



## **NEW BANK, OLD PROBLEMS**

### **HOW THE GOVERNMENT ALMOST GOT IT RIGHT WITH NOVO BANCO**

#### **MVConversations with António de Macedo Vitorino**

**By failing to fix a crucial piece of the puzzle, has the success of Novo Banco been undermined by an inability to draw a line under the BES legacy?**

The €4.9 billion bailout of Banco Espírito Santo (BES) by a special bank Resolution Fund in 2014 saw one of Portugal's largest listed banks split into Novo Banco, the 'good' bank, and a 'bad bank' of toxic assets.

This split, however, is turning out to be more of a 'break' than a clear-cut divorce, and Novo Banco is now set to receive a fresh capital injection after posting losses of over €1.4 billion.

The root of the problem, according to António de Macedo Vitorino, stems not from the good or bad bank, but from bad strategic decision-making by the Government, an open backdoor in the contract, and a free ride to the private sector resulting in a tremendous amount of collateral damage.

"What has been really 'bad' in the BES situation is the unacceptable and illogical transfer of taxpayer money by the Government to the private sector and a total lack of protection of the public interest," he explains. "Added to the damage done to the victims of BES and the taxpayers, we have the unseen costs to the judicial system, where the courts are faced with hundreds of ongoing lawsuits, and the reputational damage to Portugal as a whole."

#### **The Resolution**

While there is no doubt that major mistakes have been made in the handling of BES and Novo Banco, the fundamental action taken by the Bank of Portugal with the Resolution Fund has, according to António Vitorino, cost the taxpayer less in the long run than had BES been nationalised or if the Government had funded the recovery of the bank.

All things considered, while not without flaw, the Resolution has paid off. "When regulations are made in the midst of a crisis, it's difficult to achieve the desired end result as the whole issue becomes so politicised and discussions are based more on ideology than reality," he says. "The Government at the time was under a pressure to please the public, it was close to the elections etc, but there would always be some damages and losses coming out of the BES/GES fraud case that would be paid by the taxpayer."

The fact that Novo Banco is alive is a victory in itself, he adds, we could have lost much more. "But the real question is could we have lost less if the Government and the Bank of Portugal had acted in a speedy and competent manner ensuring that Novo Banco was clear of the BES legacy? We knew that BES loans to the Espírito Santo group would be lost; but these bad loans were supposed to stay with BES. We believed that Novo Banco would have a fresh start."



## **The Irresolution**

The real issue is an inability of the Government and regulators to manage processes and make decisions with the same level of professionalism as private companies, says António Vitorino. "They went back and forth without actually taking definitive action, as if they needed someone to decide for them. Add to that political agendas, calendars and economics, and there is an inefficiency across the board whereby politics and reality clash."

Of course, everyone makes mistakes, he adds, but here it's the taxpayers that are having to foot a far higher bill than necessary. "If things had been done properly, if the Government and the Bank of Portugal hadn't dragged their feet and had wrapped up the resolution in a couple of months, ensuring the Novo Banco sale contract was watertight and insulating the system and the various players/stakeholders, we would not be in the situation we are now in."

The State holds a tremendous amount of power in public negotiations, he explains, with that a habit of saying no, we won't do it, we don't accept it, and if you are on the other side you have to swallow it. "The problem is that they don't have the flexibility to truly understand the private sector's concerns while properly protecting the public interest, so when they do yield pressed by the political demands and accept things, they always give away too much."

In the sale of a 75% stake in Novo Banco to US Fund Lone Star, assurances were given to the public that a €3.9 billion cash reserve was there as a 'last ditch resort' but would not be touched. "But the Government knew that by allowing discussions to be centred on the intended value of Novo Banco's assets and bad loans, they had a problem: they opened a back door in the contract and set in stone the fate of the so-called reserve fund," says António Vitorino. "This reserve was not a 'last ditch resort' at all, it was always to be used up to the full €3.9 billion".

In a typical M&A, especially involving banks, the reps and warranties given by the seller rest on what they have and not on what the buyer would expect or 'like' to have, he explains. "It's an important distinction, and with Novo Banco, the Government didn't hold their ground when it came to the scope of the offer from Lone Star, nor mark a line that if crossed would result in a failed negotiation. They allowed for discussions to take place that fundamentally changed the entire tender offer and the rules mid-way through the game."

And it's important to note that this is a legal discussion, he adds. It has to do with strategic legal decisions that needed to be taken along the way. "It's not unexpected for any bank coming out of a crisis to have non-performing loans and other troubled assets, wherever they are in the world. But if there is a tender document with an offer on the table for assets and then you allow the buyer to open up discussions on price or cherry-picking assets, as well as allowing for additional capital calls, then any lawyer would, or should, know that you are creating a backdoor in the contract that will ultimately be used by the buyer."

Year-on-year, Novo Banco has been eating into this capital. The recent fresh injection of capital into Novo Banco has prompted Portugal's Finance Minister to order an audit to get some clarity on Novo Banco's capitalisation, but nothing new will be uncovered. "This is only for show, to save the face of the political decision makers."

These consequences are completely uncalled for, says António Vitorino, and one wouldn't have expected all these problems to emerge after the act. By giving this free ride to the private sector instead of



safeguarding the Portuguese taxpayer monies, the Government has undermined what could have been a successful resolution.

"The main Portuguese banks had serious bad loan problems," he adds. "But all private banks were able to repay the money loaned by the Government and paid interest on it. No public money was lost in BCP and BPI for instance." Only the money given to banks that ended up under State control was lost, namely BPN, Novo Banco and Banif. CGD was also State-owned."

As an asset Novo Banco is positioning itself extremely well to generate more money for its shareholders than the losses sustained, explains António Vitorino. "But because of the Government's inability to draw a line through where the BES legacy ends and Novo Banco's begins, we can see big profits coming through in the future that won't be used to cover the resulting costs of the bondholders' claims or pay for the extra taxpayer money that is being injected into the bank. All these unnecessary loose ends will end up being covered by the resolution fund and so ultimately the taxpayer will lose yet again."

Footnote: Macedo Vitorino & Associados is advising several Novo Banco bondholders and investors in Espírito Santo securities in various proceedings related to the BES/GES collapse.