EUROPEAN COMMISSION

Brussels, 1.6.2011
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COMP Operations

Subject: SA. 32990 (2011/N) - Spain
Fifth prolongation of the Spanish Guarantee Scheme for credit institutions - Spain

Madam,

I. PROCEDURE

1. On 14 October 2008, Spain notified a scheme for the creation of a debt guarantee scheme ("**the Scheme**"), which was approved by the European Commission on 23 December 2008, (State aid case NN 54b/2008).

2. On 31 March 2009, Spain notified changes to the Scheme, which were approved on 16 April 2009. On 23 April 2009, a corrigendum was published in order to correct some translation and stylistic mistakes.

3. On 27 May 2009, Spain notified the Commission a request to prolong, for the first time, and amend the Scheme. The first prolongation was approved on 25 June 2009 (State Aid N 336/2009).

4. On 26 October 2009, Spain notified the Commission a request to prolong, for the second time, the Scheme for an additional period of six months, which was approved on 1 December 2009 (State Aid N 588/2009).

5. On 18 June 2010, Spain notified to the Commission a request to prolong, for the third time, and amend the Scheme for an additional period of six months, which was approved on 28 June 2010 (State Aid N 263/2010).

6. On 16 November 2010, Spain notified to the Commission a request to prolong the Scheme, for the fourth time, which was approved on 29 November 2010 (SA. 31921 N 530/2010).

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7. Finally, on 17 May 2010, Spain notified to the Commission a request to prolong, for the fifth time, the Scheme for an additional period of six months commencing on 1 July 2011 and ending on 31 December 2011.

8. The Commission notes that for reasons of urgency, Spain exceptionally accepts the adoption of the decision in the English language.

II. DESCRIPTION

1. The objective of the Scheme

9. In response to exceptional turbulence in the financial markets, Spain brought forward a measure designed to preserve the stability of its financial system and to remedy a serious disturbance to its economy. In particular, the Scheme aimed at limiting the risks and re-establishing confidence in the financing mechanism of credit institutions and fostering lending to businesses and households. The exact details of the Scheme are explained in the Commission's earlier decisions.

10. The Spanish legislation implementing the Scheme[1] has been amended in several occasions in order to cater for, inter alia, the significant consolidation undergone by the Spanish credit institutions since 2009, and to facilitate the phasing out of the Scheme by increasing as from July 2010 the amount of the fees to be paid and the need, under certain circumstances, to be subject to a viability review so as to prevent overreliance by its beneficiaries ("**the Beneficiaries**").

2. Operation of the Scheme up to May 2011

11. In the original notification of the Scheme of 14 October 2008, Spain undertook to submit reports every six months on the operations of the Scheme. Those reports were submitted on 27 May 2009, 17 November 2009, 18 June 2010, 16 November 2010 and 10 May 2011. Furthermore, pursuant to commitments included in Decision N 263/2010 and N 530/2010, Spain also submitted a concise mid-term review on the operation of the Scheme as to 8 October 2010 and 12 April 2011.

12. According to the Spanish authorities, the Scheme has contributed positively to the easing of the impact of the crisis on the funding of the Beneficiaries and on the financial system as a whole. By reducing the risk premium, the Scheme provided the Beneficiaries with a funding mechanism at a significantly lower cost than would otherwise be available to them on the markets at the current juncture. To date, every guarantee requested under the Scheme has been granted.

13. As of 10 May 2011 (hereinafter "**the Reporting Date**"), the Beneficiaries applied for and issued debt instruments under the Scheme for a total of EUR 63.8 billion[2], with an aggregate take-up rate of 43.5%[3] of the global ceiling (EUR 146.7 billion) of the State guarantees pre-approved in the 2008 and 2009 programmes[4].

[1] Ministerial Orders of 29 December 2008 and 30 September 2009 implementing Royal Decree-law 7/2008.

[2] Up from EUR 56.8 billion, as from 11 November 2010.

[3] Up from 38.7%, as from 11 November 2010.

[4] Ministerial Orders of 29 December 2008 and 30 September 2009 implementing Royal Decree-law 7/2008. Updated information on the issuers may be found at: http://www.tesoro.es/EN/Avales/EmisionesAvaladasyenProceso_2008_EN.asp and at: http://www.tesoro.es/EN/Avales/EmisionesAvaladasyenProceso_2009_EN.asp

14. To the Reporting Date, the Beneficiaries have respected the behavioural commitments agreed by the Spanish authorities, there have not been any solvency issues and no guarantee has been called upon.

III. POSITION OF SPAIN

15. In line with the previous Decisions on the Scheme[5], the Spanish authorities accept that the Scheme contains State aid elements.

16. The Spanish authorities note, and the letter submitted by the Bank of Spain[6] confirms, that the Beneficiaries' access to market funding is still affected by the international financial crisis and, more specifically, by the sovereign debt crisis experienced throughout 2010 and 2011 and therefore it is necessary to prolong the Scheme. The Spanish authorities report that primary markets in Spain were shut down for most Beneficiaries during the central part of 2010 an that, after a slight recovery in September and October 2010, market conditions worsened towards the end of the year and have to date not normalized.

17. Moreover, according to the Spanish authorities the prolongation of the Scheme is desirable, as it still constitutes an important tool to address potential new difficulties in the primary debt markets in coming months. Indeed, the economic recovery is still slow and the ratio of non-performing assets, especially in the real estate sector, continues to be high. For all those reasons, the Spanish banking sector remains under pressure and it is still important to restore the confidence of depositors and financial markets.

18. The Spanish authorities are planning to prolong the window for issuing new debt instruments under the Scheme for a further six-month period commencing on 1 July 2011. Nonetheless, the proposed prolongation of the Scheme does not involve an increase in the Scheme's overall budget. Furthermore, prolonging the Scheme for an additional six-month period would permit both a higher take-up rate within the authorised budget and a better distribution of issuances over time.

19. In addition to the existing reporting obligations mentioned in paragraph 11 above, Spain undertakes to submit to the Commission a concise mid-term review, by 15 September 2011 at the latest, on the operation of the Scheme and on comparable guaranteed and non-guaranteed debt issues completed during the reporting period.

20. Spain undertakes to maintain the commitments made since the introduction of the Scheme and upheld in the context of its last prolongation. All other conditions of the amended Scheme remain unchanged.

IV. ASSESSMENT OF THE SCHEME

21. In its decision of 23 December 2008, the Commission concluded that the Scheme constituted State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("**TFEU**"). However, it found it compatible with the internal market under Article 107(3)(b) TFEU, because it was apt to remedy a serious distortion of the Spanish economy. To that end, the Commission had assessed the appropriateness, necessity and proportionality of the Scheme.

[5] Decision NN 54b/2008 of 23.12.08, Decision N 336/2009 of 26.06.09, Decision N 588/2009 of 1.12.09, Decision N 263/2010 of 28.06.10 and Decision SA. 31921 N 530/2010 of 29 November 2010.

[6] Letter from the Director General for Operations, Markets and Settlement Systems of the Bank of Spain dated 11.05.11.

22. The Commission observes that the prolongation of the Scheme is a response to the financial difficulties that Spain, as most Member States, continues to experience. Since the objective of the measure is to provide short- and medium-term financing to credit institutions which are unable to obtain funds on the financial markets or at very high margins only, it is important to ensure the availability of the Scheme as long as the global financial crisis continues.

23. Indeed, there is evidence that markets have not yet returned to normal functioning. Some tensions continue to affect the interbanking market, especially due to sovereign exposures by market participants. Against that background and taking into account the fragility of the recovery process in Spain and the spill-over of sovereign debt problems from other European countries, the continuation of the Scheme can be deemed necessary to ensure financial stability as confirmed by the Bank of Spain.

24. The Commission considers that the prolongation of the Scheme for a further six–month period, until the end of 2011, is appropriate and necessary to remedy a disturbance of the Spanish economy.

25. On the basis of the above, the notified prolongation of the Scheme does not alter the Commission's previous assessment in the original Decision of 23 December 2008 and the subsequent prolongation Decisions of 25 June 2009, 1 December 2009, 28 June 2010 and 29 November 2010.

26. As regards the specific features of the Scheme in assessing the request for the prolongation, the Commission has to balance its positive effects for financial stability with the distortions of competition and the delay in the return to a normal functioning of the financial markets that the prolongation entails. Guarantee schemes should contain minimum exit incentives, and a gradual alignment to market conditions should take place in order to minimise negative spill-over effects on competitors and other Member States.

27. According to the information submitted by Bank of Spain[7], the reliance on ECB funding has diminished but the spread between Spanish sovereigns and market benchmarks remains relatively high.

28. The prerequisites for the compatibility of guarantee schemes with Article 107(3)(b) TFEU that have been established in the Banking Communication[8] and the Commission's subsequent decisional practice continue to apply but have been complemented by additional requirements aimed at achieving two objectives:

29. First, credit institutions should be induced to scale down or terminate their recourse to government guarantees by means of pricing rules that bring the funding costs of the Beneficiaries closer to market conditions and thereby reduce distortions of competition. That realignment was achieved as from 1 July 2010 by an increase in the guarantee fee[9] in comparison with the ECB Recommendation of October 2008 that amounts at least to 20 basis points for banks with a rating of A+ or A[10], 30 basis points for banks rated A-[11], and 40 basis points for banks rated below A-[12].

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[7] Letter from the Director General for operations Markets and Settlements System of Bank of Spain of 11 May 2011.

[8] Communication from the Commission – 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.

[9] For liabilities of all eligible maturities.

[10] Or A1 and A2, depending on the rating system employed.

[11] Or A3, depending on the rating system employed.

30. Second, the use of the Scheme should not enable Beneficiaries with structural weaknesses in their business models to postpone or avoid the necessary adjustments. To this end, as from 1 July 2010, Spain should present a viability review for any Beneficiary that requests new guarantees under the Scheme which take or keep the total amount of the Beneficiary's outstanding guaranteed liabilities above 5% of its total liabilities and above the absolute amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication[13] within three months of the granting of the guarantees[14]. The viability review will either confirm the Beneficiary's long-term viability without State support or show that farther-reaching restructuring is required.

31. The Commission considers that the notified prolongation of the Scheme until 31 December 2011 complies with the requirements set out above and is compatible with the internal market.

32. As regards the combination of the State aid received under the Scheme with other aid measures, as indicated in the Annex to the Restructuring Communication, any restructuring plan should contain all State aid received either as individual aid or under a scheme 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). Accordingly, once a Member State is under an obligation to submit a restructuring plan for a certain aid beneficiary, 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.

33. Furthermore, the Commission recalls that based on point 16 of the Restructuring Communication, if aid - not initially foreseen in a notified restructuring plan - is necessary for the restoration of viability, that additional aid 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 credit institution.

34. Spain agrees to provide the Commission with a concise mid-term review of the operation of the Scheme by 15 September 2011, in addition to the pre-existing reporting requirements including updated available data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances[15.].

V. DECISION

The Commission finds that the notified six-month prolongation of the Scheme until 31 December 2011 is compatible with the internal market and the Commission has, accordingly, decided not to raise objections to the prolongation of the Scheme until 31 December 2011 included.

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12 Banks without rating will be considered as having a BBB rating.

13 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.

14 Except where the bank concerned is already in restructuring or subject a pending viability review on the basis of a restructuring or viability plan; in those circumstances the award of additional State aid will be assessed within the framework of the ongoing restructuring/viability review process.

15 See point 23 of the Commission decision of 12 December 2008.

The Commission notes that for reason for urgency Spain exceptionally accepts the adoption of the decision in the English language.

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

Your request specifying the relevant information 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