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C(2017) 1698 final

In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […]		PUBLIC VERSION This document is made available for information purposes only.

Subject: State Aid SA.47178 (2016/NN) – Portugal
Recapitalisation measures for Caixa Geral de Depósitos, S.A and limited amendments of the existing commitments

Dear Sir,

1. PROCEDURE

(1) On 28 June 2012, Portugal notified to the Commission a number of recapitalisation measures in respect of Caixa Geral de Depósitos, S.A ("CGD" or "the Bank").

(2) On 29 June 2012, Portugal implemented the recapitalisation measures consisting of the subscription by Portugal of ordinary shares newly issued by CGD in the amount of EUR 750 million and the subscription by Portugal of convertible instruments ("CoCos") issued by CGD in the amount of EUR 900 million ("2012 recapitalisation measures").

(3) On 18 July 2012, the Commission adopted a decision ("the Rescue decision")[1] authorising the 2012 recapitalisation measures as rescue aid.

[1] http://ec.europa.eu/competition/state_aid/cases/247111/247111_1420908_83_2.pdf

S. Ex.ª o Ministro dos Negócios Estrangeiros
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(4) On 27 September 2012 Portugal informed the Commission that Caixa Geral Finance Limited ("CGDF"), an affiliate of CGD, would pay out dividends to the holders of perpetual non-cumulative preference shares the next day. On 28 September 2012, CGDF executed the payment of dividends.

(5) On 18 December 2012, the Commission adopted a decision[2] initiating the formal investigation procedure for misuse of rescue aid pursuant to Article 16 of Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty[3].

(6) By publishing that decision in the *Official Journal of the European Union*, [4] the Commission invited interested parties to comment on its preliminary conclusion that the dividend payment constituted misuse of aid in breach of the terms of the Rescue decision, but has not received any related comments.

(7) On 24 July 2013, the Commission adopted a final decision on CGD's recapitalisation measures and closing the formal investigation procedure ("the 2013 Restructuring decision")[5] concluding that the 2012 recapitalisation measures are compatible with the internal market, based on a restructuring plan ("the Restructuring plan") submitted by Portugal and in the light of the commitments set out in the Annex of the 2013 Restructuring decision ("the commitments").

(8) Between April and December 2016, Portugal informed the Commission that it was unlikely that CGD could achieve all Key Performance Indicators committed to by Portugal under the 2013 Restructuring decision. Given that Portugal had also committed to present remedial actions to the Commission[6], several meetings and conference calls took place between the Portuguese authorities and the Commission services, as well as electronic mail exchanges.

(9) On 23 December 2016 Portugal notified the Commission of further recapitalisation measures in respect of CGD ("the 2016 recapitalisation measures"), accompanied by an Industrial Plan Moreover, as described in section 3.2, Portugal notified the amendment of the Restructuring plan and of two commitments issued in the framework of the 2013 Restructuring decision. The notified 2016 recapitalisation measures as well as the notified amendments are the subject of this decision.

(10) By letter dated 6 January 2017, Portugal agreed exceptionally to waive its rights deriving from Article 342 of the Treaty on Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958[7] and to have the present decision adopted and notified in English.

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[2] Commission decision SA.35062 (2012/C) (ex 2012/NN), OJ C 116, 23.4.2013, p.13.

[3] OJ L 83, 27.03.1999, p. 1.

[4] OJ C 116, 23.4.2013, p.13.

[5] Commission decision SA.35062 (2013/N-2), OJ L 323, 7.11.2014, p.19-51.

[6] Commitment 4.2.3.4 of SA.35062 (2013/N-2). 4.2.3.4. *"Should it become likely that the above balance sheet, RWA, C/I, LDR, and coverage of credit-at-risk targets will not be met, CGD shall on its own initiative, and in any case upon request by the Monitoring Trustee, present Remedial Actions within a month. The Monitoring Trustee will analyse the Remedial Actions proposed and will report to the Commission on their adequacy to meet the targets set out in the Restructuring Plan."*

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

(11) On 3 March 2017 and on 7 March 2017, the Portuguese authorities submitted limited changes to the notification including *inter alia* updated financial projections for the Industrial Plan ("updated Industrial plan projections").

2. DESCRIPTION OF THE 2016 RECAPITALISATION MEASURES

2.1. CGD

(12) CGD is the largest bank in Portugal. It is fully owned by the Portuguese State.

(13) CGD includes foreign subsidiaries and branches as well as entities providing insurance, asset management, specialist credit, investment banking and auxiliary services.

2.2. Implementation of the 2013 Restructuring plan and of the commitments

(14) In order to deal with solvency problems, CGD received the 2012 recapitalisation measures, which were approved by the Commission as State aid compatible with the internal market in the 2013 Restructuring decision on the basis of the submitted Restructuring plan and associated commitments made by Portugal, which were set out in the Annex to that decision.

(15) The Restructuring plan foresaw *inter alia* a series of measures aiming to restore CGD's long-term viability, to address competition distortions as well as providing for behavioural restrictions.

Implementation of measures aiming at restoring long-term viability

(16) In its notification for the 2013 Restructuring decision, Portugal committed to correctly and fully implement CGD's Restructuring plan. This Restructuring plan contained measures to achieve a proportionate downsizing of the Bank in terms of balance sheet size, geographical footprint (reduction of the number of domestic branches from 829 to [750-800]* and staff.

(17) In its 2013 Restructuring decision, the Commission noted that CGD had already taken measures to reduce its labour and administrative costs, including a targeted reduction of the Bank's domestic headcount (projected reduction of domestic headcount from 11 904 by end 2012 to [11 000 – 11 500] by end 2016 and to [11 000 – 11 500] by end 2017), thereby projecting a reduction of labour costs by [5-10%]. Taking into account that the budget for administrative costs would also be cut down significantly, this was considered an adequate means to achieve the required savings.

(18) According to the information submitted by Portugal, CGD has effectively reduced the Bank's headcount by more than projected in the Restructuring plan (in August 2016, CGD had a domestic headcount of [10 000 – 10 500] according to the seventh monitoring report to the Commission of 31 October 2016).

(19) The Commission furthermore noted in its 2013 Restructuring decision that the deleveraging of the balance sheet as notified by Portugal would add up to an amount of EUR [15 – 20 billion], equivalent to a reduction of [10-20%]over the restructuring period.[8]

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* Confidential information.

[8] Extending to 31 December 2017.

(20) To allow for a closer follow-up of the implementation of the Restructuring plan and the timely introduction of mitigating measures, Portugal committed to a set of Key Performance Indicators (KPIs) to be achieved on specific dates.

Table 1: KPI's included in Portugal's commitments in the 2013 Restructuring decision

KPI	Target End 2014	Actual End 2014	Target End 2016	Actual Jan. 2016
Core activities (EUR billion)	[100-150]	[90-100]	[100-150]	[90-100]
RWA[9] (EUR billion)	[70-80]	58.1	[70-80]	[50-60]
Cost-to-Income ratio	Max. [70-80]	71.5 %	Max. [50-60]	[70-80%][10]
Loan-to-Deposit-Ratio	Max. [120-130%]	94 %	Max. [120-130%]	[80-90%]
Credit Risk Coverage ratio	Min. [50-60%]	58.3 %	Min. [50-60%]	[60-70%]

(21) According to the seventh monitoring report, CGD achieved all of these KPIs, except for the Cost-to-Income ratio. The realised end 2014 Cost-to-Income ratio was 71.5% compared to the projected [70-80%] and based on the August 2016 ratio of [70-80%] the Bank did not expect to be able to achieve the 2016 target of [50-60%].

(22) In its notification for the 2013 Restructuring decision, Portugal committed to present, at its own initiative, remedial actions within a month of determining that the KPIs would not likely be achieved. On 3 March 2016, Portugal presented its first version of a plan to ensure CGD's compliance with the 2013 Restructuring decision.

Implementation of measures aiming at addressing competition distortions

(23) As described in recitals (16) to (19), Portugal committed in its notification for the 2013 Restructuring decision to do a proportionate downsizing of CGD in terms of balance sheet size, geographical footprint and staff.

(24) According to the seventh monitoring report, CGD had effectively reduced its domestic branch network to [650-700] by August 2016, compared to a target of [750-800] while at the same time reducing the number of Full Time Equivalents[11] ("FTE") to [10 000 – 10 500] by August 2016 thereby clearly achieving the target set out in the Restructuring plan.

(25) Moreover, the Commission noted in the 2013 Restructuring decision that Portugal also committed to several behavioural constraints. Those behavioural

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9 Risk-weighted assets.

10 Cost-to-Income ratio calculated based on the August 2016 figures, as reported in the seventh monitoring report.

11 FTE is a unit that indicates the workload of an employed person in a way that makes workloads comparable across various businesses. It is calculated as the number of equivalent employees working full-time, in other words one FTE is equivalent to one employee full-time.

commitments are reflected in section 6 of the commitments made by Portugal and annexed to the 2013 Restructuring decision.

(26) The behavioural measures committed to by Portugal include a ban on advertising State support, a ban on aggressive commercial practices, an acquisition ban and a restriction on the remuneration of bodies and employees of CGD.

Implementation of burden sharing measures

(27) In the 2013 Restructuring decision, Portugal committed that CGD would not pay dividends, coupons and interest payments ('coupon ban') to holders of preference shares and subordinated debt, in so far as those payments were not owed on the basis of contractual or legal obligations.

(28) At the start of the Restructuring Period, CGD sought a legal opinion to determine which coupons, interests and/or dividends were covered by the exception in the coupon ban. CGD has limited its payments to the instruments for which a legal or contractual obligation existed according to the consecutive monitoring reports received by the Commission.

Implementation of the commitment for the repayment of CoCos

(29) In 2012, CGD issued EUR 900 million of CoCos which were subscribed by Portugal and approved by the Commission as State aid compatible with the internal market under the 2013 Restructuring decision. The CoCos were hybrid capital that counted as Common Equity Tier 1 ("CET1") capital.

(30) The issuance of the CoCos included amongst others the following terms:

(a) A priority over the ordinary shareholders of CGD and other holders of instruments ranking *pari passu* with ordinary shares;

(b) A remuneration starting with an initial effective annual rate of 8.5% (paid on a semi-annual basis) and a step-up clause leading to a 9.2% average remuneration during the foreseen investment period[12]; it also included an alternative coupon payment mechanism whereby in case the payment of a coupon in cash would not be possible, it could be paid in kind through new ordinary shares of CGD;

(c) Any distributable profits were to be rather used to pay the coupon and buy back the CoCos, rather than paying dividends, whilst there would be an overall ban on dividend distribution while the CoCos where outstanding;

(d) A buyback option for CGD. This option allows the Bank to partially or fully buy back the CoCos at its own initiative at any time, their principal amount, in cash, together with accrued interest, subject to the prior written approval of the supervisor, provided that i) the CoCos can be replaced by regulatory capital of equal or better quality, or ii) that CGD has demonstrated to the satisfaction of the supervisor that its own funds would, following the buyback, exceed, by a margin that the supervisor considers to be adequate, the minimum regulatory capital ratio or other prudential requirements associated with the amount of own funds in force at that date;

[12] Defined in the term sheet as five years from the issuance date i.e. lasting until the end of 29 June 2017.

(e) Portugal has the right to convert the CoCos into ordinary shares of CGD, at a conversion rate defined by the Minister of Finance if, CGD would become non-viable without conversion, or CGD would require additional capital without which it would no longer be viable;

(f) The CoCos would be mandatorily converted into ordinary shares, if CGD was not able to buy them back by the end of the investment period i.e. by 29 June 2017;

(g) In the event of conversion of the CoCos to ordinary shares, Portugal would become a shareholder of CGD and its claim would rank *pari passu* with the rights and claims attaching to CGD's ordinary shares.

(31) As indicated in recitals (35)-(36) of the 2013 Restructuring decision, CGD had undertaken to repay the EUR 900 million of CoCos held by the State during the restructuring period spanning to 31 December 2017. That commitment by Portugal aimed to reduce CGD's average funding costs, but without endangering CGD's capital position. Therefore, CGD had committed to use, for the fiscal year 2014, [50-60%] of its excess capital (defined as the capital above the applicable minimum capital requirement under European and Portuguese law (including pillars 1 and 2) plus a capital buffer of [100 – 150] basis points ("bps")) and for the fiscal years 2015 and onwards [90-100%] of its excess capital, for the repayment of the CoCos.

(32) For the fiscal year 2014[13], the Monitoring Trustee reported that CGD did not meet the minimum capital requirements plus a capital buffer of [100 - 150] bps so it could not proceed with a repayment of the CoCos as committed in the 2013 Restructuring decision. For the fiscal year 2015, it was also not possible for CGD to proceed with the repayment of the CoCos without endangering its future solvency[14]. In particularly, the Monitoring Trustee indicated that CGD presented at 31 December 2015 a CET1 ratio of 10.87% against a minimum requirement of [5-10]% This requirement was expected to increase to [10-15%] from the end of 2016 due to the addition of the 'Other systemically important institution' ("OSII") capital buffer[15] giving rise to a CET1 minimum requirement of [10-15%]under the commitment (including the [100 – 150] bps capital buffer). Consequently, also for the fiscal year 2015, CGD could not repay the CoCos as committed to in the 2013 Restructuring decision.

(33) The Monitoring Trustee further informed the Commission that although, CGD has considered possible capital actions, to enhance its capital structure, it was expected that such actions would not be sufficient to both meet the required capital requirements and allow for a repayment of the CoCos by 30 June 2017, which would then convert into ordinary capital.

(34) Despite the implementation of the restructuring measures described in recitals (16) to (22), the Bank remained loss making since 2011.

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[13] See fourth Full Monitoring Trustee report, pages 57-58.

[14] See sixth Full Monitoring Trustee report, pages 51-52.

[15] Applied in accordance with Article 131 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338.

2.3. Description of the Industrial Plan

(35) Given the difficulties of the Bank, the State, as a shareholder, appointed a new experienced management team with a mandate to develop a new strategy for CGD to improve its performance and ensure its long-term sustainability. The management team was appointed on 1 September 2016 and has been replaced by a new management team in January 2017 with the mandate to implement the agreed plan.

(36) The Industrial Plan identifies the current weaknesses of the Bank and proposes restructuring measures. It also includes an estimate of the capital needs of the Bank necessary to implement the proposed measures and ensure satisfactory solvency levels on the medium-term as well as a way to cover them: the 2016 recapitalisation measures (see section 2.5).

2.3.1. Description of the weaknesses of the Bank's business model as described in the Industrial Plan

(37) According to the information submitted by the Portuguese authorities, the Portuguese banking sector faces deteriorating market conditions since 2007 and the Restructuring plan failed to take this fully in to account. In hindsight, this failure to recognise the changing market conditions and the irresponsiveness by the Bank to those changing conditions did not allow for the restoration of the Bank's viability.

(38) According to the Portuguese authorities, the Restructuring plan assumed levels of GDP growth did not materialise, with deviations between the projected GDP growth levels and the actual growth levels for the years 2014 to 2016 being roughly 1%. Furthermore the Restructuring plan assumed that the Euribor rate would follow an upwards trajectory, when rates have steadily been decreasing since 2013.

(39) As stated in recital (37), CGD failed to take additional measures to restore viability while its competitors adapted their business models to the worsened economic situation. The Bank was particularly affected by the decrease in net interest income due to insufficient re-pricing and by the increase of cost of risk while cost reduction was slower than peers[16].

(40) CGD suffered structurally from a high cost of risk in the past five years[17] increasing significantly the NPL ratio.

(41) In terms of operational efficiency CGD is lagging behind its competitors and did not implement significant restructuring measures to rationalise its operations and decrease its cost basis contrarily to its competitors (see table 2). CGD has a number of FTE per branch in June 2016 ([10-20]) significantly higher than the average in the Portuguese banking market ([10-20]) which is in itself already higher than in neighbouring markets (e.g. around [5-10] in Spain)[18].

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[16] Industrial Plan, slide 11, CGD particularly affected in margin and impairments and with a slower effort on cost reduction.

[17] Industrial Plan, slide 10, CGD return on equity negative since 2011.

[18] Industrial Plan, slide 32, current workforce oversized relative to distribution network and above peers

Table 2: evolution of FTEs and branches in the Portuguese banking sector 2011-2015

Evolution 2011-2015	FTE	Branches
CGD	-10%	-16%
Millennium BCP	-25%	-24%
BPI*	-14%	-21%

BPI* reduced FTE by 8% in 2011 (2% for BCP and CGD)
Source: Industrial Plan, slide 34, CGD branch network restructuring lagging relevant competitors in the market.

(42) Similarly to the rest of the Portuguese banking sector, CGD suffered in the past years from the negative evolution of interest rates. As a significant part of the loan portfolio is being indexed on floating rates (in particularly the mortgage portfolio) this evolution of the interest rates has a potentially substantial impact on CGD's interest margin if it cannot adapt its funding costs accordingly. According to the information submitted by Portugal, the adjustment of the funding costs was too slow to maintain CGD's net interest margin at a satisfactory level. However, in 2015 and in the first half of 2016 CGD proceeded with a re-pricing of funding exceeding the decrease in interest income in the same period, thereby initiating the recovery of the net interest margin.

(43) According to the information submitted by Portugal, CGD also lags behind its peers regarding the commission and fee levels it achieves[19], especially in terms of commissions and fees for cards, transfers, credit and bankassurance.

2.3.2. Presentation of the Industrial Plan

(44) To address the weaknesses identified in recitals (37) to (43), the 2016 recapitalisation measures are accompanied by the Industrial Plan which foresees the restructuring of CGD until 31 December 2020 ("the implementation period") along the following pillars:

(a) strengthening of the risk management;

(b) adjusting the domestic operational infrastructure;

(c) restructuring international operations of the CGD group, and

(d) modernising the domestic commercial franchise[20].

(45) The main financial projections of the Industrial Plan are summarised in Table 3 below.

[19] Industrial Plan, version submitted on 9 September 2016, slide 58, partial improvement of commissions levels due to reduced commercial leakage.

[20] The domestic commercial franchise includes CGD S.A. and other domestic entities.

Table 3: Main financial projections of the Industrial Plan (the balance sheet and the income statement)

EUR million		2016	2017	2018	2019	2020
Domestic	Net interest income	[...]	[...]	[...]	[...]	[...]
	Banking income	[...]	[...]	[...]	[...]	[...]
	Risk costs	[...]	[...]	[...]	[...]	[...]
	Operating profits	[...]	[...]	[...]	[...]	[...]
	Net income	[...]	[...]	[...]	[...]	[...]
EUR billion		2016	2017	2018	2019	2020
Assets	Credit to clients	[...]	[...]	[...]	[...]	[...]
	Other credit	[...]	[...]	[...]	[...]	[...]
	Total assets	[...]	[...]	[...]	[...]	[...]
Liabilities	Central bank	[...]	[...]	[...]	[...]	[...]
	Deposits	[...]	[...]	[...]	[...]	[...]
	Debt securities	[...]	[...]	[...]	[...]	[...]
	Total liabilities	[...]	[...]	[...]	[...]	[...]
Equity		[...]	[...]	[...]	[...]	[...]

Source: Updated Industrial plan projections, slides 3 – projection of CGD consolidated results - and 4 – CGD consolidated balance sheet projections.

Risk management

(46) In relation to the new credit production, risk management will be strengthened by centralising credit decisions, digitalising and automating the underwriting process, as well as by introducing a dedicated monitoring system in the area of credit origination.

(47) In relation to the outstanding stock of credit exposures, CGD will implement a NPL management strategy that will be consistent with evolving supervisory requirements and will ensure the NPL ratio[21] will be below [10-15%] by 2020.

(48) Overall, the strengthened risk management is expected to reduce CGD's domestic cost of risk[22] from 109 bps in June 2016 to below [70-80] bps from 2017 onwards and below [60-70] bps in 2020.

(49) CGD will ensure a better risk control of its securities portfolios. To ensure this strengthened risk control, Portugal undertook to implement specific guidelines and limits to minimise risks, e.g. the single name concentration risk, default credit risk and interest rate risk of its trading portfolio. The Bank will also introduce limits to sovereign exposures, even if these bear no regulatory capital requirement and cap financial assets held for trading.

(50) The Bank will also limit the growth of the domestic operations' securities book.

Adjusting the domestic operational infrastructure

(51) As part of the adjustment of the domestic operational infrastructure, CGD will reduce the number of branches and employees (FTEs), and will limit its cost base.

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21 The ratio of NPLs to total gross loans.

22 The ratio of credit impairments to credit exposure.

(52) The number of domestic retail branches will be reduced from an estimate of [650-700] at the end of 2016 to a maximum of [550-600] in 2018 and [450-500] in 2020.

(53) The number of domestic FTEs will be reduced from [9000-9500] at the end of June 2016 to a maximum of [7500-8000] in 2018 and [6500-7000] in 2020.

(54) Domestic employee costs, including bonuses but excluding restructuring costs, will decrease from EUR [500-550] million in 2015 to a maximum of EUR [450-500] million in 2018 and EUR [400-450] million in 2020. Total operating costs, including amortisation will follow the same trajectory and will decrease to a maximum of EUR [800-850] million in 2018 and EUR [750-800] million in 2020.

Restructuring the international operations of the CGD group

(55) To simplify its international portfolio, the CGD group will focus and further develop assets only in specific geographies such as […], whilst reviewing the business models and governance of such international operations to ensure a strict oversight of those entities.

(56) Other international operations will be either divested or wound down by […]. Notably, CGD group will either divest or wind down subsidiaries in […], as well as branches and representative offices in […].

(57) Overall, CGD group will reduce its international portfolio to EUR [10-15] billion (excluding the transfer of portfolios related to domestic activities) and its equity invested in the international portfolio to EUR [0-5] billion by […].

Modernising the domestic commercial franchise

(58) The domestic commercial franchise will be modernised. CGD will increase the share of its net commission income (in percentage of business volumes of domestic operations) from [0-1] in 2015 to a minimum of [0-1] in 2018 and [0-1] in 2020.

(59) Interest margins realised on each product in the credit to customer's portfolio will be adjusted with the view to increase profitability.

2.4. Presentation of the list of targets

(60) Based on the Industrial Plan, Portugal committed to a list of targets including all measures described in recitals (46) to (59).

(61) Portugal committed to respect the list of targets, which will be monitored throughout the implementation period by a third party. This third party will submit reports to the Portuguese authorities, which will be forwarded to the Commission.

(62) On top of the described targets, the list of targets also includes a specific section on adjustment mechanisms and the strengthening of the governance model.

Adjustment mechanisms

(63) In case results diverge from the financial target presented in Table 4 below, CGD will rapidly take all necessary measures to achieve them

Table 4: financial targets triggering the implementation of additional restructuring measures

Targets	2017	2018	2019	2020
Net interest income (domestic)	[…]	[…]	[…]	[…]
Gross recurrent operating income (domestic)	[…]	[…]	[…]	[…]
Cost to income (domestic)	[…]	[…]	[…]	[…]
Return on equity (consolidated)	[…]	[…]	[…]	[…]

(64) In addition, if it is crucial to strengthen the capital of CGD in case of divergence from the targets presented in Table 4 likely to lead to capital needs or to ensure the distribution of dividends or to cover additional capital shortfall, CGD will divest additional foreign assets. Divestment should be made within […] months of establishing the divergence of the Bank's performance from the targets and in size according to the deviation, if no other corrective measures are deemed enough to re-establish CGD's performance.

(65) Moreover, Portugal also committed that CGD will examine the feasibility of the sale of […] and that it will test the market […], with the aim of having the option to sell those assets if needed.

Strengthening the governance model

(66) The list of targets includes a specific section on governance, to ensure that CGD's decisions are taken on purely commercial grounds and that Portugal does not exert any influence on the day-to-day operational management of CGD.

(67) Notably, during the Industrial Plan implementation period, CGD's Chief Executive Officer will be a person having senior experience from the private financial sector.

(68) In addition, CGD's Board of Directors will be composed of experienced senior executives or business leaders, with not more than two non-executive members of the Board being civil servants.

(69) The management team of CGD will be supported by the following committees: the Executive Committee, the Audit Committee, the Risk Committee, the Nominations, Assessment and Remuneration Committee, and the Corporate Governance Committee.

2.5. Description of the 2016 recapitalisation measures

Determination of the capital needs

(70) Solvency will be strengthened with the triple objective of (i) restoring the solvency levels of CGD on a fully loaded basis from [5-10%] CET1 ratio as of 3Q 2016 to a target CET1 ratio of [10-15%] based on 2020 expected RWA, (ii) booking impairments losses following the fair evaluation of the loan and securities book and the pension fund actuarial rate revision (iii) covering the restructuring costs and loss on divestures[23] to ensure a smooth implementation of the Industrial plan.

(71) After having taken office on 1 September 2016, the management team immediately launched, with the support of external auditors, an assessment of the value of the loan portfolio. That exercise was finalised by the new management that took office in CGD in February 2017. According to this assessment the

[23] Sales of foreign assets should result in losses amounting to EUR [350-400] million (Updated Industrial Plan projections, slide 1).

estimated value of additional impairments to be recognized on a consolidated basis is EUR 2.85 billion. The impact of the revision of the pension fund actuarial rate was estimated at EUR [0-0.5] billion

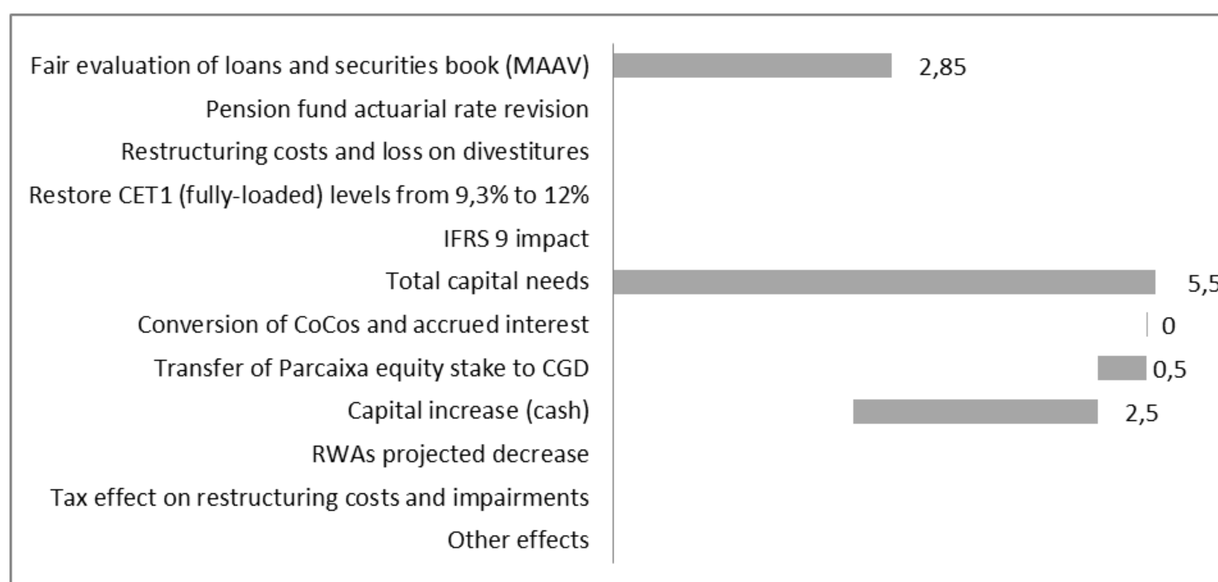
(72) The restructuring costs and losses on divestures were estimated at EUR [0-1] billion

(73) Finally, to evolve from the current solvency level of [5-10%] (fully loaded CET1 ratio as of 3Q 2016) to the target of [10-15%] on a fully loaded basis would require additional capital in the amount of circa EUR [0-5] billion (at the expected 2020 RWA)[24].

(74) Consequently, the total capital needs amount to around EUR [5-10] billion.

(75) According to the Industrial Plan, the capital needs will be covered by (i) the RWA reduction due to deleveraging for a total amount of EUR [0-0.5] billion (ii) a positive tax effect for EUR [0-1] billion [25], (iii) other effects including in particularly the expected future profits for EUR [0-5] billion and (iv) by the 2016 recapitalisation measures described in the section below.

Graph 1: CET1 fully-loaded evolution effects (EUR billion)



Source: Updated Industrial plan projections, slide 'CET1 fully-loaded evolution effects'.

Detailed description of the 2016 recapitalisation measures

(76) The State as sole shareholder of CGD approved on 4 January 2017 simultaneously:

(a) The transfer of shares of Parcaixa Holding SGPS, S.A. ("Parcaixa") owned by Parpública Holding's (100% State owned) to CGD (measure A), reducing the capital needs of CGD by EUR 0.5 billion, and;

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[24] Out of which EUR 0.5 billion are coming from the deduction of minority shareholding of Parcaixa Holding SGPS, S.A. ("Parcaixa") owned by Parpública Holding's (100% State owned) due to the implementation of Article 84 of 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 (“Regulation 575/2013”).

[25] Mostly due to the creation of deferred tax assets following the booking of impairments. Those newly created deferred tax assets are not part of the special regime approved by Law 61/2014 of 26 August 2014 and therefore do not enjoy any guarantee by the State.

(b) The transfer of the CoCos (including accrued interest) held by Portugal to CGD and corresponding immediate cancellation (measure B) without any impact on the capital needs of CGD.

(77) Measures A and B allowed CGD to increase its share capital from EUR 5.9 billion to EUR 7.344 billion, which was immediately followed by a decision to reduce the share capital increase by EUR 6 billion to increase the distributable items by the same amount.

(78) Following the increase of the distributable items to the required level, CGD will issue at least EUR 500 million of Additional Tier 1 ("AT1") instruments to be subscribed fully by investors not related to the Portuguese State (measure C).

(79) Provided that the AT1 issuance is successful, the State will subscribe to CGD's capital increase in ordinary shares for an amount of up to EUR 2.5 billion (measure D). Measures C and D are expected to take place shortly after the adoption of the present Decision. The Portuguese State will thus approve and subscribe the share capital increase. Even though Portugal acknowledges that no capital increase by the State can take place without the effective placement/settlement of the AT1 instruments, the Portuguese authorities foresee two possibilities to underwrite the capital increase:

(a) The capital increase resolution and the subscription of the shares are conditional on the successful placement/settlement of the AT1 instrument within a defined period of time; neither the resolution nor the subscription are effective until placement of the AT1 instruments and both are automatically cancelled should the AT1 instrument not be placed within the defined period of time, or;

(b) Both the capital increase resolution and the subscription of the shares are performed after binding commitments have been obtained from private investors for the AT1 instruments. The physical and financial settlement of the AT1 instruments takes place one-two days after the completion of the share capital increase.

(80) If the first AT1 issuance is less than EUR 930 million, a second AT1 issuance, will be done in the 18 months following measure C to be subscribed fully by private investors to bring the total amount of AT1 instrument to at least EUR 930 million (measure E).

(81) Measures A, B, C, D and E are referred as the 2016 recapitalisation measures. The present decision concerns those five measures as well as the proposed changes to the commitments of the 2013 Restructuring decision.

(82) Following the completion of the recapitalisation, the State will remain as the 100% shareholder of CGD.

Table 5: Summary of the different recapitalisation measures

2016 recapitalisation measures		
A	Transfer of Parcaixa's shares to CGD	EUR 500 million
B	Conversion of CoCos	EUR 945 million
C	Issuance of AT 1	At least EUR 500 million to EUR 930
D	Share capital increase	EUR 2 500 million
E	Issuance of AT 1	Measures C and E will at least amount to EUR 930 million

3. POSITION OF THE PORTUGUESE AUTHORITIES

3.1. Absence of State aid

(83) The Portuguese authorities notified the 2016 recapitalisation measures accompanied by the Industrial Plan and the list of targets to the Commission

(84) Portugal considers that the 2016 recapitalisation measures do not constitute State aid either individually or taken as a whole.

Individual operation rationale

(85) With respect to measure A, this operation essentially consists of a parent company consolidating its holding positions. According to Article 84 of Regulation 575/2013, banks have to phase-in deductions to CET1 of minority interest in subsidiaries for consolidated regulatory capital ratio purposes. The current shareholding structure of Parcaixa, which is indirectly (through Parpública Holding) 100% owned by the same shareholder, the Portuguese State, is leading to an increase in the overall capital needs of CGD. According to the Portuguese authorities, any private shareholder in the same situation (i.e. owning 100% of the parent company and having a direct shareholding in a subsidiary of that company) would hand over to the parent company the shareholding it directly owns in Parcaixa. Indeed, such transfer avoids the increase in CGD's regulatory capital requirements, whilst maintaining the same economic interest in Parcaixa (i.e. the State would continue to own 100% of CGD, which in turn would own 100% of Parcaixa).

(86) With respect to the outstanding CoCos (measure B), according to the Portuguese authorities, the exchange of these instruments for CGD shares is equally an operation that would be carried out by a private bond holder in the context of an impending share capital increase. According to the Portuguese authorities, if the CoCos exchange and cancellation does not occur, this reduces the likelihood of a successful recapitalization both due to the higher amount of new money needed and to the uncertainty on the level of dilution the new investor may face in case of a future automatic conversion of CoCos (in June 2017). An unsuccessful recapitalization of CGD may hence imply conversion of the CoCos at terms not under the control of the CoCos holder or bail-in under a resolution. In order to avoid this risk, the Portuguese authorities conclude that CoCos holders would be willing to swap immediately these for shares.

(87) Regarding the sequencing of the recapitalization operations, the Portuguese authorities consider that private CoCo (or private bond) holders in the same situation would accept to exchange their position for shares before the share capital increase in cash if (i) the price per share (at the exchange) is in line with the price per share of the capital increase in cash (as mentioned above) and (ii) the likelihood of success of that capital increase is high:

(a) Regarding (i), in the case of CGD, the Portuguese State has full assurance that the exchange of CoCos will be carried out at the same price per share as the capital increase to avoid any dilution. In terms of guarantees against shareholder dilution, pursuant to Portuguese law and CGD's by-laws, the Portuguese State, in its capacity as the sole shareholder of CGD, is the only entity that may resolve on the terms and conditions of any future share capital increase.

(b) Regarding (ii), the Portuguese authorities have already received a letter from a global investment bank with a positive assessment regarding the chance of success of the AT1 issuance. As this is the only operation dependent on participants external to the Portuguese State, the likelihood of success of all the other operations is in the hands of the Portuguese authorities themselves. A copy of this letter was submitted to the Commission on 25 November 2016.

Impact of deferred tax assets ("DTA") conversion

(88) Given that the one-off impairments that result from the asset value assessment exercise will be recognized on the Bank's Profit and Loss statement of the fourth quarter of 2016, CGD is expected to report a loss in the accounts of the full year 2016. The projected 2016 negative result will lead to the automatic conversion into fiscal credit of approximately EUR [450-500] million of DTA arising from temporary differences and protected by the Portuguese special regime under the law 61/2014[26]. Simultaneously, a special reserve of 110% of the fiscal credit amount will be created on behalf of the State ("Fiscal State" entity).

(89) According to the Portuguese authorities, the "Fiscal State" entity can become a shareholder of the Bank, and as such may dilute the existing shareholder position. Measure D will occur after the creation of the fiscal entity and therefore the return of this investment of this measure is unaffected and remains significantly above the cost of capital, as detailed below.

(90) It should also be noted that in this case, at all steps of the process the Portuguese State will remain the owner of 100% of CGD.

Risk that CGD has to make large payments to the Portuguese Resolution Fund

(91) The Portuguese Resolution Fund has a large debt due to among others the resolution of Banco Espírito Santo and Banco Internacional do Funchal. If the Portuguese banks had to pay a large extraordinary contribution immediately or in a short time frame to allow respectively an immediate or rapid repayment of this large debt, such an extraordinary contribution would represent a high cost for the banking sector, including CGD, increasing its capital needs and lowering its

[26] Law 61/2014 of 26 August 2014 approving the special regime applicable to deferred tax assets.

expected profitability. Regarding this risk, Portugal claims to have removed uncertainty regarding the future contributions by its banking sector to the Portuguese Resolution Fund. According to Portugal, no extraordinary contribution will be required from the banks to repay Portugal's loans to the Portuguese Resolution Fund in a single instalment. To that end, the maturity of Portugal's loans to the Portuguese Resolution Fund will be extended, so that the annual contributions by banks to the Portuguese Resolution Fund, that is the regular contributions and the banking sector contributions, remain at their current level. It is without prejudice to the contributions by banks to the Single Resolution Fund in accordance with relevant EU law. In addition, the interest rate of Portugal's loans to the Portuguese Resolution Fund will be indexed to the interest rate of Portuguese sovereign debt instruments and will be updated periodically, in a manner appropriate to the instrument used for the indexing. According to Portugal, the interest rate of Portugal's loans to the Portuguese Resolution Fund will therefore reflect the evolution of Portugal's own cost of financing and will ensure solvency of the Portuguese Resolution Fund.

Overall recapitalisation attractiveness

(92) According to the estimates of the Portuguese authorities, the internal rate of return of the operation for a private investor is [10-20%] when considering a value of the bank pre-recapitalisation (2017) at [0-1] and considering that the bank's value is worth at [0-5] in 2020. The implied valuation for CGD in 2020 would, according to the authorities, reflect an increase in the price-to-book ratio consistent with CGD's stronger balance sheet and improved profitability prospects that result from the execution of the Industrial Plan.

(93) The Portuguese authorities also developed a more conservative scenario with an entry price-to-book ratio of [0-1] in line with where best practice European banks currently stand. In this scenario the internal rate of return would amount to around [5-10%]

(94) On the other hand, assuming an entry price-to-book ratio of [0-0.5] as per public information based on recent capital market transactions done in the Portuguese financial sector, and [0-5] in 2020, the Portuguese authorities estimate that the internal rate of return would stand at [20-25%].

3.2. Compliance with the existing 2013 Restructuring plan and commitments

(95) The notification by the Portuguese authorities includes also a request for amendments to:

(a) the Restructuring plan;

(b) commitment 6.6, Remuneration of bodies and employees; and

(c) commitment 6.7, Ban on dividend, coupon, and interest payments;

that were issued in the framework of the procedure leading to the 2013 Restructuring Decision and annexed to that decision.

Restructuring plan

(96) According to Portugal's notification, the last quarters of the Restructuring plan (which ends at the end of 2017) will be superseded by the list of targets and supported by the Industrial Plan. This will be done without affecting the commitments made by Portugal under the 2013 Restructuring Decision, except if

those commitments are superseded by the list of targets assumed in the current decision.

(97) Portugal considers the Industrial Plan to be more ambitious than the Restructuring plan and therefore does not consider the new Industrial plan to be in breach of Portugal's commitments under the 2013 Restructuring Decision.

Remuneration of bodies and employees

(98) Portugal committed to ensure until end 2017 a restriction on the remuneration of bodies and employees (commitment 6.6) in the 2013 Restructuring Decision. As stated in recital (95), Portugal has requested an amendment to the restrictions on the remuneration of bodies and employees.

(99) By commitment 6.6 Portugal committed to continue enforcing the applicable legal regimes covering the remuneration policy of credit institutions in CGD. Portugal also committed to continue enforcing Decree-Law 71/2007 of 27 March, which establishes the regime of the statute of the State controlled companies' board members.

(100) Portugal considers that the constraints on remuneration of CGD's corporate bodies laid down in Decree-law 71/2007 of 27 March applied solely to CGD, as opposed to the restrictions that apply generally to credit institutions. Portugal therefore considers that these restrictions must be eliminated in order for CGD to be able to attract and retain qualified and talented professionals under the same conditions as its competitors.

(101) Portugal considers that the implementation of CGD's Industrial Plan is based on the grounds that CGD is allowed to operate in the market as any other privately owned bank, competing with the remaining operators on a level playing field whilst maintaining its 100% ownership by the state. Portugal has therefore amended Decree-Law 71/2007 of 27 March 2007 by Decree-Law 39/2016 of 28 July 2016, to ensure the remuneration caps of Decree-Law 71/2007 is removed before the appointment of the new management team in September 2016. Pursuant to the new law, the regime set out in Decree-Law 27/2007 does not apply any more to those individuals which are appointed to the corporate body entrusted with the management function of credit institutions which belong to the State and which are qualified as "significant supervised entities" in the meaning of point 16) of Article 2 of Regulation (EU) 468/2014.[27]

(102) More recently, following the approval of Law 37/XIII (the 2017 Budget Law), that has entered into force on 1 January 2017, CGD's employees and corporate bodies members will have no longer salary and compensation restrictions. At the same time, managers will still be bound by transparency, exclusivity and criminal, civil and financial liability requirements as Articles 18 to 25, 36 and 37 of Decree-Law 71/2007 remain applicable.

(103) Moreover, Portugal states that the Industrial Plan is based on the premise that CGD is to operate in the market as any other private bank. Thus the new

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[27] Regulation (EU) 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation), OJ L 141, 14.5.2014, p.1.

remuneration policy is no longer subject to the restrictions of the Decree-Law nr. 71/2007 of 27 March, as amended.

(104) Portugal states that all other legal regimes mentioned in commitment 6.6 remain applicable.

Ban on dividend, coupon and interest payments

(105) In the notification leading to the 2013 Restructuring Decision, Portugal committed to ban until the end of 2017 all dividend, coupon and interest payments to holder of preference shares and subordinated debt, in so far as those payments are not owed on the basis of contractual or legal obligations (commitment 6.7).

(106) Portugal considers it would not be possible to issue the AT1-instruments (Measures C and E) without an anticipated termination of commitment 6.7.

(107) According to information submitted by Portugal in the process of preparing the draft notification, dated 14 October 2016, the terms and conditions of the outstanding Upper Tier 2 instruments also state that a payment of coupon on the AT1-instruments would trigger an obligation to pay coupons on all of the remaining subordinated debt instruments[28].

(108) In its submission dated 14 October 2016, Portugal included an assessment of the total payments CGD would have to undertake to allow for measures B, C and E. According to Portugal's submissions in preparation of the notification, CGD would have to pay less than EUR [5-10] million. This amount is the additional payment to be made by CGD, on top of the dividend, coupon and interest payments for which there is no discretion on the basis of contractual or legal obligations and which therefore are anyway taking place under the existing Commitment.

(109) Portugal therefore requests the anticipated termination of commitment 6.7 of the 2013 Restructuring Decision.

4. ASSESSMENT

4.1. Existence of aid – Application of Article 107(1) TFEU

(110) Article 107(1) TFEU provides that 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, insofar as it affects trade between Member States, be incompatible with the internal market.

State resources

(111) As regards measures A, B and D, they concern investments made by Portugal, therefore they are to be considered as involving State resources within the meaning of Article 107(1) TFEU.

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[28] Response to DG COMP's questions on recapitalisation and notification preparation, dated 14 October 2016 "*All arears of Interest shall become due in full on whichever is the earliest of (i) the date on which any dividend or other distribution is next declared, paid or made on any class of stock or share capital of the Issuer, or, in the case of CGDF as issuer, the Guarantor, (ii) the date set for any repayment permitted under Condition 6 (c) or (d) and (iii) the commencement of winding up of the Issuer, provided that in the case of (i), (ii) or (iii) notice shall be given to the holders of Undated Subordinated Notes in accordance with Condition 16.*"

(112) As regards measures C and E, as described in recitals (78) and (80) they are fully private. They do not involve the use of any State resources and, therefore, are considered not to be State aid.

Advantage – market economy investor principle and private creditor test

(113) The EU legal order is neutral with regard to the system of property ownership, that is, it does not prejudice the right of Member States to act as economic operators.[29]

(114) However, under EU State aid rules, it is necessary to assess whether economic transactions carried out by public bodies (including public undertakings) are in line with market conditions, so as not to confer an advantage on its counterpart.[30] This principle has been developed with regard to different economic transactions. When public authorities make injections in the capital of a given undertaking, the Commission examines whether the State's behaviour in making the investments under consideration was in line with the market economy investor principle ("MEIP").[31] Similarly, behaviour of a public creditor is compared to that of a hypothetical private creditor in a similar situation, in line with the private creditor test.[32]

(115) The Commission will assess whether a market economy investor would have provided measures A and D under the same conditions as the State.

(116) Given that measure B concerns the conversion of a hybrid instrument already held by the State (having the features of both equity and debt), the Commission will also assess whether a private creditor would have provided measure B.

4.2. Assessment of measure A under the MEIP

(117) Measure A is part of a recapitalisation process developed by the management of the Bank at the request of its shareholder and based on a new Industrial Plan. As assessed in the section 4.3, the Industrial Plan represents a robust basis to restore the profitability of CGD and for a successful recapitalisation.

(118) Due to the implementation of Basel III rules as transposed in Article 84 of Regulation 575/2013, minority shareholding from subsidiaries will be progressively excluded from regulatory capital. The implementation of this rule will, for Parcaixa alone (which is 51% owned by CGD and 49% owned by Parpública Holding), decrease the capital of CGD by EUR 0.5 billion.

(119) In a similar situation, a private investor owning both 100% of a bank and the minority shareholding of a subsidiary of that bank would have a strong incentive to rationalise its investment and to transfer the shares of the subsidiary to the bank. In the absence of a transfer of such transfer, the investor would either have to inject additional capital in the bank, i.e. putting additional money at risk without increasing its return, or accept a dilution of its shareholding leading to a loss of control and the split of the profits of the bank. A private investor would therefore prefer transferring the shares of the subsidiary to the bank.

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[29] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Function of the European Union ("Guidance on the notion of aid"). OJ C 262, 19.7.2016, p. 17, paragraph 73.

[30] Guidance on the notion of aid, paragraph 74.

[31] Ibid.

[32] Ibid.

(120) In addition, the transfer of Parcaixa's shares (held by the State through Parpública Holding) to CGD did not increase the accounting equity of CGD at a consolidated level (i.e. equity including minority interests)[33].

(121) A private investor, confronted with a similar situation as the State (being a shareholder of the Bank and the only minority shareholding of a subsidiary of the Bank), would transfer the shares to the Bank. Therefore, the transfer of Parcaixa's shares, owned by Parpública Holding, to CGD is in line with the MEIP.

4.3. Assessment of measure B under the private creditor test and measure D under the MEIP

(122) Contrary to measure A, measures B and D entail increased risk for the State, respectively through conversion of an hybrid capital instrument into equity and through the injection of additional equity in CGD. A private creditor or investor would accept to implement those measures only if that additional risk is sufficiently remunerated.

(123) In sections 4.3.1 and 4.3.2, the Commission will assess, respectively, if the operational restructuring, the determination of the Bank's capital needs and the proposed way to cover them, as presented in the Industrial Plan, are based on robust and prudent assumptions under which an investor would take a similar investment decision.

(124) Based on the assessment in sections 4.3.1 and 4.3.2, the specific situation of the State as existing CoCo holder of CGD will be analysed in section 4.3.3.

(125) Finally, in section 4.3.4, the Commission will assess the return on investment relating to measures B and D.

4.3.1. Assessment of operational restructuring envisaged in the Industrial Plan

(126) The starting point of the Industrial Plan is a diagnosis of the Bank's deficiencies. The Industrial Plan identifies the Bank's underperformance both in the core domestic banking activities, including in the risk and NPL management, and in relation to foreign assets (see section 2.3.1). The main conclusions, supported by benchmarking against the performance of other banks, are that CGD's weaknesses are explained by unsatisfactory risk and NPL management, inadequate pricing, leading to a structurally too low net interest margin, and a lack of active restructuring measures when business environment deteriorates unexpectedly.

(127) The Industrial Plan is based on prudent macroeconomic assumptions. For instance, it is expected that Euribor rates will remain negative until 2019, reaching only 0.03% in 2020[34]. Annual growth of GDP is expected to remain stable at 1.5% for the years 2018 to 2020[35].

(128) To address the high cost of risk (i.e. high loan losses) of the recent years, the Industrial Plan entails reinforcement and centralisation of risk management and lending decisions (see recital (46)). Lending to large corporations and for

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[33] The transfer increased the share capital and decreased minority interests by the same amount, so the overall impact on the accounting equity of CGD at a consolidated level was neutral.

[34] Industrial Plan, slide 53, Prudent macroeconomic scenario with maintenance of low interest rates underlying industrial plan

[35] Ibid.

financing of commercial real estate will be reduced. The management of the outstanding stock of NPL will be improved (see recital (47)). CGD will implement a prudent investment policy and reduce the securities portfolio to decrease its exposure. CGD will also implement all recommendations and requirements of the European Central Bank regarding NPL management (both sector-wide and bank specific), having in mind that those recommendations and requirements are getting more demanding and more detailed.

(129) Regarding the inefficiency of domestic operations, the Industrial Plan provides for ambitious targets regarding the rationalisation of domestic operations, with some [25-35%] reduction of FTEs (for banking activities) and branches between June 2016 and end-2020 (see recitals (52) and (53)). Those restructuring measures are ambitious and should allow CGD to efficiently compete on the Portuguese market. Administrative costs are expected to decrease by the same percentage as the number of FTEs, with a one year lag. The proposed cost reduction relating to the domestic operations of CGD appears to be in line with the requirements of a private investor seeking to restore market-conform profitability of CGD.

(130) As described in recital (91), Portugal removed uncertainty regarding the future contributions by banks, including CGD, to the Portuguese Resolution Fund. If the debt of the Portuguese Resolution Fund would have had to be repaid by the banks by a one-off contribution, the contribution of CGD would have amounted to more than EUR 1 billion. The fact that the debt has been transformed into long-term debt provides the necessary comfort that a private investor would have sought before making an investment decision. A one-off levy on the banks to repay the entire debt of the Portuguese Resolution Fund would have threatened the expected profitability of a new equity investment in CGD.

(131) The commercial franchise of CGD will be modernised. Mainly due to […], CGD expects to increase its revenues from commission income, to bring them from [0-1%] of business volume in Portugal in 2015 to [0-1%] in 2020. The latter level is more comparable to CGD's peers and appears to be achievable.

(132) Regarding loans, the Industrial Plan projects a modest increase in CGD's market shares in Portugal […]. At the same time, the Industrial Plan provides for deleveraging in lending to large corporates and for commercial real estate.

(133) Pricing of loans will also be adjusted, to better reflect the risk of the debtor and to ensure that CGD generates a sufficient interest margin at a time when Euribor is slightly negative. The fact that Euribor is negative is a challenge for CGD, as its cost of deposits (which is lower than Euribor in a positive interest rate environment, but higher in a negative environment) will be higher than usual relatively to the interest rates charged to customers. Those pricing adjustments are crucial for CGD to return to profitability and therefore are in line with the requirements of a private investor.

(134) The Industrial Plan aims at focusing the international operations on a few selected countries, by either selling or winding down a […] part of the foreign network (see recital (57)). The total international portfolio will be reduced and amount to a maximum of EUR [10-15] billion of assets in 2020 and EUR [0-5] billion of equity. This will ensure CGD's exit from subscale foreign operations which are unable to deliver a sufficient return. In addition, this will result in a simpler international portfolio, with lower risks, and encourage a greater focus on restoring

the profitability of core operations in Portugal. CGD will also develop a comprehensive strategy for the retained foreign entities and examine the feasibility of divesting large foreign assets not initially included in the divestment perimeter by […] at the latest, regularly testing the market […].

(135) This refocusing and the divestment of entities in non-strategic geographies are in line with the requirements a private investor would set: […]. Finally, the divestment of those foreign subsidiaries, even if the expected sale price is below their current book value, will significantly decrease the RWA of the Bank, helping to reduce CGD's capital needs.

(136) The Commission observes that the Industrial Plan is not based on acquisitions, which will allow the new management team to focus on delivering the ambitious and challenging internal restructuring envisaged in the Industrial Plan, which requires full attention and dedication by the management.

(137) As CGD did not restore its profitability despite implementing the Restructuring plan approved in 2013, a private investor would verify whether the Industrial Plan is more solid and comprehensive than the Restructuring plan. In other words, a private investor would try to ensure that the Industrial Plan has a much higher probability of restoring market-conform profitability of CGD. The Commission recalls that the aid amount received by the Bank in 2012 amounted to slightly more than [0-5%] of its RWA and was therefore relatively small, not triggering the requirement to implement an in-depth restructuring. The Commission also recalls that the economic growth of Portugal has surprised on the downside during the implementation period of the Restructuring plan. Importantly, the Industrial Plan is based on a deeper analysis of the situation of the Bank, a benchmarking against corresponding performance indicators of other Portuguese banks, and it envisages much deeper operational restructuring. Moreover, the Industrial Plan is not a static plan in a sense that it provides for an adjustment mechanism in case the income projections deviate to the downside.

(138) Indeed, that mechanism, described in recital (63), ensures rapid adjustment of the Industrial Plan if the Bank is confronted with a deteriorating environment and misses its income and profitability targets. The adjustment mechanism is also used to anticipate future capital needs. This is consistent with the behaviour of a private investor who, in similar circumstances, would try to restore profitability and reduce the future capital needs of the Bank by taking additional internal restructuring measures rather than raising capital externally, which would dilute his shareholding and the value of his investment.

(139) Finally, compared with the past (including the period of implementation of the Restructuring plan), the governance of CGD will be deeply reviewed. As a first step, an experienced management team was appointed on 1 September 2016, followed by a new management team in early 2017. As described in recitals (66) to (69), the board of directors will be composed of experienced senior executive or business leaders and will be supported by adequate committees, which are necessary for a successful implementation of the Industrial Plan. The cap on the number of civil servants in the Board of the Bank will help to ensure the independence of the management of the Bank from political interference. These changes are important, as private investors would not invest if they do not have sufficient guarantees that the Industrial Plan can be implemented, i.e. if they do not

have sufficient guarantees about the quality and the independence of the management.

(140) In conclusion, the Industrial Plan correctly identifies the weaknesses in the operations of CGD and includes an ambitious and robust roadmap to address them. The operational restructuring envisaged in the Industrial Plan appears to be in line with what would be required by a private investor.

4.3.2. Assessment of the calculation of the capital needs and of the envisaged recapitalisation measures

(141) A private investor, being either an existing shareholder of CGD or an external investor contemplating the purchase of the new shares to be issued by CGD, would find a capital plan credible if the capital needs of the Bank are correctly calculated and if the proposed way to cover them are appropriate. A private investor would notably try to minimise the amount of new equity to be raised, by generating capital through internal measures and by raising capital instruments other than equity, i.e. ordinary shares.

(142) As described in recital (70), the Industrial Plan identifies three sources of capital needs: (i) the funding of restructuring costs ([…]), for a total of EUR [0-5] billion [36], (ii) the need to increase the capital ratio of the Bank to reach a fully loaded [10-15%] CET1 ratio (based on June 2016 CET1 and expected 2020 RWA), for EUR [0-5] billion (before implementation of measure A) and (iii) the need to book additional impairments due to structural under-provisioning in the past, for an amount of EUR [0-5] billion as well as the impact of the revision of the pension fund actuarial rate for EUR [0-0.5] billion.

(143) Regarding the amount of additional impairments, they directly result from the management's more conservative judgement regarding how much the Bank will be able to recover from the existing NPLs and regarding the need to impair some loans not impaired until now. The final amount will be validated by the Bank's auditors.

(144) Regarding the target CET1 ratio of [10-15%] based on June 2016 CET1 ratio and 2020 RWA allows the Bank to meet its 2017 capital requirements according to the draft Supervisory Review and Evaluation Process decision[37] and to be in line with expected future capital requirements. In addition, it appears to be in line with current market practices of prudent banks.

(145) In conclusion, CGD's capital needs, as envisaged in the Industrial Plan, seem to be calculated in a correct manner.

(146) Regarding the proposed way to cover those capital needs, it has already been concluded in section 4.2 that the transfer of the Parcaixa's shares would have been considered by a private investor in the same situation.

(147) Regarding other envisaged capital generating measures, the Commission notes that, as assessed in section 4.3.1, the Industrial Plan is based on realistic assumptions and includes significant efforts to reduce the capital needs of the

[36] Industrial Plan, slide 70, CET1 fully loaded evolution effects.

[37] According to the draft SREP decision sent by Portugal, total capital requirements should amount to [10-15%] for 2017 (and CET1 requirements to [10-15%] including guidance).

Bank by internal measures for an amount of EUR [0-5] billion (including EUR [0-0.5] billion due to decrease of RWA and EUR [0-1] billion to tax effects).

(148) No other internal measures seem immediately available to cover the residual capital needs of EUR 2.5 billion.

(149) Therefore, a private investor would also consider that CGD needs a capital injection of up to EUR 2.5 billion in the form of CET1.

(150) It seems therefore that the proposed approach to cover the capital needs fulfils the requirements of a private investor, since it minimises the amount of new equity by first taking internal capital generating measures.

(151) Importantly, a private investor considering an investment in the new ordinary shares of CGD would also take comfort from the envisaged issuance of AT1 instrument, taking place in parallel with the issuance of new ordinary shares. That issuance of AT1 will build a buffer, reducing the likelihood that CGD will have to raise new equity in the future and in this way dilute existing shareholders.

(152) The progressive implementation of the Directive 2014/59/EU[38] will increase minimum requirements for own funds and eligible liabilities, to be used to absorb losses and recapitalise institutions in case of failure. AT1 instruments are such eligible liabilities. Assuming that CGD is able to successfully issue AT1 instrument, it increases the likelihood that CGD will be able to meet future requirements of Directive 2014/59/EU, without having to issue new ordinary shares.

(153) Moreover, capital requirements set by the regulator are made of both CET1 requirements and higher total capital requirements. Without capital instruments other than ordinary shares, CGD would be forced to cover any increase in the total capital requirements entirely with CET1 capital made of ordinary shares. Assuming that CGD is able to successfully issue AT1 instrument, it increases the likelihood that CGD will be able to meet future total capital requirements, without having to issue new ordinary shares. The successful issuance of AT1 would therefore reassure a private investor considering an investment in the new ordinary shares of CGD.

(154) In conclusion, the calculation of the capital needs and the proposed way to cover them are in line with the requirements of a private investor.

4.3.3. Assessment of the measure B under the private creditor test

(155) The CoCos were granted in the framework of the 2012 recapitalisation measures which were assessed as being State aid.

(156) To be able to apply the private creditor test, measure B will first be assessed as if the existing CoCo holder was a different investor from both the existing shareholder and the new investor.

[38] 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.

(157) As explained in recital (86), if the existing holder of the CoCos decides to refuse a voluntarily conversion of those instruments into ordinary shares, the successful recapitalisation of the Bank would be endangered. The anticipated mandatory future conversion of CoCos in June 2017 would present a deterring factor for any new potential investor in equity of the Bank, as the new investors would anticipate their forthcoming dilution in June 2017 under unknown terms.

(158) In such circumstances where CGD would have not been able to raise new capital because investors would anticipate future dilution due to the upcoming conversion of the CoCos, the risk that the Bank would need State aid and/or would be subject to resolution would increase significantly. In the latter two cases of State aid and/or resolution, the holder of CoCos would face a mandatory conversion of those CoCos into shares at less favourable terms, or a write down of the CoCos, due to the mandatory burden sharing relating to capital instruments under State aid rules or to the bail-in requirements under the resolution framework.

(159) In the absence of capital increase the CoCos could not be repaid at their maturity (30 June 2017). As described in recitals (32) and (33), the Bank was not able to repay the CoCos in 2014 and 2015 without endangering its chances of meeting the regulatory requirements. Taking into account the losses that will have to be accounted for in the results for 2016, the Bank would not have the financial means to repay the CoCos at maturity.

(160) In conclusion, if the CoCo holders refuse anticipated conversion of those instruments into shares, this will jeopardize the raising of new capital from the market, which in turn will increase the risk of high losses for the CoCo holders through forced conversion or a write down. This would create a strong incentive for private creditors holding the existing CoCos to accept that conversion.

(161) The Commission also observes that, in quite similar circumstances, private investors holding subordinated debt or even senior debt have voluntarily accepted to convert their debt instruments into new shares at a nominal value, in the framework of a capital raising exercise by banks, which also included the issuance of new shares to the market. This was for instance the case in the framework of the capital raising by the four systemic institutions in Greece at the end of 2015[39].

(162) Therefore, the Commission concludes that, in the same situation, a private CoCo holder would also accept to contribute to the recapitalisation and to convert their instruments at a nominal value into new shares if the new shares offer a market-conform expected return, as explained in section 4.3.4 below. Due to the risk of mandatory write-down or conversion explained in recitals (159), the CoCo holder would also potentially accept a lower return, however this scenario does not need to be assessed if the return on investment is sufficient for both measures B and D as assessed in section 4.3.4 below.

(163) Since a private creditor would accept this conversion even if it had no other investments in the Bank, there is no reason to doubt that a private operator would

[39] See recital 99 of Alpha Bank decision, recital 100 of Eurobank decision, see recital 138 of National Bank of Greece and recital 130 of Piraeus decision, respectively OJ C 129 12 April 2016, OJ C 142, 22 April 2016, OJ C 220 22 June 2016 and OJ C 104 18 March 2016.

accept the conversion if it had other investments in the Bank (as in the case of CGD).

Additional consideration regarding the timing of the CoCo conversion

(164) If measure B (the CoCo conversion) is necessary for the success of the other recapitalisation measures, it does not necessarily make sense in their absence. Therefore measure B should in principle be simultaneous with other recapitalisation measures or at least conditional to their success.

(165) In the present case, Portugal implemented measure B, together with measure A (the transfer of Parcaixa's shares), prior to implementation of measures C (the issuance of AT1) and D (the EUR 2.5 billion recapitalisation in the form of ordinary shares). Nevertheless, Portugal committed to implement measure D if measure C is successful. In addition, CGD provided the State with a letter from an investment bank preparing measure C, stating that the initial feedback received from the market for this AT1 issuance has been positive, and that the issuance is likely to be successful (see recital (87)(b)). This letter provides a sufficient guarantee that measure C can be successfully implemented.

(166) Under such specific circumstances, a private CoCos holder would therefore accept the slightly anticipated conversion of the CoCos (i.e. the conversion taking place before implementing other recapitalisations measures) as at the conversion date it is highly likely that the other recapitalisation measures will be successfully implemented later[40].

4.3.4. Assessment of the return on investment for measures B and D

(167) As described in recital (92), the Portuguese authorities estimate the yearly internal rate of return for the new investor (measure D) at [10-20%].

(168) In their estimate of the internal rate of return, the Portuguese authorities used the following assumptions:

(a) The CoCos are converted simultaneously with the transfer of Parcaixa's shares (measure A). They are converted at their nominal value including interests at a price to book ratio of [0-1] (i.e. the value of the Bank at the estimated value of the Bank before the two transactions is equal to the equity).

(b) The accounting loss for 2016, expected to be around EUR [0-5] billion is then booked. This triggers the conversion of part of the stock of DTA eligible under the special regime, namely EUR [450-500] million As a consequence the State, as tax authority, is expected to receive shares in the Bank based on end 2016 accounting value of equity diluting the CoCo holder.

[40] A private creditor would have accepted an anticipated conversion of its debt instrument into shares only if it has sufficient certainty that the conversion takes place based on a price per shares equal to the price per share at which the shares will be then issued on the market. In other words, it would probably ask a price adjustment mechanism, such that, if, in the framework of the capital raising on the market, the investors subscribe to the new shares at a lower price per shares than the one used for the earlier conversion of the debt into shares, it would receive additional shares. In the present case, such price adjustment mechanism was superfluous, since in any circumstances the State would end up owning 100% of the shares of CGD. Hence no price adjustment mechanism was introduced.

(c) The 2,5 billion are then injected assuming value of the Bank pre-recapitalization of [0-1] price-to-book, resulting in a shareholding of around [50-100%] for the "new investor " having put 2,5 billion[41];

(d) The dilution resulting from the DTA conversion in 2018 (which is the consequence of the accounting loss expected to be booked by CGD in 2017) is expected to be negligible due to the relatively limited size of the loss compared to the equity of the Bank and due to the decrease in the stock of DTA in 2016 and 2017.

(e) The final value of the Bank at end 2020 has been estimated at EUR [5-10] billion using a discounted cash flow model with a cost of equity of [10-15%] a perpetual growth rate of [0-5%] and the recurrent income of EUR […] million in 2020[42]. Based on the expected accounting equity at end 2020, this estimated value of EUR [5-10] billion is equivalent to the price to book value of [0-5].

(f) A [0-5] years investment/discounting period was applied, as the investment will take place in the first quarter of 2017 and the final value of EUR [5-10] billion has been calculated at the end of 2020.

(169) Portuguese authorities also simulated the expected return in case another entry price-to-book ratio is used. For instance, using an entry price-to-book ratio of [0.5-1] the Portuguese authorities estimate that the annual return on investment for the new investor will amount to [5-10%]. Assuming an entry price-to-book ratio of [0-0.5] Portuguese authorities estimate that the internal rate of return would amount to [20-25%].

(170) The Commission has analysed the assumptions and calculations used and made by Portugal.

(171) Measures B and D are expected to take place in the first quarter of 2017 while the final value is calculated at the end of 2020. Therefore, a [0-5] year period is acceptable to calculate the internal rate of return.

(172) A pre-recapitalization valuation of [0-1] price-to-book seems high for a bank having to raise a large amount of capital (compared to its existing capital) and having booked high losses in the previous six years. Consequently, a pre-recapitalization valuation of [0-1] price-to-book looks closer to market valuation for such type of situation. A price-to-book of [0-1] is, for instance, close to the average of the Italian market at the end of 2016 if we only take the loss-making banks into account[43] and higher than the price-to-book value of CGD's listed Portuguese competitor.

(173) Regarding the assumptions which seem optimistic, the Commission observes, first, that the Portuguese authorities estimate the final value of CGD to be around EUR [6000-10000] million at the end of 2020 on the basis of a discounted cash flow method. However, it seems more prudent to assume that the final value of CGD in

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[41] Updated Industrial Plan projections, slide 8, Scenario for IRR of "Private Investor".

[42] Ibid.

[43] Deutsche Bank Markets Research, European Banks Valuation Weekly, 9 January 2017 edition, available at: http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/3041-05BB/207274758/0900b8c08c4d7000.pdf.

2020 will not exceed the book value of CGD at that date, i.e. EUR [6000-10000] million. The latter already represents a significant increase in value, compared to pre-2017 investment assumed value of CGD (price to book ratio of [0-1] as indicated above). It can be noted that, just after measures B and D are implemented early 2017, the estimated price-to-book ratio of the Bank would be above [0-1], so a price-to-book ratio of [0-1] is not such a large increase in valuation as it may seem initially based on the [0-1] pre-recapitalization valuation. Also, given the fact that, under the Industrial Plan, CGD is expected to reach a return on equity of [5-10%] in 2020, an increase to a price to book of [0-1] at end 2020 looks realistic.

(174) A second assumption which has to be discussed is the terms of conversion of the CoCos (measure B). Due to the high valuation of the Bank before the implementation of measures A and B (book value equal to equity), the Coco holders get a small number of shares. The CoCo holder, now a shareholder of the Bank, is then subsequently diluted by the State as tax authority due to the DTA conversion and by the "new investor" injecting EUR 2.5 billion (measure D). As a consequence, the internal rate of return for measure B is significantly negative[44]. This raises the question whether measure B would have been accepted at such terms by private Coco holders and therefore whether measure B is in line with the private creditor test (see section 4.3.3). One of the corollary of giving less CGD shares to the converted Coco holders is that the "new investor" gets a larger shareholding and hence the expected return on investment of the EUR 2.5 billion (measure D).

(175) Given these two assumptions which look optimistic, the Commission has calculated the expected return on the EUR 2.5 billion new money if one assumes that the value of CGD at end 2020 will correspond to the accounting equity at that time (i.e. price to book ratio of 1) and, cumulatively, whether better conversion terms could be offered to the Coco holders (measure B) while not jeopardizing the expected return on the EUR 2.5 billion injection of fresh money (measure D).

(176) In that context, in combination with correcting the terminal value of the Bank at the end of 2020, the Commission has simulated a scenario where the nominal amount of Coco are converted into shares using a price per share equivalent to the price per share at which the EUR 2.5 billion are injected.

(177) Using as assumptions that measure B and measure D are made based on a value of CGD pre-recapitalisation of [0-1] times its equity, a [0-5] year period and a final value of EUR [6000-10000] million in 2020, the internal rate of return on measures B and D is estimated between [10-15%] and [10-15%] per year.

(178) Returns on the market are currently very low with a risk-free interest rate close to 0 (10-year German government bonds[45]). Moreover, based on prudent assumptions, the Industrial Plan envisages that the interest rate of the AT1

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[44] The expected value of the shareholding coming from the CoCos conversion in 2020 (around EUR 450 million considering a price to book ratio of 1 is largely below the nominal value of the CoCos including interest at the date of the conversion (EUR 945 million).

[45] The interest rate on 10-year Portuguese government bonds currently is below 4%, but this reflects market perception that those bonds are not risk-free. On the other hand, a 4% interest rate on 10-year Portuguese government bonds indicates that the premium of around [5-10%] to [5-10%] offered to the equity investors in CGD correctly reflects the risk of the transaction.

instrument to be issued as part of the 2016 recapitalisations measures (measure C) will be at 10%[46]. Therefore a yearly internal return on investment between [10-15%] and [10-15%] can be considered as satisfactory given the high risk premium offered by CGD and the premium offered to the equity investor compared to AT1 instrument to be issued on the market. An internal rate on return between [10-15%] and [10-15%] would be sufficient for a private investor. This conclusion is also consistent with the required rate of return, as estimated by Portugal, namely [10-20%] (see recital (167)).

(179) Those simulations show that CGD, if its Coco were held by private investors and if it were to raise shares on the market, could offer a sufficient rate of return to convince a private investor to inject fresh equity in the Bank (measure D) and even more to convince the private holders of the convertible instrument to accept to convert their instrument into CGD shares (measure B).

4.3.5. Concluding assessment of measures B and D

(180) The State as a shareholder of CGD appointed a new experienced management team which drafted the Industrial Plan. The latter ensures the return of CGD to long-term viability and projects a deep restructuring of the Bank, in line with actions a private investor would require after investing in the Bank (as assessed in section 4.3.1).

(181) However, to successfully implement the Industrial Plan, CGD needs additional capital. As assessed in section 4.3.2, the capital needs have been determined on the basis of income projections in the Industrial Plan and an assessment of asset value validated by an external auditor.

(182) Therefore, a private investor would accept to participate in the capital increase necessary to implement the Industrial Plan provided that the terms of the recapitalisation, i.e. the terms of the measures, their sequencing and also their return on investment are satisfactory. Whilst measure B alone does not cover the capital needs of CGD, it is necessary for the successful implementation of measure D. A private creditor would accept the conversion of CoCos if it receives enough shares offering an attractive return. Finally, measure D is also in line with the MEIP provided that the return on investment of the new shares is satisfactory.

(183) Section 4.3.4 has shown that it would have been possible to offer a market conform return both to new investors and to the converted CoCos holders. The return on investment seems to have been overestimated in the simulations made by the State. However, after adjustments by the Commission, the expected return could still be in line with market requirements for similar transactions.

(184) Therefore the Commission concludes, on the basis of the notified Industrial Plan and Targets lists, that CGD could obtain the same measures from the market and therefore measures B and D are in line with, respectively, the private creditor test and the MEIP.

[46] According to CGD's management, the interest rate offered by the AT1 instruments could be [100-150] to [200-250] bps below the [10-15%] forecast.

4.4. Compatibility assessment of the notified amendments to the 2013 restructuring decision

(185) A restructuring decision can in principle be amended by the Commission where the modification is based on new commitments which can be considered equivalent to those originally provided[47]. In that situation, the existing aid measures would remain compatible on the basis of Article 107(3)(b) TFEU if the overall balance of the original decision remains intact. In order to preserve the original balance, the altered commitments should not negatively affect the viability of the aid beneficiary, with the overall set of commitments remaining equivalent in terms of burden-sharing and compensatory measures taking into account the requirements of the Restructuring Communication[48].

(186) The requested amendments concern: (i) an update of some of the 2013 commitments which overlap with the Industrial Plan targets; (ii) an early termination of some of the remuneration restrictions imposed on the bodies and employees of CGD and the ban on discretionary dividend, coupon and interest payments as set out in the 2013 Restructuring Decision; and (iii) additional measures regarding CGD, aiming to ensure the implementation of the Industrial Plan.

4.4.1. Restoration of the viability of CGD

(187) The Commission will examine whether the modifications to the 2013 Restructuring plan and the related commitments call into question the conclusion as to CGD's ability to restore its viability without needing further State aid reached in the 2013 Restructuring Decision.

(188) According to the commitments made by Portugal in the 2013 Restructuring Decision, Portugal was to ensure that the Restructuring plan for CGD was correctly and fully implemented (commitment 3.1). The Restructuring Period ends on 31 December 2017.

(189) As described in recital (20), the 2013 Restructuring plan included several KPIs which had to be reached by CGD. These KPIs included, among others, targets on the number of domestic retail branches ([750-800] by 31 December 2013), total balance sheet size of the core activities (EUR [100-150] billion by 31 December 2016), amount of RWA EUR [70-80] billion by 31 December 2016), the coverage ratio of credit at risk (minimum [50-60%] by 31 December 2016) and the Cost-to-Income ratio ([50-60%] by 31 December 2016).

(190) The Commission notes that (as described in recital (21)) Portugal has achieved all KPIs committed to in the 2013 Restructuring decision, except for the cost-to-income ratio because the income is lower than expected. As described in recital (22), the Portuguese authorities presented a first plan on 3 March 2016 to ensure

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[47] For other similar decisions see, for instance, SA.29833 KBC – Extension of the target date of certain divestments by KBC and Amendment of restructuring commitments, OJ C 135, 9.5.2012, p. 5: SA.29833 KBC – Accelerated phasing-out of the State Protection measure and amendments to the KBC restructuring plan, OJ C 163, 8.06.2013, p. 1; SA.34539 Commerzbank – Amendment to the restructuring plan of Commerzbank, OJ C 177, 20.06.2012, p. 20.

[48] Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

CGD's compliance with the Restructuring plan, in line with the commitments made by Portugal in the 2013 Restructuring decision.

(191) The Commission notes Portugal's position that the Industrial Plan replaces the existing Restructuring plan. The Commission considers the Industrial Plan to be an effective plan to ensure CGD's return to viability as it contains more ambitious targets and a more comprehensive restructuring than the Restructuring plan.

(192) The Commission considers that the Industrial Plan is in line with Portugal's commitment to present remedial actions if the cost-to-income ratio target laid down in Restructuring Plan cannot be achieved. Therefore, the Commission concludes that the replacement of the Restructuring Plan by the Industrial Plan does not alter its assessment of the State aid approved in the 2013 Restructuring decision.

4.4.2. Effect on competition distortion

(193) The Commission notes positively that the change in commitment 6.6 is limited to the amendment of Decree-Law 71/2007, as amended by Decree-Law 39/2016 and confirmed in the 2017 Budget Law. This amendment removed the remuneration limits that followed from CGD's status as a public company. The remuneration limits enshrined in Decree-Law 71/2007 were not applicable to other commercial banks.

(194) The Commission notes that the other items of the Commitment 6.6 on remuneration of CGD's bodies and employees remain applicable, ensuring that CGD must comply with the same regulatory remuneration restrictions as any other privately-run bank operating in Portugal, putting the Bank on a level-playing field with its competitors.

(195) The Commission also takes note of the claim of Portugal that removing the remuneration limits enshrined in its Decree-Law 71/2007 was necessary to attract an experienced management team able to successfully implement the Industrial Plan. According to the Portuguese authorities, the level of remuneration of CGD managers (chief executive officer, chairman and board members) before removing CGD from the scope of Decree-Law 71/2007 could not exceed the salary of the Prime Minister of Portugal[49].

(196) The Commission also recalls that the 2013 Restructuring decision assessed aid measures granted well before the entry into force of the 2013 Banking Communication, which introduced requirements regarding the limitation of the remuneration of managers of aided banks. The then applicable Recapitalisation Communication states that, until redemption of State aid, behavioural safeguards should *in principle* include, amongst others, the limitation of executive remuneration[50].

(197) The Commission regrets that Portugal implemented changes which affect its commitment 6.6 under the 2013 Restructuring decision prior to Commission's approval pursuant to this decision. Nevertheless, the Commission notes very

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[49] Less than EUR 100 000 per year, based on publicly available information.

[50] See point 45 of Communication from the Commission — The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2–10.

specific circumstances of the present case, notably the fact that the changes only affect the last 16 months of the restructuring period ending on 31 December 2017 and are counterbalanced by a major restructuring of CGD under the Industrial Plan, which limits distortions of competition. Therefore the Commission exceptionally considers that the amendment of Commitment 6.6 for the last 16 months of the restructuring period does not alter its assessment of the State aid approved in the 2013 Restructuring Decision and therefore does not object to the amendment of commitment 6.6.

4.4.3. Burden sharing

(198) In the notification leading to the 2013 Restructuring decision, Portugal committed to ban all dividend, coupon and interest payments to holder of preference shares and subordinated debt until end 2017, in so far as those payments are not owed on the basis of contractual or legal obligations (commitment 6.7).

(199) As indicated in point 26 of the Restructuring Communication, the purpose of such commitment is to avoid banks use State aid to remunerate own funds when its activities do not generate sufficient profits. This ensures that the received State aid is limited to the minimum necessary and safeguarding against undue distortions of competition.

(200) The Commission notes that, according to the information submitted by Portugal (see recital (107)), the terms and conditions of the outstanding Upper Tier 2 instruments state that a payment of coupon on the AT1-instruments would trigger an obligation to pay coupons on all of the remaining subordinated debt instruments.

(201) The Commission notes that commitment 6.7 does not allow for a lifting of the ban on coupon and dividend payments for instruments to be issued after the 2013 Restructuring Decision.

(202) The Commission considers that it would be impossible to issue new AT1 instruments if the investors are told in advance that no coupon will be paid on those instruments during the first year (i.e. until end 2017). CGD indeed currently envisages issuing instruments with quarterly or semi-annual coupon payment.

(203) The Commission notes that based on the information provided by Portugal (see recital (107)), a payment of coupons on the new AT1 instruments to be issued under Measures C and E would trigger an obligation to pay coupons on all of the outstanding subordinated debt instruments of CGD.

(204) The Commission considers that, based on the information provided by Portugal (see recital (108)) the effective additional amount which CGD would have to pay (less than EUR [5-10] million) on the outstanding subordinated debt instruments is the minimum necessary to allow measure C to take place. The Commission considers that this additional payment is negligible compared to the amount of new AT1 which CGD will be able to raise on the market to reinforce its capital position (EUR 500 million to EUR 930 million under measure C). Although the Restructuring Communication states that banks should not use previously granted State aid to remunerate subordinated debt when their activities do not generate

sufficient profits, it also requires a balance with the need to ensure the refinancing capability of the bank and the exit incentives.[51]

(205) In view of the above circumstances and taking also into account the arguments mentioned in recitals (107) to (108), the Commission considers that the anticipated termination of commitment 6.7 does not alter the Commission's assessment of the State aid approved in the 2013 Restructuring Decision.

4.4.4. Conclusion on the notified changes in the commitments

(206) The modified commitments do not negatively affect the viability of the aid beneficiary, with the overall set of commitments remaining equivalent in terms of burden-sharing and compensatory measures.

[51] See point 26 of the Restructuring Communication.

5. CONCLUSION

The Commission has accordingly decided:

- not to raise objections to the changes of the commitments issued by Portugal in the framework of the procedure concerning the 2012 recapitalisation measures and on the basis of which the Commission authorised them in the 2013 Restructuring decision,

  and;

- that the transfer of Parcaixa's shares held par Parpública Holding to CGD, the anticipated conversion of the CoCos owned by the State, and the injection of up to EUR 2.5 billion in CGD in the form of ordinary shares by the State do not constitute aid in the light of the Industrial Plan.

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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For the Commission

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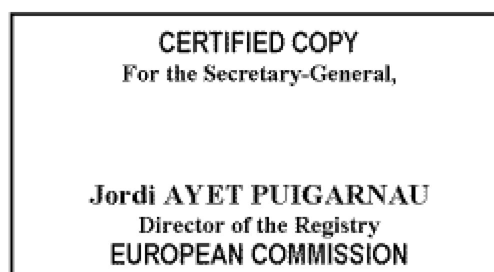
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For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
EUROPEAN COMMISSION

ANNEX I

Industrial Plan Targets Schedule

This document sets out the specific targets (the “Industrial Plan Targets”) for the implementation of the Industrial Plan of Caixa Geral de Depósitos S.A. ("CGD" or “the Bank”), which the Portuguese Republic undertakes that CGD will achieve.

The Industrial Plan Targets do not substitute commitments annexed to the 2013 CGD Restructuring Decision ("2013 commitments"), which shall continue to apply as provided by the respective decision and amended by the current decision, when there is a corresponding Target in the Industrial Plan. In case of any overlap between the Industrial Plan Targets and the 2013 commitments, the most recent of the two will be taken into account for monitoring purposes.

The Industrial Plan implementation period shall end on 31 December 2020, unless the individual Target states otherwise.

For the purpose of the Industrial Plan Targets, the singular of those terms shall include the plural (and vice versa), unless the Industrial Plan Targets provide otherwise.

The Industrial Plan Targets do not supersede supervisory requirements and recommendations.

Definitions

Term	Meaning
CGD Domestic Full Time Equivalents ("FTEs")	FTEs of Caixa Geral de Depósitos S.A., FTEs seconded to/from other group entities, and FTEs of other domestic entities, as described on slide 30 ('Expected evolution of domestic operational infrastructure') of the Industrial Plan

CGD Domestic Operations	Caixa Geral de Depósitos S.A. and other domestic entities; Caixa Gestão Activos, SGPS CaixaGest CGD pensões Fundger Caixa Leasing e Factoring IFIC Locarent Caixa Banco de Investimento Caixa Capital Caixa Desenvolvimento, SGPS Caixatec- Tecnologias de Informação Caixanet Imocaixa Esegur Sogrupo Sistemas Informação ACE Sogrupo Compras e Serviços Partilhados ACE Sogrupo IV Gestão de Imóveis ACE Caixa Imobiliário Parcaixa, SGPS Caixa Seguros e Saúde, SGPS Caixa Participações, SGPS Wolfpart, SGPS SIBS Cibergradual Yunit
CGD International Operations	all foreign subsidiaries and branches of the group
C/I ratio	the ratio of operating expenses (labour and administrative costs not including restructuring costs) to operating income (the sum of net interest income, commission income, revenues from capital instruments, revenues from financial operations, and any other income from operations)
Industrial Plan implementation period	the time period from the adoption of this Decision until 31 December 2020
Industrial Plan	the Industrial Plan and its annexes formally notified to the European Commission via SANI by the Portuguese Republic

PILLAR 1: STRENGTHENING SOLVENCY LEVEL AND RISK MANAGEMENT MODEL

(1) With the aim of strengthening its solvency and risk management levels, the Bank will adopt measures to achieve the following key initiatives outlined in the Industrial Plan[52]:

- The Bank will develop and implement an integrated business model; it will integrate finance (strategy, budgeting, accounting) and business decisions (FTP, pricing, underwriting) with risk management (risk appetite).
- The Bank will revise roles and responsibilities across business, core functions, and committees to implement a robust 3-lines of defence model in risk management.
- The Bank will develop robust control functions; it will develop a comprehensive risk taxonomy and control environment for non-financial risks; it will upgrade compliance and audit infrastructure to highest international standards.
- The Bank will proceed with a regulatory review; it will revise all risk management processes related to Supervisory Review and Evaluation Process (SREP) and ensure full alignment of CGD with regulatory expectations for ICAAP and stress-testing in particular; it will improve data quality for reporting and decision making.
- With regard to capital measurement, the Bank will improve the quality of its capital measurement models, which will be adapted to evolving regulation.
- The Bank will pay particular attention to the adequate management of legacy assets, particularly those related to real estate.
- With regard to credit monitoring and recovery, the Bank will strengthen credit monitoring through an upgrade of Early Warning Signals, and will enhance credit recovery with standardized processes, and revision of the decision framework.

(2) These measures shall be fully aligned with supervisory recommendations and requirements.

Strengthening capital

(3) The Portuguese State shall inject EUR 2.5 billion into CGD in the form of ordinary shares. In addition, the State will transfer to CGD its 49% interest in Parcaixa, which will generate around EUR 0.5 billion of additional regulatory capital for CGD. Moreover, the State shall exchange the existing EUR 0.9 billion of contingent instruments and accrued interest for ordinary shares. CGD will raise at least EUR 500 million in the form of Additional Tier 1 capital instruments (or other forms of hybrid capital) from investors not related to the Portuguese State, with a closing of the operation not later than the date of

[52] Slide 17: 'Key initiatives to strengthen solvency and risk management levels'

the closing of equity injection by the State. Both operations are interdependent (if one of the two operations does not go ahead, neither does the other). An additional amount of at least EUR 430 million in the form of Additional Tier 1 capital instruments (or other forms of hybrid capital) will be raised within 18 months after the equity injection.

Strengthening risk management

(4) The Bank shall strengthen its risk management model in domestic operations, leading to a credit-related cost-of-risk below [0.5-1%] from 2017 onwards and below [0.5-1%] in 2020[53][54].CGD will, by end-of January 2017, centralise credit decisions for business segment, increase the participation of Risk in nearly all underwriting business segment processes (with overriding decision power) for exposures above EUR [1-5] million[55], and include a requirement in the Bank's internal regulations that single name exposures above EUR [0–500] million have to be approved by the Board of Directors. CGD shall also push ahead with the digitization and automation of the underwriting process, and introduce a dedicated underwriting and monitoring system in the area of credit origination in the future.

(5) With a view to strengthening its risk management, the Bank will implement the following strategies regarding the credit origination process:

i. Underwriting processes and policies for the business segment will be reviewed by end-of January 2017, to include three components: 1) revision of the credit decision framework; 2) streamlining and standardizing of the underwriting process; and 3) monitoring of both decision and service levels (a dedicated management reporting system will be implemented to monitor decisions and their adherence to the policies, and to ensure service levels).

ii. Review of the Credit Policy; going forward, the Bank will also review the existing credit related policies (including other segments, e.g., mortgage), and explore, among others (1) more sophisticated credit assessment model; (2) differentiation of underwriting processes based on the risk and complexity of the exposure; and (3) providing guidance to network on credit origination that is aligned with the Bank's Risk Appetite.

iii. Enhancing the Early Warning Signals (EWS) system in the area of credit monitoring, to be operational by end-of year 2017.

(6) Credit monitoring will be enhanced by 1) reviewing the early warning signals (EWS) system, combining more leading and less predictive indicators with more predictive but

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[53] Slide 25: 'After fair evaluation of the assets books, cost of risk is assumed to normalize to historical average'.

[54] As regards 2018, the respective target excludes the cost of up to EUR [200-250] million incremental provisioning requirements for transition to IFRS 9.

[55] Depending on the rating, exposure limit may be increased to EUR [0-5] million

less leading indicators; 2) redefining pre-set minimum action plans for standardized recoveries (whereas corporate based recoveries will be assessed predominantly on a case by case basis coordinated by DGR); and 3) guaranteeing that the EWS are embedded in the monitoring process, with clearly defined responsibilities for identification, validation, classification, and subsequent proposal and execution of mitigating actions.

A comprehensive database will be developed in support of the credit monitoring process described, combining trigger warnings from different sources.

The EWS model will be based on automated indicators (e.g., overdrafts), operational indicators, manual expert-based indicators (e.g., loss of key employees), and additional indicators (with individual thresholds) for specific segments/industries such as CRE. Predefined action plans will be designed and organized along different watch-list categories reflecting different degrees of riskiness of customers. These watch-lists will imply a predefined set of mandatory actions per category and include a tracking and reporting process.

Non-Performing Loan (NPL) management strategy

(7) The planned changes to the Bank's NPL management strategy shall be aligned with the ECB's Draft Guidance to Banks on Non-Performing Loans, published for consultation on 13 September 2016, as well as all supervisory requirements and recommendations specific to CGD.

(8) The Bank shall incorporate all measures to tackle NPLs, in line with the NPL strategy included in the Industrial Plan and consistent with the relevant regulatory requirements.

(9) The Bank shall implement a series of strategic actions in the area of credit recovery:

i. *Credit recovery*. The recovery setup will be enhanced by end-of year 2017 to ensure that the target NPL ratio of < [10-15%] is attained in 2020. The recovery department shall be fully independent from the corporate / retail business areas.

ii. *Segmentation and recovery strategies*. A behavioural segmentation model will be developed to provide a link between the characteristics of a client, his/her propensity to pay, and the most efficient recovery strategy that can be followed with each type of client. The optimal predefined strategy will be identified for each customer segment using analytical models and embedded into decision trees.

iii. *Process definition, standardization and reorganization to be completed* by end-of year 2017. The credit recovery process will be further standardized, ensuring clear rules and process for the handover of clients from the commercial to the recovery areas (e.g., documents, background information).

iv. In terms of *organization*, the level of specialization of teams within the recovery area will be reviewed to ensure adequate capabilities across the different types of products and customer segments. Recovery areas will also be reorganized and re-sized

to ensure that all new flow-to-default is acted upon immediately, according to the recovery strategy policy. The backlog stock of NPLs will be managed in a similar fashion but with dedicated resources and sized/organized according to a "taskforce" logic.

v. *Performance management and incentives*. The performance management system will be revamped by end-of year 2017 to include metrics not solely based on volumes of credit recovered, but also linked to the quality of the recovery (e.g., involvement of collateral or no re-incidence) at individual level.

(10) *Late-stage recovery*. The Bank will review the external lawyer arrangements by end-of year 2017 (both in terms of case allocation and remuneration) to ensure adequate control and the right incentives. The bank will also explore the possibility of segregating real estate assets in a specialized asset-based recovery and sales unit. The implementation of a dedicated unit for real estate assets, if adopted, will include 4 key changes: 1) clear mandate and asset perimeter, 2) wind-down strategy for each asset type, 3) revised organizational structure, and 4) new decision and reporting processes.

Securities portfolio

(11) Portugal commits that specific guidelines and limits will be implemented to minimise risks such as among others the single name concentration risk, default credit risk and interest rate risk of its trading portfolio. The Bank will also introduce limits to sovereign exposures, even if these risks bear no regulatory capital requirement.

(12) The investment policy will include a requirement that investments above a certain threshold (10% of own funds) have to be approved by the Board of Directors. This investment policy must be fully in line with the CRR[56].

(13) Portugal commits that the prudent investment policy to be implemented in line with (2) of this section will ensure that total VaR for financial assets held for trading does not exceed EUR [0-50] million.

PILLAR 2: ADJUSTING CGD'S DOMESTIC OPERATIONS

Adjustment of branch network formats and footprint

(1) The Bank will streamline its distribution platform in line with objectives set in the Industrial Plan to adapt it to customer needs and promote overall operational efficiency. The number of domestic branches will be adjusted to a maximum of [550-600] and [450-500] branches in 2018 and in 2020 respectively. […]

(2) The adjustment of the distribution platform and the optimization of central areas will

[56] 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

allow to increase the overall productivity of the workforce in line with the objectives set in the Industrial Plan. The number of domestic FTEs will not exceed the level of [7500-8000] in 2018 and [6500-7000] in 2020.

Cost base

(3) The total staff cost (including bonus and other benefits, but excluding restructuring costs) for the domestic operations will not exceed the level of EUR [450-500] million and EUR [400-450] million in 2018 and 2020 respectively.

(4) The total recurrent operating and amortizations costs for the domestic operations, excluding restructuring costs, will not exceed the level of EUR [800-850] million and EUR [750-800] million in 2018 and 2020 respectively.

PILLAR 3: RESTRUCTURING CGD'S INTERNATIONAL OPERATIONS

'Wind-down' in this section means that the Bank or the entity concerned shall not carry out activities other than those that are consistent with managing the work-out of the loan books and securities portfolios (including loan sales where appropriate to maximise recovery values and minimise capital losses). The Bank or the entity concerned shall not develop any new lines of activity and shall not enter new markets. The Bank or the entity concerned shall conserve and use its banking licence only as long as necessary for the work-out of the loan portfolio and shall not use it to develop new lines of activity.

(1) In line with the Industrial Plan[57] as notified to the Commission, the Bank will carry out all the steps necessary, namely ensuring the timely start of the process to dispose its entire shareholding in the following foreign entities or sell these entities by […]:

- […],
- […],
- […]
- […]
- […]

Portugal commits that the full execution of these divestments will be completed as soon as possible, and no later than […].

(2) The Bank will carry all the steps necessary, namely ensuring the timely start of the process, to dispose its entire interest in the following foreign entities or put these entities in wind-down […]:

[57] Slide 42 'International portfolio-perimeter of analysis': overview of entities to divest

- […]
- […]
- […]
- […]
- […]
- […][58]
- […]

Portugal commits that the full execution of these divestitures will be completed as soon as possible, and no later […].

(3) Regarding foreign operations, up to [10-15%] of total assets from entities to be divested according to (1) and (2) can be transferred to the books CGD Portugal (domestic books). These assets could be domestic assets booked abroad or assets the buyers of the entities will not acquire.

(4) Portugal commits that by 2020, the total international portfolio of CGD (consolidated level) cannot be more than EUR [10-15] billion[59]. Regarding the foreign operations described in (1) and (2), entities that have been put in definitive wind down will not be taken into account for the purpose of measuring compliance with this commitment. The equity invested by the Bank in the international portfolio cannot be more than EUR [0-5] billion by 2020[60].

(5) Portugal commits that no assets or liabilities, except for those mentioned in paragraph (3) of this section can be transferred from the operations described in (1) and (2) of this section to the domestic operations from the moment of the Decision on until […], except for any intragroup assets and liabilities.

(6) For retained entities, Portugal commits that the Bank will, in line with ECB requirements, develop a formal business strategy that addresses potential governance, risk management and control weaknesses.

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[58] Roughly EUR [0-5] billion related to Portuguese customers' risk to be transferred to headquarters

[59] Slide 50 'International operations overview': the international portfolio will evolve to be simpler and bearing lower risk; EUR [10-15] bn of assets in 2020

[60] Slide 50 'International operations overview': the international portfolio will evolve to be simpler and bearing lower risk; EUR < [0-5] bn equity in 2020

PILLAR 4: MODERNIZING THE DOMESTIC COMMERCIAL FRANCHISE

For the whole of Pillar 4, 'Domestic Commercial Franchise' includes all CGD Domestic operations.

(1) Portugal commits that CGD will increase the share of its net commission income in the business volume of the domestic commercial franchise to bring it closer to its peers. More specifically, CGD will target as a reference that the net commission income as a % of business volume in domestic operations will increase from [0 - 0.5] in 2015 to [0 - 0.5] in 2018 and [0 - 0.5] in 2020.

(2) Portugal will ensure that the Year-on-Year growth rate of credit to customers in terms of volume for domestic operations will be aligned with conservative levels as set out in the following table[61], designed to avoid excessive risk taking:

		2017	2018	2019	2020	Avg. 17-20	Mkt fore-cast
Retail	Mortgage	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Credit to individuals	[5-10]%	[5-10]%	[5-10]%	[5-10]%	[5-10]%	[0-5]%
	Other	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Corporates	Large corporates	[-5 - 0]%	[-5 - 0]%	[-5 - 0]%	[-5 - 0]%	[-5 - 0]%	Corp: [0-5]% SMEs: [0-5]%
	Medium enterprises	[-5 -0]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%	
	Small enterprises	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%	
	Financial institutions	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%	
	Public entities	[-5 - 0]%	[0-5]%	[0-5]%	[0-5]%	[-5 - 0]%	
	CRE	[-5 - 0]%	[-5 - 0]%	[-5 - 0]%	[-5 - 0]%	[-5 - 0]%	
	Others	[0-5]%	[0-5]%	[0-5]%	[0-5]%	[0-5]%	

(3) These Year-on-Year growth rates will lead to a composition of the credit portfolio aligned, on a best effort basis, with the target segments of Retail and Small and Medium enterprises, as set out in the following table with (gross) values in 2020:

Credit portfolio composition 2020		%	bn EUR
Retail	Mortgage credit	[50-60]%	[20-30]
	Credit to individuals	[0-5]%	[0-5]
	Other retail loans	[0-5]%	[0-5]
Corporates	Large Corporate	[5-10]%	[0-5]
	Medium enterprises	[5-10]%	[0-5]
	Small enterprises	[0-5]%	[0-5]

[61] Slide 57: 'Main assumptions on interest margin – volumes evolution by product'

	Financial institutions	[0-5]%	[0-5]
	Public entities	[5-10]%	[0-5]
	CRE	[10-15]%	[5-10]
	Others	[0-5]%	[0-5]

(4) Portugal will ensure that the interest margins realised on each product in the credit to customers portfolio will be adjusted to earn appropriate returns on capital employed as set out in the following tables[62]. Limited deviations are allowed if part of an adjusted global pricing policy adopted by the Board and which continue to ensure year by year achievement of the net interest margin (in percentage) on total credit to clients envisaged in the industrial plan[63]:

Spreads New loan production		2017	2018	2019	2020
Retail	Mortgage credit	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Credit to individuals	[5-10]%	[5-10]%	[5-10]%	[5-10]%
	Other retail loans	[0-5]%	[0-5]%	[0-5]%	[0-5]%
Corporates	Large Corporate	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Medium enterprises	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Small enterprises	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Financial institutions	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Public entities	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	CRE	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Others	[0-5]%	[0-5]%	[0-5]%	[0-5]%

Spreads Stock		2017	2018	2019	2020
Retail	Mortgage credit	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Credit to individuals	[5-10]%	[5-10]%	[5-10]%	[5-10]%
	Other retail loans	[5-10]%	[5-10]%	[5-10]%	[5-10]%
Corporates	Large Corporate	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Medium enterprises	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Small enterprises	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Financial institutions	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Public entities	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	CRE	[0-5]%	[0-5]%	[0-5]%	[0-5]%
	Others	[0-5]%	[0-5]%	[0-5]%	[0-5]%

[62] Slide 56: 'Main assumptions on interest margin – interest rates evolution by product'

[63] Slide 60: 'Detailed balance sheet and net interest income evolution (2/2)', column 'Spread', line 'Total credit to clients'.'.

PILLAR 5 ADJUSTMENT MECHANISMS – SYNTHESIS OF THE INDUSTRIAL PLAN

(1) Portugal will ensure that CGD's Net Interest Income (NII) in domestic operations amounts to EUR […] million EUR […] million, EUR […] million and EUR […] million in 2017, 2018, 2019 and 2020 respectively[64]. If the realised NII diverts from these projections, the Bank will take all necessary measures (including adjustment to the pricing of its products) to ensure the targets are achieved.

(2) Portugal will ensure that CGD's Gross Operating Income in domestic amounts to EUR […] million EUR […] million EUR […] million and EUR […] million in 2017, 2018, 2019 and 2020 respectively[65]. If the realised Gross Operating Income diverts from these projections, the Bank will take all necessary measures to ensure that the targets are achieved.

(3) Portugal will ensure that CGD's recurrent Cost-to-Income in domestic operations is in line with the projections on Slide 68 ('Projection of key P & L ratios') of the Industrial Plan as notified to the Commission, and never higher than [70-80]% in 2017, [40-70]% in 2018 and [40-60]% in 2020. If the realised Cost-to-Income diverts from those targets the Bank will take all necessary measures (including further cost cutting) to ensure that those targets will be achieved.

(4) Portugal will ensure that CGD' consolidated recurrent Return on Equity is above [5-10]% by 2018 and above [5-10]% by 2020 (excluding restructuring costs and potential losses from asset divestitures up to the amounts projected in the Industrial plan). If the realised Return on Equity is lower, CGD will take all necessary measures (namely, deepen restructuring or enhancing revenue from current operations) to ensure that these RoE targets are achieved.

(5) Portugal commits that if it is a critical measure to offset future likely capital needs due to the fact that CGD is not achieving one of the targets mentioned in paragraphs (1) to (4) of this section or if it is necessary to strengthen the capital position of the Bank and to allow the distribution of dividends to the public shareholder of the Bank, CGD will divest additional foreign assets within […] of establishing the divergence of the Bank's performance from the targets in the Industrial Plan, and in size according to the deviation, if no other corrective measures are deemed enough to re-establish CGD's performance. Portugal also commits that the Bank will examine the feasibility of the sale of […] at the latest by […] and that it will test the market […], with the aim of having the option to sell those assets if needed.

[64] Slide 66: 'Projection of CGD consolidated results'.

[65] Slide 66: 'Projection of CGD consolidated results'.

PILLAR 6: GOVERNANCE STRENGTHENING

(1) Portugal commits that during the period until 31 December 2020, the Bank´s Chief Executive Officer (CEO) shall be someone with senior experience from the private financial sector.

(2) Portugal commits that CGD's Board of Directors (BoD) will be composed of no more than 20 members that will be reduced for the mandates after the 2017-2020 as may be determined by the supervisory authorities. All members of the management bodies of CGD will comply with the requirements set forth in articles 30 to 31-A of the Legal Framework for Credit Institutions and Financial Companies approved by Decree-Law nr. 298/92, dated the 31st of December 1992, as amended (the "RGICSF"), as well as in the European Banking Authority Guidelines on the assessment of the suitability of members of the management body and key function holders, of 22 November 2012 (EBA/GL/2012/06).

(3) Portugal commits that, as the shareholder of CGD, it will designate a BoD adequately composed of experienced senior executives or business leaders, with no more than two non-executive members politically appointed civil servants.

(4) The Portuguese State approved the Decree-Law nr. 39/2016, of 28 July pursuant to which individuals appointed to the corporate bodies entrusted with the management function of credit institutions which belong the State and which are qualified as "significant supervised entities" within the meaning Article 2(16) of Regulation (UE)468/2014, of the European Central Bank, of 16 April 2014 are no longer bound by the Decree-Law nr. 71/2007, of 27 March, as amended, (applicable to the so-called "gestores públicos"). Following the 2017 budget law, that will enter into force on 1st of January of 2017, those individuals are bound by transparency, exclusivity and criminal, civil and financial liability requirements. In consequence, articles 18 to 25, 36 and 37 of Decree-Law nr. 71/2007, of 27 March remain applicable. Article 18 sets out the requirements for the management contracts to be signed between the shareholder and the management of CGD. Portugal undertakes that, during the implementation period, the objectives within those management contracts will be based exclusively on the Industrial Plan of CGD and define for the management of CGD, performance tasks to deliver the Industrial Plan of CGD and the targets defined in this document.

(5) In addition, following the 2017 Budget Law approval, CGD's employees and corporate bodies members will have no longer salary and compensation restrictions.

(6) Portugal commits that the Bank shall have an organizational structure with Internal Audit and Compliance departments fully independent from commercial networks, reporting directly to the Board of Directors. The Risk Management department will be fully independent from commercial networks. An Audit Committee and a Risk Committee - created within the Board of Directors - shall assess all issues raised by those respective departments. An adequate Internal Audit Charter and Risk Management Charter shall specify the roles, responsibilities and resources of those departments. Those charters shall comply with international standards and secure full independence

to the departments. A Credit Policy shall provide guidance and instructions regarding the granting of loans, including the pricing of loans and the restructuring of loans.

(7) Portugal commits that, in addition to the Executive Committee, which shall be responsible for performing the management function of the management body of CGD, and also in order to comply with the RGICSF and European Banking Authority Guidelines on Internal Governance (GL 44) of 27 September 2011, and the Audit Committee and a Risk Committee, the management body of CGD shall appoint the following committees to support it in the discharge of its functions:

a) Nominations, Assessment and Remuneration Committee, the role of which will be, in particular, to give its opinion on the filling of any vacancy in the corporate bodies, on the choice of directors to become members of the Executive Committee and other committees, as well as on their assessment and the corresponding remuneration policy;

b) Corporate Governance Committee, the role of which will be, in particular, to draw up an annual report on the company's governance structure to be submitted to the Board of Directors, as well as to give its opinion on matters related to corporate social responsibility, ethics, professional deontology and environmental protection.

(8) Portugal ensures that an independent Remuneration Committee will be elected by the Shareholders Meeting to implement the remuneration policy approved and, specifically, to decide the remuneration of the members of the corporate bodies.

(9) Portugal ensures that the members of the management body and of the committees referred to above, shall abide with strict rules regarding conflict of interests, in full compliance with not only general corporate law but also the national and European rules and guidelines applicable to CGD on conflict of interest.

(10) Portugal commits that the committees referred to above will in majority consist out of non-executive members of the Board of Directors. The members of the committees must have recognized experience or be renowned leaders in their industry (not necessarily the financial sector) and include members with international experience.

(11) Portugal will ensure that all of CGD's decisions shall be taken on purely commercial grounds and in strict compliance with the internal governance arrangements detailed in the amended by-laws and proposed regulations, the RGICSF and all other rules, regulations and guidelines applicable to banks.

(12) The Portuguese State shall not exert any influence on the day-to-day operational management of CGD nor on CGD's internal rules regarding credit risk policies, pricing and lending, using exclusively the powers vested on it as the sole shareholder of CGD on the basis of the general terms of corporate law and assuring the full independence of CGD's management on all matters regarding the management of CGD.