“Closed bank resolution” under recent Portuguese law

15 October 2014 | by **José Pedro Fazenda Martins**

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1 Legal framework

The banking regulator (Banco de Portugal) is entitled to impose resolution measures on banks, *inter alia*, creating a new legal entity that takes forward the banking activity (bridge-bank) and leaving all the trouble in the “bad bank”. The framework for closed bank resolution was adopted in 2012 by Decree-Law no. 31-A/2012 and was amended in the verge of the BES-affair by Decree-Law 114-A/2014 and Decree-Law no. 114-B/2014, which entered into force in early August.

2 Bridge-banks

Resolution measures may involve stripping out of assets and liabilities from the distressed or failing bank to a bridge-bank (the so called “good bank”). The total amount of liabilities to be transferred to the new entity cannot exceed the amount of assets at its disposal.

Banco de Portugal is entitled to incorporate and adopt the articles of association of the good bank by a sole decision of its Board. The share capital of the good bank is subscribed by the so-called Resolution Fund (which is self-funded by the industry, but is also a legal public entity, can, in certain circumstances, receive loans and guarantees from the State) and the bank is entitled to take up banking business without the previous inscription in the Commercial Registrar, continuing the activity of the original troubled bank. No authorisation of the Competition Authority is required for this purpose.

Third parties rights based on change of control or acceleration clauses cannot be exercised against the good bank.

The Board of the bridge bank is appointed by Banco of Portugal, under a proposal of the Resolution Fund.

The good bank is brought up to be sold or liquidated. Its terminus is set by the law (two years), but Banco de Portugal can avoid any risk of a fire sale postponing the terminus up to a maximum of five years, in order, for instance, to allow the closing of any negotiations for the sale. Disposal of the assets or of the shares of the good bank can be made totally or partially. Partial disposal of shares should be put into perspective: the law should be construed as allowing selling in tranches to different acquirers the whole share capital of the bank, but it does not allow the bank to survive as a bridge bank for a non-specified period of time with only a minority part of the share capital in private hands.

3 Bad-bank and bail-in

The Banco de Portugal is entitled to select assets and liabilities to be transferred to the good bank. The remaining (bad) assets and liabilities will be kept in the troubled bank, which loses its banking license and becomes a special vehicle to be liquidated.

There are, however, some assets and liabilities bound by the law to remain in the bad bank’s perimeter, namely the obligations of the original bank before qualifying shareholders, former members of the Board of Directors and Supervisory Boards and other closely related persons, including some members of their families. This includes, *inter alia*, cash deposits held by these persons with the original bank, which, to some extent, can be deemed a legal sanction imposed on these person or entities. Creditors (according to their ranking) and shareholders’ rights, which were not transferred to the good bank are only enforceable against the bad-bank.

As the amount of assets kept in the bad-bank is in general insufficient to satisfy all these interests, in practice this means creditors and shareholders bail-in the bank.

The extension and perimeter of the bail-in is variable and depends on the decision of Banco de Portugal. For instance, in the recent case of BES, Banco of Portugal spared senior bondholders and unsecured deposit holders from bailing-in the bank, by transferring their rights to the perimeter of the good-bank.

4 Bail-in and common winding up procedures

The law sets forth the “no creditor worse-off position” principle according to which, as a result of a resolution measure, no creditor can have imposed upon him a loss higher than the loss he would incur if the original bank had been wound up.

For such a purpose, any difference is transformed into a credit towards the Resolution Fund, shifting some of the burden of the specificity of bail-in measures to the banking system as a whole.

Nevertheless, this is crucial to avoid any sort of criticism based on expropriation of creditors caused by the asset stripping required to create the good-bank.

5 Bottom-line

Resolution measures protect taxpayers and mitigate systemic risk, imposing losses mainly on shareholders, other equity product holders and junior bondholders.

Thus, from now on, investors in securities issued by banks have a different and better perception of risk, which is in fact similar to the risk taken by investors in other companies. This could have some impact on capital markets in the short run, but will reduce moral hazard and contribute to healthier functioning of those markets in the long run.

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José Pedro Fazenda Martins has a Law Degree and a Master Degree in Civil Law by the University of Lisbon, Faculty of Law. Joined Vieira de Almeida & Associados in 2011 and is currently Of Counsel and Head of the Capital Markets practice group where he has been actively involved in several transactions, in Portugal and abroad, namely in public offers, privatizations, takeovers and delisting companies, among others. Author of several scientific articles on securities law issues and member of drafting groups that elaborated draft pieces of securities legislation and regulation. He is also a founding member of the Securities Law Institute, University of Lisbon, Faculty of Law.

Before joining the firm, he was the Head of Markets and Corporate Finance Department at the Portuguese Securities Commission (CMVM) and member of the Steering Committee of the Euronext College of Regulators. In this regulatory capacity he intervened in the most important capital market transactions and listings of financial instruments that occurred in the last 5 years, including takeover bids, rights issues, securitisations and two business combination involving international Exchanges.