The Banking Regulation Review

Sixth Edition

Editor
Jan Putnis

Law Business Research

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This article was first published in The Banking Regulation Review - Edition 6
(published in May 2015 – editor Jan Putnis).

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-909830-46-2

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

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ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

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ADVOKATFIRMAN VINGE

AFRIDI & ANGELL

ALI BUDIARDJO, NUGROHO, REKSODIPUTRO

ALLEN & GLEDHILL LLP

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T STUDNICKI, K PŁESZKA, Z ĆWIĄKALSKI, J GÓRSKI SPK

URÍA MENÉNDEZ ABOGADOS, SLP

VASIL KISIL & PARTNERS

VIEIRA DE ALMEIDA & ASSOCIADOS

WERKSMANS ATTORNEYS

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EDITOR'S PREFACE

While the pace of new rulemaking affecting banking groups has slowed somewhat in Europe and the United States in the past year, the debate about the future of global banking rages on, not least because implementation of the vast body of rules made since the financial crisis continues. If anything, the debate has become a more complex one, with a number of new fronts opening. Implementing complex new rules is, of course, generally more difficult than making them, and in many areas of activity rules that took shape some time ago are only now exhibiting their shortcomings and unintended consequences.

Questions about 'too big to fail' remain, but with gradually increasing realism among regulators, some governments and banks ask themselves about how this issue might best be managed in the long term. There is now greater recognition that painstaking recovery and resolution planning was not just an urgent post-crisis task but must remain a critical feature of banking supervision in perpetuity. Indeed, the list of points on which regulators should improve cross-border coordination on recovery and resolution matters remains formidably long. There is also a risk that while 'too big to fail' was the most well known and eye-catching phrase to emerge from the financial crisis, any attempt by governments to force or catalyse the break-up of large banking groups would risk neglecting the importance of the 'too inter-connected to fail' problem, which is, of course, far less a function of the size of banks.

The past year has seen further large fines for banks from conduct regulators, most notably in the context of the spot FX markets. Many bank prudential regulators are, sensibly, thinking more seriously now about the implications of these fines (and associated litigation) for the prudential supervision of the banks affected and, potentially, for financial stability itself. The 'conduct agenda', as it is now frequently called, has moved on in other ways in some countries, including increasing discussion among regulators about competition (antitrust) aspects of wholesale as well as retail financial markets. This will begin to create new and, in many cases, unwelcome challenges for large banks.

Return on equity continues to be a significant challenge in the banking sector, with signs of increasing shareholder pressure on some banks. This may add a further dimension to structural reform in addition to the existing regulatory one. In some cases, particularly where activist investors are concerned, all involved would do well to remember that shareholder activism lay behind some of the more disastrous mergers and acquisitions in the banking sector before the financial crisis. While it can be expected that regulators in most important financial jurisdictions will be more vigilant in assessing the viability of major transactions in the sector now than they were before the crisis, boards of directors of banks will also need to avoid the temptation to give in to short termism in the face of poor shareholder returns. This is arguably particularly the case in an environment where market restructuring and new technology present long-term opportunities for some banks as well as threats.

Governance of banking groups continues to be high on the agendas of many regulators around the world. Directors of banks in the UK, many other European countries and the US rightly focus increasingly on whether they are discharging their regulatory obligations properly when taking significant decisions, and whether their knowledge (and their ability to oversee) the businesses for which they are responsible is sufficient. A cynical bystander would, however, continue to say that in a global bank with tens of thousands of employees worldwide, good governance structures will only ever play a limited role in reducing the risk of a calamity on, for example, a trading desk, and that good luck (or bad luck) is more likely to determine success or failure in global compliance. That is surely too cynical a view in light of the significant strides that many banks have made to improve their governance and oversight in recent years. However, it remains a view with some validity in relation to emerging threats that are not yet generally well understood. These include many cyber-related risks, not just the possibility of the use of banks' IT systems by criminals but also the threat to financial stability posed by vulnerabilities (and in some cases unreliability) in systems used to settle payments and securities transactions. Bank governance in the context of the use of banks for criminal purposes, including tax evasion, has continued to have a very high profile over the past year.

Important developments in prudential regulation in the past year include further advances in the EU towards implementation of the Recovery and Resolution Directive and the Financial Stability Board's proposals on Total Loss-Absorbing Capacity (TLAC). TLAC looks set to continue to dominate debates on capital structure and funding in the banking sector this year, particularly on the difficult question of where and how TLAC should be 'positioned' within groups of companies in order to facilitate their chosen resolution strategy.

This sixth edition of *The Banking Regulation Review* contains submissions provided by authors in 48 countries and territories in March and April 2015, as well as the customary chapters on International Initiatives and the European Union. It is a great privilege to share space in this book with such a distinguished and interesting group of banking and regulatory lawyers from around the world, and I would like to thank them all again for their participation (and those authors who have joined the book for the first time this year).

My thanks also to Shani Bans, Nick Barette and Gideon Roberton at Law Business Research Ltd for their further unusual levels of patience and skill in compiling this edition and for continuing to encourage the participation of the authors.

The partners and staff of Slaughter and May continue to inspire and innovate in the area of banking regulation, and to tolerate the time that I spend on chapters of this book. Particular thanks go to Ben Kingsley, Peter Lake, Laurence Rudge, Lucy Bennett, Nick Bonsall, Edward Burrows, Tim Fosh, Helen McGrath and Tolek Petch.

Jan Putnis
Slaughter and May
London
May 2015

Chapter 36

PORTUGAL

Pedro Cassiano Santos[1]

I INTRODUCTION

The landmark events of 2014 were the crisis in Grupo Espírito Santo and the resolution measure applied to one of the biggest private banks in Portugal – Banco Espírito Santo, SA (BES) – under the terms foreseen in the Bank Recovery and Resolution Directive (although not fully implemented in Portugal at the time of the resolution). 2014 also marked Portugal's successful exit from the €78 billion Programme of Economic and Financial Assistance entered into with the EU, the International Monetary Fund and the European Central Bank (ECB), a number of successful sovereign debt issues at low interest rates and the first consistent signs of economic growth.

On 3 August 2014, the Bank of Portugal (BoP) applied a resolution measure to BES in the form of a transfer to a bridge bank created for such purpose (Novo Banco, SA), after the very high and unexpected losses in BES' results for the first half of 2014 and, *inter alia*, the decision of the ECB to suspend its counterparty status. In addition to this being the first time such resolution was tested in practice in the EU, it should be noted that BES was a major Portuguese bank and part of one of the biggest economic groups in Portugal, holding interests across several sectors. Novo Banco's sole shareholder is the Resolution Fund, which depends upon contributions from the Portuguese banking system, and which must ultimately reimburse the state for the loan advanced to the Resolution Fund in August 2014 that was used to pay up most of the share capital of Novo Banco. The bridge bank has been created for an initial period of two years (which may be extended by up to five years), but the intention of the regulators, officials and the banking community seem to point to a fast sale of Novo Banco, and the Resolution Fund aims to sell Novo Banco in 2015.

1 Pedro Cassiano Santos is a partner at Vieira de Almeida & Associados. The author would like to thank Ana Moniz Macedo and Lourenço Fragoso of the same firm for their help in the preparation of this chapter.

Substantially most of the estate of BES was transferred to Novo Banco. In the 3 August deliberation, all assets, liabilities, off-balance sheet items and assets under management were transferred, unless expressly excluded in the deliberated perimeter.

During 2014, Portugal implemented a broad revision of its banking laws, mainly through Decree-Law 157/2014 of 24 October, which fully implements the Capital Requirements Directive IV (CRD IV)[2] rules and principles regarding:

a the concept of credit institutions;
b corporate governance of credit institutions, in particular with regard to the suitability, qualifications, work experience and availability of the holders of management positions;
c remuneration policies and risk management thereof; and
d sanctions regimes.

This revision has also strengthened the BoP's supervision and corrective power.

The recapitalisation process that took place in Portugal during the past three years involved complex company and regulatory banking law matters, as well as EU law and state aid considerations, since this injection of public funds into private banks (and the increase of the state's investment in CGD) constituted state aid, and was treated as such by the European Commission. As a result, all Portuguese banks deemed 'systemic' by the European Banking Authority (EBA) satisfy the stringent core Tier I capital ratio (9 per cent) determined by the EBA for 30 June 2013, including a buffer to cover sovereign exposure at market prices as of September 2011. The recapitalisation operations of the banks have been successfully implemented (except for the still-ongoing recapitalisation process of Banco Internacional do Funchal SA (Banif)),[3] notably approvals in Brussels for the restructuring plans of CGD, BPI and BCP, completed with fewer impositions than many predicted, but imposing reformist policies. BPI has already successfully paid the entirety of its convertible bonds (CoCos) and concluded the recapitalisation process, while the other banks have also started to reimburse the public funds they received in 2012 (2013 for Banif).

2014 also witnessed the current attractiveness of the covered bonds market, a trend that restarted in 2013. This market segment continued to be attractive, and some banks took advantage of this momentum to keep their programmes for issuance of this privileged asset class.[4] 2014 also saw the strengthening of Portuguese securitisation transactions to the market, with senior tranches of asset-backed notes from the 'Volta II' and 'CMEC Volta' transactions (the originator of which is the major Portuguese energy distributor company Energias de Portugal SA) having successfully been placed and distributed to qualified international investors. The Atlantes SME II transaction (prepared during 2013 and closed at the beginning of 2014), originated by Banif, and Aqua NPL No. 1 (prepared during 2014 and closed at the beginning of 2015), originated by Montepio Crédito, also saw some of their tranches successfully distributed on the international markets.

2 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013.
3 This has already been initiated but it is still subject to final European Commission approval.
4 In particular, CGD, Banco Popular Portugal and Banco Santander Totta.

On the equity side, a significantly high level of activity also took place during 2014, particularly marked by, *inter alia*, the conclusion of the privatisation process of Portuguese Post Office, Telegraphs and Telephones (CTT), following a 2013 IPO; Fosun's (a Chinese conglomerate) acquisition of Fidelidade insurance company, its successful takeover bid over Espírito Santo Saúde (a health company previously controlled by Espírito Santo Group) and its acquisition of an 11 per cent share in REN (a concession holder of Portugal's two main energy infrastructure networks); and Apollo's acquisition of Tranquilidade insurance company. During 2014, Portugal Telecom, one of the major companies in Portugal acting in the telecommunications sector, which had initiated a business combination with the Brazilian company Oi, suffered several setbacks, in particular following the solvency problems of Grupo Espírito Santo and the application of resolution measures to BES. Portugal Telecom and BES had a close relationship, and the collapse of BES Group had a significant impact on Portugal Telecom's business and structure. The French group Altice made an offer to buy the assets and activities of Portugal Telecom in Portugal and, thereafter, in November 2014, Terra Peregrin – Participações SGPS, SA, a company whose shares are held by the Angolan entrepreneur Isabel dos Santos, launched a general public and voluntary takeover bid for the acquisition of shares representing the share capital of Portugal Telecom. In December 2015, the offer was withdrawn, and Altice is still awaiting the decision of the regulatory authorities, including that of the European competition authority. In addition, at the beginning of 2015, a takeover bid was launched by the Spanish bank Caixabank for the acquisition of the shares representing the share capital of Banco BPI. The management board of Banco BPI and one of the bank's major shareholders have clearly stated their objections to the offer, but the process is still pending.

In terms of the level of debt, there were continued successful bond issues to the market – for example, the public offerings of the bonds of EDP, José de Mello Saúde and Mota-Engil – boding well for transactions to come in 2015.

On the privatisations side, the measures laid down in the Financial and Economic Assistance Programme for Portugal led the government to be extremely active and to launch a few significant privatisation processes. Apart from the privatisation of CTT, fully concluded on 2014, the government has successfully completed the privatisations of CGD's insurance company (Caixa Seguros), the airport management entity ANA, the energy grid company REN and the remaining public shares in EDP; and has relaunched the privatisation of TAP (the Portuguese airline), now scheduled to be completed in 2015. The government is currently rescheduling the privatisation of RTP (the public television company), and it is fair to say that much has been accomplished despite the financial crisis and the harsh conditions the country has endured.

II THE REGULATORY REGIME APPLICABLE TO BANKS

A credit institution qualifying as a bank, as defined in the Credit Institutions and Financial Companies Legal Framework (set out in Decree-Law No. 298/92 of 31 December 1992, as amended from time to time) (RGICSF), is an undertaking conducting the business of receiving deposits or other repayable funds from the public and granting credit for its own account to third parties in general.

Banking activities in Portugal are governed by the RGICSF, which regulates the taking up and pursuit of banking business, banking corresponding to one of the several types of credit institutions and financial entities provided for in the law and by the regulatory framework issued by the BoP through notices, instructions and orientations. These set out, *inter alia*, the composition of financial institutions' own funds, disclosure requirements about salaries and compensation packages of employees and members of the board, as well as the terms and conditions to be included in financial institutions' internal control policies.

Banks operate in Portugal under the concept of a universal financial licence, and may carry out a long list of activities such as the acceptance of deposits or other repayable funds from the public, granting credit, or any form of lending, including the granting of guarantees and other payment commitments, financial leasing and factoring. Banks having their head office in Portugal, as well as branches of banks having their head offices abroad are qualified to carry on the aforementioned activities subject to Portuguese law.

Branches of banks incorporated in EU Member States may carry out in Portugal the activities listed in Annex I to the European Directive 2000/12 of 20 March 2000, as amended from time to time, which the same bank would also be authorised to carry out in its home jurisdiction. These activities must be mentioned in a programme of operations when opening a branch, setting out, *inter alia*, the types of business envisaged to be conducted and the structural organisation of the branch. This programme of operations must be delivered by the relevant bank to its home jurisdiction authority and thereby notified to the BoP, which then is granted a relatively short period to organise its host jurisdiction supervision operations. Furthermore, since 2010, the BoP may request of the host Member State that the branch of a financial institution is treated as a 'significant branch', pending that its activity is fairly relevant in Portugal. This triggers additional disclosure of information duties, which are considered to be essential for the BoP to carry out its supervisory task in an integrated market.

According to the RGICSF, in respect of the activity of overseas banks not having a branch in Portugal, banks authorised in their home country to provide the services listed in Annex I to Directive 2000/12 may still carry on such activities in Portugal, even if they are not established here. As a prerequisite for the commencement of such services in Portugal, the supervisory authority of the bank's home jurisdiction must notify the BoP of the activities that the relevant institution intends to carry out, and certify that such activities are covered by the authorisation granted in the home country.

The current financial supervision system in force in Portugal is based on the coexistence of three supervisors, with responsibility for the three sectors of banking, capital markets, and insurance and pension funds; this corresponds to an organisational model in which the BoP acts as a central bank as well as the entity responsible for the supervision of banks and financial companies, focusing on the stability of the financial system (now in coordination with the European Single Supervisory Mechanism (SSM)), while the Portuguese Securities Market Commission (CMVM) is responsible for supervising the securities market and derivative instruments, as well as the activities of agents and financial intermediaries. Finally, the Portuguese Insurance and Pension Funds Authority is responsible for the supervision of insurance and pension funds.

The implementation of the new regulatory framework based on the 'twin peaks' model was discussed between late 2010 and the beginning of 2011, but such restructuring route was not adopted. To overcome vulnerabilities and deficiencies of the supervision system, the BoP proceeded to the restructuring of its internal supervisory structure, creating three new departments (prudential supervision, market conduct supervision and legal enforcement) and implementing working groups for some areas that were not separately supervised, such as banks' recovery or resolution and credit institutions' management supervision. Furthermore, it should be noted that the supervisory system is undergoing deep changes following the entry into force of the SSM on November 2014 and the ongoing developments regarding the Single Resolution Mechanism (SRM) that will be made up of the ECB and national competent authorities, with the ECB being responsible for the overall functioning of the SSM and SRM and having direct oversight of the eurozone banks in cooperation with national supervisory authorities.

III PRUDENTIAL REGULATION

i Relationship with the prudential regulator

The BoP is currently responsible for the prudential and market conduct supervision of banks with the aim of ensuring the stability, efficiency and soundness of the financial system. The BoP also has the power to monitor and supervise the level of compliance with the rules of conduct and transparency requirements towards bank customers, thereby ensuring the safety of deposits and the protection of consumer interests. The powers and responsibilities of the BoP as a supervisory authority are stipulated in its Organic Law and in the RGICSF.

Banks subject to the supervision of the BoP are required to comply with prudential rules aimed at controlling risks inherent in their activities. On one hand, these rules aim to ensure the solvency and creditworthiness of banks and, therefore, maintain the stability of the financial system (and to increase and maintain the level of trust of depositors, investors and economic players for such a purpose). On the other, they also aim to protect users (depositors and investors) against losses stemming from bad management, fraud or bankruptcy of financial services suppliers or providers.

The RGICSF plays a central role in Portuguese prudential regulation, largely mirroring the EU directives and regulations on financial activities. It is a set of harmonised rules covering a wide range of subjects such as the capital adequacy regime; banking and financial activities and the applicable codes of conduct; the limits on risk concentration and the rules on balance sheet consolidation; and the supervision conducted on a consolidated basis. One particular aspect should be mentioned in light of the transposition of CRD IV and of the steps taken towards tighter cooperation between the European supervisory authorities; the BoP is now required, whenever carrying out its activities, to assess the impact of its decisions on the stability of the financial systems of other Member States, especially in situations of emergency, and to take into account the convergence of the supervisory rules and practices, pursuant to Directive 2006/48/EC, namely by following the guidelines of the European Securities and Markets Authority and by participating in the activities of this entity as a member thereof.

The RGICSF also includes prudential rules or limits pertaining to certain non-harmonised areas that fall under the responsibility of the national authorities that holding banks are allowed to have (e.g., the provisioning framework, internal control requirements or limits that holding banks are allowed to have in fixed assets).

Most limits established in the context of prudential rules rely on the concept of own funds and the relationship and ratios that are required to be maintained with equity and quasi-equity instruments on both the asset and the liability side of the balance sheet.

In order to monitor compliance with the prudential rules, the BoP (or the SSM, as applicable) analyses information reported on a systematic basis by all of those institutions subject to its supervision. This mandatory reporting is defined and specified in instructions and notices published by the BoP, which is also entitled to conduct visits and inspections at its own initiative, having unlimited access to all premises and systems for such purposes.

As far as banks acting as financial intermediaries are concerned, reference is also made to the CMVM as the relevant supervising entity for activities integrating financial intermediation and the conduct of business in capital markets generally. Supervision by the CMVM focuses on the monitoring of all products and securities that are trading or placed in organised capital markets; on the granting of licences and permits that are necessary for the professional exercise of financial intermediaries' activities; and on the level of compliance by these entities with the market rules and the requirements for the operation of capital markets generally.

The CMVM also has the capacity to publish rules and regulations covering the relevant segments of financial activity, and there are various instructions that are issued by the CMVM covering many aspects, including rules on the disclosure of information imposed on either (or both) issuers of securities, on the activities of financial intermediaries and on complex financial products.

In its supervising capacity and within its powers, the CMVM complies with the main goals as supervising entity for the capital markets, namely, fostering the protection of investors, particularly those designated as 'not professional' or 'not qualified', by promoting the efficiency, equity, security and transparency of the financial markets.

ii Management of banks

The establishment of the rules governing the prevention of entry into the market of institutions that could jeopardise the stability of the financial system is now under the SSM's competence. However, the requirements for the taking up of business (also applicable to the acquisition of relevant participations in existing entities, particularly relevant when they contain an element of control or participation in the management of the relevant entity) are significantly the same (on a general basis), and may be broken down into three main groups with different but interrelated goals:

a the suitability and professional qualifications of the members of the management and auditing boards, and the fitness of character of the shareholders: contributing to increasing the efficiency of the system as a whole and maintaining the confidence of depositors and other consumers of financial services;

b the feasibility of the programme of operations: this relates to profitability levels that guarantee the long-term solvency of the institution as well as the safety and security of its operations; and

c the human, technical and financial resources that allow for adequate management and control of risks underlying financial activities: these create a minimum basis for the protection of the entities forming part of the financial sector and help prevent contagion effects and systemic risks.

The setting up of banks and branches of banks is subject to prior authorisation by the SSM (in coordination with the BoP), except in exceptional situations where this power has been retained by the Ministry of Finance.

Banks with their head offices in other EU countries may also provide services, even if those institutions are not established in Portugal, once the BoP has received the relevant information from the competent authority in their home country on the activities that the institution intends to carry out in Portugal.

In terms of decision-making policy, a general 'four-eyes policy' is required to be implemented by all banks and branches operating in the country, irrespective of whether they qualify as international subsidiaries of foreign banks or local banks. Branches operating in Portugal are required to have such decision-making powers that enable them to operate in the country, but this requirement generally does not prevent them from having internal controls and rules governing risk exposure and decision-making processes, as is customary in international financial groups.

With regard to the restrictions on remuneration of management members and employees of banking groups, reference must be made to compliance with the international principles and recommendations set out by the Financial Stability Board, the EBA and the CRD package, which includes CRD IV and the CRR.[5]

CRD III was implemented in Portugal through Decree-Law No. 88/2011, dated 20 July 2011, and following the entering into force of this diploma, the BoP issued Notice No. 10/2011, dated 29 December 2011, which was published in the Portuguese official gazette at the beginning of January 2012. This Notice has essentially updated the rules governing the remuneration policies and practices of the members of corporate bodies of institutions subject to its supervision and the respective requirements for information disclosure. According to Notice No. 10/2011, financial institutions should adopt a remuneration policy appropriate to their size, internal organisation, and the nature and complexity of the activity being carried out or developed by the bank and, in particular, with regard to the risks taken or to be taken. The remuneration policy must be transparent and accessible to all employees, as well as to all members of the corporate bodies of the financial institution.

Banks should plan and apply, in a proper manner, the remuneration policy, and must record in specific documents the respective procedures and any other items required for its implementation. These documents must identify, date and justify all changes introduced in the remuneration policy. Pursuant to Notice No. 10/2011, the implementation of a remuneration committee, which must comply with several rules and procedures, is mandatory provided that certain requirements are met by the financial institution at stake.

As regards information disclosure, banks must disclose information regarding the remuneration of both corporate bodies and employees, and the information that must mandatorily be disclosed must be included in the respective corporate governance report and in the internal compliance report to be sent to the BoP or the SSM, as applicable.

5 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

Portugal implemented CRD IV in Portugal through Decree-Law No. 157/2014, dated 24 October 2014. Although the majority of CRD IV rules were already in force, the national legal framework has been further strengthened with regard to the requirements for the relationship between the variable (or bonus) component of remuneration and the fixed component (or salary), and with regard to the disclosure and transparency of the remuneration policy and practices applicable by institutions, including information on the link between pay and performance.

iii Regulatory capital and liquidity

Capital requirements are of prime importance in maintaining the banking industry's financial stability as they form the first line of defence in the event of a crisis and reduce the risk of bank failure. The role of capital requirements works in two ways: it provides a loss-absorption cushion for unexpected events and, if properly designed, introduces incentives for banks to limit the risk of their activities. The recognition of this importance has led Europe into a banking union with a special focus on the prudential side of banking supervision.

The Financial and Economic Assistance Programme for Portugal, in force between 2011 and mid-2014, required the strengthening of financial institutions' solvency ratios. In this sense, BoP Notice No. 3/2011 required banks to comply with core Tier I capital ratios of at least 9 per cent until December 2011 (then postponed by the BoP to 30 June 2012 in order to match the dates of the EBA stress tests to be conducted on Portuguese banks) and of at least 10 per cent by 31 December 2012.

The quality of the financial institutions' own funds has also been reinforced and harmonised across Europe, in particular regarding the tightening of the criteria for the eligibility of financial instruments as Tier I and Tier II, through the entering into force of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. It should be mentioned that the compliance with such criteria is now assessed by the BoP or by the SSM, depending on the entity at stake.

In terms of securitisation, a more restrictive regime is now in force that has created a barrier to exposure to credit risk in securitisation positions for institutions that do not act as assignors or sponsors in this type of transaction.

It is important to note the legal framework applicable to a bank's exposure through the imposing of limits on the concentration of exposures to a single client or group of connected clients (i.e., a group of clients so interconnected that, if one of them were to experience financial problems, some or all of the others would be likely to face repayment difficulties) is an important mechanism for reducing the exposure of financial institutions to that client risk. Under Portuguese law, the range of exposures to one client (or a group of connected clients) must not exceed a given percentage of the banks' own funds.

Under the scope of the prudential rules, there are also limits on holdings in other companies, and on the holding of real estate assets that, whenever not used for the installation of the bank's own services, may only be held for a period of three years (extendable to five in certain situations) when they result from the enforcement of security or from other recovery measures in respect of credit exposure.

In addition, in order to avoid conflicts of interest, there are limits on loans to shareholders with qualified holdings, and loans to members of the management or supervisory bodies are prohibited (unless when for purposes specified in the law).

It is worth noting the rule that parent banks acting in Portugal, as well as banks controlled by parent financial companies in Portugal or in other EU Member States that are supervised on a consolidated basis by the BoP or the SSM, as applicable, must comply with large exposure limits and own funds requirements, particularly in respect of consolidated financial positions.

In respect of the banks' capitalisation plan, Law 4/2012 (amended by Law No. 48/2013, dated 16 July) complemented by Public Ordinance 150-A/2012, dated 17 May 2012 (as amended by Public Ordinance 421-A/2012, dated 21 December 2012) implemented measures to be adopted pursuant to the Financial and Economic Assistance Programme for Portugal, amending Law 63-A/2008 of 24 November 2008, with the aim of establishing the reinforcement of the financial solidity of banking institutions and contributing to the strengthening of their levels of core Tier I capital.

The preferential methods provided by Law 4/2012 to the capitalisation process are the purchase by the state of the credit institution's shares (or, if the institution is not a public limited company, other securities representative of its capital) or an increase in capital of the credit institution, whereby the purchased shares by public investment are automatically converted into a new class of 'special shares'.

In this sense, the banking recapitalisation programme that took place in 2012 resulted in an injection of €1,650 million of core Tier I capital into CGD, divided between an increase of share capital entirely subscribed by CGD's sole shareholder – the Portuguese Republic – and an issue of contingent convertible securities representing core Tier I by virtue of being fully subscribed by the state. With regard to BCP, the state has underwritten for €3 billion of government subscribed core Tier I instruments (GSIs), which are direct, perpetual and subordinated instruments that have been classified by the BoP as core Tier I capital. In addition, BCP has raised equity from its shareholders through a rights issue underwritten by the state (although the state's subscription has not been used since BCP has successfully completed the share capital increase with private shareholders). As regards BPI, the state has subscribed €1.5 billion of core Tier I capital in the form of GSIs issued by BPI. BPI has also raised equity from its shareholders through a rights issue that was used to buy back the outstanding GSIs,[6] a pattern of early reimbursement that BPI has since pursued with a clear intention to reimburse the GSIs received from the state as early as possible. This goal was achieved in June 2014, within two years from receiving the state aid. Finally, the state became a shareholder of Banif by subscribing to €700 million in shares and €400 million of CoCos to be repaid in tranches during the investment period. Banif has already reimbursed €250 million in terms of the CoCos and has raised private equity worth more than €450 million.

This recapitalisation programme – yet to be concluded in 2015 in respect of the recapitalisation of Banif, which is still awaiting EC final approval – has enabled

6 Source: Announcement of the Portuguese Ministry of Finance on the recapitalisation of the Portuguese banking system dated 4 June 2012.

these three banks (and hopefully will also enable Banif) to reach and even to exceed the rigorous capital targets imposed by the EBA and the BoP.

iv Recovery and resolution

One of the most relevant developments of 2012 at a legislative level corresponds to the publication of Decree-Law No. 31-A/2012, of 10 February 2012, which substantially amended the regime applying to the restructuring and liquidation of credit institutions and financial companies foreseen in the RGICSF. The new regime is mostly characterised by the existence of three different levels of intervention by the BoP corrective intervention, provisory administration and resolution.

In the event of financial distress of a credit institution (i.e., whenever it becomes incapable of meeting its obligations, or in the event of a reduction of its own funds to below the minimum required by law or of failure to comply with applicable solvency ratios), the BoP may determine the application of one (or more) measures foreseen for each of the above-mentioned levels of intervention, which are subject to the principles of adequacy and proportionality, taking into account the risk and degree of default, the legal rules and regulations governing the institution's activities, the severity of the consequences on the financial soundness and recovery of the institution, in order to avoid systemic risks in the banking sector and to protect the interests of its creditors.

Corrective intervention

In this context, and whenever the credit institution does not comply with the legal rules and regulations that govern its activities, the BoP may determine the application of one or more of the following measures:

a compliance with the corrective measures foreseen in Article 116-C of the RGICSF;
b presentation of a financial reorganisation plan;
c suspension or replacement of one or more members of the administrative or supervisory bodies;
d appointment of an auditing committee or a sole auditor to the relevant credit institution;
e imposition of restrictions to the granting of credit and to the investment of funds in specific types of assets;
f imposition of restrictions on the taking of deposits, according to the type and remuneration thereof;
g imposition or constitution of special provisions;
h prohibition or limitation on the distribution of dividends;
i submission of certain transactions or acts to the BoP's prior authorisation;
j imposition of additional reporting obligations;
k compulsory presentation of a plan to amend the conditions of debt by the relevant credit institution for the purpose of negotiating with its creditors;
l compulsory audit of all or part of the credit institution's activity by an independent entity appointed by the BoP (at the credit institution's expense); and
m compulsory request, at any time, that the credit institution's general meeting is convened and submission of proposed resolutions.

Where the implementation of the above measures does not succeed, the BoP may:

a in certain circumstances, appoint one or more temporary directors with special management powers in respect of the relevant credit institution;

b apply a resolution measure if it deems such necessary to ensure compliance with certain purposes and as long as certain requirements are fulfilled; and

c withdraw the authorisation to exercise banking business, followed by the relevant credit institution winding up.

Provisory administration

The provisory administration measures imply a much higher degree of public intervention in the credit institution's business, and should only occur in situations that could seriously jeopardise the financial stability or solvency of such credit institution, or that pose a threat to the stability of the financial system.

At this intervention level, and in certain cases, the BoP may suspend the board of directors of the relevant credit institution and appoint a temporary board of directors. The period for which the temporary board of directors shall perform its functions will be determined by the BoP and may last for up to one year (extendable once for a second year).

In addition to the above measures, in this intervention level, the BoP may apply one of the corrective measures set out above; appoint an auditing committee or a sole auditor to the relevant credit institution; and waive, for a maximum period of one year, the timely fulfilment of some of the credit institution's previously incurred obligations.

Resolution

Notwithstanding the fact that the Bank Recovery and Resolution Directive is not yet fully implemented in Portugal, the most important aspects thereof are already recognised in Portuguese law, and have been greatly boosted by a BES resolution of August 2014 and pursuant to an RGICSF amendment by Decree-Law No. 114-A/2014, dated 1 August 2014, which have both undergone material changes regarding the 'bridge bank' regime.

At the resolution level, the following two types of last-resort measures designed to defend essential interests such as financial stability and the continuity of the payment systems' process may be applied to a distressed credit institution: the total or partial alienation of the relevant credit institution's business to another institution or other institutions operating in the market; or the transfer of assets, liabilities, off-balance sheet items or assets under management to a 'bridge bank' created for this purpose.

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

a 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;

b 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

c such measures are necessary to avoid systemic risks in the banking sector; avoid potential negative impacts in the financial stability plan; minimise the costs to the public purse; or safeguard the confidence of depositors.

The effective implementation of such measures must ensure that the credit institution's losses are primarily assumed by its shareholders and creditors, according to their hierarchy, and on equal terms within each class of creditors.

If, after the implementation of any of the above-mentioned measures, the BoP determines that the relevant credit institution does not comply with the applicable requirements to maintain the authorisation to exercise banking business, it may withdraw the relevant credit institution's authorisation and initiate the winding-up process foreseen in Decree-Law No. 199/2006, of 25 October 2006, as last amended by Decree-Law 31-A/2012, of 10 February 2012, which sets out the Banking Insolvency Law.

In addition to the measures mentioned above, Decree-Law No. 31-A/2012, of 10 February 2012 has also enacted a range of preventive measures compulsory for all credit institutions, such as:

a the presentation of periodic recovery and resolution plans for submission to the BoP, which must approve such plans or request the amendment thereof (the details of these periodic recovery and resolution plans and of the information to be provided to BoP in respect of it are foreseen in BoP Notice No. 18/2012, of 18 December 2012);

b a duty to report to the BoP situations of financial difficulty that affect the credit institution and a duty to report irregularities; and

c the establishment of a resolution fund that aims to provide financial support to the implementation of resolution measures that may be adopted by the BoP at a resolution level (Resolution Fund). The regulation applying to the Resolution Fund has been enacted by Public Ordinance No. 420/2012, dated 21 December 2012, and the relevant participants[7] have already begun to pay their contribution to the Resolution Fund.

IV CONDUCT OF BUSINESS

Banks, while conducting their business, must ensure that their clients are treated with high levels of technical competence in all the activities that they carry out, providing their business organisation with the human and material resources required to ensure appropriate conditions of quality and efficiency. We would point out, in particular, the following:

a in respect of market conduct supervision, banks must:
- act expeditiously;
- provide information and assistance to customers;
- comply with the general regime on advertisements;
- adopt codes of conduct and disclose them to their customers, including through the bank's website; and

7 Which include credit institutions with head offices in Portugal; investment companies; branches of credit institutions based in non-EU Member States; branches of financial institutions based in non-EU Member States, which perform order execution activities on behalf of clients and trading for own account of one or more financial instruments; and companies that use payment systems subject to the supervision of the BoP.

- impose professional secrecy, binding on all members of management and auditing boards, employees, representatives, agents and other persons providing services to clients on a temporary or permanent basis. Facts or data subject to professional secrecy may only be disclosed to the BoP, the CMVM, the Deposit Guarantee Fund and to the Investor Compensation Scheme within the scope of these institutions' powers; similar confidentiality duties are imposed on their officers and agents under the terms laid down in the criminal law and the law of penal procedure (being subject to imprisonment of up to one year), except when any other legal provision expressly limits the obligation of professional secrecy, or upon the client's authorisation transmitted to the institution; and

b in respect of prudential supervision:
- the initial capital of banks set up originally or as a result of alterations to the purpose of a given company, or of a merger of two or more banks, or of a spin-off, shall be no less than €17.5 million. Likewise, the banks' own funds are at all times required to be no lower than the minimum capital;
- banks shall invest their available funds in such a way so as to ensure appropriate levels of liquidity and solvency at all times;
- own funds shall never be lower than minimum equity capital, and at least 10 per cent of net profits in each fiscal year must be allocated to the building up of legal reserves up to the amount of equity capital;
- instruments eligible as own funds must be eligible to cover risks or losses, whenever they occur;
- no less than 10 per cent of the net profits of a bank for each fiscal year must be earmarked for the building up of a legal reserve, up to an amount equal to the capital stock or to the sum of its set up free reserves or the carried forward results, if higher; and
- banks must also build up special reserves to strengthen their net value or to cover losses that their profit and loss account cannot support.

In the event of non-compliance by banks with these rules, the BoP may rapidly adopt the measures or actions that are needed to remedy the situation by issuing recommendations and specific determinations and, when necessary, by imposing fines that can amount up to €5 million and related penalties (in the case of a breach of professional duties, including banking secrecy, banks may even be subject to heavier penalties).

With respect to the conduct of banking business in Portugal in the past, it should be noted that the BoP has invested significantly in the 'behavioural supervision' aspect, and insisted on undertaking a policy devoted to the protection of customers of banking and financial products.

Along these lines, the BoP has published semi-annual reports covering behavioural aspects of banking in Portugal, and has taken a more active position as a mediator of conflicts between consumers and banks.

V FUNDING

The funding strategies of banks have changed substantially as a result of the financial market crisis. The economic environment prior to the crisis favoured funding structures that were highly dependent on ample liquidity. When that liquidity ceased to be available, banks that relied heavily on market funding were forced to make significant adjustments not only to their funding strategies, but also in some cases even to their business models. This was necessarily the case with Portuguese banks that had been adapting their funding structures to cushion the impact of this turbulence on their activity, profitability and solvency.

The groundwork for this adjustment has been the expansion of customer funds, with deposits as a source of funding playing an important part in the improvement of the structural liquidity situation of the Portuguese banking system. Risk aversion on the part of investors became the watchword, and substantial withdrawals from unit investment funds became the norm. Portuguese banks have also used their avenues of recourse to central banks, in line with what happened with other European banks, even though they have also managed to maintain some access to wholesale debt markets.

In terms of liquidity, the eligibility criteria imposed on collateral posting by counterparties obtaining liquidity from the Eurosystem Monetary Policy Operations were hardened by the ECB, with subordinated debt and debt instruments issued by credit institutions and trading on non-regulated markets – including such instruments as the Short Term European Paper – being no longer eligible. In any case, and despite the new eligibility criteria, ECB borrowings have continued to be an important source of funding for Portuguese banks during 2014.

Exchange offers and liability management exercises were another source of bank financing throughout 2014, whereby Portuguese banks started repurchasing issued debt through cash offers, exchange offers and liability management transactions.

It is also worth noting that 2014 followed the same route as 2013 in terms of debt issuance, and we have seen some Portuguese banks issue debt to the market, in particular CGD, Banco BPI, Banif and Banco Popular Portugal.

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

In respect of credit institutions, Regulation (EU) No. 1024/2013 of 15 October has defined that the acquisition or increase of a qualifying holding in this type of entity is decided by the SSM considering Portuguese law (i.e., RGICSF) criteria for the assessment of shareholders and management in relation to a proposed acquisition and a clear procedure for their application.

Pursuant to the rules currently in force, any natural or legal person who intends to acquire, directly or indirectly, a qualifying holding in a credit institution or to further increase, directly or indirectly, such a qualifying holding in a credit institution as a result of which the proportion of the voting rights or of the capital held would reach or exceed 10 per cent, 20 per cent, one third or 50 per cent, or so that the investment firm would become its subsidiary, shall notify the BoP.

The terms of such notice, including the information to be provided therein, are set out in Notice No. 5/2010 of the BoP. The SSM, in coordination with the BoP, is then required to assess the proposed acquisition or increase of a qualifying holding in order to ensure the sound and prudent management of the relevant financial institution – and having regard to the likely influence of the proposed acquirer on such credit institution – appraise the suitability of the proposed acquirer and the financial soundness of the proposed acquisition.

In this regard, the following criteria are to be taken into account:

a the reputation of the proposed acquirer;

b the reputation and experience of any persons that will direct the business or participate in the management and supervision as a result of the proposed acquisition;

c the financial soundness of the proposed acquirer; and

d whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing is being or has been committed or attempted, or that the proposed acquisition could increase the risk thereof.

The SSM, in coordination with the BoP, provided that all data and information necessary to conduct this analysis is duly delivered, is required to inform the relevant entity of its decision within 60 days of the aforementioned notice. In this regard, it should be noted that Decree-Law No. 157/2014 of 24 October brought some procedural amendments to this regime, under which the SSM, in coordination with the BoP, has additional assessment powers and prerogatives to request further information pertaining to the purposed transaction.

Failure to notify the BoP, carrying out the acquisition or increase of a qualifying shareholding during the decision period of the BoP, or non-compliance with the refusal of the proposed transaction by the BoP, regardless of the application of further sanctions, may determine the blocking of the acquired voting rights.

Furthermore, any acquisition of a holding equal to or in excess of 5 per cent of the voting rights or of the capital of a credit institution is also required to be notified to the BoP within 15 days of the acquisition of such holding, in order to assess whether it is to be considered a qualifying shareholding.

The criteria for determining whether a qualifying holding is met, the voting rights and the conditions regarding aggregation thereof are also laid down in the RGICSF, and are the same as those already set out in Articles 20, 20A and 21 of the Portuguese Securities Code. This means that these concepts are introduced into the legal frameworks of all financial undertakings, thus allowing an essential harmonisation of criteria, not only among financial sector players but also among the issuers of shares admitted to trading on regulated markets and insurance companies. In essence, this will mean that the criteria for imputing rights will be enlarged to cover all cases of indirect control or ability to influence the exercise of voting entitlements. This course of action was the result of an extensive work carried out by the National Council of Portuguese Financial Supervisors, comprising the BoP, the CMVM and ASF (the Portuguese Insurance and Pension Funds Supervisory Authority), which focused on better regulation measures aimed at improving transparency and control over qualifying holdings within the Portuguese financial sector.

ii Transfers of banking business

The more relevant transactions regarding the transfer of banking business in the Portuguese legal framework are the transfer of commercial undertakings integrated within the activities of banks and, in respect of corporate reorganisations, mergers and demergers.

A transfer is a type of asset deal that has as a direct object the commercial undertaking of the bank itself, or of a part of its business relationship within a certain clientele. This transaction usually aims at ensuring the transfer of each and every element of the relevant business undertaking as an ongoing concern and has been construed as a business that must necessarily be announced to third parties (including the concerned employees) in writing, under penalty of nullity. However, the absence of a specific legal regime governing transactions of this nature leads to the necessity of complying with different legal rules foreseen in respect of each class of elements of the transferred company, such as:

a in respect of real property, transfer implies the need of a formal legal act and the update of the applicable register;

b in respect of moveable property also enjoying some sort of registration, the need for such registration to be updated; or

c in respect of credits or debits, the possible need for consent of the relevant third parties or their notification, or both, depending on their position being either active or passive.

The transfer of a business concern is, therefore, a process of business transmission governed by both principles of unity of legal title (which is reflected in the transfer agreement in itself) and of diversity of modes of circulation of the various assets contained therein, as set out in specific transmission laws.

The uniqueness of this process (often making it particularly complex and time-consuming) necessitates a case-by-case analysis to determine what steps need to be taken to ensure that the right result is provided for, and to avoid the transfer affecting in a negative way the maintenance of the business and the relationships with clients and third parties in general.

Since the universal and automatic transmission of contracts, credits and debits is not, as such, provided for in the Portuguese legal framework applicable to transactions of this type, it needs to be governed by general civil rules, therefore forcing creditors' consent to be obtained for the transfer to take place and imposing the requirement that debtors be notified thereof.

Exceptions should be made in respect of transfers of credits, when an express or tacit agreement to this effect is obtained upfront between the transferor and the relevant party. This usually requires a case-specific analysis to be conducted in order to ensure that the transfer becomes enforceable against each consumer (as debtor) only upon notification or acceptance by the latter (no express consent being then required).

Please note that the above-mentioned elements (contracts, credits and debits) may also be transferred in part or individually on an asset-by-asset basis. Should this be the case, the consent notification rules stated above should be complied with in respect of any transferred asset, although naturally this will also have to be seen in light of the contracts governing the relevant situations.

In respect of corporate reorganisations, mergers and demergers in particular, a specific legal regime is applicable that is much in line with the other EU legislation. Thus, mergers and demergers are complex legal transactions, the validity and effectiveness of which are subject to a wide range of legal steps and procedures, in particular, merger proposal, internal and external audit, approval by board members, register and publication requirements, etc.

The effects of such transactions are characterised by a unitary legal regime resulting in the transmission of the entirety of the absorbed, merged or demerged entity without the need for any individual compliance requirement with transmission laws in respect of the various components forming part of the relevant transaction, under a principle of universal transfer (real estate, contracts, credits, debits etc.).

However, it must be remembered that, under the contractual freedom principle established in the Portuguese legal framework, this set of rules may not be applicable whenever this is otherwise agreed between the parties, as provided for in the working of any relevant agreement entered into in respect of the analysed transactions.

VII THE YEAR IN REVIEW

2014 was paradoxical. On one hand, the clean and successful exit from the €78 billion Programme of Economic and Financial Assistance, the first signs of economic growth and an increase of the capital markets volume and transactions should be highlighted; on the other, the crash of both BES and the Espírito Santo Group, and the consequent uncertainties regarding Novo Banco's successful sale, the disposal of relevant Portuguese controlled companies to foreign entities, and increasing political and economic reservations throughout Europe, have led to uncertainty for the Portuguese economy and banking system.

Although 2014 has brought significant and material challenges to Portuguese market players – and particularly the banking industry – it is fair to say that they have shown resilience and stamina that many would not have expected, with increasing levels in the country's trade balance and exports. Portuguese banks seem to have reacted to their economic weaknesses in a satisfactory manner, albeit enduring severe losses, but ending the year with an apparent return to stability and (at least for some issuers and products) a return to the markets, evidenced by the issuance of senior debt by some of the major Portuguese banks and companies, and furthermore by Portugal's persistent successful placement of long-term maturities in the international markets also favoured by low interest rates since the end of the Programme of Economic and Financial Assistance. In terms of capital markets and privatisations, the success of recent market-oriented operations may also be seen as an important sign of returning confidence in the Portuguese economy.

At a legislative level, reinforcement of the banking system capitalisation framework implemented in 2012 is now in place, and a stronger Portuguese banking system is being achieved.

VIII OUTLOOK AND CONCLUSIONS

The past four years have been very tough for Portugal and the Portuguese in general. Banks were seriously affected by clear deleveraging instructions, scarce liquidity, rising levels of non-performance with a sharp increase in insolvencies and unemployment, as well as a great downturn in real estate, topped off by a great need to raise capital, coming both from the EBA and from the local regulator.

2014 was very demanding for Portugal, as the country was subject to successive tests, very restrictive government strategies and many threats from the markets, and 2015 will certainly continue to be challenging. Considering the current European and national weaknesses and instabilities, and especially the future of the eurozone, the national government elections scheduled to occur in October 2015, and the ability of the Portuguese market to attract good investors to buy Novo Banco without significant losses to the banking system, the biggest uncertainty during 2015 will be ascertaining whether (and to what extent) the Portuguese economy will continue to be strong enough to adjust and grow without external help. Unemployment, tax (imposed on families and enterprises), insolvency and default rates all remain high (in spite of a continuous (but slight) recovery across 2014); as such, the real recovery of the economy mostly remains a work in progress.

As at many other times throughout Portugal's history, the country and its people's ability to adapt and to prosper in many locations around the world will inevitably bring positive results, already shown by the increase in exports. The expectation is that Portugal, and the Portuguese banks in particular, will adjust and survive, but this is not yet assured. It will be very interesting to keep an eye on Portugal throughout 2015 and to see what progress is made.

Appendix 1

ABOUT THE AUTHORS

PEDRO CASSIANO SANTOS
Vieira de Almeida & Associados
Pedro Cassiano Santos joined Vieira de Almeida & Associados in 1989, and is currently the partner in charge of the working group specialising in banking and finance law. In this capacity, he is regularly involved in the provision of legal advice in banking and capital markets regulatory matters as well as in the structuring of financing transactions, such as the issue and placement (both national and international) of debt, hybrid and equity instruments, and the issue and placement of warrants in both cash and synthetic financial products. He has a law degree from the University of Lisbon's Faculty of Law, and a postgraduate qualification in European legal studies from the College of Europe in Bruges. He was admitted to the Portuguese Bar in 1991 and has been recognised since 2004 as a financial law expert.

He has also been actively working in securitisation transactions and other types of asset-backed deals, together with the preparation of structured finance transactions. He is a regular speaker on these topics at conferences, and a guest teacher for various master's and postgraduate courses organised by different institutes and universities.

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