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Subject: State Aid SA.45753 (2016/N) – Italy
Italian bank guarantee scheme

Sir,

1. PROCEDURE

(1) On 25 June 2016, Italy formally notified a State guarantee scheme on the liabilities of Italian banks (the "Scheme").

(2) By letter submitted on 25 June 2016, Italy agreed to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958[1] and to have the present decision adopted and notified in English.

2. FACTS

(3) The objective of the Scheme is, according to the notification, to provide a remedy for a serious disturbance in the economy of Italy and to preserve financial stability.

(4) In view of the risk of systemic liquidity tensions following the results of the UK Referendum on membership to the European Union, the proposed Scheme is,

1 Council Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.

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according to the notification, expected to aid banks in meeting their funding needs and reinforce the overall financial stability of the Italian the banking system[2].

(5) On 24 June 2016, Italy submitted a draft law decree providing for the national legal basis of the Scheme. The main features of the Scheme are:

The terms of the guarantee

(6) The Minister of Finance is empowered to grant government guarantees, up to a total amount of EUR 150 billion, on:

(a) newly issued senior liabilities with a maturity between 3 months and 5 years (7 years for covered bonds);

(b) funding granted by the Bank of Italy in the context of emergency liquidity assistance ("ELA").

(7) The guarantee complies with the conditions set forth in Article 32(4)d) of Directive 2014/59/EU3, i.e.

(a) is confined to solvent institutions

(b) is conditional on final approval under the Union State aid framework

(c) is proportionate to remedy the consequences of the serious disturbance and

(d) is not be used to offset losses that the institution has incurred or is likely to incur in the near future.

(8) Guarantees with a maturity of more than three years are capped at one-third of the total outstanding amount of guarantees granted to the individual credit institution.

Beneficiaries

(9) Eligible beneficiaries are banks incorporated in Italy, including subsidiaries of foreign banks, that meet the solvency criteria provided for in Article 92 of Regulation 575/20134 certified by the competent supervisory authority. Eligible beneficiaries for government guarantees on ELA also include branches of foreign banks, in line with the Bank of Italy's procedures regarding ELA.

Guarantee commission (fee)

(10) The participation in the Scheme will require a guarantee commission calculated in accordance with the Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the

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2 Letter of Bank of Italy to the services of the Commission received on 25 June 2016.

3 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, OJ L 173, 12.6.2014, p. 190.

4 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 1.

context of the financial crisis[5] ("the 2011 Prolongation Communication"). Specifically, the fee will be:

(a) For guarantees with maturity of 3 months and up to less than 12 months, the fee amounts at least to the sum of:

– a basic fee of 50 basis points ("bps"); and

– a risk-based fee equal to 20 bps for banks with a rating of A+ or A, 30 bps for banks with a rating of A-, or 40 bps for banks rated below A- or without a rating.

(b) For guarantees with a maturity of one year or more, the guarantee fee will as a minimum be the sum of:

– a basic fee of 40 bps; and

– a risk-based fee equal to the product of 40 bps and a risk metric composed of (i) one-half of the ratio of the beneficiary's or its parent company's median five-year senior Credit Default Swap ("CDS") spread over the three years ending one month before the date of issue of the guaranteed bond to the median level of the iTraxx Europe Senior Financials five-year index over the same three-year period, plus (ii) one-half of the ratio of the median five-year senior CDS spread of all Member States to the median five-year senior CDS spread of Italy over the same three-year period[6].

– For banks without CDS data, or without representative CDS data but with a credit rating, an equivalent CDS spread will be derived from the median value of five-year CDS spreads during the same sample period for the rating category of the bank concerned, based on a representative sample of large banks in the Member States. The supervisory authority will assess whether the CDS data of a bank are representative.

– For banks without CDS data and without a credit rating, an equivalent CDS spread will be derived from the median value of five-year CDS spreads during the same sample period for the lowest rating category, based on a representative sample of large banks in the Member States. The calculated CDS spread, for this category of banks, may be adapted on the basis of a supervisory assessment.

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[5] C 356, 6.12.2011, p. 7.

[6] The formula for the guarantee fee can be written as:
Fee = 40bp x (1 + (1/2 x A/B) + (1/2 x C/D)), where A is the beneficiary's median five-year senior CDS spread, B is the median iTraxx Europe Senior Financials five-year index, C is the median five-year senior CDS spread of all Member States and D is the median five-year senior CDS spread of the Member State granting the guarantee. The medians are calculated over the three years ending one month before the date of issue of the guaranteed bond. In the case of guarantees for covered bonds, the guarantee fee may take into account only one-half of the risk-based fee.

3. POSITION OF ITALY

(11) Italy has notified a Scheme as State aid seeking to remedy a serious disturbance in its economy within the meaning of Article 107(3)(b) TFEU. The serious disturbance in the economy is the result of the instability on international financial markets and the negative impact on the Italian economy.

(12) Italy requests the introduction of the Scheme until 31 December 2016.

(13) Italy submits that the Scheme constitutes State aid within the meaning of Article 107(1) TFEU, but is of the view that the notified Scheme is compatible with the internal market on the basis of Article 107(3)(b) TFEU as it is necessary to remedy a serious disturbance in the economy of Italy.

(14) Italy submitted a letter by the Bank of Italy[7] confirming the need for the notified Scheme. The Bank of Italy considers the results of the UK Referendum on membership to the European Union had an adverse impact on markets and if the situation is left unattended there is a risk of systemic liquidity tensions that would hamper the ability of the Italian Banking system to finance the economy. The introduction of the Scheme for banks incorporated in Italy until 31 December 2016 is necessary in order to enable those banks to raise medium and long-term funding through the Scheme if the need arises.

(15) Italy submitted the following commitments relating to the Scheme:

i. to grant the guarantees under the Scheme only for new issuance of banks' senior debt (subordinated debt is excluded);

ii. 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);

iii. to limit the guarantees with a maturity of more than three years to one-third of the total outstanding amount of guarantees granted to the individual bank;

iv. to determine the minimum level of remuneration in line with the formula set out in the 2011 Prolongation Communication[8;]

v. to submit a restructuring plan, within two months of the granting of the guarantee, for any bank that is granted guarantees on new liabilities or renewed liabilities or ELA for which, at the time of the granting of the new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of this decision) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million;

vi. to submit individual restructuring or wind-down plans[9] within two months after the guarantee has been activated for banks which cause the guarantee to be called upon;

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7 Letter of the Bank of Italy to the services of the Commission received on 25 June 2016.

8 Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis (2011 Prolongation Communication), OJ C 356, 6.12.2011, p. 7

vii. to impose a ban on advertising referring to the State support on the beneficiaries of the Scheme and to prevent them from employing any aggressive commercial strategies which would not take place without the State support;

viii. to grant aid measures under the support scheme only to banks which have no capital shortfall[10] and, where a bank with a capital shortfall is in urgent need of liquidity, to submit an individual notification to the Commission;

ix. to report to the Commission on i) the operation of the Scheme, ii) the guaranteed debt issues, and iii) the actual fees charged, on a three-monthly basis, meaning by 15 October 2016 (for the period 26 June 2016 to 30 September 2016) and by 15 January 2017 (for the period 1 October 2016 to 31 December 2016) at the latest;

x. to supplement its reports on the operation of the Scheme with available updated data on the cost of comparable non-guaranteed debt issuances (as regards nature, volume, rating, currency);

4. ASSESSMENT

4.1. Existence of State aid

(16) 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.

(17) The Commission agrees with the position of Italy that the Scheme constitutes aid to the Beneficiaries pursuant to Article 107(1) TFEU.

(18) The provision of guarantees under the Scheme involves State resources which are clearly imputable to the State. Those guarantees allow the Beneficiaries to obtain liquidity at conditions which would not be available to them under market conditions and thereby provides them with an advantage. The advantage is selective since it only benefits a certain sector i.e. the banking sector. That economic advantage to the Beneficiaries strengthens their position compared to that of their competitors in Italy and other Member States. It must, therefore, be regarded as distorting competition. In light of the fact that most of the banks incorporated in Italy are active in other Member States and that subsidiaries of banks headquartered in other Member States are active on the Italian banking market, the Scheme is capable of affecting trade between Member States.

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9 The plan must be prepared on the basis of the parameters established in the 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 (Restructuring Communication) (OJ C 195, 19.8.2009, p. 9).

10 "No capital shortfall" is certified by the competent supervisory authority, as it is established, in line with point 28 of the 2013 Banking Communication, in a capital exercise, stress test, asset-quality review or an equivalent exercise at Union, euro area or national level, which has to be confirmed by the competent supervisory authority.

4.2. Compatibility of the Scheme

4.2.1 Legal basis for the compatibility assessment

(19) Under the Scheme Italy intends to provide aid in the form of guarantees in favour of banks.

(20) Given the exacerbation of tensions in financial markets that have taken place recently, the Commission considers it appropriate, as confirmed by the 2013 Banking Communication[11], to examine the measure under Article 107(3)(b) TFEU.

(21) 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[12] and the Restructuring Communication.[13] The Commission still considers that the conditions for State aid to be approved pursuant to Article 107(3)(b) TFEU are present. The Commission confirmed that view by adopting the 2013 Banking Communication[14].

(22) Therefore, the Commission bases its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

(23) In order for an aid to be compatible under Article 107(3)(b) TFEU, it must comply with the general principles for compatibility under Article 107(3) TFEU, viewed in the light of the general objectives of the Treaty. Therefore, according to the Commission's case practice any aid or scheme must comply with the following conditions: (i) appropriateness, (ii) necessity and (iii) proportionality.

(24) The 2013 Banking Communication and the Restructuring Communication formulate assessment criteria which reflect those general principles and their requirements in light of the specific policy context.

4.2.2 Compatibility assessment of the Scheme

Appropriateness

(25) The Scheme should be appropriate to remedy a serious disturbance in the Italian economy. The objective of the Scheme is to temporarily offer appropriate measures to establish backstops for the financial system in a timely and efficient manner, where banks face difficulties in obtaining sufficient funding. The Commission observes that the crisis has eroded confidence in the creditworthiness of the banks, which results in difficulties in obtaining necessary funding on the financial

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[11] Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (OJ C 216, 30.7.2013, p. 1).

[12] 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).

[13] 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).

[14] See points 4 to 6.

markets. Hence, a backstop mechanism by the Member State, which in case of urgency ensures that banks would have access to funding, is an appropriate means to strengthen banks and thus to restore market confidence.

(26) Points 23 and 60(a) of the 2013 Banking Communication explain that guarantee schemes will continue to be available in order to provide liquidity to banks but that such schemes should be limited to banks without a capital shortfall. The Commission observes that Italy has committed to restrict the Scheme only to banks without a capital shortfall as certified by the competent supervisory authority.

(27) Moreover, the Commission notes that Italy has committed to grant guarantees only for new issues of banks' senior debt, as prescribed in point 59(a) of the 2013 Banking Communication.

Necessity

(28) With regard to the scope of the measure, the Commission notes positively that Italy has limited the size of the Scheme by setting its maximum budget at EUR 150 billion and that the Scheme applies only until 31 December 2016. While it is in the decision making practice of the Commission to approve guarantee schemes for six months, the additional duration of the notified scheme is purely marginal and as such does not raise concerns.

(29) The Commission notes that Italy has committed to grant guarantees only on debt instruments with maturities from three months to five years (seven years in case of covered bonds) and limit guarantees with a maturity of more than three years to one-third of the outstanding guarantees granted to the individual bank, which complies with the requirements in points 59(b) and 60(b) of the 2013 Banking Communication.

(30) Regarding the remuneration level, the Commission observes that Italy, in line with point 59(c) of the 2013 Banking Communication, has committed to follow the pricing and other conditions for State guarantees laid down in the 2011 Prolongation Communication which requires, in particular, the application of a pricing method based largely on market data. The Commission further observes that the same pricing method will also be used in case of the State guarantee on ELA. As a result, the total cost of the State-guaranteed ELA for a bank will be higher than normal costs of ECB refinancing. As such, a bank has a sufficient incentive to avoid relying on that source of funding for developing its activities. Therefore, the measure does not provide a bank with excess liquidity which could be used to finance activities distorting competition and is limited to the minimum amount necessary.

Proportionality

(31) As regards proportionality, the Commission notes, first, that Italy, in line with point 59(d) of the 2013 Banking Communication, has committed to submit a restructuring plan within two months for any bank granted guarantees on new liabilities or on renewed liabilities or on ELA for which, at the time of the granting of the new guarantee, the total outstanding state guaranteed liabilities (including guarantees accorded before the date of the decision) exceed both a ratio of 5% of the bank's total liabilities and a total amount of EUR 500 million. That commitment 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.

(32) Secondly, the Commission notes that Italy has committed, in line with point 59(f) of the 2013 Banking Communication, to a number of behavioural safeguards such as a ban on advertisements referring to the State support and a 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.

(33) Thirdly, the Commission welcomes that Italy undertakes to submit individual restructuring or wind-down plans, within two months, for banks which cause the guarantee to be called upon, in line with point 59(e) of the 2013 Banking Communication.

(34) 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.

Monitoring

(35) The Commission welcomes, in line with point 60(c) and (d) of the 2013 Banking Communication, that Italy undertakes to present every three months a report on the operation of the scheme, on guaranteed issuances and on the actual fees charged and to supplement it with updated available data on the cost of comparable non-guaranteed debt issuances (nature, volume, rating and currency).

Conclusions on the compatibility of the aid measure

(36) On the basis of the above, the Commission finds the notified Scheme to be in line with the 2013 Banking Communication and the Restructuring Communication. The scheme is an appropriate, necessary and proportionate measure to remedy a serious disturbance of the Italian economy.

(37) The Scheme can therefore be introduced until 31 December 2016. 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.

5. COMPLIANCE WITH THE INTRINSICALLY LINKED PROVISIONS OF DIRECTIVE 2014/59/EU[15]

(38) Without prejudice to the possible application of Directive 2014/59/EU on bank recovery and resolution, in the event that an institution benefiting from the scheme meets the condition for the application of that directive, the Commission notes that the Scheme does not seem to violate intrinsically linked provisions of Directive

[15] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190.

2014/59/EU and namely Article 32(4)(d). The criteria of the Scheme ensure that the institutions benefitting from it will not be deemed failing or likely to fail on the sole basis of their participation in the Scheme. If the criteria did not ensure that outcome, the Scheme could not be deemed appropriate since it would not be apt to remedy the serious disturbance in the Italian economy.

(39) The first subparagraph of Article 32(4)(d) of Directive 2014/59/EU establishes that an institution shall be deemed to be failing or likely to fail and placed into resolution, (if all the other pre-conditions for resolution are met), where, *inter alia*, extraordinary public financial support is required, except when, in order to remedy a serious disturbance in the economy of a Member State and preserve financial stability, the extraordinary public financial support takes the form, inter alia, of a State guarantee of newly issued liabilities or on ELA.

(40) The second subparagraph of Article 32(4)(d) of Directive 2014/59/EU provides that in order not to trigger resolution such State guarantees on newly issued liabilities or ELA must be confined to solvent institutions and must be conditional on final approval under the Union State aid framework. Those measures must be of a precautionary and temporary nature and must be proportionate to remedy the consequences of the serious disturbance and must not be used to offset losses that the institution has incurred or is likely to incur in the near future.

(41) The Commission notes that the Scheme is limited to solvent institutions. The guarantees granted under the Scheme are of a temporary nature since the window of their issuance is limited and their maturity is limited to three years and are of a precautionary nature since they only cover newly issued liabilities. The guarantees granted are also proportionate to remedy the consequences of the serious disturbance as explained in recital (25).

(42) The Commission therefore concludes that, at the present stage, the notified Scheme does not seem to violate any intrinsically linked provisions of Directive 2014/59/EU, The Scheme is in compliance with the requirements of Article 32(4)(d) of Directive 2014/59/EU and, therefore, apt to remedy the consequences of the serious disturbance in the Italian economy.

6. CONCLUSION

The Commission has accordingly decided to consider the aid to be compatible with the internal market pursuant to Article 107(3)(b) TFEU and not to raise objections to the Scheme.

Italy 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: http://ec.europa.eu/competition/elojade/isef/index.cfm.

Your request should be sent electronically to the following address:

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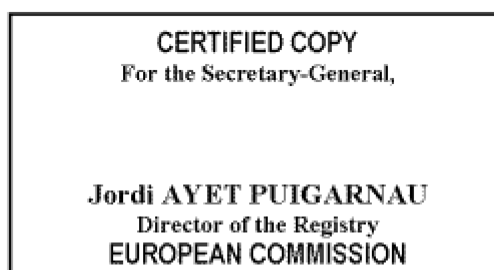
Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission



ANNEX I - ITALY COMMITMENTS

Italy commits:

- to grant the guarantees under the support scheme only for new issuance of credit institutions' (banks') senior debt (subordinated debt is excluded);

- 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);

- to limit the guarantees with a maturity of more than three years to one-third of the total outstanding amount of guarantees granted to the individual credit institution;

- to determine the minimum level of State guarantee remuneration 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[1];

- to submit a restructuring plan, within two months of the granting of the guarantees, for every credit institution that is granted guarantees on new liabilities or renewed liabilities for which, at the time of the granting of new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of this decision) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million;

- to submit individual restructuring or wind-down plans[2] within two months after the guarantee has been activated for credit institutions which cause the guarantee to be called upon;

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

- to grant aid measures under the support scheme only to credit institutions which have no capital shortfall[3] and, where a credit institution with a capital shortfall is in urgent need of liquidity, to submit an individual notification to the Commission;

- to report to the Commission on i) the operation of the scheme, ii) the guaranteed debt issues, and iii) the actual fees charged, on a three-monthly basis, meaning by 15 October 2016 (for the period 1 July 2016 to 30 September 2016) and by 15 January 2017 (for the period 1 October 2016 to 31 December 2016) at the latest; and

- to supplement its reports on the operation of the scheme with available updated data on the cost of comparable non-guaranteed debt issuances (as regards nature, volume, rating, currency).

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[1] OJ C 356, 6.12.2011, p. 7.

[2] The plan must be prepared on the basis of the parameters established in the 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 (Restructuring Communication) (OJ C 195, 19.8.2009, p. 9).