Banco de Portugal
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PRESS RELEASE

SPECIAL INSPECTIONS PROGRAMME RESULTS

Lisboa, 16 December 2011

Banco de Portugal announces today the results of the first phase of the Special Inspection Program (SIP) carried out in the eight largest national banking groups, regarding the assessment of their credit portfolios and the validation of the credit risk capital requirements.

The conclusions of the SIP have confirmed the robustness and resilience of the Portuguese banking system capital adequacy, as of 30^{th} of June 2011. The overall impact of the results of SIP on the aggregate Tier 1 ratio of the eight banking groups would imply a minor revision of this ratio, from 9.1% to 8.8%, remaining above the minimum 8% required at that date.

The second phase of SIP, related to the assessment of the parameters and methodologies used by the banks in the stress test exercises, is currently in progress and should be completed during the first quarter of 2012.

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MAIN CONCLUSIONS

The conclusions of the SIP, regarding the credit portfolios of the eight largest national banking groups, have globally validated the data used to support their solvency assessment, confirming the robustness and resilience of the Portuguese banking system, as of 30 June 2011.

The overall impact of SIP on the aggregate Tier 1 ratio of the eight banking groups would imply a minor revision of this ratio, from 9.1% to 8.8%, remaining above the minimum 8% required at that date.

With regard to the credit portfolios under assessment, it was estimated, for the aggregate of the eight banking groups and with reference to 30 June 2011, the need to reinforce their impairment by 838 million euros (not considering existent impairment buffers as of the same date), to achieve robust levels of provisioning. This amount corresponds to 9.1% of the total impairment recognized for the credits in the scope of the SIP and 0.3% of the total amount of such credits.

The total impact for the aggregate of the eight banking groups is however smaller, because the impairment reinforcement needs are partly offset (in 242 million euros) by the allocation of existent impairment buffers, already registered in the accounts on 30 June 2011, with a global amount of 339 million euros. Additionally, in the third quarter of 2011, the eight banking groups have recognized additional impairment of 208 million euros for some of the credits where the need to reinforce the impairments was identified.

Regarding the assessment of the capital requirements for credit risk, the work has identified the need to introduce some corrections, with an impact, for all the eight largest banking groups, of around 0.6% of total capital requirements at the end of June 2011.

Risk management policies, procedures and controls were also assessed in the context of the SIP and considered globally adequate despite a certain number of corrections and improvements identified.

In the follow-up of the SIP, Banco de Portugal will require to the banking groups to maintain conservative criteria to estimate the adequate amounts of impairment, taking into account the results of the exercise and the evolution of business and market conditions.

Regarding the identified areas for improvement, Banco de Portugal will require the banking groups to put in place the appropriate corrective measures with clear priorities and deadlines for their implementation.

Banco de Portugal will monitor, on a regular basis, the implementation of SIP recommendations, according with the established deadlines.

As agreed in the second review of the Economic and Financial Assistance Program, Banco de Portugal will establish the appropriate conditions for the neutralization of the SIP results, until 30 June 2012, on the prudential ratios and limits.

BACKGROUND

The Economic and Financial Assistance Programme agreed in May 2011, with the International Monetary Fund, the European Commission and the European Central Bank, defined a set of measures and actions to be taken by the Portuguese authorities concerning the financial sector, including the implementation of a solvency and deleveraging assessment framework for the eight largest national banking groups. In this context, Banco de Portugal was endorsed with the responsibility to develop a program of special on-site inspections to validate the data on assets that these banking groups provide as inputs for their solvency assessment.

To monitor this Special Inspections Programme, a Steering Committee was created, chaired by the Banco de Portugal and comprising international experts appointed by the EC, ECB and IMF, by three euro area supervisory authorities (Banco de España, National Bank of Belgium, Banque de France/ACP) and by Banco de Portugal.

The Steering Committee has approved, in July 2011, the Terms of Reference for the special inspections work, including the definition of its scope, the methodological approach, the implementation calendar and the mechanisms to monitor and control the pace and quality of work. According to the Terms of Reference, the SIP comprises three workstreams:

1. Valuation of the credit portfolio, as of 30 June 2011, based on the analysis of the impairment for a sample a credits, as well as on the review of the adequacy of the collective impairment models and the related credit risk management policies and processes;

2. Revision of the credit risk capital requirements calculations;

3. Assessment of the stress-test parameters and methodologies used by the Banks in the stress-test exercise carried out regularly as foreseen in the Economic and Financial Assistance Programme.

The SIP addressed the 8 largest Portuguese Banking Groups, on a consolidated basis: Banco Comercial Português (BCP), Banco BPI (BPI), Caixa Geral de Depósitos (CGD), Espírito Santo Financial Group (ESFG), Caixa Económica Montepio Geral (MG), Santander Totta (BST), Rentipar Financeira (BANIF) and Sistema Integrado do Crédito Agrícola Mútuo (SICAM). These banking groups represent more than 80% of the Portuguese banking system in terms of total assets.

Considering the objectives, the scope and the timetable envisaged for the SIP, it was agreed to use the services of external providers (accounting and consultancy firms) for the evaluation of the credit portfolio and for the assessment of the stress-test parameters and methodologies.

The work related to workstreams 1 and 2 of the SIP were executed from end-July to end-November and its results and conclutions were appraised these week by the Steering Committee, which has confirmed that the work was done according with the requirements and objectives defined in the Terms of Reference. The work related to the workstream 3 is undergoing and shall be finished during the first quarter of 2012.

Credit portfolio assessment

The valuation of the credit portfolio (WS1) was performed by two independent external accounting firms: Ernst & Young Audit & Associados – Sociedade de Revisores Oficiais de Contas, S.A. and PricewaterhouseCoopers & Associados – SROC, Lda. Four banking groups were allocated to each one of the accounting firms, in a way to prevent conflicts of interest and to ensure a balanced workload between the accounting firms.

The valuation of the credit portfolio has involved 226 people (in a total of about 110 000 hours of work), including foreign experts that have brought experience from similar work performed in other EU countries.

The accounting firms have assessed of the adequacy of the individual impairment levels, based on a judgmental sample of loans, which included all the entities belonging to the top 50 credit clients (in terms of economic groups with highest credit exposures) in each of the banking groups, as well as other groups and entities were selected on the basis of a comprehensive set of risk indicators. For some credits new valuations were requested for the associated collateral, performed by independent valuation experts.

In total, 5 516 entities and 61 531 credit files were reviewed, covering more than 50% of the individually assessed exposures in the scope of the SIP.

In what concerns collective impairment, the assumptions, the methodology and the historical information supporting the collective impairment models and a sensitivity analysis of the key parameters and an estimation of the impact of the identified main areas for improvement were done.

Additionally, the accounting firms have also assessed the credit risk policies, procedures and key controls, with particular emphasis on collateral valuation and problem assets.

Credit risk capital requirements validation

The validation of the calculation of capital requirements involved the collection and validation of relevant data for each of the 8 banking groups and the recalculation of the requirements through a centralized system specially developed by Banco de Portugal for this purpose.

The work related with this workstream was carried out by Banco de Portugal specialized teams and was focused on credit risk capital requirements, which represent about 90% of capital requirements for the 8 banking groups.

Banco de Portugal has processed about 16.6 million contracts/exposures, related to nearly 7.7 million obligors and incorporating the credit risk reduction effect related to 2.3 million mitigation techniques.

Assessment of the parameters and methodologies used in the stress-test exercises

Over the past six months, the materialisation of risks to financial stability increased substantially, both worldwide and in Portugal, reflecting the deterioration in macroeconomic and financial conditions, in a context of widespread tensions in sovereign debt markets in the euro area. This worsening of the economic and financial conditions has been reflected in a deterioration of the profitability of the Portuguese banking system and in a greater materialisation of credit and market risks.

In the context of the Economic and Financial Assistance Programme, Banco de Portugal was endorsed with the responsibility to conduct regular stress test exercises, in order to evaluate the resilience of the largest national banking groups in case the identified risks would materialised under an adverse scenario. In particular, the capacity of each banking group to maintain a ratio of core Tier 1 capital of 6%, after a shock simulation, will be evaluated

Through workstream 3 of the SIP, developed using the services of the specialized consultancy firm Oliver Wyman, the robustness of the methodologies and parameters used by each banking group to forecast business, prospective profitability and the evolution of their levels of capital will be assessed, in the context of stress test exercises conducted by Banco of Portugal.

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