2-22-2010

State Aid: Portugal Prolongation of the Portuguese Guarantee Scheme

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EUROPEAN COMMISSION

Brussels, 22.2.2010
C (2010)1051 final

PUBLIC VERSION

WORKING LANGUAGE

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Subject: State Aid N 51/2010 – Portugal
Prolongation of the Portuguese Guarantee Scheme

Sir,

I. PROCEDURE

1. On 15 October 2008, Portugal notified the Guarantee Scheme to the Commission. It was registered by the Commission under case number NN 60/2008 and approved on 29 October 2008 until 31 December 2009[1].

2. On 11 January 2010, Portugal pre-notified to the Commission a request to prolong the Guarantee Scheme until 30 June 2010. This pre-notification was registered by the Commission under case number PN 13/2010. Further information was received on 8 February 2010. On 11 February 2010 Portugal submitted the notification that was registered by the Commission under case number N 51/2010.

II. DESCRIPTION

1. The objective of the Guarantee Scheme

3. In response to the ongoing exceptional turbulence in world financial markets, Portugal brought forward a measure designed to preserve stability in the financial system and to

[1] Commission Decision C(2008) 8686 of 29 October 2008 – State aid NN60/2008, OJ C 9, 14.01.2009 and Corrigendum, OJ C 25, 31.01.2009.

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remedy a serious disturbance to the economy. In particular, the Guarantee Scheme aims to support the access to liquidity of solvent credit institutions in Portugal in the context of the financial crisis.

2. Description of the Guarantee Scheme approved by Commission decision NN 60/2008

4. The beneficiaries of the Guarantee Scheme are all credit institutions incorporated in Portugal, including subsidiaries of foreign banks with registered office in Portugal. Only institutions with conditions of solvability according to Portuguese law may benefit from the scheme.

5. The Guarantee Scheme covers the issuance of non-subordinated euro-denominated debt with minimum maturity of three months and maximum maturity of three years. Under exceptional circumstances, duly justified by the Bank of Portugal, the maximum maturity can be of five years.

6. The Guarantee Scheme excludes from its scope operations of interbank deposits in the money market, subordinated debt, operations which already benefit from other types of guarantees as well as financing operations in jurisdictions not complying with internationally accepted transparency standards.

7. The total budget of the Guarantee Scheme was initially set at EUR 20 billion.

8. The beneficiary must pay a fee on the guarantee according to the commercial conditions recommended by the European Central Bank. Following these recommendations, the fees for debts with maturity between 3 months and 1 year amount to 50 basis points; for debts with maturity exceeding 1 year the fees are based on the spread of the relevant Credit Default Swap plus 50 basis points[2].

9. The Portuguese authorities committed that if a guarantee is activated as a result of default by the beneficiary institution, the Bank of Portugal would exercise its competence by requesting that the beneficiary submits a restructuring plan to be notified for approval to the Commission. The restructuring plan would be drawn with urgency and, as such, certainly within six months.

10. In the event the guarantee is called as a result of default by the beneficiary institution, the State is subrogated to the rights of the creditor until full repayment of the loan. All assets of the defaulting beneficiary respond for the payment of the debt.

11. In the above scenario the State can, under certain circumstances, decide to convert its rights as a creditor into preferential shares. In this case, according to the commitments provided by the Portuguese authorities, these shares will confer the right to a dividend of not less than 10% of their nominal value, taken from the profits, and to the priority reimbursement of their nominal value in the event of liquidation of the credit institution.

12. The Portuguese authorities committed to monitor and review the expansion of the activities of the credit institutions benefitting from guarantees in order 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 Portuguese nominal GDP in the preceding year, or
    - the average historical growth of the balance sheets in the Portuguese banking sector during the period 1987-2007, or

[2] Recommendations on Government Guarantees on Bank Debt of the European Central Bank of 20 October 2008.

- the average growth rate of the balance sheet volume in the banking sector in the EU in the preceding six months.

4. Operation of the Guarantee Scheme up to 31 December 2009

13. The Portuguese authorities submitted reports on the operation of the Guarantee Scheme on 11 June 2009 and 11 January 2010.

14. Since the Guarantee Scheme was approved on 29 October 2008, six beneficiaries have issued debt instruments for a total amount of EUR 4,95 billion (Table 1).

Table 1 – Operation of the Guarantee Scheme

Credit institution	Type of financing	Date	Amount (million EUR)	Maturity	Guarantee fee p.a.
CGD - Caixa Geral de Depósitos S.A.	bond issue	24 November 2008	1.250	3 years	0,865%
Millenium - Banco Comercial Português S.A.	bond issue	10 December 2008	1.500	3 years	0,948%
BANIF – Banco International do Funchal S.A.	Schuldschein Loan Agreement	23 December 2008	50	1 year	0,50%
	bond issue	16 April 2009	500	3 years	0,948%
BES – Banco Espírito Santo S.A.	bond issue	25 November 2008 (prolonged on 26 December 2008)	1.500	3 years	0,948%
Banco Invest S.A.	loan contract (*"contrato de mútuo"*)	23 January 2009	25	1 year	0,50%
	bond issue	23 January 2009	25	3 years	0,948%
Banco Finantia S.A.	bond issue	6 April 2009	100	3 years	0,948%
Total			**4.950**		

5. Description of the proposed prolongation and amendments to the Guarantee Scheme

15. Portugal intends to prolong the scheme until 30 June 2010.

16. The amendments introduced by the present prolongation are the following:

    a) The Portuguese authorities have committed to ensure that only in exceptional circumstances they will guarantee debt with maturities exceeding three years and up to five years and only up to one-third of the total volume of the scheme if justification is provided, with no limitation on an individual bank level;

    b) The Portuguese authorities have committed to ensure that the beneficiaries of the Guarantee Scheme will not use the State guarantee as a commercial advantage in advertising or marketing activities;

c) In addition to the reporting commitment provided in paragraph 21 of the original decision NN 60/2008, the Portuguese authorities commit to submit reports that include recent data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances.

d) According to the Draft Budget Law for 2010, the total budget of the Guarantee Scheme for 2010 is EUR 9,1462 billion.

17. All the other conditions of the Guarantee Scheme remain unchanged.

III. Position of Portugal

18. In line with the previous Decision on the Guarantee Scheme, the Portuguese authorities accept that the amended scheme contains State aid elements.

19. The Portuguese authorities note that the prolongation of the Guarantee Scheme until 30 June 2010 is necessary because of the uncertainty in the economic recovery in 2010 and the restructuring of the financial systems. A letter sent by the Bank of Portugal dated 26 November 2009 has confirmed this necessity.

20. The Portuguese authorities indicate that the Guarantee Scheme fulfilled, until now, the aims proposed while allowing debt issuance to be unblocked and to improve the level of liquidity in the financial system and the risk of inherent refinancing.

IV. Assessment

1. State aid character of the prolonged and amended Guarantee Scheme

21. As set out in Article 107(1) TFEU[3], 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.

22. As indicated in the previous Decision on the Guarantee Scheme, the Commission agrees with the position of Portugal that the Guarantee Scheme constitutes State aid.

23. The prolongation and amendment of the Guarantee Scheme do not modify the nature of the State guarantees and therefore they still constitute aid within the meaning of Article 107(1) TFEU.

2. Compatibility of the prolonged and amended Guarantee Scheme

24. In the previous Decision on the Guarantee Scheme, the Commission considered the notified measure compatible with the internal market under Article 107(3)(b) TFEU.

25. The prolongation of the Guarantee Scheme is a response to the difficulties in raising funds on the Portuguese wholesale unsecured lending market. The information provided

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[3] 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. 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.

by the Portuguese authorities confirms that the prolongation of the Guarantee Scheme is necessary to insure the liquidity and the normal financing of the economy.

26. In assessing the request for the prolongation of this guarantee scheme, the Commission has to balance its positive effects for financial stability with the distortions of competition and the delay in the return to a normal functioning of the financial markets that the prolongation entails. Guarantee schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States.

27. The evolution of the market situation and the reduction of the risk premia for unguaranteed debt have brought about a first step towards an alignment with market conditions, whilst providing an exit incentive for the sounder institutions. While more convergence towards market conditions may be necessary to further reduce distortions across banks in the internal market and avoid the risk of State aid dependence, the still fragile recovery suggests that banks should retain for the time being the possibility of accessing government guarantees schemes at the present conditions.

28. The Commission notes positively the decrease of the budget of the Guarantee Scheme for 2010 (EUR 9,1462 billion) as compared to the budget of the original scheme (EUR 20 billion).

29. On balance, the Commission considers that the prolongation until mid-2010 of the State Guarantee Scheme under the present conditions is compatible with the internal market.

30. As indicated in the Annex to the Restructuring Communication, 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 this end an individual ex ante notification is necessary.

31. Furthermore, the Commission recalls that, based on paragraph 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.

32. In addition to the above, Portugal agrees to complement its future reports with updated available data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt instruments. This will allow the Commission to assess the appropriateness, necessity and proportionality of potential prolongations of the Guarantee Scheme and its conditions after 30 June 2010. 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 Guarantee Scheme’s effectiveness.

33. The Commission therefore does not object to the prolongation of the scheme until 30 June 2010.

V. DECISION

The Commission has decided not to raise objections against the prolongation of the Guarantee Scheme until 30 June 2010, since it fulfils the conditions to be considered compatible with the Treaty on the Functioning of the European Union.

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http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm

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

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Directorate-General for Competition
State Aid Greffe
Rue Joseph II, 70
B-1049 Brussels
Fax No: +32-2-296 12 42

Yours faithfully,

Joaquín ALMUNIA
Vice-president of the Commission