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Reintroduction of the Italian Guarantee Scheme

European Union: European Commission

EUROPEAN COMMISSION

Brussels, 15.12.2011
C(2011) 9492 final

Subject: State Aid SA. 34032 (2011/N) – Italy
Reintroduction of the Italian Guarantee Scheme

Sir,

I. PROCEDURE

1. On 7 December 2011 Italy notified a request to reintroduce a guarantee scheme for banks. The original measures, which were notified on 11 November 2008, were approved on 13 November 2008 in State aid case N 520a/2008[1]. On 16 June 2009, the Commission approved, under State aid case N 328/2009[2], the prolongation of the scheme until 31 December 2009.
2. The legal basis for the scheme is Decree Law n. 201 article 8[3] of 6 December 2011, published in the Italian Official Journal of 6 December 2011.
3. The Italian authorities have exceptionally accepted that the Commission decision be adopted in the English language.

II. DESCRIPTION

The objective of the original scheme

4. In response to the exceptional turbulence in global financial markets, Italy brought forward a guarantee scheme designed to sustain the liquidity of the banking system.[4]
5. The Italian authorities indicated that the notified measures are meant to address the challenges arising from the current tensions in the funding markets, which also reflect the sharp re-pricing of sovereign risk.

Description of main features of the scheme to be reintroduced

[1] State Aid Case N520a/2008, OJ C/29/2009, p.2.
[2] State Aid Case N 328/2009, OJ C 174/2009 of 28.07.2009
[3] The notification does not cover the measure described in comma 34 of Article 8 of Decree Law n. 201.
[4] Decree-law n. 155/08 converted into Law n.190 of 4/12/2008 and implementing decree n. 2107 of 27/11/08.

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6. According to the notified scheme, a State guarantee can be provided on new liabilities of Italian banks. The purpose is to enhance the capacity of banks to place debt instruments in the market.

7. The State guarantee covers financial debt instruments newly issued by banks with a residual maturity of no less than three months and no more than five years. Covered bonds (art. 7-bis of Law n. 130 of 30 April 1999), issued after 1 January 2012 with a maturity up to seven years can also be guaranteed by the State under the notified scheme. Italy provided an estimation for the total budget for the scheme of up to EUR 80 billion.

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, 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 one-third of the total value of the liabilities covered by the State guarantee, in addition to the limit of the capital for regulatory purposes ("*patrimonio di vigilanza*", see point 20 below).

10. Compared to the original scheme and its prolongation (approved under cases N 520a/2008 and 328/2009), the scope of the notified measure has been limited to the issuance of guarantees on newly issued liabilities[5].Covered bonds issued after 1 January 2012 with a maturity up to seven years can also be guaranteed. For guarantees issued before 31 December 2011, the guarantee fees and reporting obligations have been amended to comply with the 2010 Prolongation Commission.[6] For guarantees issued from 1 January until 30 June 2012, the guarantee fees and reporting obligations have been amended to comply with the 2011 Prolongation Communication.[7].

Eligibility

11. The institutions eligible for the measure are Italian banks, meaning banks incorporated in Italy, which includes Italian subsidiaries of foreign banks.

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5 The original scheme and its prolongation envisaged three measures: a) State guarantee on banks' new liabilities; b) swap between State securities and liabilities of Italian banks; c) State guarantee in favour of non-banking institutions willing to lend high-quality bonds to Italian banks for refinancing operations with the Eurosystem.

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

7 Communication from the Commission on the application, from January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

12. Only solvent banks are eligible for the measures. Banca d'Italia, the Italian Central Bank, assesses ex ante, before the Ministry of Economy and Finance (MEF) approves a transaction, whether the bank's capitalisation is sufficient, and whether the bank is able to meet the obligations.

Remuneration

Guarantees issued before 31 December 2011

13. The fees payable for eligible liabilities incurred under the Guarantee and the Bond Loan Schemes from 1 July 2010 onwards will increase to at least the following levels above the pricing formula recommended by the ECB in October 2008:

- 20 basis points for participating institutions with a rating of A+ or A[8],
- 30 basis points for participating institutions rated A-[9], and
- 40 basis points for participating institutions rated below A-.

Participating institutions without a rating will be considered to belong to the category of banks with a BBB rating[10].

14. The remuneration above will be applied to guarantees issued from the date of the approval of the present decision until 31 December 2011.

Guarantees issued after 1 January 2012

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

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

ii. a risk-based fee equal to the product of 40 basis points and a risk metric composed of (i) one-half of the ratio of the beneficiary's median five-year senior CDS spread over the three years ending one month before the date of issue of the guaranteed bond to the median level of the iTraxx Europe Senior Financials five-year index over the same three-year period, plus (ii) one-half of the ratio of the median five-year senior CDS spread of all Member States to the median five-year senior CDS spread of the Member State granting the guarantee over the same three-year period[11].

8 Or A1 and A2 depending on the rating system employed.

9 Or A3 depending on the rating system employed.

10 In the case of divergent assessments by different rating agencies the relevant rating for the calculation of the fee increase should be the higher rating. The material time for the rating in the determination of the guarantee fee is the day on which the guarantee is granted in relation to a specific bond issuance by the beneficiary.

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

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

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

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

    (1) a basic fee of 50 basis points; and

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

19. The remuneration above will be applied to guarantees issued from 1 January 2012 until 30 June 2012.

Ceiling per bank

20. No beneficiary bank can benefit from the various measures for an amount higher than its capital for supervisory purposes *(patrimonio di vigilanza).* Banca d'Italia will monitor whether the limit is respected 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 those conditions.

22. If the conditions set out in point 21 are not respected, the Ministry of Economics and Finance, having heard Banca d'Italia, can exclude the banks from the measures. The exclusion will be communicated to the Commission.

Operation of the original Scheme

23. No bank applied for a measure under the approved scheme, which expired on 31 December 2009.

III. POSITION OF ITALY

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

25. The Italian authorities claim that the scheme is compatible with the internal market because it is necessary to remedy a serious disturbance in the Italian economy pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union (TFEU)[12].

26. Banca d'Italia in its note of 7 December 2011 confirms that the current financial situation pleads in favour of the re-introduction of the Scheme. The immediate adoption of such measures is deemed necessary to avoid major disturbances in the functioning of the markets and the continuity of credit flows to firms and consumers.

27. The Italian authorities committed to maintain the existing reporting obligations under the previous Commission approval Decisions.

28. Moreover, Italy commits to provide, by 15 April 2012, a report on the operation of the scheme and on guaranteed and non-guaranteed issuance.

29. The Italian authorities commit to present a viability review for any beneficiary that requests new guarantees under the scheme which take or keep the total amount of the beneficiary's outstanding guaranteed liabilities above 5% of its total liabilities and above the absolute amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication[13]within three months of the granting of the guarantees.

30. Italy commits to price the new guarantees including roll-over, issued before 30 December 2011 on the basis of the fee levels introduced as of 1 July 2010 (i.e. an increase in the guarantee fee in comparison with the ECB Recommendation of October 2008 that amounts at least to 20 basis points for banks with a rating of A+ or A, 30 basis points for banks rated A-, and 40 basis points for banks rated below A-). The guarantees issued from 1 January to 30 June 2012 will be priced on the basis of the fee levels introduced as of 1 January 2012. To enable the Commission to assess the application in practice of the revised pricing to be applied from 1 January 2012, Italy provided an indicative fee (estimate) for banks eligible to benefit from those guarantees, based on an application of the formula using recent market data. Furthermore, Italy commits to communicate to the Commission, within three months following each issue of guaranteed bonds, the actual guarantee fee charged in relation to each issue of guaranteed bonds.

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[12] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the Treaty on the Functioning of the European Union ("TFEU"). The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

[13] Commission communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195 of 19.8.2009, p. 9.

IV. ASSESSMENT

State aid character of scheme

31. As set out in Article 107(1) TFEU, 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 internal market.

32. As indicated in its decision of 13 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 107(1) TFEU.

33. The reintroduction of the scheme does not modify the nature of the measures and therefore constitutes aid pursuant to Article 107(1) TEFU.

34. In particular, the provision of guarantee by the State allows the beneficiaries to get liquidity at advantageous conditions. It gives an economic advantage to the beneficiaries and strengthens their position 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 resources.

Compatibility

35. In its decisions of 13 November 2008 and 16 June 2009, the Commission considered the notified measures compatible with the internal market under Article 107(3)(b) TFEU.

36. The Commission considers that the exceptional circumstances at the origin of the notified measures still persist and therefore recognises the need for the reintroduction of the scheme. In particular, the exacerbation of tensions in sovereign debt markets that has taken place in 2011 has put the banking sector under increasing pressure, particularly in terms of access to term funding markets. That evaluation is confirmed by Banca d'Italia (see point 26 above).

37. The Commission notes that all major terms and conditions for the guarantees approved on 13 November 2008 and prolonged on 16 June 2009, will remain unchanged except for the limited scope of the measure, the remuneration and reporting obligations. The modifications on remuneration and reporting obligations have been introduced to align the scheme with the 2010 Prolongation Communication for guarantees issued before 31 December 2011, and with the 2011 Prolongation Communication for guarantees issued after 1 January 2012.

38. In particular the new pricing formula to be applied from 1 January 2012 takes into account the greater differentiation by risk of banks' CDS spreads in recent times, by referring to median CDS spreads over a three-year period ending one month before the grant of guarantees. Since increases in CDS spreads in recent years are partially due to influences that are not specific to individual banks, in particular the growing tensions in sovereign debt markets and an overall increase in the perception of risk in the banking sector, that formula should isolate the intrinsic risk of individual banks from changes in CDS spreads of sovereigns and of the market as a whole.

39. As regards the combination of the scheme with other aid measures, as indicated in the Annex to the Restructuring Communication[14], any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To that end an individual ex ante notification is necessary.

40. Furthermore, the Commission recalls that based on point 16 of the Restructuring Communication, if aid not initially foreseen in a notified restructuring plan is necessary for the restoration of viability, this additional aid cannot be granted under an approved scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission's final decision on that bank.

41. As to the reporting obligations, in addition to the six month report, Italy agrees to provide the Commission with a concise mid-term review of the operation of the scheme by 15 April 2012 and to complement its future reports on the operation of the scheme with updated data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances. It will allow the Commission to assess the appropriateness, necessity and proportionality of possible further prolongations of the scheme beyond 30 June 2012 and the conditions for such prolongations. Any further prolongation will require the Commission's approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness. Italy commits to communicate to the Commission, within three months following each issue of guaranteed bonds, the actual guarantee fee charged in relation to each issue of guaranteed bonds.

42. The Commission positively notes also the commitment to present a viability review for any beneficiary that requests new guarantees under the scheme which takes or keeps the total amount of the beneficiary's outstanding guaranteed liabilities above 5% of its total liabilities and above the absolute amount of EUR 500 million. That commitment is an adequate safeguard, since the scheme should not enable beneficiaries with structural weaknesses in their business models to postpone or avoid the necessary adjustments.

43. On the basis of the above, the notified measures are compatible with the internal market until 30 June 2012.

V. DECISION

The Commission has decided not to raise objections against the reintroduction of the scheme until 30 June 2012, since it fulfils the conditions to be considered compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union.

The Commission notes that Italy has exceptionally accepted that the decision be adopted in the English language.

[14] OJ C 195, 19.08.2009.

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

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President