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State Aid SA.35743 (2012/N) – Extension of the Portuguese guarantee scheme for credit institutions H1 2013

European Union: European Commission

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EUROPEAN COMMISSION

Brussels, 17.12.2012
C(2012) 9663 final

Subject: State Aid SA.35743 (2012/N) – Portugal
Extension of the Portuguese guarantee scheme for credit institutions H1 2013

Sir,

I. PROCEDURE

1. By decision of 29 October 2008 in case NN 60/2008[1] ("the original decision") the Commission raised no objection against the granting of State aid for six months, until 31 December 2009, on the basis of the Portuguese Guarantee Scheme.
2. On the basis of subsequent notifications, the Commission approved the prolongation of the guarantee scheme in its decisions of 22 February 2010 in State aid case N 51/2010[2], 23 July 2010 in State aid case N 315/2010[3], 21 January 2011 in State aid case SA.32158[4], 30 June 2011 in State aid case SA. 33178[5], on 21 December 2011 in State aid case SA. 34034[6] and 27 June 2012 in State aid case SA. 34958[7].
3. On 19 November 2012, Portugal notified an extension of the scheme until 30 June 2013. Further information was provided on 4 December 2012.
4. For reasons of urgency, the Portuguese authorities exceptionally accept that the Commission decision be adopted in the English language.

[1] Commission Decision of 29 October 2008 – State aid NN60/2008, OJ C 9, 14.01.2009 and Corrigendum, OJ C 25, 31.01.2009.
[2] Commission Decision of 22 February 2010 – State aid N51/2010, OJ C 96, 16.04.2010.
[3] Commission Decision of 23 July 2010 – State aid N315/2010, OJ C 283, 20.10.2010.
[4] Commission Decision of 21 January 2011 – State aid SA.32158, OJ C 111, 9.4.2011.
[5] Commission Decision of 30 June 2011 – State aid SA.33178, OJ C 344, 24.11.2011.
[6] Commission Decision of 21 December 2011 - State aid SA.34034, OJ C 99, 03.04.2012.
[7] Commission Decision of 27 June 2012 - State aid SA.34958, OJ C 246, 15.8.2012.

S. Ex.ª o Ministro dos Negócios Estrangeiros
Paulo PORTAS
Largo do Rilvas
P – 1399-030 - Lisboa

II. FACTS

II.1. Description of the scheme

Legal basis and budget

5. To stabilise the financial markets, Portugal passed law 60-A/2008 of 20 October 2008[8] and its implementing provisions, *Portaria* nº 1219-A/2008 of 23 October 2008[9], *Portaria* nº 946/2010 of 22 September 2010[10] and *Portaria* nº 80/2012 of 27 March 2012[11].

6. The total budget of the extended scheme is EUR 24.12 billion[12].

Objective of the Guarantee Scheme

7. In response to the ongoing exceptional turbulence in the global financial markets, Portugal brought forward a measure designed to preserve the stability of the financial system and to restore the confidence in 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.

Description of the Guarantee Scheme

8. 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 which are solvent for the purposes of Portuguese law may benefit from the scheme.

9. Under the approved *Portaria* nº 80/2012, the Guarantee Scheme covers the issuance of non-subordinated debt with a minimum maturity of three months and a maximum maturity up to five years. In case of guarantees on the issuance of covered bonds (on mortgages and on the public sector), the maturity can go up to seven years.

10. The remuneration for guarantees on liabilities will be calculated in accordance with the formula set out in the 2011 Prolongation Communication[13], and as described in the Commission Decision in State aid case SA. 34985[14]. The indicative guarantee fees for the period 1 January 2013 to 30 June 2013 can be found in Annex II, and are based on an updated sample of European banks established by the Commission on 16 November 2012.

11. A detailed description of the scheme has been provided in recitals 5 to 21 of the original decision.

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[8] Diário da República, 1.ª série, n.º 203.
[9] Diário da República, 1.ª série, n.º 206
[10] Diário da República, 1.ª série, n.º 185.
[11] Diário da República, 1.ª série, n.º 62.
[12] Article 134(2) of the 2013 Portuguese State Budget.
[13] Communication from the Commission on the application, from 1 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.
[14] Recital 13 to 16. See footnote 7.

Operation of the Guarantee Scheme up to 15 October 2012

12. The Portuguese authorities submitted a report on the operation of the Guarantee Scheme on 19 November 2012. As of 15 October 2012, the total amount of outstanding guarantees was EUR 16.525 billion, while EUR 4.9 billion have already been reimbursed. Five further requests are currently being analysed.

II.2. New elements of the scheme

13. The terms and conditions of the extended scheme remain largely the same as compared to the previous scheme. However, there are the following changes.

14. First, Portugal observes that since the beginning of the sovereign debt crisis, the individual credit default swap (CDS) spreads of the credit institutions situated in those Member States that currently face difficulties, have widened along the spreads of the sovereign. As a result, the individual CDS spreads of those credit institutions do not reflect fairly the intrinsic risk of the credit institutions in question and may lead to the remuneration of State guarantees being excessively high. Therefore, Portugal claimed that the individual CDS spreads observed for three large Portuguese credit institutions are no longer representative. For that reason, the Portuguese authorities will determine the guarantee fee for those credit institutions on the basis of the CDS of the sample of banks in the lowest rating buckets ("BBB and below").

15. Secondly, the budget of the extended scheme has been reduced to EUR 24.12 billion, as compared to EUR 29.92 billion previously.

16. Thirdly, the Portuguese authorities will no longer 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 certain values.[15]

17. Fourthly, the provision that the State can convert its rights as a creditor into preferential shares if a guarantee is called will no longer apply to the extended scheme.[16]

18. Finally, Portugal commits to respect a number of behavioural commitments, such as a ban on advertisements referring to the State support and a ban of aggressive commercial strategies. Moreover, Portugal will report on the operation of the scheme on a quarterly basis. The entirety of commitments is set out in Annex I.

III. Position of Portugal

19. On 19 November 2012 Portugal notified to the Commission a request to extend the scheme until 30 June 2013.

20. The Portuguese authorities submit that the extended scheme constitutes State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the

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[15] Commitment as given by the Portuguese authorities in 2010, see recital 12 of the Commission Decision in case N 51/2010 (see footnote 2).

[16] Commitment as given by the Portuguese authorities in 2010, see recitals 10 and 11 of the Commission Decision in case N 51/2010 (see footnote 2).

European Union ("TFEU"), but is of the view that the proposed extension is compatible with the internal market on the basis of Article 107(3)(b) TFEU as it is necessary in order to remedy a serious disturbance in the economy of Portugal.

21. Portugal submitted a letter by the Bank of Portugal[17] further supporting the need for the proposed extension of the scheme to safeguard the stability of the financial system in Portugal, because prevailing market conditions do not allow for a termination of the scheme.

22. In particular, according to the Bank of Portugal, the scheme needs to be extended for a number of reasons. First, the Memorandum of Understanding ("MoU")[18] signed between the Portuguese Government on the one hand, and the International Monetary Fund, the European Commission and the European Central Bank on the other hand, foresees measures for the banking sector which include the maintenance and the reinforcement of the scheme. Second, access to market capital by financial institutions in Portugal is very limited, given the strong risk aversion for Portugal in the market. That factor continues to affect adversely the capacity of Portuguese financial institutions to manage liquidity, with no short-term perspective of improvement. Third, the scheme is considered crucial to leverage the capacity of the Portuguese financial institutions to access the capital markets once the opportunity to issue new debt arises.

23. In line with the requirements of the 2011 Prolongation Communication, Portugal provided an indicative fee (estimation) for each financial institution eligible to benefit from those guarantees. The estimation was based on an application of the scheme's remuneration formula and recent market data. The indicative fees are set out in Annex II.

IV. ASSESSMENT OF THE MEASURE

IV.1. Existence of State Aid

24. According to 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.

25. For the reasons indicated in the original decision, the Commission considers that the Scheme constitutes State aid within the meaning of Article 107(1) TFEU, because it concerns the provision of State resources to a certain sector, i.e. the financial sector, which is open to intense international competition.[19] Therefore, any advantage from State resources to a financial institution affects intra-Union trade and therefore threatens to distort competition. The measures therefore constitute State aid within the meaning of Article 107(1) TFEU. Nothing in the extended scheme alters that assessment.

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[17] Letter of the Bank of Portugal of 16 November 2012.

[18] Portugal, "Memorandum Of Understanding On Specific Economic Policy Conditionality", 17 May 2011, http://ec.europa.eu/economy_finance/eu_borrower/mou/2011-05-18-mou-portugal_en.pdf

[19] Original decision, recitals 23 to 25.

IV.2. Compatibility

26. Under the scheme, Portugal intends to provide aid in the form of guarantees in favour of credit institutions.

27. Given the exacerbation of tensions in sovereign debt markets that has taken place since 2011, the Commission considers it appropriate to examine the measure under Article 107(3)(b) TFEU.

28. Article 107(3)(b) TFEU empowers the Commission to find that aid is compatible with the internal market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance. That assessment has been confirmed in the Recapitalisation Communication[20] and the Restructuring Communication.[21] The Commission still considers that requirements for State aid to be approved pursuant to Article 107(3)(b) TFEU are fulfilled in view of the reappearance of stress in financial markets. The Commission confirmed that view by adopting the 2010 Prolongation Communication[22], which prolonged until 31 December 2011 the application of State aid rules to support measures in favour of banks in the context of the financial crisis. The Commission has since extended the application of those rules beyond 31 December 2011 under the 2011 Prolongation Communication.

29. The Commission does not dispute the position of the Portuguese authorities that the extension of the scheme is still necessary for reasons of financial stability. Consequently, the Commission finds that the scheme aims at remedying a serious disturbance in Portugal's economy.

30. Therefore, the Commission continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

Appropriateness

31. The objective of the guarantee scheme is to temporarily offer appropriate measures to establish backstops for the financial system in a timely and efficient manner, where financial institutions face difficulties in obtaining sufficient funding. The Commission observes that the continuing crisis has eroded confidence in the creditworthiness of counterparties, which results in difficulties in obtaining necessary funding on the financial markets. Hence, a backstop mechanism by the Member State, which in case of urgency ensures that the financial sector would have access to funding, is an appropriate means to strengthen the financial institutions and thus to restore market confidence.

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[20] Commission Communication – Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

[21] 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, 19.8.2009, p. 9.

[22] Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of bank's in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

Necessity

32. With regard to the scope of the measure, the Commission notes positively that Portugal has limited the size of the guarantee scheme by reducing its maximum budget to EUR 24.12 billion and that the scheme applies until 30 June 2013.

33. The Commission notes that Portugal has committed to follow the pricing and other conditions for State guarantees as laid down in the 2011 Prolongation Communication which requires, in particular, the application of a new pricing method based largely on market data. That new pricing formula takes into account the greater differentiation by risk of banks' credit default swap (CDS) spreads in recent times, by referring to median CDS spreads over a three-year period ending one month before the granting of guarantees. 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 for Member States in difficulty and an overall increase in the perception of risk in the banking sector. However, the new pricing formula isolates the intrinsic risk of individual banks from changes in CDS spreads of sovereigns, notwithstanding the fact that sovereign spread is itself considered as a component of the price determination.

34. Since the beginning of the sovereign crisis the CDS of Member States in difficulty have rocketed. The CDS of the large banks located in those Member States have increased in line with those of their sovereign. The very high CDS of large banks in programme countries do not seem to primarily reflect their intrinsic risk profile, but are mainly driven by the sovereign risk. That linkage can lead to a situation in which the application of the guarantee pricing formula based on the individual CDS spread of the bank results in an excessively expensive guarantee, which is not justified by the risk profile of the bank. Therefore, it seems appropriate to consider the CDS spreads of individual banks located in the countries subject to a financial assistance programme as temporarily non-representative of the intrinsic risk of that bank.

35. On the basis of the above observation, the Commission does not object to Portugal's intention to determine the guarantee fee for banks which still have a traded CDS on the basis of the CDS of the sample of Union banks in the "BBB- and lower" rating category. The Commission will review its assessment of the macro-economic situation and appropriateness of that exceptional pricing mechanism whenever a further prolongation of the scheme is notified.

36. Therefore, the Commission considers the measures as limited to the minimum necessary.

Proportionality

37. As regards proportionality, Portugal committed to present a viability review for any bank that requests new guarantees under a scheme which take or keep the total amount of the bank's outstanding guaranteed liabilities above 5% of the bank's total liabilities and above the absolute amount of EUR 500 million. This ensures that the use of guarantee scheme will not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments.

38. Second, the Commission notes that Portugal has committed to a number of behavioural safeguards such as ban on advertisements referring to the State support and ban on any aggressive commercial strategies, which would not take place

without the State support. Such safeguards help ensure that the participating institutions do not misuse the received State support to expand their activities.

39. Finally, the Commission welcomes that Portugal undertakes to submit individual restructuring or liquidation plans, within six month, for banks which cause the guarantee to be called upon.

40. As regards the combination of the scheme with other aid measures, the Commission recalls that, as indicated in the Annex to the Restructuring Communication, the restructuring plans to be submitted should contain all State aid received as individual aid or under a scheme during the restructuring period.

41. Furthermore, based on paragraph 16 of the Restructuring Communication, the Commission recalls that should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, it 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 Communication's final decision on that bank.

Monitoring

42. Commission welcomes that Portugal undertakes to present every three months a report on the operation of the scheme and on guaranteed issuances, and to complement it with updated available data on the cost of comparable (nature, volume, rating, currency) non-guaranteed debt issuances.

Conclusions on the compatibility of the aid measure

43. The amended Portuguese guarantee scheme for banks remains an appropriate, necessary and proportionate measure to remedy a serious distortion of Portugal's economy and does not alter the Commission’s previous assessment in the original decision of 29 October 2008 and the prolongation decisions of 22 February 2010, 23 July 2010, 21 January 2011, 30 June 2011, 21 December 2011 and 27 June 2012. In light of the commitments set out in Annex I the notified extension complies with the requirements set out above and is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

44. In line with the Commission’s decisional practice the Portuguese guarantee scheme can therefore be extended until 30 June 2013. 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.

V. CONCLUSION

The Commission has accordingly decided:

- to consider the aid to be compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union.

Portugal exceptionally accepts that the present decision be adopted in the English language, for reasons of urgency.

If this letter contains confidential information which should not be disclosed to third parties, 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 the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:
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Your request should be sent by registered letter or fax to:

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

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

Annex I

Commitments

With regard to the notification of the extension of the Portuguese guarantee scheme for credit institutions H1 2013, Portugal made the following commitments:

a) to provide support measures under the guarantee scheme only to solvent financial institutions which meet capital requirements;

b) to provide guarantees under the guarantee scheme only for new issues of credit institutions' senior debt (subordinated debt is excluded);

c) to provide guarantees only on debt instruments with maturities from three months to five years (or a maximum of seven years in the case of covered bonds) and to limit guarantees with a maturity of more than three years to one-third of the scheme's overall budget;

d) to impose a ban on advertising referring to State support by the beneficiaries of the scheme and to prevent them from employing any aggressive commercial strategies which would not take place without the support of the Portuguese government;

e) to submit an ad hoc notification if a restructuring plan has already been submitted that does not provide for the requested guarantee or liquidity measure;

f) to submit within six months individual restructuring or wind-down plans for banks which cause the guarantee to be called upon;

g) to determine the minimum remuneration level of the State guarantees under Article 4 of Portaria No 1219-A/2008 of 23 October 2008 (as amended by Portaria No 80/2012 of 27 March 212), in line with the formula set out in the Commission's Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis (C(2011) 8744 final, p. 7.);

h) to communicate to the Commission, within three months of each issue of guaranteed bonds under the Initiative to Strengthen Financial Stability, the actual fee charged;

i) to report to the Commission on: (i) the operation of the scheme and (ii) the guaranteed debt issues. This information must be submitted no later than 15 April 2013 (for the period 1 January 2013 to 31 March 2013) and 15 July 2013 (for the period 1 January 2013 to 30 June 2013);

j) to supplement the reports on the operation of the scheme with available updated information on the cost of comparable non-guaranteed debt issuances (nature, volume, rating, currency);

k) to present a viability review for every financial institution that is granted guarantees on new liabilities or on renewed liabilities for which, at the time of the granting of the new guarantee, the total outstanding guaranteed liabilities

(including guarantees accorded before the date of that decision) exceed both a ratio of 5% of total liabilities and a total amount of EUR 500 million. The viability review should be presented on the basis of the parameters set out in the 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, 19.8.2009, p. 9) within three months of the granting of the guarantees.

Annex II

Indicative guarantee fees as of 16 November 2012	
Institute	**Premium per institute (bp)**
Banco Comercial Português, S.A.	[…][*]
Banco Espírito Santo, S.A.	[…]
Caixa Geral de Depósitos, S.A.	[…]
Banks without CDS spread	76

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[*] Confidential information.