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In-Depth: Banking Regulation (formerly The Banking Regulation Review) is an annual survey of the most important developments in banking regulation in the most significant jurisdictions worldwide. It provides high-level insight across the gamut of the legal and regulatory requirements applicable to banks, including prudential regulation, rules governing the conduct of business, funding, control and transfers of banking business and much more.

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LEXOLOGY

Portugal

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Summary

Introduction

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For the time being, changes in the Portuguese banking sector have been mainly implemented by smaller banks; however, merger and acquisition transactions in banking are expected to increase throughout 2024, with the potential sale of Novobanco and with the sales of Banco Português de Gestão and Banco Empresas Montepio awaiting regulatory clearance.

Banks operating in Portugal continue to make efforts to collectively decrease their total leverage, notably via the disposal of non-performing loans, and massive sales of these loans and other assets have occurred in recent years, thus contributing to stronger balance sheets.

The Portuguese banking and financial market and its regulators have been closely following the impacts of inflation and rising interest rates throughout 2023, as Portugal is currently facing significant pressure in the housing sector, with the increase in bank interest rates, namely Euribor.

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Year in review

The year 2023 brought multiple legal and regulatory developments in the banking sector, most of them aimed at implementing a set of EU regulations. Some of the most significant ones are highlighted below.

On 10 December 2022, Law No. 23-A/2022, of 9 December (Law No. 23-A/2022) entered into force, revising a wide range of legal acts and transposing into the Portuguese legal system Directive (EU) 2019/878 on access to banking activity and prudential supervision (CRD V) and Directive (EU) 2019/879 on the recovery and resolution of credit institutions and investment firms (BRRD II).

In what concerns the banking sector, Law No. 23-A/2022, inter alia, amends the Legal Framework of Credit Institutions and Financial Companies, as approved by Decree-Law No. 298/92, of 31 December 1992, in its current version (RGICSF). The changes introduced in RGICSF are essentially of a prudential nature and include changes in remuneration policy requirements and requirements of own funds. Concordantly, credit institutions should maintain remuneration policies and practices that are adequate in terms of prudent risk management, while being gender neutral. Remuneration policies should reflect the specific size and structure of each credit institution, under principles of proportionality and appropriateness.

Regarding requirements of own funds, a new set of rules specifies the criteria for the application of additional own funds and reinforces the scope of legal reserves and conservation measures, in connection with the requirements set out under Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013.

Also worthy of mention is the specification of certain aspects related to Minimum Requirement for own funds and Eligible Liabilities (MREL), through the transposition of BRRD II, via the introduction of an amount of own funds and eligible credits corresponding to 8 per cent of total liabilities, including own funds, applicable to institutions of global systemic importance (G-SII) (including subsidiaries). In addition, the framework for the contractual recognition of internal recapitalisation has been modified, emphasising a duty by credit institutions to include (in certain instruments and contracts) a clause through which the relevant creditor recognises that its credit may be subject to the reduction or conversion powers and accepts the production of the respective effects.

Changes introduced by Law No. 23-A/2022 are not limited to the transposition of the two EU Directives mentioned above. They also include the approval of a new sanctions regime for covered bonds, and even an extension to the deadlines for decision-taking by the Banco de Portugal (BdP) (e.g., in respect of procedures for the refusal and revocation of authorisation for credit institutions), now being subject to a decision period of 180 working days (thus the general legal deadlines of 90 or 120 working days, foreseen in the Portuguese Code of Administrative Procedure (CPA), are not applicable).

Although not directly related to banking regulation in the strict sense, a brief note must be made, due to its widespread relevance, to the publication of Decree Law No. 27/2023, of 28 April. This Law approves, as an annex, the awaited new Asset Management Regime (RGA), revoking the General Regime of Collective Investment Undertakings and the Legal Regime of Venture Capital, Social Entrepreneurship and Specialised Investment. The aim of RGA is to simplify and grant proportionality to the regulation of the asset management sector, in order to foster competitiveness and the development of the national market, while also safeguarding the protection of investors. Furthermore, CMVM Regulation No. 7/2023 has been published, regulating RGA and constituting a pivotal instrument that contributes to the stabilisation of the new legal and regulatory regime.

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The regulatory regime applicable to banks

Portuguese banks are subject to the supervision of two authorities: the BdP and the Portuguese Securities Market Commission (CMVM). Core banking activities, such as deposit-taking and lending, will fall under the supervision of the BdP, while acting as financial intermediaries and performing securities-related transactions, remain under the supervision of CMVM.

Generally speaking, the applicable set of rules includes RGICSF and comprises the Portuguese Securities Code, as approved by Decree-Law No. 486/99, of 13 November 1999, in its current version (CdVM), which accommodated in national legislation a wide range of EU Directives, including the prospectus directive, the transparency directive, the takeover directive and the directives on markets in financial instruments.

Surrounding this legal inner circle, a vast number of regulations, instructions and notices issued by the BdP and the CMVM will also apply. This is without prejudice to the possible applicability of other legislation, due to the fact that banks may carry out certain activities, such as insurance-related ones, in which case it will fall within the competence of the Insurance and Pension Funds Supervisory Authority (ASF), which is not covered in this chapter.

In addition, there is the Legal Framework of Payment Institutions and Payment Services, enacted by Decree-Law No. 91/2018 of 12 November 2018, which implemented Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market (also referred to as the Second Payments Directive).

Banking activities may only be carried out by credit institutions and financial companies with their head office:

1. in Portugal (these must take the legal form of limited liability companies;
2. abroad but operating in Portuguese through a designated branch; and
3. with head offices in an EU Member State and operating in Portugal under the freedom to provide services (provided that the relevant passporting requirements are met).

The BdP, as the Portuguese central bank, is part of the European System of Central Banks (ESCB), which is composed of the European Central Bank (ECB) and the national central banks of the EU Member States. The BdP is responsible for the prudential and market conduct supervision of credit institutions, financial companies and payment institutions, also being the national resolution authority. Although the capital markets sector is not so intensively organised, the CMVM is part of the European Securities and Markets

Authority. The supervisory system has changed following the establishment of a single supervisory mechanism (SSM) and a single resolution mechanism (SRM), which comprise 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. As such, credit institutions may ultimately be subject to the direct supervisory powers of the ECB, as a result of the introduction of the SSM in 2014.

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Prudential regulation

i Relationship with the prudential regulator

Portuguese credit institutions deemed as significant fall under the direct supervision of the ECB, while the remaining are supervised by the BdP (on a direct basis) and by the ECB (on an indirect basis, in cooperation with the BdP).

The BdP, while exercising its supervisory powers within the framework of the SSM, of which it is a participant as a national supervisory authority, aims at ensuring the solvency and financial soundness of each institution, as well as ensuring the safety of the funds entrusted to the institutions.

As a microprudential supervisor, the BdP ensures that banks meet their obligations, and may intervene in order to rectify any breaches, but never relieving banks of their responsibilities, especially from having robust and efficient governance models and internal control systems.

As described in BdP's official website, it acts in accordance with the following principles, inter alia:

1. Intrusiveness, proactivity and timeliness: it closely monitors institutions, where necessary through on-site inspections (at the premises of the supervised institutions), and takes proactive and timely action with a view to mitigating the potential risks of the institutions under its supervision.
2. Proportionality: it takes into consideration the size and complexity of the activities of the institutions under its supervision.
3. Focus on risk: it adjusts its activity to the risk profile of the institutions under its supervision.
4. Harmonisation of supervisory practices: it interprets and implements prudential rules in a consistent and coherent manner.
5. Critical attitude and independence.
6. Accountability: it is accountable to the different stakeholders, subject to its duty of professional secrecy.
7. Alignment with international best practices: it monitors and incorporates international best practices in this field in its supervisory exercise.
8. Legality: it acts in strict compliance with the law.

ii Management of banks

RGICSF establishes that the statutory bodies of credit institutions are responsible, within the scope of their respective management or supervisory competences, for defining, overseeing and implementing adequate governance to ensure the institutions' effective and prudent management, including the segregation of duties and the prevention of conflicts of interest. RGICSF further establishes that management and supervisory bodies must, inter alia:

1. assume overall responsibility for the credit institution that they manage or supervise;
2. approve and oversee the implementation of credit institutions' strategic objectives, risk strategies and internal governance;
3. ensure the integrity of accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant applicable standards;
4. oversee disclosure and information duties towards the BdP; and
5. monitor management activity.

Banks must design and apply remuneration policies correctly and must record the respective procedures and any other items required for the implementation of such policies, inter alia:

1. BdP Notice 3/2020, which regulates the governance and internal control systems and defines the minimum standards of banks; and
2. BdP Instruction 18/2020, which regulates the reporting of:
    - self-assessment reports on the adequacy and effectiveness of organisational culture and governance and internal control systems;
    - the pool of employees who have a material impact on the institution's risk profile; and
    - the process of approving a higher maximum level of the variable component of remuneration.

Moreover, banks must disclose information on the remuneration of corporate bodies and employees. This information should be included in corporate governance and internal compliance reports to be sent to the BdP or the SSM. As mentioned in Section II, Portugal has implemented CRD V, which means that remuneration policies should be reviewed to ensure that they comply with requirements of proportionality and appropriateness to the size and structure of each credit institution; this will weigh on, for example, obligations related to payment of the variable component of the remuneration of employees whose professional activities have a significant impact on the risk profile of the credit institution.

iii Regulatory capital and liquidity

In accordance with the Capital Requirement Regulation (CRR), as a rule, credit institutions must permanently satisfy the following own fund requirements:

1. Common Equity Tier 1 (CET1) capital ratio of 4.5 per cent;
2. Tier 1 capital ratio of 6 per cent; and
3. total capital ratio of 8 per cent.

These ratios compare the relevant own fund items with the risk-weighted assets (RWA in accordance with the CRR). CET1 is a component of Tier 1 capital and includes shares, other capital instruments that rank below all other claims in the event of insolvency, share premium accounts, retained earnings, other reserves and funds for general banking risk. Tier 1 capital includes, in addition to CET1, the Additional Tier 1, which consists of capital instruments ranking below Tier 2 instruments in the event of insolvency and the related share premium accounts. Conversely, Tier 2 includes subordinated instruments and related share premium accounts ranking below CET1.

In addition to the minimum capital requirements described above (the Pillar 1 requirements), credit institutions must also comply with the Pillar 2 requirement (P2R), aimed at covering risks that are underestimated or not covered by the Pillar 1 requirements. The P2R results from the Supervisory Review and Evaluation Process (SREP) carried out by the ECB.

The capital demand resulting from the SREP also includes the Pillar 2 Guidance (P2G), which indicates the adequate level of capital to be maintained to provide a sufficient buffer to withstand stressed situations. However, unlike the P2R, the P2G is not legally binding.

On top of the 4.5 per cent CET1 ratio, credit institutions must also hold the following capital buffers:

1. capital conservation buffer of up to 2.5 per cent of RWA;
2. the capital buffer for G-SIIs with no upper limit (this is not applicable to Portugal, as, currently, there are no G-SIIs in the country);
3. Other Systemically Important Institutions (O-SIIs) capital buffer of up to 3 per cent (this will apply to certain credit institutions in Portugal and ranges between approximately 0.25 and 1 per cent, as of 1 January 2024);
4. countercyclical capital buffer between zero and 2.5 per cent of RWA; and
5. systemic risk buffer in intervals of 0.5 per cent of all or some of the exposures, capped at 5 per cent, which applies to the sum of G-SII/O-SII and systemic risk buffers (it has been zero per cent in Portugal. From 1 October 2024, it will be 4 per cent on all exposures in the retail portfolio of individuals that are secured by residential property, as ruled by the BdP).

In a scenario where the above-mentioned buffers are breached, automatic safeguard measures will apply to limit the amount of dividend and bonus payments.

Finally, institutions must also meet a liquidity coverage ratio (LCR) of at least 100 per cent as required by the LCR Delegated Regulation. Banks should also have sufficient capacity on their balance sheet to absorb losses and, in case of resolution, to ensure recapitalisation, having also to comply with MREL.

iv Recovery and resolution

In accordance with RGICSF, the BdP may decide to apply four different resolution measures to failing institutions:

1. the sale of business tool;
2. the bridge bank tool;
3. the asset separation tool; and
4. the bail-in tool.

In a sale of business scenario, the BdP will decide on the transfer, in whole or in part, of assets, rights or liabilities of the intervened credit institution to one or more institutions authorised to pursue the same activity in the Portuguese market.

When deciding on the bridge bank scenario, the BdP resolves on the transfer, in whole or in part, of assets, rights or liabilities of the intervened credit institution to one or more bridge institutions specifically incorporated for such purpose, which, in turn and at a later stage, will be sold in the market or will transfer its assets and liabilities to one or more institutions authorised to pursue the banking activity in the Portuguese market. The remaining assets and liabilities not transferred to the bridge institution stay on the balance sheet of the failed bank, which typically enters into winding-up proceedings applicable to credit institutions.

In the asset-separation scenario, the BdP may determine the transfer of assets, rights or liabilities of an institution under resolution or a bridge institution to one or more asset management vehicles, to maximise the respective value in a subsequent alienation or liquidation.

Lastly, in a bail-in scenario, the BdP may also decide to apply bail-in measures to a given credit institution for the purpose of reinforcing its capital position and own funds, so that it may continue to carry out its banking activity, while complying with regulatory requirements.

Regarding bail-in, the BdP may reduce the nominal value of credits that constitute credit institution liabilities and to increase the share capital by the conversion of eligible liabilities through the issue of ordinary shares. Through this tool, losses end up being allocated to shareholders and creditors, thus in principle shifting the burden of bank rescues from taxpayers to bank creditors. Portugal has a Resolution Fund, which aims to provide financial support for the implementation of resolution measures, such as subscribing the share capital of a bridge bank (a Deposit Guarantee Fund also exists, although this is not covered in this chapter).

Conclusively, no shareholder or creditor should bear a loss exceeding that which it would have incurred had the credit institution gone into liquidation, following the 'no creditor worst off' rule.

Banks should maintain a recovery plan and a resolution plan that must be submitted to the BdP. These should cover the relevant countermeasures if a bank is in (or is likely to be) a situation of financial imbalance, as well as detailed steps to ensure a steady resolution, if it indeed comes to that point.

Conduct of business

In their relations with customers, representatives of credit institutions are subject to high level duties of diligence, neutrality, loyalty and discretion regarding the interests entrusted to them.

The BdP is watchful of the information and advertising made by banks. Credit institutions authorised in other EU Member States may advertise their services in Portugal under the same terms and conditions as institutions having their head office in Portugal.

Regarding retail marketing, banks must provide information on the possible remuneration that they offer, the features of the products offered and any applicable charges and commissions. In particular, when in comes to lending, pre-contractual information must be provided to costumers, in printed or other durable formats, on the conditions of the credit and total cost, as well as on obligations and risks associated with default on the loan.

Possible sanctions and liability

Unauthorised deposit-taking or lending is punishable by imprisonment of up to five years. Refusal to comply with orders or warrants of the BdP is subject to the penalty provided for the crime of qualified disobedience if the BdP or an official has issued a warning of such commission.

Some offences are punishable by a fine ranging from €3,000 to €1.5 million (or €1,000 to €500,000, in the event that the offence is committed by a natural person), ranging from:

1. exercise of an activity in breach of the rules on registration with the BdP;
2. infringement of the rules on the subscription or paying-up of share capital;
3. non-compliance in relation to the prudential limits determined by law or the regulator;
4. failure to comply with accounting standards and procedures determined by law or the regulator; and
5. non-disclosure of information due to the BdP.

Other severe offences are punishable by a fine of € 10,000 to € 5 million (or € 4,000 to €5 million, in the event that the offence is committed by a natural person), ranging from:

1. unauthorised practice of transactions exclusively reserved for credit institutions or financial companies;
2. fraudulent payment of the capital;
3. falsification of accounts and the non-existence of organised accounting, as well as non-compliance with other applicable accounting rules determined by law or the regulator;
4. breach of rules on credit granted to holders of qualifying holdings;
5.

willful acts of detrimental management, to the detriment of depositors, investors and other creditors, practised by members of a banks' statutory bodies;

6. failure to contribute to the Deposit Guarantee Fund or the Resolution Fund; and
7. acquisition of a qualifying holding despite the against a decision of the regulator, among others.

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Funding

The main source of funding from Portuguese banks is deposit-taking.

It is also common for banks to engage in debt issuance and other market instruments. In principle, there are no restrictions on debt and debt like instruments, as long as they comply with general securities markets rules and regulations and are approved by the BdP and the CMVM (if applicable).

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Control of banks and transfers of banking business

i Control regime

Acquisition, by direct or indirect means, of a qualifying holding in a credit institution by any investor is subject to prior communication to the BdP. In addition, increases of qualifying holdings must also be previously communicated to the BdP, whenever the increased qualifying holding may reach or exceed 10 per cent, 20 per cent, one-third or 50 per cent of the share capital or the voting rights, or if the credit institution becomes a subsidiary of the acquiring entity.

The BdP may oppose the proposed acquisition if information provided by the potential acquirer is deemed incomplete or if the relevant potential acquirer does not fulfil the conditions to ensure a sound and prudent management of the credit institution. As to the potential acquirer of a qualifying holding, the following criteria should be taken into account:

1. suitability;
2. reputation, professional qualification, independence and availability of the members of the management body of the credit institution to be appointed as a result of the proposed acquisition;
3. financial soundness of the proposed acquirer; and
4. ability by the credit institution to comply and continue to comply with any applicable prudential requirements.

Banking acquisitions are subject to corporate rules on financial assistance, capital maintenance and other similar rules. Depending on the specific scenario, Portuguese law may limit the ability of a bank to grant security interests for the obligations of a purchaser to repay acquisition finance, as leverage buyout limitations may apply.

ii Transfers of banking business

Transfer of the business of a bank may occur by way of a demerger or an acquisition deal (strictly speaking), meaning an asset deal.

By way of a demerger, the proposed segregation of the business unit would occur, followed by its incorporation into another company. The need to obtain consent from costumers in a demerger scenario is not clear and may be disputable, depending on the specific case, namely if only a partial spin-off is considered and the positions being assigned are mostly passive (i.e., deposits or debt entitlements).

If the transfer of banking business is made through an asset deal, it shall typically be governed by a master agreement covering the transfer of assets and liabilities for which the transfer is being envisaged. In this case, the transfer of agreements with customers or third parties will, in principle, require consent of the customers and third parties, except for the transfer of employment contracts or the leased premises or equipment, as well as the transfer of positions that only comprise active entitlements (i.e., credit entitlements), for example. If consent is not obtained, the transferor will remain formally and bound by law.

Outlook and conclusions

Rising inflation and the increase in interest rates, together with significant pressure in the housing market, have set the tone for discussions on the Portuguese economy in 2023. The banking sector has not been immune to this and, naturally, inflation will still be a major concern for 2024. Banks are generally sound on footing and their balance sheets look more robust, but their resilience will inevitable be constantly put to test.

It is expected that environmental, social and governance (ESG) matters will remain at the centre of the agenda, with a steady increase in demands for ESG evaluation criteria to be generally required in all banking services being rendered to the corporate community, as well as with the market also pushing forward this evolution trend with green and sustainable debt issues and sustainability linked transactions being completed by some of the main listed companies on the national market and even by smaller market participants. At the same time, ESG KPIs are increasingly being incorporated into corporate financing transactions.

The year 2024 may yet prove to be one in which the new Banking Activity Code is approved, following a long period where the draft thereof has been made available for public consultation. If this Code is approved, it will likely be linked to a political evolution, particularly in view of the results of the March 2024 parliamentary elections, and it will mean a total replacement of RGICSF and the consolidation, in a single legislative act, of the core regulation of banking activities.

The new Banking Activity Code could prove to be a true paradigm shift in banking regulation in Portugal, with the final draft, already approved, proposing measures such as:

1. a prohibition on self-placement (a ban on banks selling to non-professional investors financial instruments issued by themselves or by shareholders with a stake of 2 per cent or more of the capital);
2. a minimum amount of €100,000, which is established for the subscription of financial instruments subject to bail-in;
3. the BdP now having the power to apply compulsory pecuniary measures to banks, calculated on a daily basis, in order to guarantee a more effective supervision; and
4. the BdP having the power to force the largest shareholders of banks to sell their holdings, partially or totally, if the soundness of the institution is at risk or if there are suspicions of money laundering.

Rising inflation and the increase in interest rates, together with significant pressure in the housing market, have set the tone for discussions on the Portuguese economy in 2023. The banking sector has not been immune to this and, naturally, inflation will still be a major concern for 2024. Banks are generally sound on footing and their balance sheets look more robust, but their resilience will inevitable be constantly put to test.

It is expected that environmental, social and governance (ESG) matters will remain at the centre of the agenda, with a steady increase in demands for ESG evaluation criteria to be generally required in all banking services being rendered to the corporate community, as well as with the market also pushing forward this evolution trend with green and sustainable debt issues and sustainability linked transactions being completed by some of the main listed companies on the national market and even by smaller market participants. At the same time, ESG KPIs are increasingly being incorporated into corporate financing transactions.

The year 2024 may yet prove to be one in which the new Banking Activity Code is approved, following a long period where the draft thereof has been made available for public consultation. If this Code is approved, it will likely be linked to a political evolution, particularly in view of the results of the March 2024 parliamentary elections, and it will mean a total replacement of RGICSF and the consolidation, in a single legislative act, of the core regulation of banking activities.

The new Banking Activity Code could prove to be a true paradigm shift in banking regulation in Portugal, with the final draft, already approved, proposing measures such as:

1.

a prohibition on self-placement (a ban on banks selling to non-professional investors financial instruments issued by themselves or by shareholders with a stake of 2 per cent or more of the capital);

2. a minimum amount of €100,000, which is established for the subscription of financial instruments subject to bail-in;
3. the BdP now having the power to apply compulsory pecuniary measures to banks, calculated on a daily basis, in order to guarantee a more effective supervision; and
4. the BdP having the power to force the largest shareholders of banks to sell their holdings, partially or totally, if the soundness of the institution is at risk or if there are suspicions of money laundering.

Endnotes

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