EUROPEAN COMMISSION

Brussels, 23.5.2010
C(2010) 3363 final corr.

Subject: State aid N 202/2010 - Spain
Recapitalisation of CajaSur

Sir,

1 PROCEDURE

(1) On 10 December 2009, following the Commission's request for information, Spain sent information explaining that the Savings Banks Deposit Guarantee Fund (*Fondo de Garantia de Depòsitos de Cajas de Ahorro*) would grant capital and a guarantee on impaired assets to the entity resulting from the merger of Montes de Piedad y Caja de Ahorros de Ronda, Cádiz, Almería, Málaga y Antequera ("Unicaja") and Caja de Ahorros y Monte de Piedad de Córdoba ("CajaSur"), two savings banks.

(2) The European Commission requested additional information during two meetings with the Spanish authorities, held on 17 December 2009 and 3 May 2010.

(3) Since the merger did not crystallize, on 22 May 2010 the Spanish authorities notified to the Commission their intention to provide a capital injection and liquidity support to CajaSur through the *Fondo de Restructuración Ordenada Bancaria* (FROB) [1].

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

Excmo. Sr. Don Miguel Ángel MORATINOS
Ministro de Asuntos Exteriores
Plaza de la Provincia 1
E-28012 MADRID

(4) The legal basis for those measures is article 7, para 2 of the Royal Decree-Law 9/2009 of 26 June 2009, *sobre reestructuración bancaria y reforzamiento de los recursos propios de las entidades de crédito.*

(5) Spain has accepted that the decision will be adopted in English.

2 DESCRIPTION OF THE MEASURE

2.1 The beneficiary

(6) CajaSur is a Spanish saving bank (*"caja de ahorros").* Cajas de ahorros are credit institutions that have no shareholders, but instead are governed by their members. Their legal form is a private charity that holds a banking license and is entitled to provide banking services as commercial or cooperative banks do. Profits are partially used to strengthen capital and the remainder is used to fund the social activities that each caja de ahorros carries out through its *Obra Benéfico-Social ("OBS")*[2].

(7) CajaSur was founded by the *Excelentísimo Cabildo Catedral de Córdoba* (Cathedral Chapter of Córdoba), as *Monte de Piedad*, on 1 September 1864 and it was classified as an independent non-profitable social institution by Royal Order of 25 January 1866. It was then founded as *caja de ahorros* by the same Ecclesiastical Chapter on 2 October 1878. Its first Statutes and Regulations were approved by the Royal Orders of 14 July 1877, 14 March and 24 August 1878.

(8) The current statutes governing the running of the Institution were approved by the Andalucian Government Ministry of Economy and Finance in an order dated 15 June 2005. They were modified in accordance with Law 15/1999, on Andalucian Savings Banks and Law 44/2002, on Financial System Reform Measures.

(9) It is registered with the Bank of Spain, in the special General Savings Banks Register, and with the Mercantile Register of the Province of Córdoba. CajaSur is also a member of the Savings Banks Deposit Guarantee Fund.

(10) CajaSur mainly operates in the Community of Andalucia, and particularly in the region of Córdoba, where it has a strong footprint.

(11) CajaSur's main figures are (as of 31 March 2010):

	31.03.2010
Total assets	17 023 million €
Loans to customers	[…][*] €
Retail deposits	[…] €
Total wholesale funds	[…] €
Employees	2 972
Number of branches	474

[2] OBS are charity institutions funded by the cajas de ahorros. Each caja de ahorros has an OBS, and each OBS receives from its caja de ahorros the part of the profits that is not used to build up reserves.

[*] Confidential information.

2.2 The events triggering the measures

(12) The loan portfolio of CajaSur expanded considerably between 2002 and 2007, especially loans to the real estate sector. Such exposure to real estate developers and other real estate transactions made CajaSur lose EUR 596 million in 2009 and EUR […] in the first quarter 2010.

(13) The aforementioned losses decreased CajaSur's equity to EUR 184 million and total own funds to EUR 444 million at the end of 2009, (3.7% solvency ratio). On 31 March 2010, further losses reduced equity to EUR […] and total own funds to EUR […] ([…]). As a consequence, CajaSur has not been meeting the required 8% solvency ratio. In addition, it has also breached the limits on concentration to three economic sectors, due to the capital decrease.

(14) From the funding perspective, CajaSur obtained the funds to finance growth of its loan portfolio mainly from wholesale markets. Wholesale funding as of 31 March 2010 covered […]% of the loan portfolio.

(15) On 20 April 2009, the rating agency Fitch downgraded CajaSur from BBB+ to BB+ (non-investment grade), which made access to wholesale financing almost impossible for CajaSur. In addition, the bank's deposit base has been weakened; more than EUR […] deposits have been withdrawn since the beginning of 2010. CajaSur's weak solvency position, together with its limited liquidity, has made the bank severely distressed.

2.3 The failed merger with Unicaja and the decision to place CajaSur under administration.

(16) On 27 July 2009, CajaSur announced the beginning of the negotiations to merge with another caja de ahorros, Unicaja. On 29 July 2009, the Executive Board of Bank of Spain approved the roadmap presented together by CajaSur and Unicaja to merge, which entailed financial support from the Fondo de Garantía de Depósitos.

(17) […]. On 21 May 2010 CajaSur reported to Bank of Spain that the merger had not been approved by its board of directors. The Spanish authorities consider such outcome a breach of the July 2009 roadmap that may significantly increase the risk of a run on the bank.

(18) As a consequence, on 22 May 2010 the Executive Board of Bank of Spain agreed to replace the current management of CajaSur by FROB.

2.4 The rescue package: measures to strengthen CajaSur's capital and liquidity position.

(19) CajaSur's failure to meet regulatory capital requirements (paragraph (13)) has triggered the need for a recapitalisation, in order to achieve the 8% risk-weighted assets solvency ratio (stressed under a time horizon of three months) required by Spanish banking legislation. The recapitalisation will be achieved through issuance of EUR 800 million *cuotas participativas*, an equity-like instrument available to *cajas de ahorro*. The capital injection represents […]% of the bank’s risk-weighted assets.

(20) *Cuotas participativas* are included among core tier 1 capital (*recursos propios basicos*) under Spanish legislation. Remuneration to the holders of such instruments is based on availability of distributable profits, and is not linked to a coupon payment like, for example, hybrid capital. Under the current Spanish banking legislation, the percentage of annual remuneration to the holders of *cuotas participativas* cannot be lower than the percentage on distributable profits granted to the Obra Benéfico-Social[3].

(21) As holder of the aforementioned *cuotas participativas*, the FROB will also hold voting rights in the General Assembly of CajaSur proportional to the contribution of the *cuotas participativas* to the overall equity of CajaSur. Preliminary estimates indicate that the FROB will hold at least […]% of the voting rights.

(22) In addition, in order to achieve EUR 2.300 million expected liquidity needs, together with the aforementioned capital injection of EUR 800 million, FROB will grant a EUR 1.500 million credit facility. CajaSur is expected to need EUR […] to meet its wholesale funding due in 2010. Furthermore, EUR […] deposits per month are expected to be withdrawn in the next eight months (totalling EUR […]). In addition, EUR […]covered bonds currently used as collateral for funding from the European Central Bank may not be considered eligible, in case they are downgraded. Thus, a prudent estimate of the liquidity necessary in the short term is EUR 2,300 million (this includes a safety buffer of EUR […] due to the uncertain situation of the bank e.g. regarding the pace of deposit withdrawals).

(23) CajaSur has currently access to EUR […] outstanding from a EUR […] credit line granted by Bank of Spain (Eurosystem financing). Other wholesale funding could be available from issuance of EUR […] covered bonds, which could be used as collateral for funding from the European Central Bank as long as the bonds meet the rating standards.

(24) In order to achieve the EUR 2,300 million expected liquidity needs, together with the aforementioned capital injection, FROB will grant a EUR 1,500 million credit facility. CajaSur will pledge assets to secure repayment of the advances to the extent possible[4]. Interest charged on the credit facility will be equivalent to 100 basis points on top of the ECB's marginal credit facility (currently at 1%).

3 POSITION OF THE SPANISH AUTHORITIES

(25) The Spanish authorities accept that the two measures constitute State aid. However, the Spanish authorities are of the view that the measures in favour of CajaSur are compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union (hereinafter "TFEU") as they are necessary in order to remedy a serious disturbance in the Spanish economy. In particular the Spanish authorities, supported by the opinion of Bank of Spain, submit that the measures are (i) appropriate and well-targeted; (ii) necessary and limited to the minimum amount necessary; and (iii) proportionate as designed to minimize negative spill-over effects on competitors.

[3] 27.6% in 2008. Nil in 2009.
[4] As defined in Disposición Adicional Sexta of Law 13/1994, de Autonomía del Banco de España.

(26) *Appropriate and well-targeted*. The Spanish authorities submit that CajaSur is systemically important within the Spanish financial system, especially in its geographical operation area (the autonomous community of Andalusia) and, in particular, in the province of Córdoba. Moreover, Spain considers CajaSur systemically important due to the current tensions in the financial markets and the need to avoid additional risks entailing potential contagion.

(27) *Necessary and limited to the minimum amount*. The Spanish authorities submit that the measures (recapitalisation and liquidity line) are required to rescue CajaSur and so avoid negative spill-over effects on other financial institutions which can reduce the confidence of depositors in the banking system as a whole. In addition, the measures are limited in size to what is necessary to ensure that CajaSur: i) meets a solvency ratio of 8% of the risk weighted assets (stressed under a time horizon of three months) set by the Spanish banking regulation; ii) has sufficient liquid resources in order to meet its liabilities during the restructuring period. Finally, the Spanish authorities observe that these measures are limited in time since they are part of a restructuring plan which will be developed by the FROB in one month. This restructuring plan is to be approved by the Bank of Spain and will be notified to the Commission.

(28) *Proportionate*. The Spanish authorities submit that the terms and conditions of the two measures, together with the terms and conditions which will be imposed on CajaSur, contain an extensive range of safeguards against possible abuses and distortions of competition.

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

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

(ii) To suspend any payments to the " Obra-Benéfico-Social" for new projects:

(iii) To consult the European Commission before making any payments on hybrid instruments unless those payments are required by legal obligation; not to exercise a call option on the same instruments without obtaining the prior approval of the Commission;

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

(v) To submit a restructuring plan by 22 November 2010 in line with the principles laid down in Commission's Communication on the return to viability and the assessment of the restructuring measures in the financial sector (hereinafter "Restructuring Communication")[5] and the Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis" (hereinafter "the Banking Communication")[6].

[5] OJ C195, 19.8.2009, p. 9.

[6] Commission Communication on "The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis", OJ C 270, 25.10.2008, p. 8.

4 ASSESSMENT

4.1 Existence of State Aid

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

(31) The Commission observes that in this case, the intervening authority (the FROB) is directly financed through State resources.

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

(33) As regards the first proposed recapitalisation measure which is being provided by the State, it would not have been provided by a market economy investor expecting a reasonable return on his investment, especially given its size. The Spanish authorities have acknowledged that, the merger negotiations with Unicaja having failed, no market solution was available to CajaSur. As stated by the Spanish authorities, the desire to avoid a further deterioration in CajaSur's financial position, which would represent a threat to the stability of the financial system as a whole due to the current macroeconomic conditions in Spain and the turbulence in financial markets, has determined the State intervention, rather than the possible return for the FROB as an investor[7] As regards the liquidity line, Spain knows that CajaSur does not have sufficient liquid resources in order to meet its liabilities during the restructuring period and to maintain the confidence of depositors. In addition the State does not foresee a significant remuneration in the recapitalisation measure, and only a very low remuneration in the credit facility which is not in line with market conditions especially in view of the distressed situation of the bank. Therefore, the measures provide a selective advantage to CajaSur.

(34) The Commission furthermore finds that the measures distort competition as they allow CajaSur to obtain the capital and liquidity necessary to avoid technical insolvency and exit from the market in the very short term.

(35) The Commission finds that the measures are also likely to affect trade between Member States as CajaSur is competing on the Spanish retail savings markets, the Spanish mortgage lending markets and the Spanish commercial lending markets. In all these markets, some of CajaSur's competitors are subsidiaries of foreign banks. CajaSur is also active on the European (and international) wholesale funding markets.

[7] Article 7 para 2, lett.b) states that the FROB "…will submit to Bank of Spain a restructuring plan for institution, which will enable it to overcome its situation of difficulty by merger or part of its business to another or other institutions by transfer en bloc or in part of its assets and liabilities…".

Conclusion

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

4.2 Compatibility of the aid

(37) As regards compatibility with the internal market of the aid provided to CajaSur, the Commission first needs to determine whether the aid can be assessed under Article 107(3)(b) TFEU, i.e. whether the aid remedies a serious disturbance in the economy of Spain. Subsequently, the Commission, using this legal basis, has to assess whether the measures at issue are compatible with the internal market

4.2.1 Legal basis for the compatibility assessment

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

(39) Given the present circumstances in the financial markets, the Commission considers that the measures may be examined under Article 107(3)(b) TFEU.

(40) The Commission observes that market conditions have been difficult globally since the last quarter of 2008. The Commission notes that Spain in particular is being severely hit by the financial and economic crisis. The economic downturn combined with the fall in property prices and the exposure of some Spanish banks to land and property development loans have lead to significant impairment of assets.

(41) The Spanish authorities have shown that CajaSur has witnessed a considerable deterioration of its capital and liquidity position in the past months. Indeed, according to the Spanish authorities, the solvency ratio of CajaSur was at […]% at 31 March 2010, against a minimum requirement of 8%. In February 2010, the bank presented a plan to Bank of Spain where it estimated that it needed € […] of additional capital in order to achieve the minimum requirement (over three months period). In addition, it indicated that it needs a credit facility to face its decrease in funding capability. The failure of the merger talks with Unicaja meant that no market solution was available to raise this capital.

(42) Without the capital injection and the liquidity line CajaSur would be technically insolvent with severe adverse impacts on other banks and the wider financial system in Spain, and in particular on other saving banks. The assessment of the Spanish authorities is that the bank's insolvency has the potential to inflict severe losses on other financial institutions, destabilising the Spanish financial markets and triggering a generalised confidence crisis at the present delicate juncture. CajaSur's position as a systemically important financial institution has been confirmed by Bank of Spain.

(43) For these reasons the Commission accepts that in the current circumstances the recapitalisations and the credit facility in favour of CajaSur are necessary to avoid a serious disturbance in the economy of Spain.

4.2.2 Compatibility assessment

(44) In line with point 15 of the Banking Communication, in order for an aid or aid scheme to be compatible under Article 107(3)(b) TFEU it must comply with general criteria for compatibility under Article 107(3) TFEU, which imply compliance with the following conditions[8]:

a. *Appropriateness*: The aid has to be well targeted in order to be able to effectively achieve the objective of remedying a serious disturbance in the economy. This would not be the case if the measure were not appropriate to remedy the disturbance.

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

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

(45) The Commission Communication on "The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortion of competition" (hereinafter "the Recapitalisation Communication")[9], further elaborates on the three principles of the Banking Communication and states that recapitalisations can contribute to the restoration of financial stability. In particular the Recapitalisation Communication states that recapitalisations may be an appropriate response to the problems of financial institutions facing insolvency.[10]

4.2.2.1 Compatibility with the Banking and Recapitalisation Communications

a. Appropriateness of the Measures

(46) The recapitalisation measure aims a re-establishing the minimum capital requirement of 8% for CajaSur (stressed over three months horizon), taking into account further losses stemming from its loan portfolio in the near future. The recapitalisation will be in the form of 'cuotas participativas', an equity-like instrument specific to saving banks which qualifies as own funds (Core Tier 1) under Spanish legislation.

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

(48) The Commission considers that the measures are appropriate because they effectively meet their objective to ensure that CajaSur is in compliance with its regulatory capital

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

9 Commission Communication on " The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortion of competition ", OJ C 10 of 15.01.2009, p. 2.

10 Recapitalisation Communication, paragraph (6).

requirements in a three months horizon and can meet its funding needs until 31 December 2010, and that the measures effectively achieve the objective of preventing the failure of CajaSur. The measures furthermore ensure that financial stability in Spain is maintained, as confirmed by Bank of Spain.

b. Necessity – limitation of the aid to the minimum

(49) According to the Banking Communication, the aid measure must, in its amount and form, be necessary to achieve the objective. That implies that the capital injection must be of the minimum amount necessary to reach the objective. In this context, the Commission observes that the amount of the measures will ensure that CajaSur will again fulfil its ordinary regulatory capital requirements and will be able to fund its current activities.

(50) As regards the remuneration CajaSur has to pay, the FROB will receive no fixed remuneration on its capital injection given that the rescue aid is granted through an equity-like instrument whose remuneration is based on distributable profits. The FROB will only be remunerated if CajaSur is in a position to pay out a dividend. This however is unlikely given the overall situation of the saving bank. Spain also accepts that the FROB is unlikely to make a return on its investment in CajaSur Finally, Spain committed to suspend any payments for new projects to the Obra-Benéfico-Social.

(51) The Commission considers therefore that given the situation and prospects of CajaSur, it is highly unlikely that it will be in a position to fulfil the conditions which allow it to adequately remunerate the capital injection.

(52) The Commission in this context notes that paragraphs 15 and 44 of the Recapitalisation Communication explain that lower remuneration in duly justified cases can be accepted in the short term for distressed banks on the condition that this lack of remuneration will be reflected in the restructuring plan. In this case, there is no doubt that CajaSur is not fundamentally sound, according to the criteria set out in the Annex to the Recapitalisation Communication: it is not complying with the capital adequacy ratios, its business model is unsustainable, the size of the recapitalisation is […] weighted assets which is significantly above the 2% threshold, and its financial rating (BB+) is below investment grade[11].

Obligation to submit a restructuring plan or a liquidation plan

(53) The Recapitalisation Communication states that financial institutions that receive a capital injection while they are not fundamentally sound, such as CajaSur, are under the obligation to submit a far-reaching restructuring plan or a liquidation plan within six months of their recapitalisation.[12]

(54) The extent to which CajaSur will need to restructure its activities is increased by the very high aid amount and by fact that the recapitalisation measures do not foresee a return for the State. Paragraph 15 of the Recapitalisation Communication allows an exception to the general requirement of remuneration for recapitalisations only in the

[11] CDS spreads are not available for CajaSur

[12] Recapitalisation Communication, paragraph 44.

short term, and only under the assumption and condition that the costs of public intervention and the competitive impact of the State intervention will be reflected in the compensatory measures within the restructuring plan.

c. Proportionality – measures limiting negative spill-over effects

(55) Spain has committed to suspend any payments to the OBS for new projects, to consult the European Commission before making any payments on hybrid instruments unless those payments are required by legal obligation; not to exercise a call option on the same instruments without obtaining the prior approval of the Commission. Taking into consideration the difficulties CajaSur is facing combined with the need to maintain financial stability in Spain, the Commission considers these measures at this time to be sufficient to be able to temporarily approve the measures as rescue aid.

Conclusion

(56) The Commission thus concludes that: (i) the recapitalisation and the credit facility are appropriate to restore the solvency of CajaSur and necessary as they are limited to the minimum; (ii) CajaSur is not a fundamentally sound bank, in particular, in view of its financial situation and of the very high aid amount; (iii) the fact that the investment in CajaSur is highly unlikely to provide any remuneration or positive return is justified under the circumstances; (iv) CajaSur is under the obligation to submit a restructuring plan before 22 November 2010, which has to reflect the level of distress of the bank, the size of the State recapitalisation, and the absence of return for the State; and (v) there are sufficient measures limiting the negative spill-over effects for other competitors to enable the Commission to temporarily approve the measures as emergency aid. The Commission can therefore temporarily approve the measures for six months.

4.2.2.3 Restructuring plan

(57) As regards the need for an assessment of the institution's balance sheet and activities, the Recapitalisation Communication states in paragraph 44 that the use of recapitalisation for a distressed bank can only be accepted on the condition of a far-reaching restructuring. The Commission furthermore observes that the aid provided to CajaSur exceeds 2% of its RWA, confirming that an in-depth restructuring would be required. The Commission furthermore observes that the Spanish authorities have committed to submit a restructuring plan for CajaSur.

(58) The Commission therefore requests the Spanish authorities to submit a restructuring plan for CajaSur taking into account all aid measures CajaSur has received that fulfils the requirements of the Restructuring Communication[13] as regards return to viability, burden-sharing and own contribution and measures limiting the distortion of competition. The restructuring plan should be submitted to the Commission by 22 November 2010.

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[13] Communication from the Commission "The return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules", OJ C195, 19.8.2009, p. 9.

CONCLUSION

- The Commission concludes that the two measures (EUR 800 million capital injection and the EUR 1.5 billion credit facility) in favour of CajaSur constitute State aid pursuant to Article 107(1) TFEU

- The Commission finds that the emergency measures in favour of CajaSur are temporarily compatible with the internal market for reasons of financial stability. The measures are accordingly approved for six months or, if Spain submits a restructuring plan before that date, until the Commission has adopted a final decision on the restructuring plan.
- The Commission requests the Spanish authorities to submit an in-depth restructuring plan at the latest by 22 November 2010.
- The Commission notes that for reason of urgency Spain exceptionally accepts the adoption of the Decision in the English language.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

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Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
State Aid Greffe
Rue Joseph II 70
B-1049 Brussels
Fax No: (+32)-2-296.12.42

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President of the Commission