Europe Guide

BANKING & FINANCE — PORTUGAL

Overview

PORTUGAL: An Introduction to Portugal

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Figures show that in 2016 the Portuguese economy grew – for the third year running – at a projected rate of approximately 1.3%. This growth follows a deep recession experienced between 2011 and 2013, years that were also marked by the collapse of foreign demand and investment. In 2011, Portugal signed a bailout agreement – worth EUR78 billion – with the European Union, the European Central Bank and the International Monetary Fund (the "Troika") to reduce its budget deficit. In conformity with this agreement, the Portuguese Government launched a major structural adjustment and reform plan. Portugal succeeded in reducing its public deficit to 4% in 2014, and in May 2015 Portugal emerged from this financial aid programme. Parliamentary elections held in October 2015 saw the introduction of a new political solution, namely, a socialist government supported by the left-wing parties. In early 2016, investors were concerned that the new government would be unable to comply with the budget goals and would end up reversing the reforms implemented under the 2011-14 bailout, sending bond yields sharply higher. However, the Government succeeded in securing the approval of the 2016 budget, in addition to a long-term stability plan required by Brussels and a national reform programme, and it has since also passed its 2017 budget, revealing a political stability that many would not have predicted. The 2017 State Budget Law ("OE 2017") was approved and gazetted on 28 December 2016 and the situation seems stable, at least for the current year, but it may not end here.

The OE 2017 implements a new deduction equal to 7% of cash contributions — for capital increases or the incorporation of an entity — and shareholder loan conversions, not to exceed EUR2 million. Companies may claim this deduction against taxable profits in the current and subsequent five tax years with respect to the year in which the contributions or conversions are made. Under current law, eligible investments can benefit from a 25% tax credit on the first EUR5 million invested. The OE 2017 increases the amount eligible for the 25% credit from EUR5 million to EUR10 million and maintains the 10% rate for investments exceeding this limit. Investments

made in tax years beginning on or after 1 January 2016 will be considered eligible investments even if they have not been treated as such in prior tax years. The OE 2017 also clarifies that the special tax regime under Decree-Law 193/2005 (dated 7 November 2005) shall also apply to perpetual bonds and Tier 1 and Tier 2 own funds instruments that comply with the requirements under European Union (EU) Regulation 575/2013 of the European Parliament and of the Council (dated 26 June 2013), and it is therefore expected that banks in Portugal will resort to these instruments to reinforce and complement their *quasi-equity* and own funds.

Nevertheless, public debt still represents 130% of the Portuguese GDP, and Portugal is under obligation to make annual payments to its creditors until 2020 to reimburse its debt. The business climate is otherwise friendly, given the currently weak euro, low oil prices and the accommodating monetary policies of the European Central Bank, but all these factors may change rather suddenly.

The Banking sector in 2016

Pursuant to the resolution measure applied by the Bank of Portugal ("BoP") to Banco Espírito Santo ("BES") in August 2014, through the incorporation of a bridge bank – Novo Banco S.A. ("Novo Banco") – to which certain assets, rights and liabilities of BES were transferred, a Resolution Fund was established to proceed with the sale of Novo Banco.

This sale process is currently ongoing and, at the start of 2017, the BoP issued a press release indicating that an offer had been selected and granted prospective purchaser status, but negotiations are still in progress.

In late 2016, the national authorities – more specifically, the Portuguese Government and the BoP – had already advanced with the sale of the business segment of Banif – Banco Internacional do Funchal, S.A. ("Banif"), and of most of its assets and liabilities, to Banco Santander Totta ("BST") to the amount of EUR150 million. The restrictions imposed by European institutions and the unviability of Banif's voluntary sale led to the sale being carried out within the context of a resolution tool. The BoP deemed this a solution capable of preserving the integrity of the domestic financial system, in that it safeguarded the savings of families and businesses by transferring them to Santander, while also providing for the continued financing of the economy.

As regards the Portuguese banking sector, we further highlight the success of the takeover bid for Banco Português de Investimento ("BPI") launched by the Spanish group CaixaBank ("CaixaBank"), a major shareholder of BPI. CaixaBank completed the takeover in 2017, paying EUR645 million (USD690 million) to raise its stake in BPI from 45% to 84.5%. Before completion of the takeover, BPI handed over control of its lucrative Angolan unit, BFA, to the Angolan

telecoms company Unitel in order to meet requirements set by the European Central Bank on risky exposure to the Angolan economy. BPI registered a 33% rise in its 2016 net profit, as net interest income rose, while impairments for bad debt fell sharply. Its fully-loaded capital ratio at the close of 2016 stood at 11.1%.

Finally, 2016 also saw the purchase by Bankinter ("Bankinter"), a leading Spanish bank, of Barclays' retail, private and corporate banking and life insurance segments, which resulted in the opening of Bankinter's first branch in Portugal in April 2016. Barclays' credit card component and Barclaycard trademark was acquired in November 2016 by Wizink Bank, also a Spanish bank, corresponding to a joint venture between Banco Popular Español and the US international investment firm Värde Partners.

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