

ATTACHMENT II: PORTUGAL—TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

May 17, 2011

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 transmission of the data covered by this TMU will begin having as a reference the month of June 2011, being the Ministry of Finance (MoF), by the Direção-Geral do Orçamento (DGO), and the Banco de Portugal (BdP), responsible for the transmission.

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 MTU, 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 includes:
 - The Central Government. This includes:
 - The entities covered under the State Budget, as defined in the current Budget Framework Law, Law No. 91/2001 of August 20, amended by Law 48/2004 of August 24, 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), including Caixa Geral de Aposentações (CGA) and National Health Service (NHS) entities, and other entities belonging

to the budgetary Central Government classified by the National Statistical Authority (INE) as part of the Central Government.

- Other entities 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 Authority (INE) as part of the Central Government.
- State-owned enterprises (SOE) which are, under the ESA95 and ESA95 Manual on Government Deficit and Debt rules, classified by the INE as part of the Central Government (ISOE).
- Regional and Local Governments (*Administrações Regionais and Locais*), including 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.
- 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 2011, shall not include entities nor operations that are re-classified into General Government during the remainder of 2011.

5. **Supporting material:**

- 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.
- Data on the cash balances of the other parts of General Government as defined in paragraph 4 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 called guarantees and PPP-related revenues and expenditures.

- Data on domestic and foreign debt redemptions, new domestic and foreign debt issuance, change in the domestic and foreign cash balances of the Central Government at the BdP and other financial institutions, and all other sources of financing including capital transactions, and arrears of the General Government will be provided to the EC, the ECB, and the IMF by the DGO in the MoF within seven weeks after the closing of each month.
- 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.

QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILINGS, AND CONTINUOUS PERFORMANCE CRITERIA: DEFINITIONS AND REPORTING STANDARDS

G. 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. The net acquisition of financial assets for policy purposes, including loans and equity participation will be recorded as cash expenditures, except for transactions related to the banking sector support and restructuring strategy under the Program.

- **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 non-recurrent 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; EU expenses, and called guarantees (excluding those related to the banking sector support and restructuring strategy) where the Central Government makes payments on behalf of entities that are not part of the General Government.
- **The cash balance of the Regional and Local Governments, Social Security Funds and 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 MoF will make this specification available by end-May 2011. The reporting by Local Government will be phased as set out in paragraph 8 below.

- **The change in the stock of arrears of all entities of the General Government.** The stock of arrears, defined according to the definition below, as at June 30, 2011 will be measured through a survey and the results of the survey will be published by end-August 2011. From September 2011 onwards monthly report of arrears of the General Government will be published reconciling the stock at the beginning and end of the month and identifying repayments and other movements during the month. Data will be in line with the monthly publications of State Budget arrears, published on the MoF website.

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. Transactions that are excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchases of troubled assets. 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. Production of the consolidated General Government budget execution report for internal, EC, ECB, and IMF monitoring will begin in July 2011. The reports will be published externally from end-December 2011. The larger municipalities (defined as those with a population of 100,000 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, 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 quarterly 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.**

- Data on cash balances of the State Government, SEO 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 MoF will submit by end-July and end-January, 2012 a full reconciliation of the cumulative monthly cash deficit up to, respectively, end-March and end-September with the corresponding cumulative accrual deficits determined by the INE in accordance with ESA 95 rules. 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.

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

10. **Definition.** For the purpose of the Program, domestic arrears are defined as invoices 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 in the supplier contract, arrears are defined as invoices that have remained unpaid for 90 days or more after the date of the invoice. Data on arrears will be provided within six weeks after the end of each month. The continuous target of non-accumulation of domestic arrears requires that the total arrears at the end of any month are not greater than the corresponding total at the beginning of the month. Furthermore, in line with quantitative targets to be established at the time of the first review, the existing stock of arrears will be settled or otherwise reduced. This also includes arrears that are being accumulated by the NHS and SOE, which are, otherwise, to a degree excluded from the General Government under ESA95 and ESA95 Manual on Government Deficit and Debt rules classification.

11. Commitment is defined as an explicit or implicit agreement 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.

12. **Supporting material.** Starting in September 2011, 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.

I. 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 ceiling on the stock of General Government debt will exclude debt arising from payments for bank restructuring, when carried out under the Program's banking sector support and restructuring strategy. This includes loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by the central government to support banks, including the issuance of guarantees or provision of liquidity will be immediately reported to the EC, ECB and IMF.

14. **Adjusters.** For 2011, 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 2010 general government debt of EUR160.47 billion.

15. **Supporting material.** Quarterly data on the total stock of General Government debt as defined in paragraph 13 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.

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

16. **Definition.** For the purposes of the Program, an external debt payments arrear will be defined as a payment on debt to non-residents 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.** The stock of external debt payment arrears of the General Government will be provided by the MoF with a lag of not more than seven days after the test date.

K. Bank Solvency Support Facility

18. EUR 1 billion will be provided in cash and be made available in a separate dedicated account to be set up at the Bank of Portugal by end-June 2011. The remainder of the EUR 12 billion foreseen for the bank support fund will be deposited into the dedicated account consistent with the need for bank capital determined by Program reviews.

L. 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.
20. Concerning the Central Administration, and Regional and Local Administrations owned companies not classified by INE within the General Government, the MoF will provide by end-September 2011 data on the 2010 financial statements reported under the Simplified Business Information framework, to be reported by end-June 2011.