

International Monetary Fund

[Portugal](#) and the IMF

Portugal: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

Press Release:

[IMF Completes Tenth Review Under an EFF Arrangement with Portugal, Approves €0.91 Billion Disbursement](#)
February 12, 2014

January 27, 2014

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Portugal: Letter of Intent

Lisbon, January 27, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes the progress made in recent months toward the objectives laid out in our program supported by the Extended Arrangement. It also updates previous MEFPs and highlights the policy steps to be taken in the months ahead.
2. We have made further progress towards the program objectives. The end-September deficit and debt performance criteria were met, and preliminary information suggests that we are also on track to comfortably meet the end-year targets, reflecting our firm commitment to fiscal discipline. We continue to take steps to fight tax evasion and mitigate fiscal risks, including through the recent creation of the Compliance Risk Management Unit. As part of our structural efforts, we have recently made further progress in the services sector, with steps aiming at eliminating entry barriers and increasing competition. Moreover, to secure the resilience of the banking sector amidst a still challenging operating environment, Banco de Portugal has proactively stepped up its supervisory activity.
3. Nevertheless, further efforts are still needed to anchor growth on a sustainable basis, complete our ambitious fiscal consolidation plan in line with our European commitments, and vigilantly monitor the resilience of the financial system in the context of the ongoing deleveraging and rebalancing of the economy. In particular,
 - Many of the structural reforms originally envisaged in the program are now in place, and are beginning to have an impact, as evidenced by the gradual improvement in the macroeconomic outlook, underpinned by a solid export performance and improved market conditions. Yet, despite recent signs of economic stabilization, unemployment remains high, calling for renewed efforts to promote an adjustment more favorable to growth and employment. To this purpose, we are assessing necessary policy actions to further promote the dynamism and efficiency of the labor market, while continuing to reduce excessive rents in product markets and supporting a business-friendly environment.
 - The 2014 budget law was approved by Parliament, with measures largely drawn from our ambitious Public Expenditure Review, targeting a general government deficit of 4 percent of GDP and ensuring a consolidation strongly tilted towards permanent spending measures.

Moreover, in response to a recent adverse Constitutional ruling on a key provision of the pension reform, we have identified offsetting measures of comparable size and quality. These include the frontloading of the planned increase in the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM) and a recalibration of the parameters of the existing extraordinary solidarity contribution on pensions (CES). Submission to Parliament of the revised CES through a supplementary budget and approval by the Council of Ministers of the decree law on the change in contributions to the special health insurance schemes are *prior actions* for completion of this review. We are now in the process of developing new comprehensive measures as part of the ongoing structural reform of pensions, in line with the Court ruling. Stocktaking of this process will be made during the next review. More generally, we are determined to advance further our comprehensive reform of Public Administration, underpinning our commitment to the fiscal sustainability rules in the European Treaty on Stability, Coordination, and Governance.

- To support our medium-term fiscal objectives and ensure a more equitable adjustment, we remain determined to make further progress in streamlining the public sector, curbing tax evasion, and strengthening our budget control. In particular, we are determined to halt any new accumulation of arrears through targeted programs and full enforcement of the Commitment Control Law.
- We are committed to preserving financial stability and supporting an orderly deleveraging of balance sheets. Efforts to promote adequate funding conditions for the dynamic segments of the economy continue. In anticipation of the European Central Bank's comprehensive assessment, to be conducted this year in the context of the Single Supervisory Mechanism, Banco de Portugal will continue to vigilantly monitor the banking system, ensuring its supervisory standards remain in line with international best practice.

We trust that our continued commitment to fiscal discipline and structural reforms will further support investors' confidence in the Portuguese economy and secure our successful return to capital markets on a durable basis.

4. On the basis of the strength of the policies outlined in this letter, and in light of our performance under the program, we request the completion of the tenth review under the Extended Arrangement, as well as a waiver of applicability for the end-December deficit and debt performance criteria.

5. We remain confident that the policies described in the current and previous MEFPs are adequate to achieve the objectives under the program. We stand ready to take additional measures should they be needed to meet the objectives of the economic program and will consult with the IMF, the European Commission, and the ECB, in advance of any necessary revisions to the policies contained in this letter and attached Memorandum.

6. This letter is copied to Messrs. Dijsselbloem, Rehn, and Draghi.

Sincerely yours,

/s/

Paulo Portas
Deputy Prime Minister

/s/

Maria Luís Albuquerque
Minister of State and Finance

/s/

Carlos da Silva Costa
Governor of the Banco de Portugal

Attachments: 1. Memorandum of Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

Attachment I. Portugal: Memorandum of Economic and Financial Policies

January 27, 2014

Macroeconomic Outlook

- Recent Macroeconomic Developments.** Economic activity is recovering. In the third quarter of 2013, output grew by 0.2 percent, thereby registering, for the first time in three years, two consecutive quarters of growth. This growth is underpinned by a modest recovery in domestic demand and robust exports, with the latter growing 6.6 percent year-on-year. The unemployment rate has fallen further to 15.6 percent in the third quarter, from 16.4 percent in the second quarter and 15.8 in the third quarter of 2012, driven by the expansion of employment, in particular in tourism-related activities, while the labor force remained broadly stable following previous declines.
- Outlook.** High-frequency indicators point to a continued moderate expansion in activity, and sentiment is gradually approaching its long-term average. Accordingly, we expect output to contract by 1.6 percent, compared with a contraction of 1.8 percent projected at the time of the last review. Growth in 2014 is still expected to pick up to 0.8 percent, supported by an increase in investment, a continued strong export performance, offset in part by higher imports, recovery in domestic consumption, and with unemployment projected to peak at 16.8 percent. Headline inflation averaged 0.3 percent in 2013, reflecting still weak domestic demand. Despite recent improvements, uncertainty remains elevated, as the negative impact of private sector deleveraging and of fiscal consolidation on growth may turn out to be stronger than expected, particularly if the competitiveness adjustment achieved to date is not sustained.
- External adjustment.** The current account adjustment continues, albeit at a slower pace, and is estimated to have registered a small surplus of about $\frac{1}{2}$ percent of GDP in 2013, to be followed by a surplus of about 1 percent this year. This is lower than projected at the time of the last review, mainly due to an upward revision in domestic demand and imports. Nevertheless, strong export growth continues to underpin the external adjustment, supported by robust demand from non-EU trading partners with export market share gains in most markets. In addition, exports within the EU appear to have troughed, with exports to Spain—Portugal's main trading partner—growing by 10 percent in the first eleven months of 2013. In the short term, however, weaker demand from trading partners remains the main downside risk to external adjustment. Most importantly, while the structural reforms envisaged in the program have largely been implemented and are starting to bear fruit, maintaining robust export growth over the medium term will require continued improvement in external competitiveness.

Fiscal Policy

4. **2013 Budget.** The end-September quantitative performance criteria on the general government cash balance and debt were met by a comfortable margin, in the context of solid revenue performance. Moreover, the budgetary overruns and revenue shortfalls identified at the time of the previous review were addressed through additional measures—including use of the provisional budget allocation, reduction of funds available to line ministries, and recourse to a one-off (tax and social security contribution) debt recovery scheme—approved in a second supplementary budget of November 2013. While final figures are not yet available, preliminary data indicate that we are on track to achieve our general government deficit objective of 5.5 percent of GDP (excluding the BANIF recapitalization costs of 0.4 percent of GDP). This is consistent with an underlying structural primary adjustment of around 0.5 percent of GDP in 2013.

5. **2014 Budget.** We remain committed to achieving our 2014 deficit target of 4 percent of GDP in 2014—consistent with a structural primary adjustment of 1 percent of GDP. To achieve these objectives while arresting the accumulation of domestic arrears, the 2014 budget law, approved by Parliament last November, and its supporting legislation identify around 2.3 percent of GDP in measures. Specifically,

- **Public Expenditure Review (PER).** Most of the budget measures were drawn from our ambitious public expenditure review, aimed at ensuring the sustainability, effectiveness, and social equity of the state expenditure programs, through (i) a wage bill reform; (ii) a pension reform; and (iii) sector specific savings, in line with the understandings reached at the time of the eighth and ninth reviews. As a result of the Parliamentary discussion of the budget law, key wage bill and pension measures have been amended to better protect lower income earners and ensure more equitable savings, with necessary compensating measures already identified in the budget. Moreover, in response to an adverse Constitutional ruling on December 19th on a key provision of the pension reform, aligning the rules and benefits of the public sector pension funds, CGA, to the general pension regime, we have identified offsetting measures of comparable size and quality to ensure the attainment of the fiscal deficit target of 4 percent of GDP. These include the frontloading of the planned increase in the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM), with corresponding savings for the State, and a recalibration of the parameters of the existing extraordinary solidarity contribution on pensions (CES). Submission to Parliament of the revised CES through a supplementary budget and approval by the Council of Ministers of the decree law on the change in contributions to the special health insurance schemes are *prior actions* for completion of this review. The existing pension legislation of the CGA will be also modified to ensure that the new rules on retirement age effectively apply also to this regime. We are monitoring closely the attainment of the defined budget objectives for each line ministry, through monthly reporting to the Council of Ministers, in particular on the targeted reduction in the size of the public sector workforce. In this context, following the conclusion of the first voluntary separations scheme, we have recently launched two new schemes on teachers and other qualified employees, respectively, and other schemes targeting excessive employment in the

public administration are currently under preparation. In the design of any new programs aimed at reducing over-employment in specific sub-sectors, we will continue to aim at a change in the composition of the public sector workforce towards high-skilled and better-trained civil servants.

- **Additional measures.** The approved budget law and supporting legislation also included additional measures to offset upward expenditure pressures. The supporting legislation necessary to implement these measures is being finalized. In particular, we have approved the ministerial order defining the contribution for the media spectrum, as well as the decree law on the remaining measures on survivors' pensions. We will approve the ministerial order defining the levy on financial institutions by end-March 2014. The final proposal for the measure on online gambling is expected to be sent to the Council of Ministers for approval by end-February 2014. The port concession tender and real estate sale is expected by end-September 2014, while the winning bidder for the Silopor concession has been selected. The transfer from the CTT health fund and the sales of excess oil reserves will take place by end-year.
- **CIT Reform.** In parallel, we have also approved in December a comprehensive reform of the Portuguese corporate income tax (CIT) regime aimed at boosting investment and growth. The reform includes measures to simplify the CIT regime through a broadening of the tax base, the gradual lowering of the rate (frontloaded for SMEs), and the rationalization of surcharges and incentive schemes. The reform also includes steps aimed at lowering compliance costs, reducing litigation, improving international competitiveness, as well as reducing policy-induced debt bias. The measures envisaged in the reform for 2014 and the outer years will be implemented within the existing fiscal target commitments.

Should any risks to the execution of the budget materialize, we remain committed to implement, following discussion with EC/ECB/IMF staff, compensatory measures of equivalent size and quality to meet the agreed deficit target.

6. **Medium-term fiscal consolidation.** We will advance our fiscal consolidation efforts in 2015, with a targeted deficit of 2.5 percent of GDP, consistent with a structural primary adjustment of around 1¼ percent of GDP, securing a successful exit from the EU Excessive Deficit Procedure. Moreover, further fiscal effort of about ½ percent of GDP will be needed in the outer years to keep public debt on a downward trajectory, in compliance with the medium-term fiscal sustainability requirements in the European Treaty on Stability, Coordination, and Governance. To this end, the following initiatives are currently ongoing:

- The new **Public Administration** law—aiming at aligning the current public employment regime to private sector rules—was submitted to Parliament and is expected to be approved by end-March 2014. Building on the principles identified in the law, we are conducting a comprehensive review and reform of wage supplements, with a draft law expected to be submitted to Parliament by end-June. In parallel, we have also started a comprehensive review of public sector remunerations and careers, which we expect to finalize in the second half of 2014. We are also in the process of developing new comprehensive measures as part of the ongoing

structural reform of pensions, in line with the recent Constitutional Court ruling on the CGA convergence reform. Stocktaking on this process will be made during the next review.

- The above-mentioned steps to reform the Public Administration are part of our far-reaching **Proposal for the Reform of the State**, whose general principles were approved by the Council of Ministers last October. The reform will aim at achieving efficient and sustainable public sector policies, underpinning the balanced budget objectives and fiscal sustainability rules in the recently-ratified European Treaty on Stability, Coordination, and Governance—which now ranks higher than ordinary legislation. Broad-based consultations with political and social partners are ongoing to seek consensus on specific reforms. Following this first round of consultations, we will submit a new document to the Council of Ministers by end-March 2014 with draft proposals, preferably with broad-based political and social consensus, on different reform areas, which should ideally include social security sustainability, flexibilization and requalification of the public sector workforce, rationalization of general government entities, as well as greater efficiency in health and education. Progress with this process will be discussed at the time of the next review.
- Moreover, in order to comply with EU budgetary framework requirements, the **2014 Fiscal Strategy Document** will provide details of the medium-term budgetary plans, to be discussed at the time of the eleventh review.

7. **Debt Path.** Under the programmed fiscal path, gross debt is set to have peaked below 129½ percent of GDP in 2013. The increase in the debt peak vis-à-vis the eighth and ninth reviews is largely explained by the higher Treasury cash balance at end-2013. Accordingly, net debt—excluding IGCP’s deposits—is projected to smoothly peak at close to 120 percent of GDP in 2013 and 2014, slightly below the previous review. The decline in the general government gross debt-to-GDP ratio starting in 2014 is expected to be partly supported by further use of cash deposits as well as the ongoing reallocation of the Social Security portfolio from foreign assets to government securities.

Containing Fiscal Risks

8. **Public Financial Management.** We have made further progress in advancing our Public Financial Management reform, but stricter compliance with the commitment control law is needed to prevent any new accumulation of domestic arrears, particularly in the health sector.
- Important steps have been taken in transposing the EU economic and governance fiscal framework. We remain committed to complete this process in our Budget Framework Law (BFL) by end-March 2014. In parallel, on the basis of the report of the technical group charged with revising the BFL, we will work, in close consultation with IMF staff, on developing the key principles and elements that will be reflected in the new legislation crystallizing reforms undertaken so far and underpinning an effective public financial management system. As the next step, we will consult in the early part of 2014 with key stakeholders to discuss the key elements of the legislation, notably imparting a medium-term focus to public finance, streamlining the budget appropriation structure, and strengthening accountability relations. We

will aim at reaching an agreement on the key aspects and structure of the new law and completing the underlying technical work by end-April 2014. As part of these efforts, we will undertake an IMF Fiscal Transparency Evaluation by the end of the program, which will be made publicly available. In line with the above, we have already published for the second year a tax expenditure report as well as providing information on the fiscal risks along with the Budget.

- We remain committed to preventing any accumulation of new domestic arrears, the stock of which amounted to €2.7 billion at end-August 2013. We have identified, with support from IMF/EC/ECB staff, selected public entities—including some of the large hospitals—that face structural financial imbalances. As a next step, we will develop, by end-February, targeted programs to underpin the financial sustainability of these entities. The Commitment Control Law will be enforced in full to all public entities—including entities under targeted programs—so as to bring to zero the net accumulation of arrears in line with the continuous indicative target under the program. We will also establish by end-February a dedicated unit with the Ministry of Finance, reporting directly to the State Secretary of the Budget in charge of the expenditure arrears for the public sector. The second settlement program in the health sector—in the value of €432 million— following the same procedures as envisaged in the March 2012 strategy document, was finalized last December.

9. **Revenue Administration.** To bolster revenue performance in support of our medium-term fiscal objectives, we remain determined to make further progress in curbing tax evasion. Recent steps in this direction included hiring 1000 new tax auditors, besides making fully operational the Large Taxpayer Unit and conducting successfully an e-invoice reform. The Compliance Risk Management Unit, created last November, is expected to become fully operational by end-March 2014. This unit aims at strengthening tax compliance by (i) phasing in of a modern compliance risk model; (ii) strengthening PIT compliance management, through the pilot projects on the High Net Wealth Individuals and the Self-employed Professionals; and (iii) enhancing control of the monthly PIT withholding information. Consistent with our ongoing efforts to curb tax and social security fraud, we have increased sanctions for criminal offenders. Moreover, we are planning to establish by end-2014 a dedicated Taxpayer Services Department, unifying most services related to taxpayers and improving their relationship with the tax administration. As part of the reorganization of the tax administration, we are committed to close 25 percent of local tax offices by end-March and additional 25 percent by end-May 2014. Moreover, we will also further strengthen the exchange of information between the tax and the AML authorities, in line with international best practices.

10. **State-Owned Enterprises.** Cost-reduction efforts and voluntary separation programs have helped improve the consolidated operational balance of state-owned enterprises (SOEs), although some of them are expected to have remained in negative territory in 2013, also as a result of the reinstatement of the 13th and 14th month salaries. We will retain formal cost-reduction objectives for loss-making firms, while requiring other firms to continue improving operating balances with a view to reducing debt burdens and financial costs. We also continue to manage the high debt burdens of some firms, ensuring that any treasury support remains within the envelope of budgeted transfers. Moreover, we have further strengthened governance with the entry into force of the new framework

law for SOEs last December. The law enhances financial and operational reporting requirements, concentrates all shareholder functions in the Ministry of Finance, and envisages the creation of a dedicated Technical Unit – which is expected to be operational by end-April 2014. The law also reinforces the monitoring of SOE debt by centralizing borrowing decisions at the Debt Management Agency (IGCP).

11. **Privatization.** The privatization program remains on track. The initial public offering for 70 percent of the shares of the postal company CTT was successfully completed in early December, with shares priced at the upper end of the range. The sale of the airline, TAP, however, is on hold, after the initial privatization plan fell through at end-2012 due to inadequate financial assurances by the final bidder. We continue to actively seek buyers for the group as a whole and expect to re-launch the process in the course of this year. The privatization of the rail cargo firm, CP Carga, has been postponed pending the unbundling of its terminals, expected to take place by June 2014. We have prepared a strategic plan for the water and waste sectors, with a view to improving their efficiency, including by introducing private capital and management in the system. Binding offers for the sale of the waste management company, EGF, are expected by mid-May 2014. Opening water concessions to private capital and management is expected to take longer. The restructuring of transport SOEs in Lisbon and Porto is ongoing, with five concessions expected to be launched by end-March 2014. The government will further consider expanding the privatization program to include additional assets for sale or concessions.

12. **Public-Private Partnerships (PPPs).** We continue taking steps to achieve a fiscally responsible PPP model. We are finalizing a major renegotiation of road contract PPPs with all concessionaires, generating additional structural accumulated savings of more than €2.5 billion over the life cycle of these concessions. Moreover, the renegotiation of the Security Integrated System (SIRESP) PPP contract is proceeding as envisaged, with the objective of generating further permanent savings in 2014 via a reduction on its internal rate of return and scope optimization. The revision of the regulatory framework for the road and rail sectors, reducing operation, maintenance, and major repair requirements, in line with EU standards and with the objective of minimizing fiscal risks is nearly finalized. Furthermore, the Ministry of Finance PPP unit continues working towards enhancing fiscal transparency, improving reporting on PPPs, expanding its field of action to other sectors, namely health and security, and advising the autonomous region of Madeira.

13. **Regional and Local Governments.** We remain committed to fiscal discipline in local and regional governments. The program for local governments' arrears settlement (PAEL) supported 95 municipalities with disbursements of €534 million as of end-December 2013. The remaining 10 municipalities will be supported, for an amount of up to €300 million, pending clearance by the Court of Auditors. With the Regional Finance Law and Local Finance Law (LFL), both approved by Parliament and published last September, we have created a coordination council between the central and subnational governments, which will be operative by end-February. The council is expected to enhance exchange of information in order to support budgetary planning. The LFL also introduced an insolvency procedure for local governments, including an early warning system for debt accumulation and a Municipality Resolution Fund. The rules and procedures of this fund are

being designed by a group of specialists and are expected to be submitted to Parliament in a separate draft law by end-March 2014. In terms of regional governments, Madeira's program with the State (PAEF) remains broadly on track, but we will continue to closely monitor budgetary risks.

Safeguarding Financial Stability

14. **Bank Supervision.** While compliance of the banking system with regulatory requirements has continued to be satisfactory, the Banco de Portugal (BdP) remains vigilant amidst a challenging operating environment.

- *Management of Distressed Loans.* The BdP, supported by an external advisor, has finalized the Special Assessment Program (SAP) that sought to review the policies and procedures of the eight largest banks in the area of distressed loan management. The results of the SAP have been discussed with the banks and the BdP is monitoring the timely implementation of the recommendations issued.
- *Credit Impairment.* Guidelines on measuring credit portfolio impairment and disclosure of asset quality and risk management practices will be published by mid-February, incorporating best practices identified during the three impairment reviews that have been conducted since May 2011. Additional disclosure requirements envisaged in the impairment guidelines will be reflected in banks' financial statements as of June 30, 2014. Where needed, banks have made substantial progress in enhancing their collective impairment models in line with recommendations made as part of the Special Inspections Program. High priority items have been addressed satisfactorily by end-December 2013.
- *Loan Classification.* The BdP has amended its instruction on the identification and marking of restructured loans due to financial difficulties of the client, incorporating definitions of forbearance that have been developed by the European Banking Authority (EBA). The BdP will review its standards on nonperforming loans, in line with the timeframe set at the EU level for the implementation of relevant technical standards. The BdP will continue to rigorously enforce prudent loan classification by the banks.
- *Real Estate.* The BdP is promoting the development of a consistent and common set of criteria for real estate appraisers for the Portuguese financial system, under the aegis of the National Council of Financial Supervisors. The new standards impose strict rules on appraisers' fit and properness—including remuneration rules and code of conduct, among others. In addition, real estate valuation requirements, applicable to all financial institutions, have been tightened to ensure that institutions' collateral valuations remain sufficiently conservative. Banks have updated valuations of all real estate assets that have been obtained in lieu of payment and whose last valuation was done before July 31, 2012. The BdP will verify compliance with these requirements by the second quarter of 2014.

15. **Stress Test Exercise.** To ensure the rigor of the quarterly stress test exercise, the BdP has further enhanced its quality assurance and review process of the bottom-up results. In particular, the

BdP enhanced its credit risk model. Moreover, the BdP has further developed its top-down stress testing framework, which now can allow for an estimation of key drivers of the results of the bottom-up exercise. The BdP expects to integrate the top-down stress testing framework into the quality assurance process in the next round of quarterly stress tests, to be finalized in February 2014.

16. **Transition to CRD IV.** As of January 1, 2014, banks are expected to maintain, at a minimum, a common equity Tier 1 (CET1) capital ratio of 7 percent, consistent with the CRD IV package considering all the transitional provisions related to the definition of capital. In the context of the ECB's forthcoming asset quality review, the largest banks are expected to maintain a CET1 add-on of 1 percentage point. Additional measures will be in place to preserve banks' current capital buffers, ensuring that they remain commensurate with the challenging operating environment. We will also ensure compliance with the requirements envisaged in the EBA Recommendation on the preservation of capital and any future regulatory initiatives at European level.

17. **BSSF.** We remain committed to providing further support to the banking sector, in the event new capital needs were to arise. While we will continue to encourage banks to seek private solutions, resources from the Bank Solvency Support Facility (BSSF) remain available to support viable banks if needed. The resources in the BSSF will solely be utilized to provide public support, if needed, to the banking system. State aid will remain subject to strict conditionality, in line with the recently amended EU State-aid rules, aimed at avoiding subsidizing private shareholders and preventing migration of private liabilities to the public sector balance sheet, while ensuring adequate lending to the real economy.

18. **Recovery and Resolution Plans.** The BdP has issued recommendations on the recovery plans of the largest banks, and is currently reviewing the plans from all the other banks. The BdP has received the data submission on the resolution plans for the largest banks and initiated on-site visits to these institutions, with a view to validating the data received and enhancing their resolution preparedness. The necessary amendments to the recapitalization law, reflecting the recent updated Banking Communication, issued by the European Commission in July 2013, on the application of the State-aid rules to support measures in favor of banks in the context of the financial crisis, were approved by Parliament in December 2013 and entered into force in January 2014. Moreover, we remain committed to swiftly transposing the new EU Directive on bank recovery and resolution once it has been adopted.

19. **Funding and Liquidity Conditions.** Deposits have remained stable in an environment of gradually decreasing remuneration rates. Furthermore, banks' access to money market funding is improving. Nonstandard measures by the ECB to restore the proper transmission of monetary policy have helped ease liquidity pressures and continue to play a pivotal role in absorbing remaining funding constraints, while strengthened collateral buffers provide an important shield against potential adverse shocks. In parallel, we continue to explore with our European partners further initiatives to support funding conditions, including potential mechanisms to securitize banks' high quality mortgage and SME credit.

20. **Initiatives to Facilitate Access to Finance.** Notwithstanding some improvements, the credit situation remains challenging, especially among SMEs. In this context and consistent with their funding and capital plans, banks continue to ensure that the deleveraging process takes place in an orderly manner to achieve stable market-based funding positions, while adequate and sustainable financing is provided to the economy. Furthermore, we've stepped up our efforts to promote more efficient financing allocation to the productive segments of the economy through further enhancements to our existing government-guaranteed credit instruments as well as the promotion of an efficient use of EU structural funds and alternative private funding options for SMEs. Specifically,

- *Government-Guaranteed Credit Instruments.* To make these schemes more efficient, we have implemented the key policy recommendations from the recent external audit of the National Guarantee System (NGS) and also other measures that resulted from the assessment of the Ministry of Economy. In particular, we have taken steps to improve the competitiveness and transparency of the current pricing system. These include (i) a refinement of the methodology of determining the maximum interest rates (caps) that participating institutions can charge on guaranteed credit lines, updated on a semi-annual basis, reflecting their banks' funding and administrative costs, and differentiated by various risk profiles of SMEs; (ii) a full disclosure by participating institutions of the caps per risk class in the marketing material; (iii) a close monitoring of the rates effectively charged. Moreover, we will explore, by end-February 2014, additional steps to be taken by individual participating institutions to further enhance the transparency of their pricing practices. A report will be prepared by May 15, 2014 to take stock of the impact of these enhancements on actual interest rates and, if needed, to propose remedies and policy alternatives including a competitive bidding system, in order to ensure that guaranteed loans will be priced in a competitive and transparent manner, in favor of end users. Moreover, to support viable firms in financial difficulties and to encourage these firms to go through the debt restructuring process at an early stage, a new guaranteed credit line has been designed, in line with the EU State-aid rules, for viable firms that have successfully completed a corporate debt restructuring process and effectively reduced nominal debt level. We will finalize the general guidelines and start a pilot test within the existing budgetary envelope by end-March 2014. We will continue to monitor the balance sheet performance of the firms benefiting from government-guaranteed credit lines through our quarterly monitoring framework.
- *Development Financial Institution.* The Council of Ministers has approved the establishment of a development financial institution (DFI) aiming at streamlining and centralizing the management of the reimbursable part of the financial instruments of the EU structural funds for the 2014-2020 programming period. The DFI's sole purpose shall be to address market failures in the financing of private nonfinancial corporations, notably SMEs, and in doing so it shall not accept deposits or other repayable funds from the public, nor engage in direct lending. Its final structure and by-laws will reflect in-depth consultation with EC, ECB and IMF staff and will be designed to ensure no additional burden on or risks to public finances.

- *Development of SMEs Commercial Paper.* The necessary amendments to the existing rules regulating the commercial paper market were approved by the Council of Ministers and will become effective by end-January, aiming at facilitating the expansion of the commercial paper market among a wider investor base and increasing the use of this alternative funding option by the corporate sector, notably SMEs.

21. **Central Credit Registry.** We are on track to complete the enhancements in our credit registry, as agreed in the combined eighth and ninth reviews. IT systems have been updated in order to receive additional information, allowing for the earmarking of loans that are classified as nonperforming or have been restructured due to financial difficulties of the borrower. The proposal from the BdP for revising the legal framework of the Central Credit Registry has been sent to the Ministry of Finance for consideration and in consultation with the Portuguese Data Protection Authority, and will be sent to the Council of Ministers for approval by end-April 2014. The proposed legislation allows financial institutions to have access to companies' historical information as well as to the corporate balance sheet database, reducing information asymmetries, especially for smaller companies. We expect to complete the implementation of these changes by end-June 2014.

22. **BPN SPVs.** The gradual recovery of the assets from Banco Português de Negócios (BPN), held by three state-owned Special Purpose Vehicles (SPV), is progressing. Contracts with external service providers for the management of part of the credit portfolio of Parvalorem have been signed, and the disposal of the participations and assets held by the other two state-owned SPVs is continuing. CGD's state-guaranteed claim will be gradually settled in cash, according to the schedule agreed with the EC, ECB, and IMF staff. Any net recoveries realized on the assets will also be applied towards the settlement of CGD's claim.

Boosting Employment, Competitiveness, and Growth

23. **Overall Reform Strategy.** The ultimate objective of our structural reform agenda is to enhance competitiveness and improve the business environment, so as to engineer a sustainable rebalancing of the economy toward the tradable sectors and boost medium-term growth and job creation prospects. Reforms initiated at the beginning of the program are drawing to a close. Significant steps were taken on the labor and product market fronts, where reforms were designed to alleviate nominal rigidities, facilitate adjustment, and foster a reallocation of resources toward the tradable sector. Important steps were also taken to reduce red tape and raise the efficiency of the judicial system. We are now refocusing our efforts on assessing the impact of the reforms already implemented and ensuring that the initial objectives are being achieved. In this context, an outcome-based accountability framework is being prepared to draw more concrete links between notional reforms and actual outcomes. Concurrently, we are working toward identifying the remaining policy distortions and other potential priority areas which will be tackled in the next phase of reforms.

24. **Labor Market Institutions.** Significant steps have been taken over the past couple of years to make the labor market more dynamic and efficient—including reforming the Employment Protection Legislation, streamlining unemployment benefits and reforming the wage-setting

mechanism. In view of the still high unemployment, notwithstanding recent signs of stabilization, we have launched an analysis of policy options to promote an adjustment more favorable to employment. In this context, the government has prepared by end-December 2013 a report assessing policy options in three main areas (i) ensuring more effective decentralization of wage bargaining, (ii) ensuring more wage flexibility, and (iii) study proper alignment of incentives to challenge dismissals in court. The report findings and policy proposals will be discussed in the context of the eleventh review. In light of the recent Constitutional Court ruling against legislative provisions that made it easier for firms to lay off employees in case of redundancy or unsuitability, the government's immediate priority will be to enact alternative measures. In particular, specific economic criteria to select employees in case of redundancies (including performance and cost-related) will be introduced in the law. Regarding dismissals for unsuitability, employers will be required to assess the possibility of finding an alternative position in the same professional category. We will submit these legislative amendments to Parliament by end-January 2014.

25. **Energy.** We continue our efforts to improve the sustainability of the national electricity system. Steps have been taken in the past year to reduce excessive rents, mainly through renegotiation. Nonetheless, our revised medium-term tariff debt projections clearly show strong upward pressures on the system's debt, reflecting partly downward pressures on the demand for electricity. Since we are concerned about the potential impact on competitiveness of the large electricity price increases necessary to eliminate the system's debt by 2020, we are preparing other options to better balance the burden of adjustment between the various stakeholders of the electricity sector, notably by eliminating remaining excess rents. These options will be discussed with the IMF/EC/ECB at the time of the eleventh review. Following the identification by the government of the problem of distortion on the system services market and highlighted in the reports of the relevant regulators, we will implement the necessary measures in line with these reports concerning the risks of overcompensation in the adjustment calculations (*revisibilidade*) of the CMEC scheme, including an independent audit on risk of overcompensation and the amount of past overcompensations. Finally, we will ensure that the energy sector levy introduced in the context of the 2014 budget will not be passed through to end-users.

26. **Ports.** We are taking steps aimed at reducing costs for exporters. Following reductions in fees on port use (*TUP-Carga*) and a revision of the Ports Work Law, we are now seeking further transmission of lower labor costs to end-users of port services. We have prepared detailed timetable for other measures ensuring cost reduction and enhanced performance of both port authorities and port operators. The immediate priority will be to engage with concessionaires with a view to modifying existing concession contracts so as to foster price reduction. However, in view of the ongoing discussions on implementation of the new Port Work Law, negotiations will start in the first quarter of 2014. We will also revise incentives for port operators by adopting a new performance-based model for future concessions and encourage entry of new operators. A review of the overall cost savings for exporters generated by the Port Work Law is being conducted, the result of which will be discussed at the time of the eleventh review.

27. **Competition/Regulation.** A framework law for the functioning of regulators was recently enacted. The law: (i) establishes a regulatory environment that protects the public interest and promotes market efficiency, (ii) guarantees the independence and the financial, administrative and management autonomy of the National Regulatory Authorities in the exercise of their responsibilities, including the necessary conditions to safeguard adequate human and financial resources being able to attract and retain sufficiently qualified staff, and (iii) strengthens the role of the Competition Authority in enforcing competition rules. We will redouble efforts to finalize the amendment of the corresponding bylaws of the National Regulatory Authorities, with the last revised drafts expected to be approved (by the parliament or the government) by end-February 2014. Once the regulators bylaws and internal regulations are in place, the regulators will continue to pursue the adoption of best international regulatory practices, including by organizing international peer review exercises. We are taking the necessary steps to ensure the effective functioning of the Competition Authority financing model and avoid disruptions in the transitory period up to the entry into force of the corresponding provisions in the forthcoming bylaws by enforcing the necessary transfers from the contributing regulators.

28. **Services.** Reforms in the services sector aim at eliminating entry barriers and increase competition. Significant progress has already been made in amending sector-specific legislations to align them with the Services Directive. We expect adoption by Parliament of the remaining necessary amendments—including to the Construction Law—by end-February 2014. The related ordinance, ensuring appropriateness of fees linked to construction activities, will be adopted under the same timeline. The new legal framework aiming at improving the functioning of the regulated professions for which regulation involves a professional body (such as accountants, lawyers, notaries) was published in early 2013. The professional bodies' statutes will be amended accordingly and submitted to Parliament for final approval by end-February 2014. The new legislations eliminate unjustified restrictions to activity and further improve the conditions for mobility of professionals in line with the EU Directives in the area of free movement of professionals.

29. **Licensing and Administrative Burden.** Tackling excessive licensing procedures, regulations and other administrative burdens—which are impeding the establishment, operation, and expansion of firms—is a government priority. The New Legal Regime on Urbanism and Building (RJUE) will be adopted by end-February 2014. To prevent future growth in excessive licenses and regulations, the government will adopt a rule that makes it mandatory to propose eliminating an existing regulation for all new regulations generating costs for businesses. We are preparing an inventory of regulations that are likely to have higher impact in economic activity (at central, regional and local levels), selecting the most burdensome. On this basis, we will devise a cost-analysis (currently under preparation) and roadmap for a regulatory simplification to be discussed at the time of the eleventh review. We have already adopted legislation to ease licensing requirements for tourism and industrial sectors. We have also taken significant steps and will continue our efforts to make fully operational the Point of Single Contact, an e-government portal which allows administrative procedures to be conducted online.

30. **Judiciary.** We are making further progress in the implementation of judicial reforms. The legislation to enhance the supervision of enforcement agents and insolvency administrators (CAAJ) entered into effect on December 21, 2013. We expect CAAJ to be fully implemented by the first half of 2014. We will publish quarterly reports on the clearance rate and disposition time of enforcement cases for the third quarter of 2013 onwards (within four months after the end of the relevant quarter).

Table 1. Portugal: Quantitative Performance Criteria
(Billions of euros, unless otherwise specified)

	Mar-13		Jun-13		Sep-13		Dec-13	Mar-14
	Program	Actual	Program	Actual	Program	Actual		
1. Floor on the consolidated General Government cash balance (cumulative)	-1.9	-1.4	-6.0	-3.8	-7.3	-4.3	-8.9	-1.7
2. Ceiling on accumulation of domestic arrears by the General Government (continuous indicative target) 1/	0	Not met	0	Not met	0	Not met	0	0
3. Ceiling on the overall stock of General Government debt	182.2	178.5	187.3	184.1	188.9	184.7	191.3	193.0
4. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the general government (continuous performance criterion)	0	...	0	...	0	0	0	0

1/ As of end-September, domestic arrears for the purpose of the program increased by close to €0.06 billion since end-June and €0.5 billion since end-December 2012, largely due to the accumulation of arrears by SOE hospitals.

Table 2. Portugal: Structural Conditionality: Tenth Review Under the EFF

Measure	Timing	Status
Prior Actions		
1 Submit to Parliament a supplementary budget to enact the necessary changes to the existing extraordinary solidarity contribution on pensions (CES), consistent with the general government deficit target of 4 percent of GDP (MEFP 15).		Met
2 Approve the decree law on the increase in the beneficiaries' contributions to the special health insurance schemes (ADSE, SAD and ADM) (MEFP 15).		Expected to be met by end-January
Structural Benchmarks		
A. Fiscal policy		
1 Submit to Parliament a new draft public administration labor law that will aim at aligning current public employment regime to the private sector rules, including for working hours and holiday time, and termination of tenure.	July 15, 2013	Met with delay
2 Submit to Parliament a draft law on the redesigned mobility pool.	End-June 2013	Met
3 Submit to Parliament a legislative proposal that increases the statutory retirement age to 66 years.	July 15, 2013	Changed to prior action and met
4 Submit to Parliament a legislative proposal that aligns the rules and benefits of the public sector pension fund, CGA, to the general pension regime.	July 15, 2013	Met with delay
A. Strengthen financial stability		
5 Submit to Parliament amendments to the law governing banks' access to public capital.	End-January, 2013	Met
B. Enhance competitiveness and address bottlenecks to growth		
6 Enact the severance pay reform that reduces severance payments to 12 days per year for all new permanent labor contracts	October 1, 2013	Met
7 Update projections of the medium-term energy tariff debt path and identify policy options to eliminate the tariff debt by 2020 .	June 15, 2013	Met
C. Strengthen fiscal institutions and reduce fiscal risks		
8 Revise and submit to Parliament the draft regional and local public finance law.	End-Dec 2012	Met
9 Implement a full-fledged Large Taxpayer Office (LTO), to cover audit, taxpayer services, and legal functions concerning all large taxpayers, including the adoption of account managers.	End-Dec 2012	Met

Attachment II. Portugal: Technical Memorandum of Understanding

January 27, 2014

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the tables annexed to the Memorandum of Economic and Financial Policies. It also describes the methods to be used in assessing the Program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the EC, the ECB, and the IMF before modifying measures contained in this letter or adopting new measures that would deviate from the goals of the Program, and provide the EC, the ECB, and the IMF with the necessary information for Program monitoring.
2. For Program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at “Program exchange rates” as defined below, with the exception of the items affecting government fiscal balances, which will be measured at spot exchange rate (i.e., the rate for immediate delivery) prevailing on the date of the transaction. The Program exchange rates are those that prevailed on May 5, 2011. In particular, the exchange rates for the purposes of the Program are set €1 = 1.483 U.S. dollar, €1 = 116.8390 Japanese yen, €1.09512 = 1 SDR.
3. For reporting purposes, the MoF and BdP will employ the reporting standards and templates considered to be appropriate given the transmission of data covered by this TMU, unless otherwise stated or agreed with the EC, the ECB and the IMF.

General Government

4. **Definition.** For the purposes of the Program, the General Government, as defined in the Budget Framework Law, Law No. 91/2001 of August 20, amended by Law 22/2011 of May 20, includes:

- 4.1. The Central Government. This includes:
 - 4.1.1. The entities covered under the State Budget, which covers the budgets of the Central Administration, including the agencies and services that are not administratively and financially autonomous, agencies and services that are administratively and financially autonomous (*Serviços e Fundos Autónomos – SFA*).
 - 4.1.2. Other entities, including Incorporated State-owned enterprises (ISOE), or extra-budgetary funds (EBF) not part of the State Budget, but which are, under the European System of Accounts (ESA95) and ESA95 Manual on Government Deficit and Debt rules, classified by the National Statistical Institute (INE) as part of the Central Government.

- 4.2. Regional and Local Governments, that include:
 - 4.2.1. Regional Governments of Madeira and Azores and Local Governments (*Administrações Regionais and Locais*);
 - 4.2.2. Regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government.
- 4.3. Social Security Funds comprising all funds that are established in the general social security system.
- This definition of General Government also includes any new funds, or other special budgetary and extra budgetary programs or entities that may be created during the Program period to carry out operations of a fiscal nature and which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE in the correspondent subsector. The MoF will inform the EC, ECB, and IMF of the creation of any such new funds, programs, entities or operations at the time of its creation or statistical re-classification or, in the case of Regional and Local Governments, at the time the Government acknowledges its creation.
- The General Government, as measured for purposes of Program monitoring in 2013, shall not include entities nor operations (including pension funds) that are re-classified into the General Government during 2013, but shall include those reclassified in 2011-12.¹
- The General Government, as measured for purposes of Program monitoring in 2014, shall not include entities nor operations (including pension funds) that are re-classified into the General Government during 2014, but shall include those reclassified in 2012-13.

5. **Supporting Material**

- 5.1. Data on cash balances of the State Budget will be provided to the EC, the ECB and the IMF by the MoF within three weeks after the end of the month. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published by the MoF.

¹ An operation refers to part of a legal entity that is involved in the production or delivery of goods and services—including government services provided on a nonmarket basis. As such, it does not include transactions relating to the assets or liabilities of an entity. For example, should an entity handle a number of PPPs, reclassifying only one PPP would be considered as reclassifying an operation. In contrast, taking over part of an entity's debt by the government would not qualify for the exclusion. On this issue, see also paragraph 13.

- 5.2. Data on the cash balances of the other parts of General Government as defined in paragraph 4² will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of the month. Data will include detailed information on revenue and expenditure items. Data will also include detailed information on PPP-related revenues and expenditures for those PPP reclassified within the General Government sector according to ESA 95, and called guarantees.
- 5.3. Data on domestic and external debt redemptions (securities), new domestic and external debt issuance (securities), change in the domestic and foreign currency assets and liabilities of the Central Government at the BdP and other financial institutions will be provided to the EC, the ECB, and the IMF by the BdP within 40 days after the closing of each month.
- 5.4. BdP will provide to the EC, the ECB, and the IMF detailed monthly data on the financing of the General Government, as defined in ESA95, within seven weeks after the closing of each month.
- 5.5. Data on the revenues, operating expenses, capital expenditure, remuneration of personnel, EBITDA, and number of staff will be provided for state-owned enterprises (SOEs) on a quarterly basis, within 7 weeks after the end of each quarter. Aggregate data for the SOEs within the perimeter will be provided, with company-specific information for REFER, Estradas de Portugal, Metro de Lisboa, and Metro de Porto. Furthermore data for Comboios de Portugal and Parpública (outside the perimeter) will also be provided.

Quantitative Performance Criteria, Indicative Ceilings, and Continuous Performance Criteria: Definitions and Reporting Standards

A. Floor on the Consolidated General Government Cash Balance (Performance Criterion)

6. **Definition.** The consolidated General Government cash balance (CGGCB) is defined as the sum of the cash balances of the entities covered by the State Budget, the ISOE, the Regional and Local Governments, and the Social Security Funds, and other entities and EBFs, as defined in paragraph 4. Privatization receipts will be excluded from cash receipts. In 2012 and beyond, revenues from the reclassification of pension funds into the general government will not be accounted for as cash revenues for the purpose of the calculation of the consolidated general government cash balance. In 2012-13, the cash proceeds from the sale of the ANA airport concession will be accounted for as cash expenditure-reducing transactions. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash

² In 2011, data exclude regional and local government-owned enterprises or companies, foundations, cooperatives and other agencies and institutions, which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as Local Government, i.e., entities referred in paragraph 4.2.2.

expenditures, except for transactions related to the banking sector support and restructuring strategy under the Program. Called guarantees (excluding those related to the banking sector support and restructuring strategy), where entities of the General Government make cash payments on behalf of entities that are not part of the General Government, will be recorded as cash expenditures.

- **6.1. The Cash Balance of the State Budget.** The cash balance of the State Budget will be measured from above the line, based on budget revenues (recurrent revenue plus nonrecurrent revenue, including EU revenues, minus tax refunds) minus budget expenditures of the State Budget as published monthly on the official website of the DGO of the MoF, and in line with the corresponding line items established in the State Budget. Budget expenditures will exclude amortization payments but include salaries and other payments to staff and pensions; grants to Social Security Funds, medical care and social protection; operational and other expenditure, interest payments; cash payments for military equipment procurement; and EU expenses.
- **6.2. The Cash Balance of the Regional and Local Governments, Social Security Funds, ISOE and Other Entities or EBFs.** The cash balance of each of these parts of the General Government will be measured from above the line, based on revenues minus expenditures as it will be provided by the DGO of the MoF in the monthly General Government budget execution report (see Para 5), and in line with the corresponding line items established in their respective budgets. All entities including ISOE that prepare accrual-based financial statements will submit monthly cash flow statement in accordance with form and content specified by the MoF. The reporting by Local Government will be phased as set out in paragraph 8 below.
- **6.3. Adjustor.** The 2013 and 2014 quarterly floors on the consolidated general government cash balance will be adjusted for the cumulative amount of arrears settled in the context of the arrears clearance strategy: (i) health sector arrears (up to €432 million), (i) local government arrears settled through the €1 billion credit facility created in May 2012, and (ii) RAM government arrears subject to concluding the agreement with the central government (up to €1.1 billion).

Other Provisions

7. For the purpose of the program, the expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector and restructuring strategy. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to the EC, ECB, and IMF.

8. Quarterly consolidated accounts for the General Government on a cash basis will be reported for internal, EC, ECB, and IMF monitoring 7 weeks after the reference period, starting with the first quarter of 2012. The reports will be published externally starting with December 2011 data.

SOEs will be consolidated with the general government accounts starting with the first quarter 2012. The larger municipalities (defined as those with a population of 100,000 voters or more) are required to provide monthly reports under current arrangements, and their cash balance will be included in the calculation of the monthly cash General Government balance. The cash balance of the smaller municipalities, i.e. those with a population of under 100,000 voters, will be excluded until any necessary legal changes requiring them to provide monthly reports have been put in place. In this transitory period, the MoF will provide a monthly estimate of the cash balance of these smaller municipalities excluded from the General Government reports to the EC, the ECB, and the IMF.

9. Supporting Material

9.1. Data on cash balances of the State Government, ISOEs, Regional and Local Government and Social Security Funds will be provided to the EC, the ECB and the IMF by the MoF within seven weeks after the end of each month. The information provided will include general government net acquisitions of financial assets for policy purposes, including loans and equity participations, as well as called guarantees where entities that are part of the General Government make cash payments on behalf of entities that are not part of the General Government.

9.2. The MoF will submit quarterly data on General Government accounts determined by the INE in accordance with ESA 95 rules, showing also the main items of the transition from cash balances to the General Government balances in national accounts. The reconciliation will be accompanied by necessary explanatory materials for any indication of potential deviation of the annual general government cash target from the annual general government accrual target determined in accordance with ESA 95 rules.

B. Non-Accumulation of New Domestic Arrears by the General Government (Continuous Indicative Target)

10. **Definitions.** Commitment, liabilities, payables/creditors, and arrears can arise in respect of all types of expenditure. These include employment costs, utilities, transfer payments, interest, goods and services and capital expenditure. Commitments are explicit or implicit agreements to make payment(s) to another party in exchange for that party supplying goods and services or fulfilling other conditions. Commitments can be for specific goods and services and arise when a formal action is taken by a government agency, e.g., issuance of a purchase order or signing a contract. Commitment can also be of a continuing nature that require a series of payments over an indeterminate period of time and may or may not involve a contract, e.g. salaries, utilities, and entitlement payments. Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources (usually cash) embodying economic benefits or service potential. In relation to commitment, the liability arises when a third party satisfies the terms of the contract or similar arrangement. Payables/creditors are a subset of liabilities. For the purposes of the program payables/creditors exclude provisions, accrued liabilities. Arrears are a subset of payables/creditors. For the purposes of the Program domestic arrears are defined as payables/creditors (including foreigner commercial creditors), that have remained unpaid for 90 days or more beyond any specified due date (regardless of any

contractual grace period). In case no due date is specified, arrears are defined as payables/creditors that have remained unpaid for 90 days or more after the date of the invoice or contract. Data on arrears will be provided within seven weeks after the end of each month. The continuous indicative target of non-accumulation of new domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the end of the previous month—based on the same perimeter with respect to the entities covered. This also includes arrears that are being accumulated by the SOEs not included in the General Government.

11. **Supporting Material.** The stock of arrears will be measured through a survey. Reports on the stock of arrears of the General Government are being published monthly. The MoF will provide consistent data on monthly expenditure arrears of the General Government, as defined above. Data will be provided within seven weeks after the end of each month and will include total arrears classified by the different constituent sectors of the General Government sub-sector as defined in paragraph 4, as well as the monthly amounts of arrears cleared under the arrears clearance strategy (see paragraph 6.3).

12. **Adjustor.** In 2013 and 2014, the monthly change in the stock of arrears will be adjusted for any stock adjustment related to the arrears clearance strategy as per paragraph 6.3. This will allow monitoring the underlying flow of new arrears.

C. Ceiling on the Overall Stock of General Government Debt (Performance Criterion)

13. **Definition.** The overall stock of General Government debt will refer to the definition established by Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the Excessive Deficit Procedure annexed to the Treaty establishing the European Community. For the purposes of the Program, the stock of General Government debt will exclude: (i) debt contracted for bank restructuring, when carried out under the Program's banking sector support and restructuring strategy; (ii) IGCP deposits; and (iii) (from end-September 2011) the *'prepaid margin'* on all EFSF loans.

14. **Adjusters.** For 2013, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock at end-December 2012 general government debt of EUR 204.5 billion. For 2014, the ceiling of the overall stock of General Government debt will be adjusted upward (downward) by the amount of any upward (downward) reclassification of entities or operations that affects the stock at end-December of the previous year.

15. **Supporting Material.** Quarterly data on the total stock of General Government debt as defined in paragraph 12 will be provided to the EC, ECB, and IMF by the BdP no later than 90 days after the end of each quarter, as reported to the ECB and the Eurostat. Monthly estimates will be provided to the EC, ECB and IMF by BdP no later than seven weeks after the end of each month.

D. Non-Accumulation of New External Debt Payments Arrears by the General Government (Continuous Performance Criterion)

16. **Definition.** For the purposes of the Program, the definition of debt is the same as in paragraph 12. An external debt payment arrear will be defined as a payment on debt to nonresidents, contracted or guaranteed by the general government, which has not been made within seven days after falling due (taking into account any applicable contractual grace period). The performance criterion will apply on a continuous basis throughout the Program period.

17. **Supporting Material.** Any external debt payment arrears of the General Government will be immediately reported by the MoF.

E. Bank Solvency Support Facility

18. The dedicated Bank Solvency Support Facility (BSSF) account will be maintained at the Bank of Portugal. As per previous review, resources for the BSSF will be agreed at each review and deposited in the dedicated account.

F. Overall Monitoring and Reporting Requirements

19. Performance under the Program will be monitored from data supplied to the EC, the ECB, and the IMF by the MoF and BdP. The authorities will transmit to the EC, ECB, and IMF any data revisions in a timely manner.