

BES/NOVO BANCO: resolution measures

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**I. CREDIT INSTITUTION UNDER DISTRESS:
FORMS OF INTERVENTION**

**II. REASONS FOR THE APPLICATION OF THE RESOLUTION MEASURE
TO BANCO ESPÍRITO SANTO, S.A. (“BES”)**

III. WAS IT THE BEST SOLUTION?

IV. THE BRIDGE BANK: NOVO BANCO

V. NEXT STEPS

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

- a) Recapitalisation with recourse to public funding;**
- b) Nationalisation;**
- c) Judicial liquidation;**

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

d) Application of a resolution measure

Special procedure to be applied in order to achieve the resolution objectives which are of a public interest nature and consist in avoiding adverse effects on financial stability, preserving the continuity of critical banking functions, ensuring depositor's protection and safeguarding public funds, minimizing reliance on extraordinary public financial support.

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

Although the application of resolution measures does not necessarily imply the prior adoption of corrective intervention measures, they are reserved for extreme situations, when both corrective measures and provisory administration measures are no longer viable and when:

- (1) the credit institution does not meet or is in serious risk of not meeting the requirements to maintain the authorisation to carry on its business;
- (2) it is not foreseeable that such credit institution can, within a reasonable time frame, perform the necessary measures to return to financial soundness and comply with prudential ratios; or

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

(3) such measures are necessary to:

- avoid systemic risks in the banking sector (*follow-on wave of failure of other financial firms*);
- avoid potential negative impacts in the financial stability plan;
- minimise the costs in the public purse; or
- safeguard the confidence of depositors.

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

By the time the resolution measure was adopted there were 2 types of resolution measures available:

(1) (Total or partial) sale of the business to another credit institution authorised to carry on the activity in question;

(2) Setting-up of one or more bridge bank(s) and (total or partial) transfer of the business of the distressed institution to the new bank(s).

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

Before the resolution of BES on 3 August 2014:

- the principles of shareholders and subordinated creditors bearing losses first and the last resort nature of resolution tools were already in place; and
- the possibility of transferring part or all of the activity and assets, liabilities, off-balance sheet items and assets under management to another credit institution *or* a bridge bank were already hard law.

I. CREDIT INSTITUTION UNDER DISTRESS: FORMS OF INTERVENTION

In 2015, the key resolution tools now available are:

a) SALE OF BUSINESS: *selling the bank or parts of the bank;*

b) BRIDGE INSTITUTION: *setting up a bridge institution;*

PLUS

c) ASSET SEPARATION: *separating good assets from bad ones;*

d) BAIL-IN: *bailing in shares (write down) and debt instruments (creditor claims are reduced or converted into equity)*

II. REASONS FOR THE APPLICATION OF THE RESOLUTION MEASURE TO BES

On 3 August 2014, the Bank of Portugal (BoP) imposed on BES in the face of BES imminent risk of default and in order to preserve the stability of the entire Portuguese Banking system the resolution measure consisting in the *transfer of most of its business (assets, liabilities, off-balance-sheet items and assets under management) to a newly created bridge bank (“banco de transição”), Novo Banco, S.A. (“Novo Banco”), specifically set up for this purpose, which is envisaged to be sold at a later stage.*

II. REASONS FOR THE APPLICATION OF THE RESOLUTION MEASURE TO BES

BoP announced that the general activity and assets of BES are transferred, immediately and definitively, to Novo Banco, which is duly capitalised and clean of problem assets.

Deposits are fully preserved, as well as all unsubordinated bonds.

BES was a major Portuguese bank and part of one of the biggest economic groups in Portugal, holding interest across several sectors.

II. REASONS FOR THE APPLICATION OF THE RESOLUTION MEASURE TO BES

BES was at the heart of a complex web of family-owned companies with investments that stretched from mining projects in Angola to hotels in Portugal.

This measure was applied after the very high and unexpected losses in its results for the first half of 2014 and, inter alia, the decision of the ECB to suspend its counterparty status.

BES had reported a EUR 3.6bn loss, taking Common Equity Tier 1 levels to 5%, below the minimum regulatory level.

II. REASONS FOR THE APPLICATION OF THE RESOLUTION MEASURE TO BES

BES collapsed amid a record first-half loss triggered by its exposure to its troubled family-controlled parent company

Depositors and senior debt holders were protected by the BoP (resolution authority) as they were transferred to Novo Banco; shareholder and holders of BES junior debt instruments were not transferred to Novo Banco.

Besides their investment in the shares of BES, qualified shareholders' credits over BES were retained at the 'bad bank'.

II. REASONS FOR THE APPLICATION OF THE RESOLUTION MEASURE TO BES

As for Covered Bonds, as Senior Secured debt instruments, the relevant issues were transferred to Novo Banco:

- BES HIPOTEC.SER.6 PTBENAOE0014 BES Senior Debt / Obrigações hipotecárias
- BES– Obrigações Hipotecárias – Série 4 PTBER9OE0012 BES Senior Debt / Obrigações hipotecárias
- BES – Obrigações Hipotecárias – Série 7 PTBEQAOE0011 BES Senior Debt / Obrigações hipotecárias
- BES– Obrigações Hipotecárias PTBLMVOE0011 BES Senior Debt /Obrigações hipotecárias
- BES– Obrigações Hipotecárias – Série 5 PTBLMIOE0018 BES Senior Debt / Obrigações hipotecárias

III. WAS IT THE BEST SOLUTION?

- Recovery and Resolution Plans are commercially highly sensitive, unpredictable and highly political;
- This was the first application of the resolution regime under Portuguese banking law;
- The resolution scheme adopted by Bank of Portugal for BES helped stabilise the system while (apparently) limiting the taxpayer contribution needed to support the bank;

III. WAS IT THE BEST SOLUTION?

- The negative developments at BES and uncertainties around the magnitude of the losses that the bank was facing had some short-term market implications for Portugal's largest banks, which faced substantial volatility in their stock prices and credit spreads;
- The failure of BES demonstrated the vulnerability of the system to any event that could negatively affect investor's perception of the creditworthiness of Portuguese banks;

III. WAS IT THE BEST SOLUTION?

- Resolution of a systemically important financial firm constitutes a credible alternative to bail-out or some other sort of taxpayer assistance;
- It would have been desirable that an initial valuation at the entry into resolution determine once and for all the allocation of losses between shareholders and the different class of creditors but it was unrealisable;
- The intervention by the BoP and subsequent protection of depositors and senior creditors quickly calmed the market.

IV. THE BRIDGE BANK: NOVO BANCO

NOVO BANCO is subject to the legal and regulatory framework applicable to Portuguese banks.

Novo Banco's equity capital in the amount of €4.9 billion is held in full by the Resolution Fund, which is its sole shareholder;

The Resolution Fund depends upon contributions by the Portuguese banking system, and which will need to ultimately reimburse the Portuguese State of the loan it advanced to the Resolution Fund and was used to pay most of the share capital of Novo Banco.

IV. THE BRIDGE BANK: NOVO BANCO

If the sale of Novo Banco fails to be accomplished in a fashionable manner, Portuguese banks could face losses on the portion of their contributions to the Resolution Fund.

The state loan to the Resolution Fund will be paid back from the proceeds of Novo Banco's sale. If the price tag is below €4.9 billion, banks, not taxpayers, in theory fall liable for the difference.

IV. THE BRIDGE BANK: NOVO BANCO

This summer, the Portuguese central bank made a short list of three bidders for Novo Banco (the Anbang Insurance Group, had made the highest offer, followed by Apollo Global Management. Fosun International, another Chinese insurance and asset management company, was reported to have been third)

The continued difficulties of Novo Banco, linked to the investments and unchecked lending activities of BES, were seen as an impediment to Portugal's securing a high auction price for the institution.

IV. THE BRIDGE BANK: NOVO BANCO

Novo Banco recently reported a first-half loss of almost €252 million, mostly because of the cost of writing off interest payments from big corporate loans inherited from BES.

Novo Banco also had to state provisions for the loss of value in some of its telecommunications holdings.

With ‘unquantifiable liabilities’ noted by Novo Banco’s auditors PwC, mainly due to pending legal actions

V. NEXT STEPS

- BOP has temporarily shelved the sale of Novo Banco;
- none of the proposals, according to the BoP, met the conditions on price and risk;
- the sale was postponed after the government elections (4 October) and stress tests (uncertainty about capital requirements for Novo Banco);

V. NEXT STEPS

- ongoing restructuring of Novo Banco in order to optimise its balance sheet and reinforce its own capital: Novo Banco intends to focus on its core banking business and dispose of non-strategic assets;
- relaunch of the sale process in the future in the hope of achieving a higher price;
- Novo Banco must be sold within two years (August 2016), but the period can be extended by periods of a year if it is deemed in the public interest.

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