the last available supervision report,
 - no net accounting loss in more than one of the last three consecutive accounting years.

Ceiling per bank

12. The Implementing decree determines that each beneficiary bank cannot benefit from the various measures included in the decree for an amount higher than their 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

13. The Implementing decree contains conditions relating to the commercial conduct of the beneficiary banks. 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 (Article 1 (4) of the Implementing decree). Banca d'Italia will verify the respect of these conditions.

² For the purpose of the Decision "MEF" refers to the Ministry of Economy and Finance itself as well as to its Treasury department.

³ NB: guarantees on deposits are covered by Decree-law N° 155 which is not covered by this Decision.

14. 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.

If the balance sheet growth exceeds such level, the Italian authorities will adopt the measures necessary to ensure its respect including a modification to the notified Implementing decree, except if the excess is due to reasons independent from the measures included in the Implementing decree.

15. 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

16. 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 have committed to communicate to the European Commission the results of such review and to notify the necessity to prolong the scheme and any modification thereof after 6 months following its entry in force.

2.1. State guarantee on new banks' liabilities

17. According to Article 1.1 of Decree-Law 157, a state guarantee can be provided until 31/12/2009 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.

Temporal scope

18. Accordingly to Article 2 (1) of the implementing decree, the State guarantee will cover financial debt instruments issued by the eligible banks after its entry into force until 31 December 2009 with the residual maturity of no less than three months and no more than five years.

Material scope

19. Accordingly to Article 2(1) of the implementing decree, 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, 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.
20. 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.

Financial conditions

21. The terms of the guarantee follow the European Central Bank recommendation of 20 October 2008, with a top-up for maturities longer than 2 years.
22. For a guarantee for financial instruments with a residual maturity of no more than one year, a fee of 0.50 percentage points shall be payable (Article 6(1)(a) of the Implementing decree).
23. For a guarantee for instruments with a residual maturity of more than one year and for banks with Credit default Swap (CDS) data, a fee shall be payable equal to the lesser of the following two values (Article 6(1)(a)(2) of the Implementing decree):
 - (a) the median of the spreads on five-year CDS contracts relating to the bank or the parent company in the period from 1 January 2007 to 31 August 2008, plus 0.50 percentage points;
 - (b) the median of the spreads on five-year CDS contracts in the same period for the rating category to which the bank belongs, plus 0.50 percentage points;
24. In the case of banks for which no CDS contracts have been concluded, or for which in any event no representative data are available, the fee is established as follows:
 - (a) in the case of banks with a credit rating assigned by a recognised ECAI, the median of the spreads on five-year CDS contracts in the period from 1st January 2007 till 31 august 2008 recorded for the major banks which have their registered offices in countries of the euro area and whose senior unsecured debt is in the same rating category, increased by 0.50 percentage points;
 - (b) in the case of banks without a rating, the median of the spreads on CDS contracts recorded in the same period for the major banks which have their registered offices in countries of the euro area and which are in the lowest available rating category, increased by 0.50 percentage points.
25. 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 (Article 6(4) of the Implementing decree).

26. The fee shall be payable annually on the nominal value of the guaranteed securities issued by the banks.
27. Should the guarantee be called, the bank remains liable of the reimbursement of the amount paid by the State including the legal interest charge until the reimbursement date. One of the crisis management procedures set in Title IV of the Banking law (Testo Unico Bancario⁴) could also be activated; in this event, notice will be given to the Commission within six months of the implementation of such procedures.

2.2. Swaps between State securities and liabilities of Italian banks

28. According to article 1(2) of the decree law 157, the MEF is authorised until 31/12/2009 to carry out temporary exchange between government bonds and financial instruments owned by Italian banks or liabilities of Italian banks. Italy indicated that the provisions of the Decree-Law referring to swap of Treasury debt and securities held by the banks (assets side) will not be implemented; transactions will be therefore limited to swaps of liabilities issued by banks after 13 October 2008 in exchange for government bonds (liabilities side).
29. 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 purpose⁵ is therefore to make available to Italian banks Treasury bonds that can be used to get refinancing through operations with the Eurosystem and the interbank market.

Temporal scope

30. Accordingly to Article 3 (7) of the implementing decree, the swaps will last a maximum of 6 months and can be renewed until 31 December 2009.

Material scope

31. Accordingly to Article 3(1) of the implementing decree, the liabilities eligible for the swap must be issued after the entry into force of Decree-law; 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.
32. If the criteria set by the Implementing decree for the use of the bonds as described in point 29 are not fulfilled the MEF will apply a penalty equal to 20 % of the transaction value. A specific procedure set by an existing decree⁶ will be applied in case the bonds are not given back: in particular, after five days of delay, the unreturned bonds will be purchased on the market and all incurred costs will be debited to the defaulting bank. In addition, the crisis management procedures set in Title IV of the Banking law (Testo

⁴ Decree n. 385 of 1 September 1993 and subsequent modifications thereof.

⁵ See explanatory memorandum to decree law 157, fourth paragraph.

⁶ Decree of 5 May 2004 published in the *Gazzetta Ufficiale* of 13 May 2004.

Unico Bancario⁷) could also be activated; of such event, notice will be given to the Commission within six months of the implementation of such procedures.

Financial conditions

33. The commission to be paid by the beneficiary bank is fixed at 1 % on a yearly basis. The fee shall be payable annually on the nominal value of the Government bonds issued in exchange of bank's liabilities.

2.3. State guarantee on non banking institutions willing to lend high quality bonds to Italian banks for refinancing operations with the Eurosystem

34. As explained in the accompanying memorandum to Decree Law 157, the MEF will provide – until 31/12/2009- 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.
35. The purpose is to favour the transfer to the banking sector of high quality bonds available in other financial sectors of the economy.

Temporal scope

36. Accordingly to Article 4(3) of the implementing decree, the guarantee can be granted on temporary loans of a duration of less than three years.

Material scope

37. Accordingly to Article 4(2) of the implementing decree, the guarantee will be given for an amount equal to the total value in Euro of the lent bonds. The latter will be the market value of the bonds. The total value of each operation should not be lower than €500.000.

Financial conditions

38. The financial conditions for these transactions are exactly those foreseen for state guarantee on new banks' liabilities as described in points 21 to 27, including the add on fee of 50 basis points in case the guarantee exceed 24 months.

3. Swaps by Banca d'Italia

39. Banca d'Italia has adopted on 13 October, in combination with the adoption by the government of decree law 157, measures to increase the liquidity of the banking system. In particular, a new swap facility was introduced to allow a temporary exchange of government bonds held by Banca d'Italia with financial instruments held by banks.
40. The transaction tenders are announced on Banca d'Italia's website, for a global amount not exceeding 10 billion euro for each tender; no counterparty may obtain, with one

⁷ Decree n. 385 of 1 September 1993 and subsequent modifications thereof.

transaction or cumulating several transactions, more than 5 billion euro; independently of the counterparties involved, the overall amount of the operations outstanding may not exceed 40 billion euro.

41. The first operation was concluded on 16 October⁸ and a total amount of € 1.9 bn of government bonds (out of the € 10 bn available) was assigned (...)⁹. The second operation was announced on 23 October and no request was presented to Banca d'Italia¹⁰.

Eligibility

42. Operations will be made available to all banks operating in Italy (branches of foreign banks included) and admitted to monetary policy operations with the Eurosystem.

Temporal scope

43. Each operation has a maximum duration of one month. There is no indication on when Banca d'Italia will stop these operations.

Material scope

44. Each transaction provides for lending of Euro area government bonds, held by Banca d'Italia in its investment portfolio, against collateral represented by debt instruments issued by OECD (Organisation for Economic Co-operation and Development) entities, held by the counterparties.
45. The collateralized instruments shall be at least BBB rated, if denominated in G10 currencies, or single A rated, if denominated in other currencies. ABS, covered bonds and subordinated debts are included with some limitations, while credit linked notes and any other securities with derivative structures are not allowed. Securities issued directly by the counterparty or by correlated entities are not accepted.

Financial conditions

46. The price is fixed to 1% on an annual basis. The value of the collateral is assessed with reference to current market prices reduced by appropriate hair-cuts, taking into account the underlying risks.

III. POSITION OF ITALY

47. The Italian authorities accept that the notified measures as specified in the Implementing decree contain State aid elements.
48. In their view the new Swap facility introduced by Banca d'Italia is within the remit of the Banca d'Italia's role as a monetary authority and do not contain elements of State aid. The transactions are opened without distinction to any bank who conducts business in Italy

⁸ On 15 October the European Central Bank has decided to expand the list of assets eligible as collateral in the Eurosystem credit operation.

⁹ (...) – NB: The parts of the text in brackets refer to sensitive information that have been left out.

¹⁰ Source: Web site of Banca d'Italia.

(branches of foreign banks included) and that has regular access to monetary policy refinancing. The collateral offered by the counterparties must ensure a full coverage of the risks borne by Banca d'Italia, and its value is assessed according to prudential methods and haircuts. The remuneration is in line with market conditions for the corresponding risk level; the current 1% fee has been determined by Banca d'Italia on the basis of other central banks' facilities and it is higher than the fee which would apply for similar transactions under ordinary circumstances.

49. The Italian authorities seek urgent authorisation for the financial support scheme. According to the Italian authorities, fears regarding the creditworthiness of counterparties have led to an extreme and dangerous loss of confidence across the global financial system. Public sector intervention is necessary to restore market confidence. The measures which are the object of the present decision represent in their view a necessary and proportionate package to restore financial stability in Italy and elsewhere. Given the severe stress in global financial markets and in the Italian financial system, it is in their view imperative that the measures are implemented immediately.
50. 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.
51. A letter sent by Banca d'Italia dated 10 November 2008 confirms that the notified measures are urgently required to prevent harmful spill-over effects on the entire Italian financial system and on the economy as a whole.
52. Furthermore the implementing decree notified by Italy specifies that banks that default on their liabilities and which cause the guarantee to be called upon (article 9-3 of the decree), or which do not return the swapped Treasury bills (article 3-5 of the decree), have to establish a restructuring plan as stipulated in the Communication of the Commission of 13 October 2008¹¹. Such plan will be transmitted to the Commission within 6 months of the default.

IV. ASSESSMENT

53. The Commission observes that the measure at issue is a set of measures in favour of Italian banks for which a general framework was provided by the Decree-law No 157 of 13 October 2008 and further specified by the Implementing decree. The Commission also notes that the above mentioned measures are complemented by the measures taken independently by Banca d'Italia as described in points 39 to 46 of this decision.
54. The present decision concerns the above mentioned measures and is without prejudice to the Commission's assessment of any other future measures Italy may take in order to remedy financial crisis, in particular the measures under the Decree-law No 155 of 9th October 2008.

¹¹ Communication of 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 of 25 October 2008, p.8

1. State aid character of scheme

55. 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.
56. First, 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.
57. The guarantee on the new issued debt, the swap of bank's liabilities for Treasury bonds and the guarantee for securities that can be used for refinancing with the Eurosystem allow the beneficiaries to get liquidity at advantageous conditions. This gives an economic advantage to the beneficiaries and strengthens the position of these beneficiaries compared to that of their competitors in Italy and other Member States and must therefore be regarded as distorting competition and affecting trade between Member States. The advantage is selective since it only benefits the beneficiaries of the scheme and is provided through State resource.
58. In particular, the two types of guarantees and the liabilities' swap would not have been provided by a market economy investor. The Commission is convinced that in the current circumstances of financial crisis no private investor would have granted such a significant guarantee in favour of the participating banks¹².
59. Moreover, as regards the new swap facilities provided by Banca d'Italia the Commission shares the point of view of the Italian authorities that the operations are within the remit of a central bank's role as a monetary authority of the Eurosystem, and would normally be characterised as general measures.
60. However, the Commission notes that some beneficiaries may obtain the collateral asked by Banca d'Italia as the result of the above described State guarantees. It is these guarantees that may make such bank debt into the type of collateral that Banca d'Italia requires. While this might be irrelevant from the point of view of the central bank, the collateral is only eligible because of the guarantee. Given that these new facilities of Banca d'Italia are indeed part of a package of the support measures indentified as aid, the swaps offered by Banca d'Italia can be viewed as linked to the entire package, and the compatibility assessment addressing a serious disturbance in the Italian economy must also be extended in this respect.

2. Compatibility

Application of Article 87(3)(b) EC

61. 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 crisis¹³, given the present circumstances in the financial market, the Commission

¹² Cf for example Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark* at point 32.

¹³ See footnote 11 above

considers that it may be acceptable to examine this measure directly under the Treaty rules and in particular under Article 87(3)(b) EC¹⁴.

62. Article 87 (3) b) EC enables the Commission to declare aid compatible with the Common Market if it has the effect "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 State¹⁵.
63. The Commission considers that the present scheme concerns the entire Italian banking industry. In fact, the Commission does not dispute the analysis of the Italian authorities that even fundamentally sound banks are having trouble getting access to liquidity, a difficulty which shall be overcome by the scheme. The Commission also considers that this shortage of liquidity will not only result in difficulties for the banking sector but due to its pivot role in providing funds to other sectors is having a systemic effect for other industry sectors and thus the entire Italian economy. The Commission agrees with the Italian assessment that, in view of the current exceptional situation, the present scheme contributes to overcome the inaccessibility for liquidity to Italian banks. Hence it finds that the scheme is apt to remedy a serious disturbance in the Italian economy.
64. The Commission notes that the letter from the Banca d'Italia dated 10 November confirmed that the notified measures are urgently needed to prevent harmful spillover effects on the entire Italian financial system and on the economy as a whole.

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

65. 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, in order for an aid or aid scheme to be compatible under Article 87 (3) b) EC, it 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) (g) and 4 (2) EC, which imply compliance with the following conditions¹⁶:
 - a. *Appropriateness*: The aid has to be well targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy.

¹⁴ Cf. Commission Decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*. Commission Decision of 13 October 2008 in case N 507 /2008, *Financial Support Measures to the Banking Industry in the UK*; Commission Decision of 13 October 2008 in case NN 48/2008, *Guarantee scheme for banks in Ireland*. Commission Decision of 27 October 2008 in case N 512/2008, *German support scheme for financial institutions*; Commission Decision of 29 October 2008 in case NN 60/2008, *Portuguese support for financial institutions*; Commission Decision of 29 October 2008 in case N533/2008, *Swedish support scheme for financial institutions*.

¹⁵ 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*, 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*.

¹⁶ Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, at point 41, Commission Decision of 29 October 2008 in case NN 60/2008, *Portuguese support for financial institutions*; Commission Decision of 29 October 2008 in case N533/2008, *Swedish support scheme for financial institutions*.

- 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 (e.g. a temporary and limited guarantee instead of a capital injection) 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.¹⁷
- 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.

Assessment of the conditions for compatibility under Article 87(3)(b)

a) Appropriateness

- 66. As regards appropriateness, the general objective of the three measures of decree law 157 is to provide sufficient access to liquidity to Italian banks. This is a reaction to the international market-failure where even healthy banks are having trouble getting access to liquidity. The Commission has established that such guarantee scheme should help to overcome this market failure by allowing for a revival of the interbank lending and considers it therefore as an appropriate means.¹⁸ The Commission considers that this particular guarantee and liabilities swap scheme should help overcome this market failure through creating conditions for revival of credit institutions financial operations and thereby the regular financing of the economy.
- 67. Moreover, the measures are targeted at the appropriate beneficiaries as the eligibility of participating firms is limited to solvent companies. Also, all banks in Italy, including Italian subsidiaries of foreign banks, are eligible for the support. Thus, the Commission considers that the design of the present scheme is appropriate to address the problem of refinancing currently faced by Italian financial institutions.¹⁹

¹⁷ 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 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 [...]."

¹⁸ See Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark* at point 42; Commission Decision of 13 October 2008 in case N 507 /2008, *Financial Support Measures to the Banking Industry in the UK*; Commission Decision of 13 October 2008 in case NN 48/2008, *Guarantee scheme for banks in Ireland*. Commission Decision of 27 October 2008 in case N 512/2008, *German support scheme for financial institutions*, Commission Decision of 29 October 2008 in case NN 60/2008, *Portuguese support for financial institutions*; Commission Decision of 29 October 2008 in case N533/2008, *Swedish support scheme for financial institutions*.

¹⁹ See Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark* at point 45.

b) Necessity

68. As regards necessity, the Commission considers that the measures are limited to the minimum necessary in scope and time.
69. In relation to the scope, the Commission does not dispute that the measures in object are needed to restore confidence.²⁰ Moreover, the Commission notes that Italy is limiting the guarantee and liability swaps to the form of financing that is experiencing the greatest problems at the moment, short to medium term interbank financing. The Commission notes that first, subordinated debt is not guaranteed, and neither are complex structured instruments, and second, that existing debt is not covered but only newly issued debt.
70. The Italian guarantee on banks' liabilities is intended to cover newly issued financial instruments with a maturity up to five years. Similarly, the state guarantee that can be granted on temporary loans, it is also foreseen that the guarantee can cover loans of a duration of less than five years. The guarantees can be granted until 31 December 2009. The Commission normally considers that two years are the longest period necessary for such scheme to safeguard financial stability by contributing to facilitate the resumption of interbank lending²¹. Notwithstanding this, the Commission acknowledges that an additional fee of 50 basis points is charged to the beneficiary for guarantees exceeding two years.
71. Also, in addition to the limit of the "patrimonio di vigilanza" for the three measures set in Decree-Law 157, the part of the liabilities covered with a maturity longer than 3 years cannot exceed 25% of the total guaranteed for each bank, thus limiting the possibility for a bank to use only the longest maturities, whilst reflecting its immediate needs.
72. Furthermore, the Commission notes positively an additional safeguard in the present scheme in so far as it has shorter issuance period than two years as the scheme elapses on 31 December 2009. Furthermore the continuation of scheme after the 6 months initial period is subject to a notification of its prolongation and possible modifications; if the crisis persists, the Commission can authorize a prolongation of the scheme after these 6 initial months.
73. As to the Swaps between State securities and liabilities of Italian banks, these operations have a duration of a maximum of 6 months and can be renewed until 31/12/2009. Moreover, the swaps are subject to the same issuance window and a review clause as the guarantees.
74. It can be concluded that the temporal scope is thus also justified.

c) Proportionality

²⁰ See Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark* at point 47; Commission Decision of 13 October 2008 in case N 507 /2008, *Financial Support Measures to the Banking Industry in the UK*; Commission Decision of 13 October 2008 in case NN 48/2008, *Guarantee scheme for banks in Ireland*, Commission Decision of 27 October 2008 in case N 512/2008, *German support scheme for financial institutions*.

²¹ See for example the Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark* at point 47

75. Third, as regards proportionality, the distortions of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market oriented premium, reflecting in principle the varying degree of risks and the beneficiaries credit profiles, which gives a presumption of an appropriate contribution by the beneficiary. It can be estimated that in this way the banks pay on average an adequate price. Moreover, the Commission positively values that in case of guarantee exceeding 24 months, an additional fee of 0.5% is introduced. This can be considered proportionate and consistent with the recent practice of the Commission²². The Commission notes that this is also in line with the recommendations of the European Central Bank²³, which also aim at the establishment of an appropriate framework for premiums on guarantees issued in the Eurozone, and goes in certain cases above the recommended premiums.
76. For the Swaps between Treasury bonds and bank's liabilities, a fee of 100 basis points per annum for 6 months swaps is applied. Accordingly to Italian authorities, the fee was fixed in relation to the price of the guarantee for a comparable transaction, increased in order to take account of the fact that the bank does not bear the cost of placing the financial instruments on the market. The Commission notes that in such a case, the total cost of liquidity for the bank will comprise the fee and the cost of refinancing of the Treasury bonds in the Eurosystem. The Commission considers this proportionate and consistent with the recent practice of the Commission²⁴.
77. Finally, behavioural constraints are included in the implementing decree, which help to ensure that beneficiary banks do not expand their activities under the scheme and thus do not receive more support than necessary for re-establishing their long term viability.²⁵ This concerns limitations in the commercial conduct (see above point 13) and limitation of the expansion of activities on an aggregate level against clear benchmarks (see above point 14).
78. Furthermore, the Commission acknowledges the commitment by the Italian authorities that banks that default on their liabilities and which cause the guarantee to be called upon, or which do not return the swapped Treasury bills, are subject to precise enforcement procedures described in points 27 and 32 and will anyway have to establish a restructuring plan as exposed in point 52. The Commission notes that such plan will be transmitted for its review within 6 months of the default.
79. On the basis of the above, the measures adopted by Italy can be considered compatible with the Common market.

Assessment of the swap facility provided by Banca d'Italia

80. The Commission observes that it is appropriate that in dealing with liquidity problems of financial institutions, some Member States may wish to accompany the MEF measures with complementary forms of liquidity support from the Central bank.

²² A similar approach is taken in Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, point 66, and in the Commission Decision of 13 October 2008 in case N 507/2008 *Financial Support Measures to the Banking Industry in the UK*, point 61; a well as Commission Decision of 29 October 2008 in case NN 60/2008, *Portuguese support for financial institutions*; Commission Decision of 29 October 2008 in case N533/2008, *Swedish support scheme for financial institutions*.

²³ Ref European Central Bank recommendations on government guarantees on banks debt, 20 October 2008.

²⁴ A similar approach is developed in the Commission decision of 27 October 2008 in case NN 512/2008 *Guarantee scheme for banks in Germany*, points 72 – 74.

²⁵ A similar principle is imposed by point 44 of the rescue and restructuring guidelines.

81. The Commission recalls that the three above conditions indicated in point 65 are the underlying principles for any kind of aid to be approved under Article 87 (3) EC and considers that they have already been put into operation in other areas of application of Article 87 (3). Given that the present measure concerns problems of temporary access to finances, it considers the present framework similar to that tackled as rescue measures under the R & R guidelines.
82. The Commission observes that the scheme is in principle in line with the principles underlying point 80 of the Rescue and Restructuring guidelines²⁶. Banca d'Italia provides a special liquidity facility against collateral under the above indicated conditions that is limited in amount to €40 bn. Indeed, it is an operation for which a market alike premium in the sense of point 25 a) of the Rescue and Restructuring guidelines is paid. Second, it is mandated by the same overall economic reasons as the guarantee measures above and should fulfil point 25 b). Third, it can be presumed that given the price for the use of the facility, it is limited to the liquidity the company really needs in the sense of point 25 d). This is supported by the fact that in the first operation (on 16 October) less than 20% of the maximum amount was requested by Italian banks and that in the second one (23 October) no request was introduced.
83. Therefore, to the extent that the measure might be considered aid it is compatible with the Common market.

V. DECISION

The Commission concludes that the notified measures are compatible with the Common market and has accordingly decided not to raise objections against the notified package, since it fulfils the conditions to be considered compatible with the EC Treaty.

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:

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

²⁶ OJ 2004 C 244, p. 2, § 80: "In order to be approved by the Commission, rescue aid schemes must satisfy the conditions set out in points (a), (b), (d) and (e) of point 25...". NB: point 25 e) refers to the "one time – last time" principle.

Neelie Kroes
Member of the Commission