EUROPEAN COMMISSION

Brussels, 01.12.2009
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COMP Operations

Subject: State Aid N 588/2009 – Spain
Prolongation of the Guarantee Scheme for credit institutions in Spain

Sir,

I. PROCEDURE

1. On 8 October 2008, Spain notified a scheme for the creation of a debt guarantee scheme (hereafter "**the Scheme**"), which was approved on 23 December 2008, in State aid case NN54b/2008 (hereafter "**the original Decision**").

2. On 31 March 2009, Spain notified changes to the Scheme, which were approved on 16 April 2009.

3. On 23 April 2009, a corrigendum to the original Decision was published in order to correct some translation and stylistic mistakes.

4. On 27 May 2009, Spain notified the Commission a request to prolong and amend the Scheme, which was approved on 26 June 2009 (State Aid N336/2009).

5. On 26 October 2009, Spain notified the Commission a request to prolong the Scheme for an additional period of six months. Further information on the functioning of the Scheme was received on 17 November 2009.

II. DESCRIPTION

1. The objective of the Scheme

6. In response to the ongoing exceptional turbulence in financial markets, Spain brought forward a measure designed to preserve stability of the financial system and to remedy a serious disturbance to its economy. In particular, the Scheme aimed at

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limiting the risks and re-establishing confidence in the financing mechanism of credit institutions and fostering lending to businesses and households.

2. Description of the original Scheme notified in October 2008

7. The institutions eligible for the Scheme are credit institutions, consolidated groups of credit institutions and pools of credit institutions. Subsidiaries of foreign credit institutions are also included subject to the same requirements as Spanish credit institutions (hereinafter "**the Beneficiary**" and together as "**the Beneficiaries**"). Branches of foreign credit institutions are excluded from the scheme.

8. Debt instruments to be guaranteed under the Scheme comprise: emissions of notes (*pagarés*), bonds (*bonos*) and obligations (*obligaciones*) traded in secondary markets in Spain. These instruments must not be covered by other types of guarantees. Securitization notes and subordinated debt are not eligible instruments.

9. The interest rate of debt instruments issued can be fixed or variable and must be placed within the market yield of emissions and issuers with similar characteristics, as well as in line with prior emissions (pre-crisis) of the same issuer. The principal needs to be re-paid in one payment. The minimum nominal value of each emission has to be at least of EUR 10 million.

10. The Minister for Economic Affairs and Finance allocated for each Beneficiary the maximum amount that can be guaranteed in direct proportion to its market share[1]. The Beneficiary must pay a fee on the guarantee based on the recommendations of the European Central Bank[2].

11. The maturity of the debt instruments were between three months and three years. In exceptional circumstances, instruments may be guaranteed with a maturity of five years, subject to a report from the Bank of Spain. The Spanish authorities committed to notify individually to the Commission the cases in which the financial instruments have a maturity exceeding three years.

12. Originally, the Scheme provided for State guarantees covering new issuance of debt instruments up to an amount of EUR 100 billion, which was later increased to EUR 164 billion[3].

3. The modifications to the Scheme in March and May 2009

13. On 31 March 2009, the Spanish authorities, based on the Commission Communication on the "*recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*"[4], requested that some behavioural constraints included in the original Decision, in the form of a limitation of the expansion of the balance sheet of the Beneficiaries, be removed. On 16 April 2009, the Commission accepted that amendment, since there were no indications that the absence of such limitations leads to undue distortions of flows of funds between Member States.

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1 Ministerial Order EHA/3748/2008 of 23 December modifying Ministerial Order EHA/3364/2008.

2 Recommendations on Government Guarantees on Bank Debt of the European Central Bank of 20 October 2008.

3 The initial overall Budget for the Scheme was EUR 200 billion distributed equally over the annual Budget of 2008 and 2009. However, the budget for 2009 was reassigned pursuant to Royal Decree Law 9/2009 of 26 June, leaving it with a grand total of EUR 164 billion for 2008 and 2009.

4 OJ C 10, 15.01.2009, p. 2.

14. Upon the first extension of the Scheme on 27 May 2009, the Spanish authorities requested an extension of the maturity of the debt instruments issued under the Scheme up to five years as the Beneficiaries expressed the need to align the Scheme to other national schemes which have a maximum maturity of five years, in order to avoid creating a competitive disadvantage. Furthermore, a longer issuance window allowed the Beneficiaries to source their funding from a wider variety of investors, thus giving them the flexibility of using both short- and medium-term maturities to suit their requirements and market appetite. According to the Spanish authorities, the proposed five-year extension avoided an excessive concentration over the original three-year period. In this respect, the Commission noted that the amount of debt with maturities exceeding three years and up to five years was limited to an aggregate maximum of one-third of the total budget that could be guaranteed under the Scheme.

4. Operation of the Scheme up to December 2009

15. On 30 September 2009, the Ministry of Economic Affairs and Finance issued a Ministerial Order of preapproval with the maximum guarantee authorised for each Beneficiary.

16. In the original notification of the Scheme of 8 October 2008, Spain undertook to present reports every six months on the operations of the Scheme ("**the Report**"). The Spanish authorities submitted the Report on 27 May and on 17 November 2009.

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

18. As of 16 November 2009 (hereinafter "**the Reporting Date**"), thirty nine Beneficiaries applied for and issued debt instruments under the Scheme for a total of EUR 45 billion, with an aggregate take-up rate[5] of 33% of the global ceiling budgeted for 2008 and 2009. 11% of the total debt issued under the Scheme has a maturity of five years. The remaining part (89%) has a maturity of up to three years. Up to the Reporting Date, only two debt instruments issued under the Scheme have been denominated in a currency other than the euro.

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

5. Description of the proposed additional prolongation of the Scheme

20. The Spanish authorities are planning to extend the window for issuing new debt instruments under the Scheme for a further six-month period as from 1 January 2010. However, the proposed extension of the Scheme does not involve an increase in the Scheme's overall budget already approved.

[5] Total take-up rate of the Scheme's overall pre-approved ceiling can be broken down as follows: 30.8% of debt securities issued, 0,07% of debt securities authorised but not yet issued and 0,15% requested but for which authorisation is pending.

21. All other conditions of the amended Scheme remain unchanged.

III. POSITION OF SPAIN.

22. In line with the previous Decision on the Scheme[6], the Spanish authorities accept that the amended scheme contains State aid elements.

23. The Spanish authorities note and the letter submitted by the Bank of Spain[7] confirms that the Beneficiaries' access to market funding is still affected by the international financial crisis and that it is thus necessary to prolong the Scheme with the above-mentioned modifications. While an increasing number of credit institutions are obtaining long-term financing through issues outside the Scheme, this might not be the case for medium-to-small credit institutions which continue to make significant use of the Scheme.

24. Difficulties in Beneficiaries' access to market funding have already caused repercussions for households' and firms' ability to refinance their own obligations. In order to avoid strengthening the negative feedback loop between the real economy and the financial sector, it is imperative that the Scheme be prolonged.

25. Extending the Scheme would permit both a higher take-up rate and a better distribution of issues time wise. Furthermore, an exit of the scheme on 31 December 2009 would entail a high concentration of new debt issues under the Scheme at the end of the year driven by precautionary reasons in order to avoid losing the opportunity to do so in the future. This concentration may result in higher financing cost for the Beneficiaries.

IV. ASSESSMENT

1. State aid character of the prolonged Guarantee Scheme

26. As set out in Article 107(1) TFEU[8], 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.

27. The guarantee on the newly issued debt allows the Beneficiaries to refinance at advantageous conditions. This gives the Beneficiaries an economic advantage and strengthens their position compared to their competitors in Spain and other Member States and must, therefore, be regarded as distorting competition and affecting trade between Member States.

28. In particular, since the Scheme was first approved no private investor would have granted such a significant guarantee to the Beneficiaries.

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[6] Decision NN 54B/2008 of 23.12.08 and Decision N 336/09 of 26.06.09.

[7] Letter of Mr. Javier Alonso Director General for Operations, Markets and Settlement Systems of the Bank of Spain dated 15 October 2009.

[8] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the TFEU. The two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate.

29. Therefore, the Scheme constitutes aid to the Beneficiaries pursuant to Article 107(1) TFEU.

2. Compatibility of the Prolonged Guarantee Scheme

a) Application of Article 107(3)(b) TFEU.

30. The Banking Communication[9] acknowledges that Article 107(3)(b) TFEU may be available as a legal basis for aid measures undertaken to address the current systemic crisis. It lays down conditions which have to be complied with by all the aid measures. Paragraph 1.5 of that Communication explains that: "*all general support measures have to be:*

- *well-targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy;*
- *proportionate to the challenge faced, not going beyond what is required to attain this effect, and*
- *designed in such a way as to minimize negative spill-over effects on competitors, other sector and other member States"*

31. For the reasons indicated in its previous Decisions on the Scheme, the Scheme is compatible with the internal market under Article 107(3)(b) TFEU, as the Scheme meets the criteria of: appropriateness, necessity and proportionality set out in the Banking Communication.

b) Assessment of the proposed prolongation to the Scheme.

32. The extension of the scheme is a response to the continuing difficulties on the funding side that some banks in Spain continue to experience. Since the objective of the measure is to alleviate liquidity constraints for solvent banks that experience them, it is important to ensure the availability of the Scheme as long as these remain.

33. Notwithstanding this, the Commission notes that the take-up rate of the Scheme is only 33% of the global ceiling budgeted for 2008 and 2009 (*cf.* paragraph 18 above). That low take-up rate may be an indicator of the restoration of financial stability in the European markets and a sign that parts of the Spanish financial sector do not experience difficulties in raising funding in the market. In this context, the Commission must ensure that the distortions of competition created by guarantee schemes are limited to remedying a serious disturbance in the economy and that a return to market conditions takes place as soon as such disturbance is terminated.

34. However, the Commission also notes that at the present time the indicators for recovery are still fragile. For this reason, and taking into consideration the specificities of the Spanish economy, including indications of the persistence of a funding gap in some segments of the Spanish financial sector, the Commission believes that the prolongation of the Scheme for a further six-month period from 1 January 2010 until 30 June 2010, is appropriate and necessary to remedy the disturbance of the Spanish economy.

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9 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 270, 25.10.2008, p. 10.

35. Indeed, as far as the appropriateness is concerned, the extension of the Scheme aims at providing liquidity to the Beneficiaries and at promoting lending to business and households. Since the extension of the Scheme is targeted at filling the ongoing funding gap in Spain, the aid is therefore well targeted.

36. As regards proportionality, the extended Scheme is proportionate to addressing the funding problems facing the Spanish financial institutions, in view of the continuing challenging medium-term liquidity conditions. The Commission takes note of the letter sent by the Bank of Spain in this regard[10].

37. Regarding the duration of the extension itself, the proposed measure will be temporary in nature, lasting for six months as from 1 January 2010, which limits the potential distortion of competition.

38. Regarding the minimisation of negative spill-over effects on competitors and other Member States, the Commission considers that while banks may still need access to government guarantees, they should however all have minimum exit incentives and a gradual alignment to market conditions. Since no additional budget has been allocated for the prolongation of the Scheme, it shows improving conditions in financial markets increasing the capacity of credit institutions to raise funds in the next months.

39. In view of the overall cost of access to the debt market for Spanish banks and the conditions of the scheme, the Commission considers that the continuation of the Spanish scheme under unchanged conditions does not outweigh the need to minimise undue competition distortions and delays in return to normal market functioning.

40. As regards the lending commitments, it is appropriate that banks accessing the measures are committed to continuing lending to the real economy.

41. In addition to the above, Spain agrees to complement its future Reports with updated available data on the cost of comparable (nature, volume, rating, currency, etc.) non-guaranteed and guaranteed debt issuances. This will allow the Commission to assess the appropriateness, necessity and proportionality of eventual prolongations of the Scheme and its conditions after 30 June 2010.

V. DECISION

The notified six-month extension of the Scheme until 30 June 2010 is compatible with the internal market and the Commission has accordingly decided not to raise objections against it, since it fulfils the conditions to be considered compatible with the Treaty on the Functioning of the European Union.

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

[10] Letter of Mr. Javier Alonso Director General for Operations, Markets and Settlement Systems of the Bank of Spain dated 15 October 2009.

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

Neelie KROES
Member of the Commission