EUROPEAN COMMISSION

Brussels, 30.6.2011
C(2010) 4715 final

<u>Subject:</u> **State aid SA.33177 (2011/N) – Portugal**
Fourth extension of the Portuguese Recapitalisation Scheme

Sir,

I. PROCEDURE

1. On 20 May 2009, the Commission approved under case number N 556/2008 the Portuguese Recapitalisation Scheme (hereafter "the Scheme") until 20 November 2009[1]. On 17 March 2010, the Commission approved the first prolongation of the Scheme until 30 June 2010 under case number N 80/2010[2]. On 23 July 2010, the Commission approved the second prolongation of the Scheme until 31 December 2010 under case number N 314/2010[3]. On 21 January 2011, the Commission approved the third extension of the Scheme until 30 June 2011.[4]

2. On 14 June 2011, Portugal notified to the Commission the extension of the Scheme until 31 December 2011. On 22 June 2011, the Portuguese authorities exceptionally accepted that the Commission decision be adopted in the English language.

II. DESCRIPTION

1. The objective of the Scheme

3. The objective of the Scheme is to strengthen financial stability by recapitalising credit institutions in order to increase their creditworthiness and to allow beneficiaries to continue complying with capital requirements.

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1 Commission Decision C(2009) 4028 of 20 May 2009 – State aid N556/2008, OJ C 152, 04.07.2009
2 Commission Decision C(2010) 1733 of 17 March 2010 – State aid N80/2010, OJ C 119, 7.5.2010
3 Commission Decision C(2010) 5128 of 23 July 2010 – State aid N314/2010, OJ C 283, 20.10.2010
4 Commission Decision C(2011) 324 of 21 January 2011 – State aid SA.32157 OJ C 111, 09.04.2011

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2. Description of the Scheme

4. The beneficiaries of the Scheme are all credit institutions with a registered office in Portugal, irrespective of their financial soundness.

5. The recapitalisation operations can be carried out with any financial instruments that are eligible as Tier 1 capital. The Portuguese authorities have undertaken to notify to the Commission any individual recapitalisation measures in which State participation is executed through the subscription of instruments other than ordinary shares or preferential shares with special rights.

6. The budget of the Scheme was EUR 3 billion. It will be increased to EUR 12 billion, with effect from the date of entry into force of the relevant amended law in Portugal, which is not yet enacted.

3. Operation of the Scheme

7. The Portuguese authorities submitted a report on the operation of the Scheme on 14 June 2011.

8. According to the information provided by the Portuguese authorities, no recapitalisation operations have been carried out under the Scheme.

III. Position of Portugal

9. The Portuguese authorities have notified the extension and the amendments to the Scheme as compatible State aid within the meaning of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("TFEU").

10. According to the letter of Bank of Portugal dated 17 June 2011, the Scheme must be extended for a number of reasons. First, the Memorandum of Understanding ("MoU")[5] signed between the Portuguese Government on the one hand, and the International Monetary Fund, the European Commission and the European Central Bank on the other hand foresees measures for the banking sector, which include the maintenance and the reinforcement of the recapitalisation scheme. Second, access to market capital by financial institutions in Portugal is currently almost inexistent, with no short-term perspective of improvement. Third, the *'Aviso de Banco de Portugal n° 3/2011'* requires credit institutions to reach a consolidated basis Core Tier 1 ratio of 9% by 31 December 2011.

11. Under those circumstances, the Portuguese authorities consider necessary the extension of the Scheme until 31 December 2011.

12. Portugal undertakes to maintain the commitments made in the context of the original authorisation of the Scheme and of its prolongations, and confirms that all other conditions as reflected in the Commission decisions in State aid cases N 556/2008, N 80/2010, N 314/2010 and SA.32157 (2010/N) remain unchanged and continue to apply.

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5 Portugal, " Memorandum Of Understanding On Specific Economic Policy Conditionality", 17 May 2011, http://ec.europa.eu/economy_finance/eu_borrower/mou/2011-05-18-mou-portugal_en.pdf

IV. ASSESSMENT

1. Existence of State aid

13. As set out in Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

14. For the reasons indicated in its original decision in State aid case N 556/2008, the Commission considers that the measure constitutes State aid. The notified extension does not affect that finding. The measure remains State aid within the meaning of Article 107(1) TFEU.

2. Compatibility of the Scheme

15. For the reasons indicated in the original decision, the Commission found the measure to be compatible with the internal market under Article 107(3)(b) TFEU, as it met the relevant criteria of appropriateness, necessity and proportionality.

16. The Commission observes that the high instability on the financial markets determined by the sovereign risk continues to have a significant impact on the capacity of Portuguese financial institutions to raise funds. Moreover, the Commission also notes that the extension of the Scheme is part of the measures agreed upon under the MoU.

17. The Commission considers that the exceptional circumstances at the origin of the notified Scheme justify the need for the extension of the Scheme. The letter from the Bank of Portugal confirms that necessity.

18. The Commission notes that the Scheme has not been used up to now. However, the Commission considers that the Scheme could function as a safety net in order to allow Portuguese credit institutions to maintain their support to the financing of the economy. Therefore, the Commission considers that the extension of the Scheme until 31 December 2011 is appropriate and necessary to remedy the serious disturbance of the Portuguese economy.

19. The Commission notes that the extension is limited in time (until 31 December 2011) which will limit the potential distortion of competition. The extension of the Scheme and the increase in the budget with resources of up to EUR 12 billion is a response to the difficulties that Portuguese banks have to deal with.

20. In particular, the Commission notes that the Portuguese banking system is currently facing severe difficulties. Banks are highly leveraged and non-performing loans are increasing due to the highly indebted economy with weak growth prospects.

21. In order to enhance confidence in the solvency of the banking system under the current circumstances and to maintain the credit supply to the economy, the Bank of Portugal has requested banks to further strengthen their capital buffer. All banks will have to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent at the latest by end-2012 (and maintain it thereafter). If needed, the Bank of Portugal will also require some banks, based on their specific risk profile, to reach those higher capital levels sooner. Banks will try to raise that money from private sources as a first step, before applying for the scheme.

22. The increase of the budget of the Scheme up to EUR 12 billion, which is also agreed in point 2.4 of the MoU, takes into account the scale of the new capital requirements and the current economic context.

23. The renewed extension is in line with the requirements set out in the Commission Communication of 1 December 2010 on the application, after 1 January 2011, of State aid rules to support measures in favour of banks in the context of the financial crisis[6]. In particular, that Communication requires the presentation of a restructuring plan in any event of granting of recapitalisation measures.

24. The Commission notes that Portugal confirms that all the commitments made in relation to the Scheme will continue to apply, including those related to presenting every six months a report on the operation of the Scheme. Furthermore, the Commission notes that Portugal committed to submit individual restructuring plans within six months for all beneficiaries. In addition, Portugal commits to notify to the Commission any modification of the conditions of the notified Scheme that may be introduced once the new national legal basis is enacted.

25. As regards the combination of the Scheme with other aid measures, as indicated in the Annex to the Restructuring Communication, any restructuring plan should contain all State aid received as individual aid or under a scheme during the restructuring period and all such aid needs to be justified as satisfying all criteria prescribed by the Restructuring Communication (i.e. return to viability, own contribution by the beneficiary and limitation of competition distortion). It means that the Commission needs to take a view in its final decision as to whether any aid granted during the restructuring period satisfies the criteria required for the authorisation of restructuring aid. To that end an individual *ex ante* notification is necessary.

26. Furthermore, the Commission recalls that, based on paragraph 16 of the Restructuring Communication, should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, it cannot be granted under an approved scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission's final decision on that bank.

27. On the basis of the above, the Commission does not object to the extension of the Scheme until 31 December 2011.

V. DECISION

The Commission concludes that the notified extension of the Portuguese Recapitalisation Scheme does not alter its previous assessment in the decision of 21 January 2011 in State aid case SA.32157 (2010/N) that the Scheme is compatible with the internal market. The Commission has accordingly decided not to raise objections to the extension of the Scheme until 31 December 2011 included.

The Commission notes that Portugal has exceptionally accepted that the decision be adopted 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

6 OJ C329, 7.12.2010, p.7

agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:
http://ec.europa.eu/eu_law/state_aids/state_aids_texts_en.htm

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

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Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-President of the Commission