The Banking Regulation Review

Second Edition

Editor
Jan Putnis

Law Business Research

THE BANKING REGULATION REVIEW

This article was first published in
The Banking Regulation Review, 2nd edition
(published in May 2011 – editor Jan Putnis).

For further information please email
Adam.Sargent@lbresearch.com

THE BANKING REGULATION REVIEW

Second Edition

Editor
Jan Putnis

Law Business Research Ltd

PUBLISHER
Gideon Roberton

BUSINESS DEVELOPMENT MANAGER
Adam Sargent

MARKETING MANAGERS
Nick Barette
Hannah Thwaites

EDITORIAL ASSISTANTS
Nina Nowak
Lydia Gerges

PRODUCTION MANAGER
Adam Myers

PRODUCTION EDITOR
Kathryn Smuland

SUBEDITORS
Davet Hyland
Sarah Morgan

EDITOR-IN-CHIEF
Callum Campbell

MANAGING DIRECTOR
Richard Davey

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

www.TheLawReviews.co.uk

ISBN 978-1-907606-02-1

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: +44 844 2480 112

ACKNOWLEDGEMENTS

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

ABDULAZIZ ALGASIM LAW FIRM IN ASSOCIATION WITH ALLEN & OVERY LLP

AFRIDI & ANGELL

ANDERSON MŌRI & TOMOTSUNE

ARTHUR COX

BONELLI EREDE PAPPALARDO

BREDIN PRAT

BUGGE, ARENTZ-HANSEN & RASMUSSEN

CLAYTON UTZ

DAVIES WARD PHILLIPS & VINEBERG LLP

DAVIS POLK & WARDWELL LLP

DE BRAUW BLACKSTONE WESTBROEK

ELVINGER, HOSS & PRUSSEN

F.O. AKINRELE & CO

FORMOSA TRANSNATIONAL ATTORNEYS AT LAW

GANADO & ASSOCIATES

GERNANDT & DANIELSSON

GIDE LOYRETTE NOUEL AARPI

GORRISSEN FEDERSPIEL

HENGELER MUELLER

KADIR, ANDRI & PARTNERS

KIM & CHANG

LENZ & STAEHELIN

MARVAL, O'FARRELL & MAIRAL

MATTOS FILHO ADVOGADOS

MULLA & MULLA & CRAIGIE BLUNT & CAROE

MUÑOZ TAMAYO & ASOCIADOS ABOGADOS SA

NAGY ÉS TRÓCSÁNYI ÜGYVÉDI IRODA

NAUTADUTILH

PAKSOY

PARASKEVAS LAW FIRM

PATRIKIOS PAVLOU & ASSOCIATES LLC

RUSSELL MCVEAGH

RUŽIČKA CSEKES SRO

SCHOENHERR ŞI ASOCIAŢII SCA

SKUDRA & ŪDRIS

SLAUGHTER AND MAY

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

URÍA MENÉNDEZ

VIEIRA DE ALMEIDA & ASSOCIADOS

WEBBER WENTZEL

WONGPARTNERSHIP LLP

ZHONG LUN LAW FIRM

CONTENTS

Chapter 31

PORTUGAL

*Pedro Cassiano Santos**

I INTRODUCTION

2010 was not yet the year when the financial markets could bounce back to their pre-crisis state. The crisis seems now to have hit the entities providing bailouts, the states themselves, which tried to absorb the shock waves that began in 2007.

Portugal was no exception, however, the national banking industry showed some resilience to these adverse conditions. Banking activity increased in the debt markets, namely, through commercial paper programmes, EMTN programmes and hybrid instruments. Furthermore, the popularity of securitisation remained high among financial institutions - more so through the usage of securitisation companies rather than securitisation funds to undertake the issuance of asset-backed securities directly out of the Portuguese jurisdiction. Once this type of security is guaranteed by a segregated pool of assets, it allows the originators to obtain higher ratings for their portfolios and, therefore, to make them eligible as collateral for the European Central Bank ('the ECB'), namely, in short-term financing repurchase operations, widely known as repos.

In respect of capitalisation, the four major Portuguese banks passed the stress tests carried out by European authorities in July, presenting a considerable level of resistance in the event of an adverse scenario. Moreover, the banks themselves reacted relatively well to the newly proposed Basel III capital requirements related measures, with their spokesmen stating that ratios and deadlines therein were fairly achievable.

Concerning deals, 2010 also marked the come back of takeovers to the national credit institutions market with Montepio Geral, a medium-sized Portuguese bank, acquiring 100 per cent of the share capital and voting rights of Finibanco, a smaller bank.

---

* Pedro Cassiano Santos is a partner at Vieira de Almeida & Associados. The author would like to thank António Antunes Gomes of the same firm for his help in the preparation of this chapter.

On the downturn, the attempt of the Portuguese government to (re)privatise Banco Português de Negócios ('BPN'), nationalised due to a lack of liquidity and capitalisation during 2008, proved unsuccessful. In addition, Banco Privado Português ('BPP'), a small investment bank, also became insolvent in April, after all recovery attempts failed and the government withdrawing its support to this institution.

Regulation was also a hot topic during the past year with major changes in this chapter, such as the introduction of the 'country risk' as a new concept to be considered in the calculation of the credit institutions' own funds, the transposition of several EU Directives (2007/44/EC on qualifying holdings and 2009/111/EC, amending the rules for capital requirements appear to be most significant) and the new rules concerning the Portuguese credit institutions own funds, including the terms of tier I and II admitted for such purpose, securitisation transactions and risk exposure laid down by the Bank of Portugal ('the BoP') through Notices 6, 7, 8 and 9/2010, presented and will present a whole set of new challenges to the national financial institutions to be dealt throughout the years to come.

In light of the aforementioned, 2010 was, all in all, a positive year for the Portuguese banking industry. The bases for the continuing of the recovery of this sector in 2011 are laid and, hopefully, the slightly favourable yet prudent forecast will prove accurate.

II THE REGULATORY REGIME APPLICABLE TO BANKS

A credit institution qualifying as a bank, as defined in the Legal Framework of Banks and Financial Companies ('the 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.

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, in accordance with the recent legislative amendments, the BoP may request 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 in order 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, while the Portuguese Securities Market Commission ('the CMVM') has the responsibility for supervising the securities market and derivative instruments as well as the activities of agents and financial intermediaries. Finally, the Portuguese Insurance Institute ('the ISP') is responsible for the supervision on insurance and pension funds.

This tripartite model was expected to be replaced during late 2010/beginning of 2011 by a 'twin peaks' model, with the number of supervisory authorities downsized from three to two. The main goal of this change was to appropriately respond to the overstress that tripartite models have been subjected to worldwide due to the changes in the financial services business. With the new model, the regulatory functions would be separated between two supervisory authorities, one responsible for supervision of market conduct and the other responsible for the safety and soundness of the financial system, also called prudential supervision, instead of the current approach, where a supervisory authority carries out both prudential and market conduct supervision over an entity, based on its legal status and the business it conducts. The proposed regulatory framework is expected to increase the levels of transparency, market integrity and consumer protection as all institutions providing financial services would be under the supervision of both authorities, and to reduce the risk of concurrence or lack of supervision of a certain institution.

In practice, the BoP will be allocated the sole responsibility for all prudential supervision, while a new entity (resulting essentially from a merger between the CMVM and the ISP) will concentrate the competences regarding market conduct supervision. Both of these entities will have oversight of all players in the financial system, each focusing on its approach and area of expertise.

The implementation of the new regulatory framework has, however, come to a halt and the BoP, by means of an informative letter dated 10 January 2011, has proceeded to the restructuring of its internal supervisory structure, creating three new departments: prudential supervision, market conduct supervision and legal enforcement. This course of action, as well the lack of the required further steps for such change, have raised the idea that Portugal may not be implementing a new supervisory model as soon as expected.

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 has also 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 hand, 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 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, as well as the supervision conducted on a consolidated basis. One particular aspect should be mentioned in light of the transposition of the Capital Requirements Directive IV and of the steps taken towards a tighter cooperation between the European supervisory authorities; the BoP is now required to, whenever carrying out its activities, to assess the impact of its decisions on the stability of the financial system 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 ('ESMA') and by participating in the activities of this entity as a member thereof.

It also includes prudential rules or limits pertaining to certain non-harmonised areas that fall under the responsibility of the national authorities; for example, the provisioning framework, internal control requirements or limits that holding banks are allow 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 prudential rules, the BoP 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 its own initiative, having unlimited access to all premises and systems for such purposes.

As far as banks acting as financial intermediaries is 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 and on the granting of licences and permits that are necessary for the professional exercise of financial intermediaries' activities, as well as on the level of compliance by these entities with 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 and on the activities of financial intermediaries.

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 efficiency, equity, security and transparency of financial markets.

ii Management of banks

The BoP has a key role to play as it establishes the rules governing the prevention of entry into the market of institutions that could jeopardise the stability of the financial system. 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) may be broken down into three main groups, with different but interrelated goals:

a suitability and professional qualification of the members of the management and auditing boards and fitness of the character of the shareholders – contributing to increase the efficiency of the system as a whole and maintaining the confidence of depositors and other consumers of financial services;

b 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 human, technical and financial resources that allow for adequate management and control of risks underlying financial activities – they 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 is subject to prior authorisation by the competent authority, which is normally the BoP except in exceptional situations where this power has been retained by the Ministry of Finance.

The establishment of a branch is usually initiated by the supervising authority in the local jurisdiction and then communicated to the BoP, along with the information requested by the latter, which includes:

a the country in which the proposed branch is to be established;

b a programme of operations, setting out, *inter alia*, the types of business envisaged and the structural organisation of the branch;

c the address of the branch in the host country;

d the identity of those responsible for the management of the branch; and *e* the scope of activity to be authorised.

When the branch originates in it a non-EU Member State, the process is essentially assessed by the BoP in the same way as would be applicable to the creation of a local bank and the branch is required to hold allocated capital. In these cases, the capital earmarked for operations to be carried out by the branch must be sufficient to adequately cover such operations and be no less than the minimum amount required by the Portuguese law for banks of the same type.

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 control and rules governing risk exposure and decision-making processes, as customary in international financial groups.

Referring to the latest restrictions on remuneration of management members and employees of banking groups, reference must be made to compliance with the latest international principles and recommendations set out by the Financial Stability Board, including those published following the recent financial crisis. In this respect, the BoP has issued several recommendations to be taken in a 'comply or explain' perspective, which requires justification in the event of non-compliance by the supervised financial institution. Financial institutions should therefore adopt a remuneration policy consistent with effective management and risk control, avoiding excessive risk exposure and potential conflicts of interest, and being coherent in its objectives, values and long-term interests. Remuneration policy should be appropriate to the size, 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.

Banks should adopt a clear, transparent and appropriate structure on the definition, implementation and monitoring of the remuneration policy, which objectively identifies which employees are involved in each process, as well as their roles and responsibilities. The implementation of this remuneration policy must be monitored by the parent company for its subsidiaries on an annual basis.

iii Regulatory capital

Capital requirements are of prime importance in maintaining the banking industry 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 at least 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 Capital Requirements Directive was implemented into the Portuguese legal framework through Decree-Laws 103/2007 and 104/2007, both dated 3 April 2007. In general terms, Decree-Law 104/2007 sets out the obligations concerning the minimum level of own funds and the risk limits that banks have to comply with. According to the latter Decree-Law, and regarding credit risk and risk reduction of the amounts receivable in respect of all activities (except those concerning trading-book and illiquid assets that are deducted from own funds), banks must have own funds that are at all times higher than or equal to 8 per cent of the total weighted exposure risk. The total weighted exposure risk calculation methods used by Portuguese banks may be distinguished between the standardised approach or the internal ratings-based methods as specifically defined in the aforementioned legislation.

Institutions are thus required to comply with the regulatory capital provided therein aiming to protect themselves (and the market in general) against risk exposure.

Decree-Law 104/2007, as well as the RGICSF have been subject to the amendments late in the year resulting from the implementation of Directive 2009/111/EC by the Decree-Law 140-A/2010 of 30 December. With the coming into force of the new rules, the quality of the financial institutions own funds has been reinforced, in particular regarding the tightening of the criteria for the eligibility of financial instruments as tier I and tier II, with a focus on the eligibility of hybrid capital as such. In accordance with its powers as the competent supervisory authority, the BoP has issued Notices 6, 7, 8 and 9/2010 setting out new rules in respect of own funds, securitisation transactions and concentration exposures of banks.

In respect of securitisation, a more restrictive regime is now in force, namely, it has created a barrier to the exposure to credit risk in securitisation positions to institutions that do no act as assignors or sponsors in this type of transactions.

One important remark must be made in respect of the legal framework applicable to bank's exposure as 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 in order to reduce the exposure of financial institutions to that client risk. Under Portuguese law, the range of exposures to one client (or group of connected clients) must not exceed a given percentage of the banks' own funds.

Under the scope of prudential rules, there are also limits on holdings in other companies as well as limits 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).

Decree-Law 104/2007 also establishes the rules 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, must comply with, particularly in respect of consolidated financial positions, large exposure limits and own funds requirements.

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 like to 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
- impose professional secrecy, binding to all members of management and auditing boards, employees, representatives, agents and other persons providing services to them on a temporary or permanent basis. Facts or data subject to professional secrecy may only be disclosed to the BoP, the Portuguese Securities Market Commission, 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.

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 own funds of banks is at all times required be less 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 the 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 shall also build up special reserves to strengthen their net value or to cover losses that their profit and loss account cannot support.

In the case 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 to €2 million and related penalties (in the case of a breach of the professional duties including banking secrecy, banks may even be subject to heavier penalties).

With respect to the conduct of banking business in Portugal over the past few months 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 took a more active position as a mediator of conflicts between consumers and banks. With the implementation of the 'twin peaks' supervision model, this is a tendency that will certainly increase (particularly if the behavioural supervision is located within the scope of the new regulatory and supervisory authority, it is likely to devote more efforts and resources to these matters).

V FUNDING

The funding strategies of banks has 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, deposits as a source of funding playing an important part in the improvement concerning 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.

A recent Financial Stability Report of the BoP has restated the need for Portuguese banks to redirect their funding strategy to client's funds as the permanent recourse to the Eurosystem is not a sustainable option to the stability of the national financial system, recommendation that was followed by the major national banks as they reduced their exposure to the ECB during late 2010. Also, as of January 2011 the ECB hardened the eligibility criteria imposed on collateral posting by counterparties obtaining liquidity from Eurosystem monetary policy operations, making this a less available source for the future.

As previously mentioned, funding through debt issues, including, securitisation transactions and Eurobonds programmes have continued to fuel the Portuguese financial institutions with liquidity. The higher costs related with shorter maturities and higher funding costs (spreads, fees or commissions payable to arrangers, dealers and brokers also increased) seen during the peak of the crisis in 2008 that produced a decrease in the net flow of liabilities represented by securities in this period, have now decreased and, as a result, raised the significance of these instruments in the national banking industry.

One particular change concerning the banks funding strategy has been the non distribution of dividends. One of the major Portuguese banks, has fully incorporated its yearly profits as reserves, thus not distributing any dividends for the first time in this institution's history.

The call for tighter capital requirements as well as the more restrictive ECB lending policy pose a challenge to the banks' funding strategies, which will require new approaches yet to be seen. A certain imagination shall inevitably be required and hybrid instruments under the new rules governing own funds are certainly going to be a valuable option.

VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

i Control regime

With reference to this subject, 2010 brought some significant changes as the European Directive 2007/44/EC of 5 September 2007 on procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector was transposed to the Portuguese legislation by Decree-Law 52/2010 of 26 May. In respect of credit institutions, this Decree-Law has proceeded to the amendment of the RGICSF. The new legal framework decreases the BoP's discretion when approving the acquisition or increase of a qualifying holding in this type of entity as it provides specified 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 now 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 provide therein, are set out in Notice 5/2010 of the BoP. 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 reputation of the proposed acquirer;

b reputation and experience of any person(s) 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 BoP, provided that all necessary data and/or information in order to conduct this analysis is duly delivered, is required to inform the relevant entity of its decision within 60 days from the aforementioned notice.

Failure to notify the BoP or 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 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 in order to assess whether or not is to be considered a qualifying shareholding.

The criteria for determining whether or not a qualifying holding is met, the voting rights as well as the conditions regarding aggregation thereof are also laid down in 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 market. 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 the ISP, that 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.

Transfer is a type of an asset deal, which 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 (making it often particularly complex and time-consuming) forces necessarily a case-by-case analysis, in order to determine what procedures and steps need to be accomplished 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.

Exception should be made in respect of transfers of credits, when an express or tacit agreement to this effect is obtained up front 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 aforementioned 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 in the paragraphs above should be complied with in respect of any transferred asset, but naturally this will also have to be seen in light of the contracts governing the relevant situations.

In respect of corporate reorganisations, in particular, mergers and demergers, a specific legal regime is applicable much in line with the other EU legislation. Thus, mergers and demergers are complex legal transactions, the validity and effectiveness of which is 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 absolved, merged or demerged entity without the need for any individual compliance requirement with transmission laws in respect to the various components forming part of the relevant transaction, under a principle of universal transfer (such as real estate, contracts, credits, debits etc.).

However, it must be borne in mind that, under the contractual freedom principle established on 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

2010 brought significant changes to the Portuguese banking regulatory framework. The new criteria for the eligibility of certain instruments as own funds, the higher scrutiny in respect of the acquisition of qualifying holdings in credit institutions, the more restrictive rules in respect of credit risk transfer in securitisation transactions, the 'country risk' as a new concept to be considered in the calculation of the coefficient of the credit institutions' own funds pose significant questions and issues in respect of their descent from the theoretical level to the practical world, with their true effectiveness remaining to be seen. Even though aimed at creating a more transparent financial system and enhancing its stability, only a permanent dialogue between supervisory authority and supervised entities will be able to clarify its application.

As to the performance of the Portuguese banking industry in 2010, the outcome was mildly positive not only in terms of results, which were higher than in 2009, but in respect of investments as well. On the top side, Millennium BCP increased by four its revenue with its activity in Poland, Angola and Mozambique and Banco Espírito Santo acquired a 25 per cent stake at Moza Banco, a well positioned Mozambique bank. In addition, the takeover of Finibanco by Montepio Geral, even though these are smaller players, also presented a sign of soundness and confidence in the Portuguese financial markets. In what concerns distribution of dividends policy, the national banking industry has, in general, opted to follow BoP's guidelines and either refrained from distributing dividends or did it in moderate terms, or both. Banco Português do Investimento decided to incorporate the total amount of its profits as reserves and, therefore, increase its tier I ratio. This concern was met and cautioned by the other major banks with Santander Totta, Millennium BCP and Banco Espírito Santo also incorporating part of their yearly profits as reserves.

The exposure to the ECB and its risks has also been taken into account of the national banking industry which, in the last quarter of 2010 significantly reduced the exposure to this entity fearing the fragility of the European markets.

Furthermore, for the past years the national banking industry has developed all efforts necessary in order to comply with the latest regulatory innovations. This course of action has proved fruitful as the stress tests carried out in July by the European Authorities presented a satisfactory outcome of the Portuguese banking industry when submitted to high stress scenarios.

VIII OUTLOOK AND CONCLUSIONS

In the end, it is fair to say that in 2010 the global financial markets have not yet fully recovered from the financial crisis, particularly if taking into account the increase of the sovereign debt risk, together with the downgrading of states' credit ratings. Nonetheless, it is just as fair to say that the Portuguese banking industry has shown positive signs; the increase in debt market activity, the higher profits throughout the sector and the satisfactory results of the stress tests, to name a few, are facts evidencing that recovery is on the way and that investors are finally regaining their confidence in the markets.

2011 still looks to be a year of many questions, the most relevant being the new regulatory framework, which will require tight cooperation between all market players in order to avoid doubts as to the application of the provisions in force, and secondly, as to what type of funding mechanisms will be used by the Portuguese banking industry throughout next year. As these are inevitably complex issues, it is not yet realistic to face 2011 with optimism but, considering the past four years and the resilience of the national banking industry in critical scenarios, the expectations are that it continues to resist and to search for all possible sources of liquidity.

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 masters and postgraduate courses organised by different institutes and universities.

VIEIRA DE ALMEIDA & ASSOCIADOS

Av. Duarte Pacheco 26
1070-110 Lisbon
Portugal
Tel: +351 21 311 3479
Fax: +351 21 352 22 39
pcs@vda.pt
www.vda.pt