



**THE RECAPITALISATION OF NOVO BANCO, S.A.
A NEW BEGINNING FOR NOVO BANCO OR MORE LITIGATION AHEAD**

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The end of 2015 was difficult for the battered Portuguese banking sector. The Bank of Portugal and the European Central Bank wanted to clean up the house before the entry into force, on 1 January 2016, of the unified European bank resolution mechanism.

On 20 December, the Portuguese Government was forced to intervene in BANIF which was about to lose access to the ECB's emergency liquidity funding. Although BANIF was a small bank it may end up costing Portuguese taxpayers over €3,000 million.

On 29 December, the Bank of Portugal adopted a second resolution in respect of BES ordering the "re-transfer" of certain Novo Banco senior notes worth approximately €2,000 million to BES, the bad bank that resulted from the collapse of the Espírito Santo Group.

As announced by the Bank of Portugal, this measure increased Novo Banco's capital ratio to 13% making it more attractive to potential buyers.

In anticipation of the litigation that will certainly follow, the Bank of Portugal stated in its press release that its decision was due to the additional "*losses arising from facts with their origin at Banco Espírito Santo, S.A. and prior to the date of the resolution [3 august 2014]*"; in other words, the Bank of Portugal is arguing that the measure aims to solve a problem created before the incorporation of Novo Banco. The Bank of Portugal also states that the resolution was "*necessary to ensure that, as set out in the resolution legal framework, the losses of Banco Espírito Santo, S.A. are absorbed, firstly, by the shareholders and creditors of this institution and not by the banking system or the taxpayers*", which would justify the less favourable treatment given to the holders of the notes "re-transferred" to BES. Lastly, the Bank of Portugal concludes that this last decision "*is the final and definitive change in the perimeter of assets, liabilities, off-balance sheet and assets under management transferred to Novo Banco*" that was left open in the original resolution measure is now "*definitively closed*" by this decision.

In contrast with the Bank of Portugal's original resolution measure of 3 August 2014, which, we have always believed, would be hard to challenge in court, in this particular case investors have strong reasons to question the timing and the proportionality of the measure adopted.

As regards the timing, this last measure was taken one year and four months after the Bank of Portugal's first intervention in BES, which took place on 3 August 2014. It is difficult to understand which facts occurred before August 2014 could justify such a serious measure. As is publicly known, since the adoption of the original resolution, Novo Banco approved its 2014 financial statements, which have been audited by its statutory auditors and reviewed by the Bank of Portugal in the exercise of their supervisory functions. Novo Banco also approved quarterly and semi-annual financial statements concerning the year 2015 and was subject to stress tests by the European Central Bank, which were announced by the Bank of Portugal on 14 November 2014.

The Bank of Portugal's decision also breaches the principle of equal treatment of creditors within their respective rankings, as Novo Banco has repaid other notes with the same ranking in 2015 and assumed responsibility for other senior bonds issued by BES and/or vehicles of BES. Therefore, the decision favours



other unsecured creditors of Novo Banco whose rights are not affected by the resolution now adopted in relation to the senior notes that were "re-transferred" to BES.

The banking resolution legal framework does not allow a differentiated treatment of creditors of the same ranking, with the exception of depositors that benefit from legal preference over other unsecured creditors and creditors essential to the continuation of the bank's activities. It is therefore difficult to understand why this measure does not apply to the holders of other senior notes.

It is more than likely that harmed investors will take the matter to the courts and that they will have a strong case against the Bank of Portugal.

Significantly, the Bank of Portugal states in its press release that "*it is the responsibility of the Resolution Fund to neutralize, by way of compensation to Novo Banco, the possible negative effects of future decisions, arising from the resolution procedure, which result in liabilities or contingencies*"; in other words, the Bank of Portugal is impliedly accepting that some claimants may be successful in court and by this statement wants to assure potential buyers' of Novo Banco that the bank will not be affected by litigation.

It is generally known that the ultimate responsibility that may arise from claims concerning the resolution of BES will have to be satisfied by the Resolution Fund. By stating it in its press release, the Bank of Portugal seems to indicate that the creditors affected by this latest measure have stronger chances of success when compared with the claims of subordinated creditors now in court.

The Bank of Portugal's main goal with this measure was to improve Novo Banco's financial ratios to facilitate its sale.

However, with this decision legal certainty is lost and investors may distrust the word given by the Bank of Portugal and the European Central Bank, which breach the laws that they should protect.

The question remains as to whether Novo Banco's prospective buyers of should not be aware of a regulator that allowed (and required) a capital increase of a bank with serious internal problems that the same regulator would put into resolution only a few weeks after investors put their money into the bank and a regulator which reverted its own decision more than one year and four months later. Only time will tell.