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State Aid: Portuguese Guarantee Scheme for Credit Institutions in Portugal

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**Subject: State Aid NN 60/2008 – Portuguese
Guarantee scheme for credit institutions in Portugal**

Sir,

I. PROCEDURE

1) By letters dated 12 and 13 October 2008, the Portuguese authorities informed the Commission of their intention to put in place a special guarantee scheme for credit institutions registered in Portugal.

2) The Commission requested additional information concerning this measure by electronic message of 14 October 2008.

3) By electronic message dated 15 October 2008, the Portuguese authorities formally notified this measure.

4) By electronic message dated 20 October 2008, the Portuguese authorities provided further information. The Commission requested additional elements by electronic messages dated 21, 22 23 and 28 October 2008. The Portuguese authorities replied by electronic messages dated 21, 22, 23 27 and 29 October 2008, thus completing the notification.

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II. DESCRIPTION

1. The Objective

5) The measure – **"Concessão extraordinária de garantias pessoais pelo Estado, para o reforço da estabilidade financeira e da disponibilização de liquidez nos mercados financeiros"** (hereafter the "guarantee scheme") consists in the possibility for the State to grant guarantees forliabilities resulting from financing agreements and the issuance of non-subordinated debt of credit institutions incorporated in Portugal. It aims to support the access to liquidity of solvent credit institutions in Portugal in the context of the present financial crisis. Thereby, the market failure where even healthy banks are having difficulties to get access to liquidity shall be overcome, a key factor in ensuring the normal functioning of the economy as a whole.

6) The scheme's objective is to guarantee compliance by credit institutions with liabilities resulting from financing agreements and the emission of non subordinated debt 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 mentioned before can be of five years.

7) The guarantees 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.

2. The Beneficiaries

8) The beneficiaries of the scheme are all credit institutions incorporated in Portugal, including subsidiaries of foreign banks with registered office in Portugal. The Portuguese authorities estimate that about 51 to 100 credit institutions are eligible. Only institutions with conditions of solvability according to Portuguese law may benefit from the scheme.

4. Legal basis of the scheme

9) The legal basis is Lei n° 60-A/2008 of 20 October and its implementing provisions, Portaria n° 1219-A/2008 of 23 October.

3. Form and amount of aid

10) The scheme overall budget amounts to EUR 20 billion. The guarantee will be provided against a fee to be paid by the beneficiary (see below).

11) The guarantee scheme will in principle be financed through the issuance of public debt securities. According to the notification, the net cash balance at the moment of the scheme's wind-up, whether due to being unused or resulting from reimbursements of credit institutions as well as from the guarantee fees, will be used to repay the public debt that was issued.

5. Conditions for granting the aid

12) The scheme provides for detailed information to be submitted to the granting authority as a condition for the approval of the guarantee, including a draft financing agreement or documentation relative to the issue of non-subordinated debt, identifying the financial terms and conditions of the operation, together with proof that the guarantee is essential to ensure the applicant's normal financing. The request is made jointly to the Bank of Portugal and the Institute of Management of Treasury and Public Credit ("Instituto de Gestão da Tesouraria e do Crédito Público, I.P") which will examine the conditions of eligibility before submitting the application for approval by the Minister of Finance. The guarantee lapses if the financial operation is not initiated after one month from the moment the beneficiary was informed of its granting. This period may be extended, if dully justified in the application.

5.1. Calculation of the guarantee fees

13) The beneficiary must pay a fee on the guarantee according to the commercial conditions recommended by the European Central Bank[1]. 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 (see Annex for details).

14) The scheme provides that the State may revise the value of the fee while the guarantee remains effective, particularly in the event of the normalisation of the conditions of access to liquidity in the financial markets[2]. The Portuguese authorities explained that the objective of this provision is in particular to allow the State to increase the price of the guarantee in the case of normalization of the markets, so as to limit the use of the scheme to cases where they are necessary.

5.2. Measures in case the guarantee is activated

15) 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.

16) In the above scenario the State can, under certain circumstances[3] decide to convert its rights as a creditor into preferential shares. In this case, according to 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.

17) The Portuguese authorities further committed that in case a guarantee is activated, as a result of default by the beneficiary institution, the Bank of Portugal will exercise its

[1] Recommendations on Government Guarantees on Bank Debt of the European Central Bank, of 20 October 2008.
[2] Article 4 (5) of Portaria n° 1219-A/2008 of 23 October also states that the calculation of the fee is without prejudice to counter-guarantees being provided in which case the value of the fee can be duly adjusted.
[3] Article 10 (a) of Portaria n° 1219-A/2008 of 23 October.

competence under article 141° of the Law concerning financial institutions ("Regime Geral das Instituições de Crédito e Sociedades Financeiras"), notably by requesting that the beneficiary submits a restructuring plan ("plano de recuperação e saneamento") in accordance with article 142 of the same Law. In these cases a notification will be made to the Commission describing the measures envisaged or the restructuring plan to be implemented. The Portuguese authorities have assured that the restructuring plan will be drawn with urgency and, as such, certainly within six months.

5.3. Monitoring provisions

18) The scheme provides for monitoring provisions of the activities of the beneficiaries while the guarantee is in force. In addition, 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
- the average growth rate of the balance sheet volume in the banking sector in the EU in the preceding six months,

19) If the activities of the beneficiary credit institutions exceed the above thresholds, the Portuguese authorities will take as a matter of urgency the necessary measures to adjust the guarantee scheme in order to re-establish the discipline, unless there is evidence that the thresholds are exceeded for reasons unrelated to the guarantee scheme.

6. Duration of the scheme and review clause

20) Under the scheme guarantees may be granted until 31 December 2009.

21) According to the notification, the scheme may be reviewed at any time, in particular if justified by market conditions or if required for reasons of coordination within the Euro Area and the European Union and it will be in any event reviewed no later than six months from its entering into force. Portugal committed that any appraisal or review of the scheme will be notified and articulated with the European Commission[4].

III. POSITION OF PORTUGAL

22) Portugal considers that the aid scheme is compatible with Article 87(3) (b) of the Treaty, in so far as it aims to remedy for a serious disturbance in the Portuguese economy. Portugal noted that although the Portuguese financial system is fundamentally sound, it is currently being subject to a substantial external shock, due

[4] The Law (Lei n° 60-A/2008 of 20 October) foresees in this respect that the Ministry of Finance will report to the Portuguese Parliament, on a bi-annual basis, all the guarantees granted under the scheme, as well as their execution. The Portuguese authorities committed to report to the Commission any such reports.

to severe liquidity restrictions in international financial and money markets. The guarantee scheme is thus necessary to allow the re-establishment of liquidity in the financial markets so as to preserve financial stability and the availability of credit to the Portuguese economy.

IV. ASSESSMENT

1. State aid character of the scheme

23) 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.

24) The Commission notes that the present guarantee scheme is financed with State resources. It provides an advantage to the credit institutions benefitting from the guarantee which, without State support and in the context of the present financial crisis, might otherwise face restrictions of access to liquidity in the financing markets. The measure thus gives an economic advantage to the beneficiaries and strengthens their position compared to that of their competitors in Portugal and other Member States not receiving the same type of aid. It distorts or threatens to distort competition and has an effect on trade between Member States.

25) The measure therefore constitutes State aid within the meaning of Article 87(1) of the EC Treaty. This was not disputed by Portugal.

2. Compatibility

2.1. Application of Article 87(3)b) EC

26) Portugal intends to provide aid under a guarantee scheme to assist credit institutions having access to liquidity.

27) 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 (hereafter the "Banking Communication")[5], given the present circumstances in the financial market, the Commission considers that it may be acceptable to examine this measure directly under the Treaty rules and in particular under Article 87(3)(b) EC[6].

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[5] http://ec.europa.eu/competition/state_aid/legislation/horizontal.html

[6] Commission Decision of 10 October 2008 in case NN 51/2008, *Guarantee scheme for banks in Denmark*, not yet published; Commission Decision of 13 October 2008 in case N 507 /2008, *Financial Support Measures to the Banking Industry in the UK*, not yet published; Commission Decision of 13 October 2008 in case NN 48/2008, *Guarantee scheme for banks in Ireland*, not yet published

28) 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". However, the Commission recalls that the Court of First Instance has stressed that Article 87 (3) (b) EC Treaty needs to be applied restrictively and must tackle a disturbance in the entire economy of a Member State[7] .

29) The Commission notes that the present scheme concerns all credit institutions incorporated in Portugal. Furthermore, given the pivotal role that banks have in providing funds to all sectors of the economy, any market failures as the one persisting now whereby even healthy banks are having difficulty to have access to liquidity severely impacts on the possibility of banks in turn playing their financing role. As a consequence, there is a systemic crisis that affects not only the entire functioning of the financial market but of the economy as a whole.

30) A letter sent by the Bank of Portugal dated 29October 2008 confirms that the notified measure is urgently required to prevent harmful effects on the Portuguese economy as a whole.

31) The Commission therefore considers that, in line with the previous decisions in similar cases[8], the assessment of this measure under Article 87(3)(b) of the Treaty is justified in the present case.

2.2. Conditions of compatibility under Article 87(3)(b)

32) 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 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 conditions[9]:

> *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.
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> *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

[7] 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.

[8] See footnote 6 above.

[9] Cf. Commission decision of 10 October 2008 in case NN 51/2008 *Guarantee scheme for banks in Denmark*, at point 41 and Commission Decision of 13 October 2008 in case N 507 /2008, *Financial Support Measures to the Banking Industry in the UK*, at point 45.

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.[10]

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.

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

33) As regards appropriateness, the objective of this guarantee scheme is to support access to liquidity of credit institutions, by guaranteeing compliance by these institutions liabilities resulting from the issuance of new debt or the renewal of existing one. The scheme is a reaction to the international market failure where even healthy credit institutions are facing restrictions on access to liquidity. The Commission considers that this guarantee scheme should help to overcome this market failure, by establishing the conditions for a revival of credit institutions financing operations and thereby the regular financing of the economy.

34) Moreover the scheme is targeted at the appropriate beneficiaries as the eligibility of participant institutions is limited to solvent companies. Also, all credit institutions incorporated in Portugal, including subsidiaries of foreign banks are eligible. On this basis the Commission concludes that the guarantee scheme is appropriate.

35) As regards necessity, the Commission considers that the guarantee scheme is limited to the minimum necessary in scope and time. As regards scope, the Commission notes that the scheme aims to protect and restore the confidence of lenders, thereby facilitating the access to liquidity of credit institutions. It targets debts and liabilities that are considered a specific source of difficulties, i.e. short and medium-term debt that is not covered by other types of guarantees. The scheme also excludes from its scope subordinated debt.

36) As regards the temporal scope of the scheme, guarantees may be granted until 31 December 2009. It covers liabilities with maturity of up to three years, and only in duly justified cases up to five years.

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[10] 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 […]."

37) The Commission considers that the coverage of liabilities with a maturity up to two years is in principle sufficient to attain the objectives pursued but accepts that liabilities with a longer time-frame may be accepted if additional safeguards are put in place in order to prevent excessive distortion of competition.

38) The Portuguese authorities justified the duration of liability coverage in view of the need to give sufficient flexibility for credit institutions for managing their liquidity needs. Portugal noted in this respect that the scheme only guarantees specific financing operations of individual credit institutions and is thus relatively limited in scope. The guarantee fees may be increased, if so justified by the normalization of conditions of access to liquidity in the financial markets (see point 11 above) which is dissuasive of beneficiaries engaging in longer operations on the basis of State guarantees. Further, the scheme may be reviewed at any time, in particular if justified by market conditions and will in any event be reviewed no later than six months from its entering into force. All reviews will be notified to the Commission. The Commission concludes that these safeguards are sufficient to justify the temporal scope of the scheme.

39) As regards the proportionality of the measure, the distortion of competition is minimised by various safeguards. Above all, the aid amount is minimised through a market oriented premium, based on the recommendations of the European Central Bank, reflecting in principle the varying degree of risks and the beneficiaries credit profiles, which gives a presumption for an appropriate contribution by the beneficiary (see annex on details of calculation of the fee).

40) In addition, the scheme contains a claw-back mechanism whereby if the guarantee is activated the State is entitled to full reimbursement of the loan by the defaulting institution. One possibility is that the State is paid in the form of preferential shares, in which case such shares give right to dividends of not less than 10% of the shares nominal value, taken from profits and to priority payment in case of liquidation of the defaulting institution.

41) The Portuguese authorities have in addition indicated that pursuant to Portuguese law, in case of default by the beneficiary, a recovery and viability plan is drawn for the relevant institution and that such restructuring plan will be notified to the Commission (point 17 above).

42) Finally, the scheme provides for a limitation on the expansion of activities on an aggregate level of the beneficiary credit institutions against appropriate benchmarks which help to ensure that support will not be given beyond what is necessary for restoring the normal functioning of the economy (point 18 above).

43) On the basis of the above, the guarantee scheme can be considered compatible with the Common market.

V. DECISION

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

The Portuguese authorities indicated that the notification does not contain any confidential information. The Commission will therefore disclose this letter to third parties by publishing its full text in the working language on the Internet site http://ec.europa.eu/community_law/state_aids/index.htm.

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Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission

Annex

1. The value of the fees is established according to the following table:

Maturity of guaranteed finance contract	**Fee**
Greater than or equal to 3 months and less than or equal to 1 year	50 basis ponts
Exceeding 1 year	"Relevant Credit Default Swap Spread" + 50 basis points

2. The Relevant Credit Default Swap Spread referred to in no.1 is calculated according to the following table:

Beneficiary entity	**Relevant Credit Default Swap Spread calculation formula**
a) Credit institution with representative Credit Default Swap data	The lower of the follwing values: i) The median value of 5-year Credit Default Swap spreads, for the credit institution in question, during the period from 1January 2007 to 31 August 2008; ii) The median value of 5-year Credit Default Swap spreads for a representative sample of institutions with the same credit rating as the institution in question, as defined by the Eurosystem, during the period from 1 January 2007 to 31 August 2008.
b) Credit institutions without Credit Default Swap data, or without representative Credit Default Swap data:	
i) Credit institutions with a credit rating of "A" or higher	The median value of 5-year Credit Default Swap spreads, for a representative sample of institutions with the same credit rating as the institution in quaestion, as defined by Eurosystem, during the period from 1 January 2007 to 31 August 2008.
ii) Credit institutions without a credit rating or with a credit rating below "A"	The median value of 5-year Credit Default Swap spreads, for a representative sample of institutions defined by the Eurosystem, with a credit rating of "A", during the period from 1 January 2007 to 31 August 2008.

3. For the purpose of calculating the relevant Credit Default Swap spread referred to in subparagraph (a) of no. 2, the Portuguese Central Bank is responsible for ascertaining if the credit institution in question has representative Credit Default Swap data.

4. For the purpose of calculating the relevant Credit Default Swap spread referred to in subparagraph (b) of no. 2, the Portuguese Central Bank can, following reasoned assessment and whenever necessary, adapt the value of the relevant Credit Default Swap spread.