EUROPEAN COMMISSION

Brussels, 21.11.2011
C(2011) 8663 final

Subject: SA. 33917 (2011/N) – Spain
Recapitalisation and Liquidity support for Banco de Valencia, S.A.

Sir,

1 PROCEDURE

(1) On 21 November 2011, Spain notified to the Commission its intention to provide the Banco de Valencia S.A. ("the Bank") with a capital injection and liquidity support through the *Fondo de Restructuración Ordenada Bancaria* ("**the FROB**")[1]. The legal basis for the proposed measures is Article 7 of the Royal Decree-Law 9/2009 of 26 June 2009, *sobre reestructuración bancaria y reforzamiento de los recursos propios de las entidades de crédito.*

(2) Spain exceptionally accepts that the decision be adopted in the English language.

2 DESCRIPTION OF THE MEASURES

2.1 The beneficiaries

(3) The Bank is a Spanish commercial bank, which operates mainly in the regions of Valencia (which represents [68-71%][*] of its credit activity) and Murcia. It is listed on the Spanish

1 FROB has been established, in the context of the financial crisis, to provide public support for the consolidation of the Spanish banking sector by, inter alia, strengthening the capital buffers of credit institutions. FROB has an initial funding capacity of EUR 9 billion, of which EUR 6.75 billion is contributed by the State Budget and the rest (EUR 2.25 billion) is contributed by the Deposit Guarantee Funds. FROB can increase its budget by up to 10 times its initial finding by borrowing from the market. The Commission adopted on 28 January 2010 a decision not to raise objections (case N 28/2010, OJ C57 of 09.03.2010, p. 2) on FROB as a recapitalisation scheme for fundamentally sound institutions. The present case is not covered by that decision, since *inter alia*, it involves a non fundamentally sound institution.

[*] Business secret: contains confidential information, where possible, figures have been replaced by ranges in [brackets].

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stock exchange. At the end of June 2011, the bank had 427 branches and 2 028 employees. At a national level, its market share in deposits is 0.93% (but [6-7%] in Valencia and [4-5%] in Murcia).

(4) On 29 June 2010, Spain informed the Commission that the FROB had resolved to participate in the integration project among seven savings banks[2], creating Banco Financiero y de Ahorros ("**BFA**"), Spain's third biggest credit institution, with assets totalling EUR 332 billion[3]. The FROB subscribed for EUR 4,465 million of convertible preference shares issued by BFA. On the same date, the Commission services considered that the requirements for BFA to benefit from the FROB were met and informed the Spanish authorities accordingly

(5) Following the integration process that resulted in the creation of, BFA, BFA currently holds a controlling 39.11% equity stake in the Bank via a holding company, the other shareholders being retail investors. Since BFA has effective control of the Bank, the latter was fully consolidated with BFA.

(6) The Bank's main figures are:

	30.09.2011	
Total assets	[23000 - 24000]	million €
Loans to customers (gross)	[18000-19000]	million €
Retail deposits	[8000-10000]	million €
Total wholesale funds	[9000-10000]	million €
Employees	2 028	
Number of branches	427	

2.2 The events triggering the measures

(7) On 19 February 2011, the Spanish authorities approved a new solvency framework for credit institution operating in Spain[4]. The new legal framework established that by 30 September 2011 any credit institution without private investors holding at least 20% of its equity or with wholesale funding exceeding 20% of its financing needs had to meet higher solvency levels (defined as "*capital principal*"). Depending of the amount of social capital not held by the main shareholder, that level is set at 8 or 10 % of its RWA. The new rule applies at consolidated and solo level[5].

(8) On 20 July 2011 BFA listed 47.6% of its shares in Bankia, a commercial bank where most of the banking businesses of BFA's merging savings banks were regrouped. Through the

2 Caja de Ahorros y Monte de Piedad de Madrid (CajaMadrid), Caja de Ahorros de Valencia, Castellón y alicante (Bancaja), Caja Insular de Canarias (Caja Insular), Caixa D'Estalvis Laietana (Caixa Laietana), Caja de Ahorrosy Monte de Piedad de Avila (Caja de Avila), Caja de Ahorros y Monte de Piedad de Segovia (Caja Segovia) and Caja de Ahorros de la Rioja (Caja Rioja).

3 As of 31 December 2010.

4 See Royal Decree-Law 2/2011 of 18 February.

5 According to article 1 of Royal Decree-Law 2/2011 of 18 February 2011 on the strengthening of the Spanish financial system, the so-called "core capital ratio" is to be required on a consolidated and solo basis.

capital raised in its initial public offering (EUR 3.1 billion), BFA attained the new solvency levels established by Spain.

(9) In November 2011, following an inspection by the Bank of Spain that revealed capital and liquidity shortfalls, the Bank failed to raise capital from its key shareholders or from other private sources and failed to meet its obligations towards depositors and creditors.

(10) According to the Spanish authorities, under Spanish law, the consolidation of Banco de Valencia into the BFA consolidated group is only for accounting purposes. Banco de Valencia and BFA are separate legal entities and the fact that Banco de Valencia is included in the 'consolidation perimeter' creates no legal obligation for BFA to assist Banco de Valencia by subscribing newly issued capital or by other means. As a consequence, BFA is not legally bound to assist Banco de Valencia if the Bank fails to meet the required ratios.

(11) Following its inspection, the Bank of Spain estimates the immediate liquidity needs to be comprised between EUR 1 000 and 2 000 million. Those needs are mainly due to the bank's weaknesses […].

(12) BFA failed to support the Bank to meet its capital and liquidity requirements.

(13) Consequently, the Bank of Spain considers granting to the Bank the rescue package described below.

2.3 The rescue package: measures to strengthen the Bank's capital and liquidity position

(14) The Bank's failure to meet regulatory capital requirements, on an individual basis, and its liquidity obligations have triggered the need for its recapitalisation, in order to achieve the capital principal ratio required by Spanish legislation[6].

(15) The recapitalisation will be achieved through issuance of a maximum of EUR 1 billion of ordinary shares by the Bank, representing 6.32% of the bank's risk-weighted assets as of 31 December 2010. The amount effectively injected will be strictly limited to the quantity necessary for the Bank to comply with the prudential regulation.

(16) The corresponding number of shares to be attributed to the FROB will be determined according to the valuation method implemented for prior recapitalisations made on the basis of article 9 of the 9/2009 Royal Law Decree. Considering the size of the capital injection, it is expected that the FROB will effectively take control of the Bank.

(17) In addition, in order to meet the expected liquidity needs of the Bank, together with the aforementioned capital injection, the FROB will grant the Bank a liquidity facility amounting at maximum to EUR 2 billion. That liquidity facility will be subject to the

[6] The Spanish authorities state that it is not possible to estimate *ex ante* if the legal requirement of *capital principal* for the entity should reach 8% or rather 10% of the entity's RWAs. It will depend of the relative size of the FROB shareholding compared with the other shareholders, which will be determined by the future valuation of the entity.

regime described in the Law 13/1994 of 1 June 1994 on the Autonomy of the Bank of Spain.

(18) Interests charged on the liquidity facility will be equivalent to 100 basis point on top of the ECB's marginal credit facility.

3 POSITION OF THE SPANISH AUTHORITIES

(19) The Spanish authorities accept that the measures constitute State aid and request the Commission to verify if the proposed measure is compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("**the TFEU**"), as it is necessary in order to remedy a serious disturbance in the Spanish economy.

(20) By letter of 21 November 2011 the Spanish authorities stated that the situation of the Bank threatened financial stability and that the FROB's intervention was therefore necessary to avoid a serious disturbance in the economy of Spain.

(21) In particular, the Spanish authorities submit that the measures are (i) appropriate and well-targeted; (ii) necessary and limited to the minimum amount necessary; and (iii) proportionate as designed to minimize negative spill-over effects on competitors.

(22) *Appropriate and well-targeted*. The Spanish authorities submit that the Bank is important within the Spanish financial system and, especially, in its geographical area.

(23) *Necessary and limited to the minimum amount*. The Spanish authorities submit that the measures proposed are required to rescue the Bank. In addition, the measures are limited in size to what is necessary to ensure that the Bank: i) meets the regulatory solvency ratio required by the Spanish banking regulation; and ii) has sufficient liquid resources in order to meet its immediate liabilities.

(24) Finally, the Spanish authorities observe that the measures are limited in time since they will form part of a restructuring plan that will be developed by the FROB within one month from the present decision and subsequently submitted for approval to the Bank of Spain. The restructuring plan will be notified to the Commission within six months from the date of this decision.

(25) *Proportionate*. The Spanish authorities submit that the terms and conditions of the measures proposed together with the terms and conditions undertaken by Spain on the Bank, contain a range of safeguards against possible abuses and distortions of competition.

(26) The Spanish authorities have also provided the following specific commitments:

(i) To notify to the Commission any increase in the amount of the measures proposed in case such an increase would appear necessary;

(ii) To refrain from distributing any dividend and from making any payments on hybrid instruments, unless those payments stem from a legal obligation, and not to exercise a call option on the same instruments without prior approval of the Commission; in addition before undertaking any other capital management deals (e.g. buy-back) on hybrid instruments and/or any other equity-like instruments, the Bank must consult with the Commission in advance;

(iii) To seek prior approval of the Commission before amending any commitments or constraints mentioned in this decision;

(iv) To notify a restructuring plan for the Bank within six months in line with the principles laid down in Commission's Communication on the return to viability and the assessment of the restructuring measures in the financial sector (**"the Restructuring Communication**")[7] and 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" ("**the Banking Communication**")[8].

4 ASSESSMENT

4.1 Existence of State Aid

Aid to the Bank

(27) The Commission first has to assess whether the measures constitute State aid within the meaning of Article 107(1) TFEU. According to that provision, State aid is any aid granted by a Member State or through State resources in any form whatsoever which distorts, or threatens to distort, competition by favoring certain undertakings, in so far as it affects trade between Member States. The Commission in that context observes that the Spanish authorities do not dispute that the measures constitute State aid.

(28) The Commission observes that both aid measures, the recapitalisation of up to EUR 1 billion and the liquidity assistance of up to EUR 2 billion, are granted by the FROB, a fund that is directly financed through State resources.

(29) The measures confer a selective advantage on the beneficiary of the aid, the Bank. In particular, the measures provide capital and liquidity and allow the Bank to restore its regulatory solvency ratio and to avoid technical insolvency.

(30) The Commission finds that the measures distort competition as they allow the Bank to obtain the capital and liquidity necessary to avoid technical insolvency and its exit from the market.

(31) The Commission finds that the measures are also likely to affect trade between Member States as the Bank competes on the Spanish retail savings markets, the Spanish mortgage lending markets and the Spanish commercial lending markets. In all those markets, some of the Bank's competitors are subsidiaries and branches of foreign banks.

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7 OJ C195, 19.8.2009, p. 9.
8 OJ C 270, 25.10.2008, p. 8.

Conclusion on the aid to the Bank

(32) On the basis of the forgoing, the Commission considers that the measures fulfil all the conditions laid down in Article 107(1) TFEU and that the measures qualify as State aid to the Bank.

Aid to BFA

(33) The Commission take note of the arguments provided by the Spanish authorities indicating that BFA, although the controlling entity of the Bank, does not have an obligation under Spanish legislation to step in to provide capital and/or liquidity in support of the Bank

(34) However, the Commission is not in the position, at this stage, to ascertain whether the FROB intervention also entails a selective advantage to BFA. For that reason, the present decision only assesses the aid to the Bank, and not possible aid to BFA. Should the Commission in the context of the restructuring plan establish that there might be an aid element in favour of BFA, be it of financial or reputational nature, it will examine such possible aid according to the rules in force.

4.2 Compatibility of the aid

(35) As regards compatibility with the internal market of the aid measures provided to the Bank, the Commission must first determine whether the aid can be assessed under Article 107(3)(b) TFEU, i.e. whether the aid remedies a serious disturbance in the economy of Spain. Subsequently, the Commission, applying that legal basis, has to assess whether the notified aid measures are compatible with the internal market.

4.2.1 Legal basis for the compatibility assessment

(36) Article 107(3)(b) TFEU provides that aid falling within the scope of Article 107(1) TFEU may be regarded as compatible with the internal market where it "*remedies a serious disturbance in the economy of a Member State*".

(37) The Commission has acknowledged in its approval of the Spanish scheme[9] that there is a threat of serious disturbance in the Spanish economy and that State support of banks is suitable to remedy that disturbance. In view of the persistent turbulence that continues to affect the financial markets and institutions, the Commission still considers that requirements for State aid to be approved pursuant to Article 107(3)(b) TFEU are fulfilled. The Commission confirmed that view by adopting in December 2010 a Communication that prolongs until 31 December 2011 the application of State aid rules to support measures in favour of banks in the context of the financial crisis[10].

[9] See Commission Decision N 28/2010, OJ C 57, 09.03.2010 p.2 and Commission Decision N 317/2010, OJ C 242, 09.09.2010, p. 2.

[10] Communication from the Commission 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.

(38) The Commission observes that market conditions have remained difficult globally since the end of 2008. The Commission notes that Spain, in particular, is being severely hit by the financial, economic and sovereign crisis. The economic downturn combined with the fall in property prices and the exposure of some Spanish credit institutions to land and property development loans have led to significant impairment of their asset portfolios.

(39) The Spanish authorities have shown that the Bank has witnessed a considerable deterioration of its asset portfolio[11], particularly in the mortgages portfolio and other assets linked to real estate, which had an impact on its capital and liquidity position over the past months. The failure of BFA, its majority shareholder, to provide capital support to the Bank meant that no market solution was available to raise capital.

(40) Without the proposed capital injection and the liquidity facility, the Bank would have been technically insolvent and would have faced liquidity problems with potential severe adverse impacts on other banks and the wider financial system in Spain. The assessment of the Spanish authorities is that the Bank's insolvency would have likely inflicted severe losses on other financial institutions, destabilising the Spanish financial markets and triggering a generalised crisis of confidence at the present delicate juncture.

(41) By letter of 21 November 2011 the Spanish authorities stated that the situation of the Bank threatened financial stability and that the FROB's intervention was therefore necessary to avoid a serious disturbance in the economy of Spain.

(42) The Spanish authorities have not provided information to assess why winding down of Banco de Valencia would not be a suitable option. In the current circumstances, the Commission accepts that the recapitalisation and the liquidity facility in favour of the Bank are necessary to avoid a serious disturbance in the economy of Spain.

(43) In view of the above the Commission considers that the aid measures have to be examined under Article 107(3)(b) TFEU.

4.2.2 Compatibility assessment

(44) In line with point 15 of the Banking Communication, in order for an aid to be compatible under Article 107(3)(b) TFEU it must comply with general criteria for compatibility under Article 107(3) TFEU, which imply compliance with the following conditions[12]:

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. It would not be the case if the measure were not appropriate to remedy the disturbance.

b. *Necessity*: The aid measure must, in its amount and form, be necessary to achieve the objective. Thus, it must be of the minimum amount necessary to reach the objective, and take the most appropriate form to remedy the disturbance.

c. *Proportionality:* The positive effects of the measure must be properly balanced against the distortions of competition, in order for the distortions to be limited to the minimum necessary to reach the measure's objectives.

[11] The bank's non-performing loans ratio amounts to 7%.

[12] See paragraph 41 of Commission decision, Case NN 51/2008, *Guarantee scheme for banks in Denmark*, OJ C 273, 28.10.2008, p. 2

(45) The Recapitalisation Communication[13] elaborates further on the three principles of the Banking Communication and states that recapitalisation can contribute to the restoration of financial stability. In particular, the Recapitalisation Communication states that recapitalisations may be an appropriate response to the problems of financial institutions facing insolvency.[14]

4.2.2.1 Compatibility with the Banking and Recapitalisation Communications

a. Appropriateness of the Measures

(46) First of all, the aid measures have to be appropriate to remedy a serious disturbance in the Spanish economy. The measures aim at bringing the Bank's solvency position in line with the minimum "capital principal" requirement, taking into account possible further losses stemming from its loan portfolio in the near future. The recapitalisation will be in the form of new ordinary shares in the Bank.

(47) The credit line will ensure that the Bank will be able to face the likely decrease in funding capability (in terms of deposits, wholesale funding and reduction in assets eligible for liquidity at the ECB) in the near term.

(48) The Commission considers that the measures are appropriate because they effectively meet their objective to ensure that the Bank is in compliance with its regulatory capital requirements and can meet its immediate funding needs, and that the measures effectively achieve the objective of preventing the failure of the Bank. The measures thus remedy a serious disturbance in the economy.

b. Necessity – limitation of the aid to the minimum

(49) According to the Banking Communication, the aid measure must, in its amount and form, be necessary to achieve its objective. That requirement implies that the capital injection and the liquidity facility must be of the minimum amount necessary to reach their respective objectives. In that context, the Commission observes that the amount of the measures will ensure that the Bank will again fulfill its regulatory capital requirements and will be able to fund its current activities.

(50) As regards the remuneration, the Commission considers that the Recapitalisation Communication provides the appropriate framework for assessment.

(51) As regards the liquidity facility, the Spanish authorities informed the Commission that it will be remunerated at a premium of 100 basis points over the ECB's marginal credit facility.

(52) As regards the capital injection, the FROB will receive no fixed remuneration given that the rescue aid is granted through ordinary shares whose remuneration is based on distributable profits. The FROB will only be remunerated if the Bank is in a position to pay out a dividend. However, the Bank may be unable to pay out a dividend given its overall situation. Spain also accepts that the FROB is unlikely to make any return on its investment in the Bank.

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[13] See also Commission Communication 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.

[14] Recapitalisation Communication, point (6)

(53) The Commission considers that given the situation and prospects of the Bank, it is highly unlikely that it will be in a position to fulfill the conditions which allow it to adequately remunerate the capital injection of the State.

(54) Points 15 and 44 of the Recapitalisation Communication explain that lower remuneration in duly justified cases can be accepted in the short-term for distressed banks on the condition that the lower remuneration will be reflected in the restructuring plan. The Commission considers that it is justified that no remuneration is paid for the recapitalisation measure and that only a very low remuneration is paid for the liquidity line provided that the overall very low remuneration will be compensated by in-depth restructuring in the restructuring phase.

(55) In view of the fact that, at least in the short-term, keeping the Bank afloat is necessary for financial stability, that the Bank is currently in any event not able to provide any remuneration and that the Spanish authorities have committed to carry out an in-depth restructuring of the Bank, the Commission can at this stage temporarily accept that no remuneration is paid. A final conclusion in that respect will be left for the restructuring assessment.

c. Proportionality – measures limiting negative spill-over effects

(56) Spain has committed that the Bank will suspend dividend and coupon payments on outstanding hybrid instruments unless those payments stem from a legal obligation, will not exercise a call option on the same instruments and will not carry out any other capital management deals (e.g. buy-back) on hybrid instruments or any other equity-like instruments without consulting with the Commission in advance.

(57) Therefore, taking into consideration the capital shortage (up to EUR 1 billion) and the liquidity needs (up to EUR 2 billion) of the Bank combined with the need to maintain financial stability in Spain, the Commission considers the measures to be sufficient to minimise the distortions of competition caused by the aid during the rescue period. That evaluation is, however, without prejudice to additional measures to address distortion of competition that may be needed to ensure that the restructuring plan for the Bank can be approved.

Conclusion

(58) The Commission, thus, concludes that: (i) the liquidity facility is appropriate and necessary to ensure the stability of the bank, as it is limited to the minimum, (ii) the recapitalisation is appropriate and necessary to bring the solvency levels of the Bank up to the new legally required level established in Spain, as it is limited to the minimum; (iii) the Bank must submit a restructuring plan or a liquidation plan within six months from the date of this decision, which should reflect the level of distress, the size of the State recapitalisation and the overall very low level of remuneration of the aid measures ; and (iv) there are sufficient measures in place limiting the negative spill-over effects for other competitors to enable the Commission to temporarily approve the measures as rescue aid. The Commission can, therefore, temporarily approve the measures for six months.

4.2.2.2 Restructuring plan

(59) As regards the need for an assessment of the institution's balance sheet and activities, the use of recapitalisation for a distressed bank can only be accepted on the condition of the bank's winding up or a far-reaching restructuring[15]. The Commission furthermore observes that the Spanish authorities have committed to submit a restructuring plan within six months.

(60) The Commission, therefore, takes note of the commitment of the Spanish authorities to submit a restructuring plan for the Bank taking into account all aid measures the Bank has received to date[16]. The restructuring plan shall fulfil the requirements of the Restructuring Communication as regards return to viability, burden-sharing and measures limiting the distortion of competition. The restructuring plan should be submitted to the Commission within six months from the date of this decision.

(61) The Commission, therefore, takes note of the commitment of the Spanish authorities to submit a restructuring or a liquidation plan for the Bank taking into account all aid measures the Bank has received to date[17]. The restructuring or liquidation plan shall fulfil the requirements of the Restructuring Communication as regards return to viability, burden-sharing and measures limiting the distortion of competition. The restructuring or the liquidation plan should be submitted to the Commission within six months from the date of this decision.

CONCLUSION

- The Commission concludes that the notified aid measures in favour of Banco de Valencia S.A. in form of the capital injection amounting to up to EUR 1 billion and the liquidity facility of up to EUR 2 billion constitute State aid pursuant to Article 107(1) TFEU.

- The Commission finds that the emergency measures in favor of Banco de Valencia S.A. are temporarily compatible with the internal market for reasons of financial stability on the basis of Article 107(3)(b) TFEU. The measures are accordingly approved for six months or, if Spain submits a restructuring plan within six months from the date of this decision, until the Commission has adopted a final decision on the restructuring plan.
- The Commission recalls that the Spanish authorities have committed to submit an in-depth restructuring plan.
- The Commission notes that Spain exceptionally accepts that the adoption of the Decision be in the English language.

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15 See point 44 of the Restructuring Communication.
16 See above section on "The rescue package: measures to strengthen the Bank's capital and liquidity position"
17 See above section on "The rescue package: measures to strengthen the Bank's capital and liquidity position"

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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