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PORTUGAL: An Introduction to Banking & Finance

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Portugal managed to end 2018 with a budget deficit of 0.6%, substantially less than the 7.2% and 3% recorded in 2014 and 2016, respectively, having accomplished a smooth and steady economic recovery following the more demanding years of the international bail-out between 2011 and 2014, during which the country was under supervision by the European Union ("EU"), the European Central Bank ("ECB") and the International Monetary Fund ("IMF"). In addition, and confirming most economic forecasts, the Portuguese economy is set to have grown in 2018 for the sixth year running. Figures released by the Bank of Portugal calculated an annual GDP growth rate of approximately 2.52% in 2017 – the highest rate since the year 2000 – following a growth of 1.39% in 2016.

The Portuguese government's efforts to scale back public debt are showing results, in a context of relative political stability. The left-wing coalition government, led by the Socialist Party, managed to approve four annual state budgets and to sail the more favourable winds brought into Portugal by the international economy, with a relevant push from the tourism sector. Nevertheless, according to the IMF, public debt still represented approximately 120.8% of the GDP as of the end of 2018, despite being forecast to drop for a third consecutive year to 117.2% in 2019.

In 2017, the EU institutions approved a new waiver that allows Portugal to continue with its early reimbursement of the IMF loan granted back in 2011 – a policy to be sustained during 2019.

The international markets registered a positive response to this evolution, reflected in Moody's recent revision of the rating awarded to the Portuguese Republic, now at Baa3, following similar revisions by the other agencies. It should be noted that, at present, all the main rating agencies have upgraded the country back to investment grade, which translates into a broadening of the range of potential investors in Portuguese public debt, with positive impacts on Portuguese banks and the generality of the countries' issuers.

The Banking Sector in 2018

Over the last few years, the Portuguese government had to overcome a series of difficulties in the Portuguese banking sector, giving rise to several rescue programmes and two resolution cases that had a significant impact on the Portuguese banking landscape. In March 2017, Caixa Geral de Depósitos, a fully state-owned bank, completed a EUR0.5 billion subordinated debt issuance which allowed the authorities to advance with the EUR2.5 billion public capital injection foreseen in the EUR5 billion recapitalisation plan agreed with the European Commission – a process now well underway and already showing positive results, with the bank returning to profit generation in 2017 and having grown steadily during 2018.

The banking sector is undergoing a smooth reorganisation, with the execution of some mergers and acquisitions, and particularly with the enlargement of the stakes held by Spanish peers. Banks in Portugal are managing to handle existing non-performing exposures by implementing non-performing asset disposal programmes with relative success and attracting relevant international, mostly specialised, investors, many times also associated with the acquisition of real estate assets.

In line with the global concerns regarding the credit crunch, two significant trends currently characterising the Portuguese banking sector should be highlighted: firstly, the granting of credit appears to have regained a growth curve, in line with the recent economic growth in a context of relatively low unemployment; and secondly, banks operating in Portugal seem to be undertaking a collective deleveraging effort, evidenced in the shut-down or disposal of certain branches or business lines, and also the disposal of their non-performing exposures. On this latter point, according to the report on the Portuguese banking system published by the Bank of Portugal in January 2019, the ratio of non-performing loans has been reduced by 6.6% over the past two years, reflecting the effort being made across the board to resolve the excessive levels of indebtedness and very high levels of non-performing loans sitting on the banks' balance sheets.

Last year, a considerable number of new and relevant legal and regulatory frameworks also entered into force, giving rise to one of the main challenges facing the Portuguese banking sector in 2018 – namely, its ability to respond to regulatory and supervisory requirements. A number of regulatory updates, detailed below, are particularly worthy of mention.

Firstly, the transposition of MiFID II/MiFIR into Portuguese law, concluded in 2018 with the enactment of Law no. 35/2018, of 20 July, aimed at amending the rules on the marketing of financial products and on the organisation of financial intermediaries. The national transposition of this directive brought several changes to relevant Portuguese legal diplomas, including the Securities Code and the General Framework for Credit Institutions and Financial Companies, and made way for the approval of three new legal frameworks, specifically: (i) the legal framework governing the design, marketing and supply of investment advice services on structured deposits, (ii) the

legal framework for Packaged Retail and Insurance-based Investment Products ("PRIIPs") and (iii) the legal framework for central securities depositories.
Secondly, as regards PRIIPs, the European PRIIPs Regulation came into force on 1 January 2018, comprising a set of rules aimed at improving the level of protection of retail investors by increasing the transparency and comparability of investment products through the issue of a standardised short form disclosure document – the PRIIPs Key Information Document ("KID"), making it easier for retail investors to understand and compare the key features, risks and costs of different products within the PRIIPs' scope.

Thirdly, Decree-Law no. 91/2018 of 12 November was enacted, introducing Directive (EU) 2015/2366 of the European Parliament and of the Council, of 25 November 2015 ("PSD 2"), into the Portuguese legal order. PSD 2 introduces new types of payment services, enhances customer protection and security, and enlarges the scope of the original PSD. Banks will now be required to provide licensed third-party businesses with free access to customer data and account information, where the customer has given explicit consent for this purpose. These new transparency measures seek to promote payment innovation in the current technological context and constitute an important step towards establishing the Digital Single Market in Europe – the European Commission's strategy to ensure fair competition and a high level of consumer and personal data protection in the access to online activities.

2019 is expected to be generally marked by the abovementioned Decree-Law, which introduces a set of requirements and measures aimed at changing the regulation of new payment services existing on the market, to allow such new payment services providers to share information between themselves. The Decree-Law additionally establishes cross-border payments in the European Union, the technical and business requirements for credit and direct debit transfers in euros, and the currency exchange rates applicable to transactions paid by card, while also regulating the provision of information on accounts and the initiation of payments.

Fourthly, EU Regulation no. 2016/679 of the European Parliament and of the Council, of 27 April 2016, also known as the General Data Protection Regulation ("GDPR"), and which is aimed at unifying the regime governing the processing and movement of personal data throughout the European Union, became applicable as of 25 May 2018. The GDPR introduced significant changes, forcing a shift in privacy policies for every company that deals with private and personal data and imposing a set of new obligations on companies handling data, non-compliance with which results in heavy fines. Rules on client (or data subject) consent have been strengthened and extraterritorial applicability has been introduced, as the regulation applies to all companies which process the personal data of data subjects residing in the EU, regardless of the company's location.

In light of the above, the first challenge businesses now face is to provide a timely and due response to all regulatory and supervisory developments and requirements.
Coupled with this increased regulatory pressure, the Portuguese banking sector is

undertaking a deep review of existing business models, in order to better respond to customer trends and the technological innovations that are transforming banking activity around Europe and throughout the world.
Notwithstanding the opportunity for improved efficiency in the banking sector, these technological innovations present a wide range of new challenges – notably, in terms of cyber-security and the potential increase in competition in certain activities banks have traditionally undertaken – and, as such, it is still uncertain whether all banks will manage to successfully respond to these challenges.

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