EUROPEAN COMMISSION

Brussels, 07.09.2012
C(2012) 6308 final

Subject: State aid SA.35369 (2012/N) – Spain
Urgent recapitalisation of BFA Group

Sir,

1 PROCEDURE

(1) On 29 June 2010, Spain informed the Commission that the Fondo de Reestructuración Ordenada Bancaria ("**FROB**") had decided to give an aid measure to BFA Group ("**BFA Group**" or "the **Group**") by subscribing EUR 4.47 billion ("**bn**") of convertible preference shares in the holding company Banco Financiero y Ahorro, S.A. ("**BFA**"), of which Bankia is a subsidiary.

(2) On 18 and 19 June 2012, the Spanish authorities notified the Commission that the convertible preference shares subscribed for by the FROB in BFA were to be converted into ordinary shares. A liquidity guarantee of up to EUR 19 bn was also to be granted in the context of the conversion. The Commission approved both measures through a Rescue Decision on 27 June 2012[1] (the "**Conversion decision**").

(3) On 4 September 2012, the Spanish authorities notified a new aid measure in favour of BFA Group (the "**measure**") via a capital injection of up to EUR 4.5 bn into BFA making possible a subordinated loan to Bankia.

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

[1] Case SA34820, OJ C 220, 25.07.2012, p. 7

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2 DESCRIPTION OF THE MEASURE

2.1 The beneficiary

(5) On 14 June 2010, an agreement was signed in order to integrate seven[2] Spanish savings banks ("**Cajas**") in a regulatory consolidated group (BFA Group) through an Institutional Protection Scheme ("**IPS**"). That concentration process involved the granting of State aid by the FROB for a total amount of EUR 4.5 bn in the form of convertible preference shares, which was approved by the Commission under the Spanish Recapitalisation Scheme on 30 July 2010.

(6) On 3 December 2010, BFA was established as the central vehicle of the IPS, which was owned by the seven Cajas in the following percentages:

Caja Madrid	52.06%
Bancaja	37.70%
Caja Insular	2.45%
Caja de Ávila	2.33%

Caja Laietana	2.11%
Caja Segovia	2.01%
Caja Rioja	1.34%

(7) Cajas are credit institutions that have no shareholders, but instead are governed by their stakeholders. Their legal form is a private charity that holds a banking license and is entitled to provide banking services as commercial or cooperative banks do. Profits are partially used to fund the social activities that each Caja carries out through its Obra Benéfico-Social ("**OBS**"). OBS are charity programmes funded by the Caja with the profits that are not used to build up reserves. The remainder is used to strengthen their capital.

(8) On 28 January 2011, all of the assets and liabilities of the banking business of the seven Cajas were contributed to BFA. Later, in April 2011, BFA transferred 95% of the banking business previously transferred to it by the seven Cajas to Bankia, its fully-owned listed subsidiary, while BFA kept the remaining 5%. The BFA Group could, thus, be broken down into three levels: a) the seven Cajas that by integrating established the BFA Group in 2010 and that owned 100% of BFA, b) the holding company (BFA) that does not carry out regular banking operations but holds equity stakes in Bankia and in other industrial participations of the BFA Group and finally c) Bankia, the retail commercial bank.

(9) On 18 February 2011, Spain adopted more stringent capital requirements[3] ("**RDL 2/2011**") for its entire banking sector, which, *inter alia*, obliged all credit institutions in Spain to meet higher solvency levels, known as "capital principal", by 30 September 2011. As a result, solvency requirements were raised to 10% for banks with a wholesale funding higher than 20% and where the share of third party ownership would be less than 20%, and to 8% for the other banks.

[2] Caja de Ahorros y Monte de Piedad de Madrid (CajaMadrid), Caja de Ahorros de Valencia, Castellón y Alicante (Bancaja), Caja Insular de Ahorros de Canarias (Caja Insular), Caixa D'Estalvis Laietana (Caixa Laietana), Caja de Ahorros 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] See Royal Decree-Law of 2/2011 of 18 February 2011.

(10) Subsequently, the Bank of Spain ("**BOS**"), informed BFA that it required EUR 5.78 bn of additional capital if it remained unlisted[4] or EUR 1.8 bn if it fulfilled the requirements for an 8% ratio.

(11) On 20 July 2011, Bankia was listed at the Madrid Stock Exchange through an IPO (Initial Public Offering) in which private investors bought 47.6% of Bankia for EUR 3.09 bn, leaving BFA with the rest.

(12) Bankia itself is a large universal retail bank, with presence in all main business segments: mortgage and consumer lending, SMEs, large corporations as well as public and private institutions. At 31 December 2011, Bankia's total assets amounted to about EUR 306 bn and its credit portfolio amounted to EUR 201.1 bn, of which EUR 40.6 bn is in real estate-related assets (mainly loans to real estate developers).

2.2 The aid measures already received

(13) On 29 June 2010, the FROB informed the Commission that it had decided to subscribe EUR 4.47 bn of convertible preference shares issued by BFA. Based on BFA's financial accounts as of 31 December 2009, the amount of aid requested represented 2% of the risk weighted assets of BFA.

(14) On 18 and 19 June 2012, the Spanish authorities notified the Commission that the nominal amounts of the convertible preference shares subscribed for by the FROB in 2010 together with accrued and unpaid interest would be converted into ordinary shares, and that they would grant a liquidity guarantee of up to EUR 19 bn. Those measures were approved by the Commission on 27 June 2012[5]. As a result of that conversion and in view of the economic valuation carried out on BFA, the FROB became the sole shareholder of BFA.

2.3 The events triggering the measure

(15) The current situation of the Group is characterized by a significant vulnerability associated with the lack of sufficient capital to meet regulatory requirements approved by the Spanish government and liquidity problems. The value of the franchise of the Group has progressively deteriorated as a result. The great weakness of the Group has become more evident with the public disclosure of financial information for the first half of 2012 on 31 August 2012.

(16) The financial information disclosed on 31 August 2012 revealed losses of EUR 2.81 billion in BFA and EUR 4.45 billion in Bankia, as a result of, among other reasons, the partial recording of higher loan-loss provisions required for real estate and construction sector exposures in the Royal Decree-Laws 2/2012 and 18/2012 on rationalisation of the Spanish financial system and reorganisation and sale of real estate assets in the financial sector. Those losses leave BFA with a negative equity and both entities, BFA and Bankia, with a shortfall of regulatory capital.

[4] 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 required at a consolidated basis**.**

[5] Case SA34820, OJ C 220, 25.07.2012, p. 7.

(17) The Group's capital requirements to meet the legal minimum capital requirements of solvency internationally (BIS II[6]=8%) are:

30.06.2012, in billion EUR and %	**Amount**	**Ratio**	**Deficit**
Solvency ratio (BIS II)	[…]*	[…]%	[…]

(18) With the new capital injection of up to EUR 4.5 billion in BFA Group, BIS II solvency ratio of the Group would increase to […] %.

(19) The publication of the information that the legal minimum capital requirement might not be fulfilled, i.e. without the measure, may cause further reactions from investors and depositors that might be critical for the stability of the Group and, given the systemic nature of the entity, to the financial stability of the entire sector through contagion to other Spanish financial institutions. The measure would help to restore confidence in the BFA Group, stabilizing the Group until the restructuring of the BFA Group is approved by the end of November 2012.[7]

(20) Furthermore, that situation of BIS II regulatory capital deficit could deny BFA and Bankia the access to the liquidity provided by the Eurosystem through its monetary policy operations.

2.4 The measure

(21) The possibility of granting new rescue measures had already been envisaged in recital 34 of the Conversion decision: "*The Spanish authorities have also informed the Commission, that in addition to the conversion of preference shares and the liability guarantees, BFA has asked for additional aid measures, which it might also receive in the future. The Spanish authorities commit to notify those additional measures to the Commission in due time."*

(22) On 4 September 2012, a new aid measure was notified to the Commission by Spain. The aid measure consists of a capital increase through the issue of ordinary shares by BFA amounting to up to EUR 4.5 billion to be subscribed for by the FROB through a contribution in kind consisting of government debt securities for an equivalent amount.

(23) Subsequently, BFA will grant to Bankia a subordinated loan for the same amount qualifying as Tier II regulatory capital in order to strengthen the latter's solvency. That loan will accrue to BFA an annual nominal interest rate of 8% and does not contain an alternative coupon satisfaction mechanism.

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6 Bank of International Settlements, international solvency ratio.

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

7 Pursuant to the Memorandum of Understanding on Financial Sector Policy Conditionality between the Kingdom of Spain and the Heads of State and Government of the Euro Area (“the MoU”), BFA Group will have to present a restructuring plan enabling the Commission to approve the plan in November 2012.

(24) The capital injection will restore the capital position of the BFA Group, mitigating the negative effects of the current financial situation and ensure its access to the different sources of funding, as it completes its restructuring process.

(25) The Spanish authorities have stated that the aid measure will be covered by the regime established in paragraph 2 of article 4 of the Royal Decree-Law 24/2012, by which the new funds provided by the FROB will be protected from future burden-sharing measures and therefore not affected by any future management operations of hybrid instruments by BFA within its restructuring process in order to implement burden-sharing by other stake holders in BFA with the aim of minimising the cost for tax payers.

3 POSITION OF THE SPANISH AUTHORITIES

(26) The Spanish authorities ask for the approval of the capital injection into BFA which enables the granting of the subordinated loan to Bankia as rescue aid 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.

(27) The Spanish authorities consider that the capital injection constitutes State aid.

(28) It is the position of the Spanish authorities that the aid measure will be an interim advance payment of the final capital injection to be carried out under the financial assistance programme embodied in the Memorandum of Understanding ("**MoU**") signed by the European Commission and the Spanish authorities on 23 July 2012. The Spanish authorities hold that position[8] because, once the Commission takes a final decision on the restructuring plan in November 2012[9], the funds now injected should in the view of the Spanish authorities be included within the final support to be provided by the FROB to the Group under the financial assistance programme. They are of the view that the Spanish government bonds provided to BFA will then be replaced by bonds from the European Financial Stability Facility (EFSF).

(29) The Spanish authorities have provided the following specific commitments in line with the Conversion decision:

(i) To notify to the Commission for approval any increase in the principal amount of the measures proposed;

(ii) To suspend any payments from BFA to the OBS for new projects;

(iii) 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 call or buy back the same instruments without prior approval of the Commission;

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

[8] Letter from the FROB of 3 September 2012.

[9] See footnote 7

(v) To notify a restructuring plan in line with the Restructuring Communication[10] and in line with the MoU for enabling the Commission to take a restructuring decision not later than by 30 November 2012.

(30) In addition to the commitments set out in recital (30), the Spanish authorities commit to ensure the implementation of the following commitments with regard to the BFA Group recapitalisation until the European Commission has approved a final restructuring plan of the Group:

(i) To respect a ban on acquisitions in the following form:

i. That BFA Group will not acquire any stake in any undertaking. That commitment covers both undertaking which have the legal form of a company and packages of assets which form a business.

ii. That commitment will apply until the Commission approves a final restructuring plan for BFA Group which might modify that acquisition ban. The commitment will enter into force starting from the date of this Commission decision.

iii. Notwithstanding that prohibition, BFA Group may, after obtaining the Commission's approval, acquire businesses if to do so is in exceptional circumstances necessary to restore financial stability or to ensure effective competition.

iv. Notwithstanding that commitment, BFA Group may make acquisitions that take place in the ordinary course of the banking business of BFA Group as regards the management of existing claims towards ailing firms;

(ii) BFA Group shall not use the circumstance of being supported by the FROB for commercial purposes, and shall respect a ban on aggressive commercial strategies;

(iii) BFA Group shall adjust its remuneration policy to the provisions in Article 5 of the Royal Decree-Law 2/2012 and its implementing regulations;

(iv) To consult the Commission prior to any further liability management exercises (including buy-backs) on hybrid instruments and subordinated debt to be carried out by BFA Group in order to ensure compliance with Commission State aid rules;

(v) To respect a dividend ban by BFA Group, unless previously authorised by the Commission, except for the adequate remuneration of the State;

(vi) To seek the agreement of the European Commission for any eventual decision that exempts BFA Group of some of the commitments given for the purpose of this decision and in the MoU;

(vii) To do all in their ability so that the Commission can approve a restructuring plan of BFA Group by 30 November 2012.[11]

[10] OJ C195, 19.8.2009, p. 9.
[11] See footnote 7.

4 ASSESSMENT

4.1 Existence of State Aid

(31) The Commission first has to assess whether the measure constitutes 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 favouring certain undertakings, in so far as it affects trade between Member States.

(32) The Commission observes that the intervening authority, the FROB, is directly financed through State resources. As the resources used in the measure are therefore directly attributable to the State, the Commission concludes that they are State resources within the meaning of Article 107(1) TFEU.

(33) The new capital injection strengthens the Core Tier I capital of BFA. The measure will enable BFA to provide a subordinated loan to Bankia, which will reinforce Bankia's Tier II capital position. The Group, as a whole, consisting of both BFA and Bankia, is, therefore, the beneficiary of the measure.

(34) Given the fragile state of BFA Group, including its subsidiary Bankia, and the general uncertainties in the Spanish economy and the Spanish financial sector, it can be excluded that a similar measure would be undertaken by a private investor at all, and certainly not on the terms foreseen in the measure as notified. In addition, a stress test exercise determining the full capital needs of the BFA Group is to be completed during September 2012 in line with the MoU, which will probably require significant but still wholly undefined measures for the purposes of burden-sharing and addressing competition distortions. That factor is an additional reason why a private investor would not inject capital before that uncertainty is resolved.

(35) Given that investors' concern is currently greatly focussed on the capital available for banks, the measure allows both beneficiaries to get an economic advantage when compared with other competing banks in both Spain and other Member States and must therefore be regarded as distorting competition.

(36) The Commission finds that the measure is likely to affect trade between Member States because the Group competes on the markets for retail savings, mortgage lending and commercial lending in Spain. In all those markets, some of BFA and Bankia's competitors are subsidiaries and branches of foreign banks. In addition, the Commission considers that the banking sector operates internationally.

Conclusion

(37) On the basis of the foregoing, the Commission considers that the measure fulfils all the conditions laid down in Article 107(1) TFEU and that the measure constitutes State aid to the benefit of the Group, and therefore to BFA and Bankia. Spain has not implemented the measure so far, and therefore has respected the standstill obligation under Article 108 (3) TFEU.

4.2 Compatibility of the aid

(38) As regards compatibility with the internal market of the aid provided to BFA and its subsidiary Bankia, 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, using that legal basis, has to assess whether the measures proposed are compatible with the internal market.

4.2.1 Legal basis for the compatibility assessment

(39) 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"*.

(40) Given the present circumstances in the financial markets, the Commission considers that the measures may be examined under Article 107(3)(b) TFEU. In view of the deteriorating conditions of the Spanish economy and banks' limited access to international and wholesale funding markets, the Commission still considers that the 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 2011 a Communication that prolongs the application of State aid rules to support measures in favour of banks in the context of the financial crisis ("the 2011 Prolongation Communication")[12]. In particular in the case of Spain, the Commission notes that the Spanish authorities are seeking financial assistance from euro area Member States for recapitalising Spanish banks[13].

(41) Given the systemic importance of the Group and the significance of the lending activities of both BFA and Bankia for the Spanish economy, the Commission accepts that a lack of access to the ECB liquidity facilities and the failure of BFA and Bankia would have entailed serious consequences for the Spanish economy. The aid must therefore be assessed under Article 107(3)(b) TFEU.

4.2.2 Compatibility assessment

(42) 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[14]:

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.

[12] Communication from the Commission from 1 December 2011, 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.

[13] See Eurogroup Statement on Spain, 9.06.2012, see: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130778.pdf

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

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.

4.2.2.1 Compatibility with the Banking and Recapitalisation Communications

a. Appropriateness of the Measures

(43) The Spanish authorities have informed the Commission that the Group has witnessed a considerable deterioration of its capital and liquidity position in the past months, owing to the lack of confidence of the markets. As a result, a private capital raise in the current market is virtually impossible for BFA and its subsidiary Bankia.

(44) The Commission notes first that BFA is already entirely State-owned. It considers that the current capital injection is appropriate as that measure is helpful in addressing the issues facing BFA. The use of the capital injected in order to grant a subordinated loan to Bankia is also appropriate as it addresses the lack of confidence as well as a capital shortfall which is degrading the value of that franchise. The capital injection should help to preserve the stability of BFA and Bankia until their problems are addressed in a restructuring plan. It has to be recalled that a rescue decision is meant to help the beneficiary survive and to prepare a restructuring plan. The Commission recalls in that context that the Spanish authorities have committed in the MoU to do all that is necessary to enable the Commission to decide on a restructuring plan in line with the Restructuring Communication by the end of November 2012.

b. Necessity – limitation of the aid to the minimum

(45) 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 aid measure must be of the minimum amount necessary to reach the objective. With the aid received, both BFA and Bankia will remain eligible counterparts for Eurosystem monetary policy operations, which is of paramount importance at present. The measure should ensure that BFA and Bankia will meet regulatory capital ratios for now. The aid is also limited to the minimum necessary as, without the support of the Spanish State via the measure, BFA and Bankia would fall below the regulatory capital ratio and face significant problems in remaining as going concerns in the Spanish banking market.

(46) The Spanish authorities have committed to ensure that capital will not flow to other existing capital-providers. In that regard, there is the commitment of not making any payments on hybrid instruments, unless they stem from a legal obligation, and not to buy back and/or call the same instruments without consulting the Commission. Furthermore, the Spanish authorities have stated that by virtue of the new Royal Decree-Law 24/2012 the intended interim capital injection will not compromise the possible subordinated liabilities management exercises as set out in the MoU and in

that Royal Decree-Law.

(47) In addition, adequate remuneration of any State intervention contributes to ensuring that the aid is limited to the minimum necessary. As regards the required remuneration of the aid for recapitalisation in the form of ordinary shares, point 8 of the 2011 Prolongation Communication lays down that the new shares should be subscribed at a discount to the market price prevailing at the time of the announcement. However, such a discount is not necessary in the present case as BFA is already wholly State-owned.

(48) Since the advantage from the capital injection will in large part also benefit Bankia in the form of the subordinated loan from BFA to the latter, the Commission must have regard to the remuneration of that loan in order to ascertain if Bankia is obtaining an excessive advantage from the measure. The Commission notes that the 8% coupon rate can be considered as appropriate for a Tier 2 capital instrument in line with the Recapitalisation Communication. However, contrary to the clarifications on remuneration of capital injections set out in point 13 of the 2011 Prolongation Communication, the subordinated loan contains no alternative coupon satisfaction mechanism. However, Spain can remedy that shortfall in the final restructuring plan. Given that Spain has committed to ensure that the Commission will be in a position to take a final decision on restructuring aid for the Group by 30 November 2012, that restructuring aid can still be equipped with an alternative satisfaction mechanism to ensure that any missed coupon for the year 2012 will be made good.

c. Proportionality – measures limiting negative spill-over effects

(49) Spain has committed that Bankia will suspend dividend and coupon payments on outstanding hybrid instruments, unless those payments stem from a legal obligation and it will not purchase or call the same instruments. In addition, there are a number of commitments ensuring that there are measures limiting negative spill-over effects of the measure such as an acquisition ban and a ban on aggressive commercial strategies.

(50) Therefore, taking into consideration the difficulties that BFA and Bankia is facing 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.

Conclusion

The Commission, thus, concludes that the measure is appropriate, necessary and proportional.

4.2.2.2 Restructuring plan

(51) The Recapitalisation Communication only required a restructuring plan for non-fundamentally sound financial institutions receiving State aid. However, the 2010

Prolongation Communication[15] requires a restructuring plan for all entities receiving aid in the form of a recapitalisation measure as from 1 January 2011.

(52) There is therefore a need for a submission of a restructuring plan under the Recapitalisation Communication and the 2010 Prolongation Communication. In that context, the Commission recalls that such a plan might also need to foresee deep restructuring measures, depending on the size and the amount of the aid granted, or an orderly bank winding-up if a bank cannot return to viability.

(53) The Commission takes note of the commitment of the Spanish authorities to submit a restructuring plan for BFA Group in line with the Restructuring Communication and in line with the MoU and the new Royal Decree-Law 24/2012, so putting the Commission in a position to take a restructuring Decision by 30 November 2012.

CONCLUSION

(54) The Commission concludes that the notified measure in favour of the Group, and therefore BFA and Bankia, constitutes State aid pursuant to Article 107(1) TFEU.

(55) The measure benefitting BFA Group is compatible with the internal market as rescue aid for reasons of financial stability on the basis of Article 107(3)(b) TFEU. The measure can accordingly be approved until the Commission has adopted a final decision on the restructuring plan which according to the MoU should be taken by the Commission no later than 30 November 2012.

(56) The Commission recalls that Spain undertook to submit a restructuring plan in line with the Restructuring Communication and the Memorandum of Understanding and the new Royal Decree-Law 24/2012 early enough so as to allow the Commission to take a final restructuring decision by 30 November 2012.

5 DECISION

- The Commission concludes that the notified measure in favour of the Group in the form of a capital injection of EUR 4.5 bn in favour of BFA which enables it to grant a subordinated loan of EUR 4.5 bn to its subsidiary Bankia constitutes State aid pursuant to Article 107(1) TFEU.
- The aid measure is compatible with the internal market as rescue aid on the basis of Article 107(3)(b) TFEU until a decision on the restructuring plan of BFA Group is adopted.
- The Commission notes that Spain exceptionally accepts that the adoption of the Decision be in the English language.

Spain is requested to forward a copy of this letter to the potential recipient of the aid immediately.

[15] See point 14 of the 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.

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President