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Subject: State Aid SA. 48549 (2017/N) – Portugal
Eighth prolongation of the Portuguese Guarantee Scheme on EIB lending

Sir,

1. PROCEDURE

(1) On 27 June 2013 the Commission approved the Portuguese Guarantee Scheme on European Investment Bank ("EIB") lending ("the scheme") by its decision in State aid case SA.36180 ("the original decision")[1].

(2) On 7 October 2013 the Commission approved an amendment of the scheme by its decision in State aid case SA.37417 pursuant to which State guarantees granted under the scheme would not trigger the obligation of the beneficiary bank to submit a restructuring plan[2].

(3) On the basis of subsequent notifications, the Commission approved the prolongation of the scheme in its decisions of 17 December 2013 in State aid case SA.37688[3], of 30 July 2014 in State aid case SA.38778[4], of 6 February 2015 in State aid case SA.39958[5], of 15 July 2015 in State aid case SA.42156[6], of 1 February 2016 in State aid case SA.44013[7], of 28 July 2016 in State aid case SA.45671[8], and of 2 February 2017 in State aid case

1 OJ C 220, 01.08.2013, p. 3.
2 OJ C 251, 01.08.2014, p. 4.
3 OJ C 117, 16.04.2014, p. 25.
4 OJ C 393, 07.11.2014, p. 9.
5 OJ C 136, 24.04.2015, p. 6.
6 OJ C 277, 21.08.2015, p. 10.
7 OJ C 284, 05.08.2016, p. 4.
8 OJ C 341, 16.09.2016, p. 12.

S. Ex.ª o Ministro dos Negócios Estrangeiros
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SA.47164[9]. By its decision in case SA.47164, the Commission authorised the prolongation of the scheme until 30 June 2017.

(4) On 30 June 2017 Portugal notified a prolongation of the scheme for 6 months from the adoption date of the present decision. The notification was completed by further submissions of information on 12 July 2017, 18 July 2017 and 24 October 2017.

(5) By letter of 5 July 2017, Portugal agreed exceptionally to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958[10] and to have the present decision adopted and notified in English.

2. FACTS

2.1. Description of the scheme

(6) The scheme is based on Portuguese Law 112/97 of 16 September 1997 and Article 103-A of Law 64-B/2011 of 30 December 2011 as amended by Law 20/2012 of 14 May 2012. Furthermore, on 7 December 2012 the Republic of Portugal and the EIB reached an agreement ("Garantia de Carteira") on the terms and conditions of the scheme.

(7) The total budget of the scheme is EUR 2.8 billion, covering a maximum exposure up to EUR 6 billion of existing and new funding from the EIB to the real economy in Portugal.

(8) The turbulences that occurred in the past years in the global financial markets, and, in particular, the sovereign debt crisis that affected Portugal gave rise to rating downgrades of large parts of the Portuguese financial sector. In response, Portugal brought forward the scheme to preserve on the one hand the stability of the financial system and, on the other hand, to maintain existing lending and to increase future lending from the EIB to the real economy in Portugal.

(9) Currently, the EIB grants loans to undertakings in Portugal ("the final borrowers") either directly, with banks guaranteeing those loans ("the guarantors"), or through intermediary banks which lend on the funds to the final borrowers.

(10) A detailed description of the scheme is provided in the original decision, in particular at recitals 15 to 22.

2.2. Utilisation of the scheme

(11) Regarding the utilisation of the scheme, Portugal submitted a report of existing guarantees. As of 30 September 2017, they included an overview of the currently guaranteed operations, split between the outstanding maximum exposure (EUR 2.051 billion) and the effectively outstanding amount within that exposure (EUR 1.909

9 OJ C 110, 07.04.2017, p. 1.

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

billion)[11]. The total budget of the scheme, which is the effective guarantee cap, is still EUR 2.8 billion. This budget has not been exceeded.

3. POSITION OF PORTUGAL

(12) Portugal requests a prolongation of the scheme for 6 months from the adoption date of the present decision, under the same conditions as approved through the previous Commission decisions regarding the scheme.

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

(14) Portugal submitted a letter by the Bank of Portugal further supporting the need for the proposed prolongation, even in the current conditions of economic recovery in Portugal. The Bank of Portugal considers that financial stability considerations still require that investment and economic growth is promoted by facilitating access to capital markets especially for SMEs, for which it remains difficult. The Bank of Portugal also notes that the ratings of Portuguese banks continue to be mostly in the non-investment grade area, despite some improvements in 2017. Against this backdrop of vulnerability, the scheme represents, in the opinion of the Bank of Portugal, a tool to ensure an appropriate flow of credit to non-financial corporations. Also according to Bank of Portugal, from a liquidity point of view, the prolongation of the scheme appears necessary since this will allow the Portuguese credit institutions to maintain the level of collateral available, which consequently will ease the access of banks to external funding sources.

(15) In line with the requirements of the 2011 Prolongation Communication[12], Portugal has provided an indicative fee (estimation) for each financial institution eligible to benefit from those guarantees. The estimation was based on an application of the scheme's remuneration formula and recent market data.

(16) As for the previous prolongations of the scheme, Portugal submitted its intention to continue to determine the guarantee fee for banks which still have a traded CDS on the basis of the CDS of the sample of Union banks in the "BBB-rating and lower" rating category, as has been approved through the previous prolongation decision regarding the scheme.

(17) Portugal confirmed that the credit institutions benefiting from the scheme have complied with their obligations in relation to the guaranteed operations, as well as with the payment of the guarantee fee to the Portuguese State.

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[11] The report at 31 September 2017, indicated the remaining scope to include new operations in the scheme was around EUR 880 million (this amount corresponds to the difference between the original EUR 6 billion and the maximum guaranteed amounts committed to date, i.e. EUR 3.178 billion approved at the date of entry into force of the scheme and EUR 1.942 billion of new operations approved between December 2013 and September 2017). This follows from the fact that the EUR 6 billion maximum guaranteed portfolio cannot be replenished; in other words, once a guarantee operation is included in the EUR 6 billion portfolio, the maximum guaranteed portfolio is reduced with the same amount.

[12] Communication from the Commission on the application, from 1 January 2012 , of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

(18) Portugal reasserted the commitments put forward at the second prolongation of the scheme[13]:

a) The Portfolio State Guarantee (PSG) covers an exposure of up to EUR 2.8 billion of the Portuguese State towards the European Investment Bank (EIB), for a portfolio of liabilities of up to EUR 6 billion granted or to be granted by the ЕШ;

b) The PSG was designed to cope with rating downgrades of banks guaranteeing EIB liabilities towards investments in Portugal whereby banks need to either post additional collateral or seek alternatives;

c) The PSG is subject to an agreement between Portugal and the EIB signed on the 7th December 2012;

d) The participating banks will not retain any advantage from the PSG that could serve to develop other business activities. The banks will either pass the full advantage of the State guarantee to the final recipients of the funds provided by EIB or they will pass the advantage to toe Portuguese State;

e) With respect to the bank's busmess covered specifically by the PSG, the participating banks can only retain an adequate compensation that covers only:
- Their capital costs,
- Their credit risk,
- Their general and administrative costs incurred by that particular business,
- A handling fee to cover for the additional administrative cost linked to the monitoring of the compliance with the terms and conditions of the State guarantee, of up to a maximum of 10 bps (as a percentage of the institution's exposure)[14].

f) The PSG is limited to the minimum necessary in scope and time: the guarantees will not exceed 7 years and the guarantee shall cease as soon as the banks benefitting from it recover a Tating allowing them not to post additional collateral as per ЕШ standards, whichever is earlier,

g) The PSG scheme is open to all banks operating in Portugal and willing to join the scheme;

h) In case there is any aid passed to the final beneficiaries, the Republic of Portugal will ensure its compatibility;

i) The PSG will not cover loans considered by the EIB as non-performing;

j) As of the entry into force of the new Commission's Guidelines on State Aid to financial services Portugal commits to impose on banks to refrain from aggressive commercial practices or from advertising having gained access to state aid funds eventually retained from the PSG;

k) As of the entry into force of the new Commission's Guidelines on State Aid to financial services Portugal commits to provide the Commission individual restructuring or liquidation plans, within six months, for banks which cause the PSG to be called upon.

[13] See footnote 4.

[14] Should there be good reasons for an institution to exceed this amount, a duly justified request will be made to the Commission.

Pricing of the guarantee

l) The pricing of the PSG will be in line with the methodology established in the 2011 Prolongation Communication that determines the minimum fees applicable for the compatibility of crisis-related State aid in the form of guarantees to banks.

Monitoring of the scheme

m) The Republic of Portugal will put in place a monitoring system that will ensure that participating banks abide by the terms and conditions of the PSG scheme. In particular, if banks retain any additional benefits they will have to pay it back to the State, with interest;

n) The Republic of Portugal commits to re-submit the PSG for state-aid analysis every six months.

4. ASSESSMENT

4.1. Existence of State Aid

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

(20) Although the terms and conditions of the scheme may not give rise to an advantage in relation to new exposures, the scheme is devised as a single mechanism which covers both existing and new exposures of a portfolio of revolving credits. For the reasons indicated in the original decision, the Commission notes that the scheme concerns the provision of State resources to a certain sector, i.e. the financial sector, which is open to intense international competition. The scheme essentially provides the guarantors with an advantage, as it allows them not to post additional collateral in relation to existing exposures but still remain eligible for the purposes of the EIB in guaranteeing new EIB loans. However, Portugal has committed that the participating banks will not retain any advantage from the scheme that could serve to develop other business activities. The banks will either pass the full advantage of the State guarantee to the final recipients of the funds provided by EIB or they will pass the advantage to the Portuguese State.

(21) The measure is selective because it is only open to the financial sector and indeed only to guarantors who have issued or will issue guarantees for funding provided by the EIB. The provision of that advantage to the guarantors is capable of affecting intra-Union trade.

(22) As the measure is a scheme covering several elements, and as at least one or some of the elements of the scheme constitutes State aid, the measure therefore involves State aid within the meaning of Article 107(1) TFEU.

4.2. **Compatibility of the scheme**

4.2.1. Legal basis for the compatibility assessment

(23) Under the scheme Portugal intends to provide aid in the form of guarantees, subject to certain conditions, in favour of the guarantors for the funding granted by the EIB to the final borrowers, either directly or indirectly through banks.

(24) Given the exacerbation of tensions in sovereign debt markets that has taken place since 2011 and in light of the persisting circumstances and risks, the Commission considers it appropriate, as confirmed by the 2013 Banking Communication[15], to examine the measure under Article 107(3)(b) TFEU.

(25) Article 107(3)(b) TFEU empowers the Commission to find that aid is compatible with the internal market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance. That assessment has been confirmed in the Recapitalisation Communication[16] and the Restructuring Communication[17]. The Commission still considers that the conditions for State aid to be approved pursuant to Article 107(3)(b) TFEU are present. The Commission confirmed that view by adopting the 2013 Banking Communication[18].

(26) The Commission does not dispute the position of the Portuguese authorities that regular access of banks to funding in financial markets remains vulnerable at the current juncture, despite recent positive developments concerning Portugal's sovereign rating. The Commission notes that Portugal ended its three-year Economic Adjustment Programme in May 2014, which included the implementation of an ambitious reform agenda and contributed to regaining economic growth and restoring investor confidence for the sovereign and that one rating agency (S&P) increased Portugal's credit rating in September 2017 one notch to BBB-, returning it to "investment-grade" status. Yet, the issuance activity of Portuguese financial institutions in the international debt market is not yet broad-based, with vulnerabilities in the sector. Those concerns should continue to be addressed in order to safeguard financial stability and credit availability in the Portuguese economy, therefore the existence of the scheme continues to be a safeguard instrument for the Portuguese financial system for the time being.

(27) Therefore, the Commission cannot firmly conclude yet that market access conditions for the Portuguese banking system as a whole have been fully restored. The Commission notes that the availability of the scheme can enhance the ability of the Portuguese financial institutions to access increased funding, by maintaining and increasing EIB lending, directed to sectors of the Portuguese economy affected by the deleveraging process in the financial sector. Hence, the Commission finds that the scheme aims at remedying a serious disturbance in the Portuguese economy.

(28) Therefore, the Commission continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

(29) In order for an aid to be compatible under Article 107(3)(b) TFEU, it must comply with the general principles for compatibility under Article 107(3), viewed in the light of the general objectives of the Treaty. Therefore, according to the Commission's case

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

16 Commission Communication - Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

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

18 See points 4 to 6 of that Communication.

practice[19] any aid or scheme must comply with the following conditions: (i) appropriateness, (ii) necessity and (iii) proportionality.

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

4.2.2. Compatibility assessment of the scheme

Appropriateness

(31) The scheme should be appropriate to remedy a serious disturbance in the Portuguese economy. The objective of the scheme is to temporarily offer appropriate measures for the Portuguese financial system in a timely and efficient manner, where financial institutions face difficulties in maintaining their eligibility as guarantors vis-à-vis the EIB in the aftermath of the financial crisis and the resulting material credit rating downgrades of Portuguese financial institutions. The Commission observes that confidence in the creditworthiness of the banks is still vulnerable in Portugal, and does not yet reflect the improved economic environment. Hence, the scheme is an appropriate means to address eligibility of the banks from an EIB perspective.

(32) Pursuant to point 61 of the 2013 Banking Communication, in exceptional cases the Commission may also approve guarantees covering exposures of the EIB towards banks for the purpose of restoring lending to the real economy in countries with severely distressed borrowing conditions compared to the Union average. In assessing such measures, the Commission examines in particular whether they do not confer an undue benefit that could for example serve to develop other business activities of those banks.

(33) The Commission notes that Portugal has committed to ensure that the guarantors do not retain any undue benefits that could for example serve to develop other business activities of those banks. In addition, the original description of the scheme (see recital 17 of the original decision) restrictively defines the elements of the aggregate fee that the guarantors can charge to the final borrowers.

(34) The scheme is limited to guarantors who have issued or will issue guarantees for funding provided by the EIB.

Necessity

(35) With regard to the scope of the measure, the Commission notes positively that Portugal has limited the size of the guarantee scheme by setting its maximum budget at EUR 2.8 billion and that the scheme applies for 6 months from the adoption date of the present decision. The Commission also notes that, taking into account that the EUR 6 billion maximum guarantee portfolio cannot be replenished, the remaining scope to include new operations is limited to EUR 880 million[20].

(36) Additionally, the State guarantee is issued for a maximum period of seven years and will expire as soon as a guarantor regains credit rating eligibility status for the EIB, whichever happens earlier.

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[19] See Commission decision of 6.9.2013 in State Aid Case SA.37314 "Rescue aid in favour of Probanka", OJ C314, 29.10.2013, p. 1 and Commission decision of 6.9.2013 in State Aid Case SA.37315 "Rescue aid in favour to Factor Banka", OJ C 314, 29.10.2013, p. 2.

[20] See footnote 11.

(37) Regarding the remuneration level, the Commission observes that Portugal, in line with point 59(c) of the 2013 Banking Communication, has committed to follow the pricing and other conditions for State guarantees laid down in the 2011 Prolongation Communication which requires, in particular, the application of a pricing method based largely on market data.

(38) For Member States currently or recently subject to a financial assistance programme, it is appropriate to consider the CDS spreads of individual banks located there as temporarily non-representative of the intrinsic risk of those banks, because the respective CDS rates reflect not only the banks' intrinsic risk profile, but also the sovereign risk. Portugal has exited its financial assistance programme almost three years ago, under which an ambitious reform agenda was implemented that contributed to restoring investor confidence for the sovereign. However, the markets' risk perception of the sovereign has recently widened again, while banks' access to international debt markets is not broad-based, with vulnerabilities in the sector.

(39) On that basis and for the time being, the Commission does not object to Portugal's intention to continue to determine the guarantee fee for banks which still have a traded CDS on the basis of the CDS of the sample of Union banks in the "BBB- and lower" rating category. The Commission will review its assessment of the macro-economic situation and appropriateness of that exceptional pricing mechanism whenever a further prolongation of the scheme is notified.

Proportionality

(40) The Commission notes that Portugal has committed[21], in line with point 59(f) of the 2013 Banking Communication, to a number of behavioural safeguards such as a ban on advertisements referring to the State support and a ban on any aggressive commercial strategies which would not take place without the State support. Such safeguards help ensure that the participating institutions do not misuse the received State support to expand their activities.

(41) Finally, the Commission welcomes that Portugal undertakes to submit individual restructuring or liquidation plans, within two months, for banks which cause the guarantee to be called upon, in line with point 59(e) of the 2013 Banking Communication.

(42) As regards the combination of the scheme with other aid measures, the Commission recalls that, as indicated in the Annex to the Restructuring Communication, the restructuring plans to be submitted should contain all State aid received as individual aid or under a scheme during the restructuring period.

(43) Furthermore, based on point 16 of the Restructuring Communication, the Commission recalls that, should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, such additional aid cannot be granted under an approved scheme but needs to be subject to individual ex ante notification. All State aid measures received by a bank as individual aid or under the scheme during the restructuring period will be taken into account in the Commission's final decision on that bank.

Monitoring

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[21] See recital (18).

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

(45) Portugal has put in place a monitoring system that ensures that participating banks abide by the terms and conditions of the scheme. In particular, if banks retain any additional benefits they will have to pay it back to the State, with interest.

(46) Portugal commits to re-notify the scheme for State aid analysis every six months.

Conclusions on the compatibility of the aid measure

(47) The scheme remains an appropriate, necessary and proportionate measure to remedy a serious disturbance of the Portuguese economy and does not alter the Commission's previous assessment in the original decision. The notified prolongation therefore complies with the requirements set out above and is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

(48) In line with the Commission's decisional practice, the scheme can therefore be prolonged for 6 months from the adoption date of the present decision. Any further prolongation will require the Commission's prior approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness.

5. CONCLUSION

The Commission has accordingly decided to consider the aid to be compatible with the internal market and not to raise objections to the scheme.

Portugal exceptionally accepts that the present decision be adopted in the English language, for reasons of urgency.

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Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

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