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MEETING OF THE BOARD OF DIRECTORS OF BANCO DE PORTUGAL

29 December 2015

On 29 December 2015, at the ordinary meeting of the Board of Directors of Banco de Portugal, chaired by Governor Carlos da Silva Costa, and attended by Vice-Governors Pedro Duarte Neves and José Ramalho, and Directors João Amaral Tomaz and António Varela, and also attended by João da Costa Pinto acting on behalf of the Audit Board, the following decision was adopted regarding the following point on the agenda: “Re-transfer of non-subordinated bonds from Novo Banco, S.A. to Banco Espírito Santo, S.A.”:

DECISION*

Pursuant to Article 146.1 of the General Legal Framework of Credit Institutions and Financial Companies, enacted by Decree-Law 298/92, of 31 December 1992 (RGICSF), the following decision is deemed urgent on the terms and for the purposes of Article 124.1(a) of the Administrative Procedure Code, without prior hearing of the interested parties taking place. This waiver is also justified under Article 124(c) and (d) of the Administrative Procedure Code.

Background

* Including the rectifications made on 12 January 2016



1. Banco de Portugal's decision of 3 August 2014 (8.00 p.m.), as clarified and adjusted by the decision of 11 August 2014 (5.00 p.m.) - hereinafter for the purposes of the following recitals, the "Decision of 3 August" - which ordered the incorporation of Novo Banco, S.A. ("Novo Banco"), further ordered the transfer of a set of assets, liabilities, off-balance-sheet items and assets under management from Banco Espírito Santo, S.A. ("Banco Espírito Santo" or "BES") to Novo Banco, detailed in Annex 2 to the Decision of 3 August.
2. After 3 August 2014, in light of additional information which became available, Banco de Portugal, in its capacity as resolution authority, has been gaining an ever deeper understanding of the financial situation of the set of assets, liabilities, off-balance-sheet items and assets under management of Novo Banco and their fair value as at 3 August 2014, notably through the processes described below.
3. Since the transfer pursuant to the Decision of 3 August, it has become clear that the assets of BES (even as adjusted for the purposes of the Decision of 3 August) were significantly overvalued in BES's books. Substantial overvaluations even higher than those already identified by the PricewaterhouseCoopers & Associados – Sociedade de Revisores de Contas, Lda ("PwC") audit, carried out subsequent to the resolution measure, have now become obvious.
4. The RGICSF, enacted by Decree-Law 298/92, of 31 December 1992, provides that shareholders and creditors of an institution under resolution should bear the losses of that institution, in line with European legislation on the matter.
5. RGICSF also provides that the resources of the Resolution Fund cannot be used to directly support the losses of the credit institution under resolution, and the value of the liabilities and off-balance-sheet items to be transferred to a bridge bank must not exceed the aggregate value of the transferred assets.



6. Banco de Portugal has a legal power, exercisable at any time prior to the withdrawal of the authorization of BES for the exercise of activity or the sale of Novo Banco, to order further transfers of assets and liabilities between Novo Banco and BES (the “**Re-transfer Power**”). The Re-transfer Power is provided for in Chapter III (*Resolution*) of Title VIII of the RGICSF and was specifically provided for in paragraph 2 of Annex 2 to the Decision of 3 August.
7. Pursuant to the exercise of the Re-transfer Power, this decision:
 - a. Orders the re-transfer from Novo Banco to BES of the issuances of non-subordinated debt set out in Annex I, originally transferred from BES to Novo Banco following the Decision of 3 August; and
 - b. Provides for certain matters ancillary to the re-transfer.

Overvaluation as at the date of the resolution measure of the assets transferred from BES to Novo Banco

8. For the purposes of evaluation of the assets, liabilities and off-balance-sheet items transferred as part of the resolution measure, paragraph 5 of Annex 2 added the following to the Decision of 3 August: *“the assets, liabilities and off-balance-sheet items are transferred at their book value, and the assets are adjusted in compliance with the values listed in Annex 2A, in order to ensure a conservative valuation, to be confirmed in the audit referred to in Point Three”*. And paragraph 6 of that same annex stated that *“Based on this valuation, the capital requirements for Novo Banco, SA, are calculated to be €4.9 billion”*.
9. The audit mentioned in paragraph 3 for the purposes of evaluation of the transferred assets, liabilities, off-balance-sheet items and assets under management, as at the date of the resolution measure, was carried out by PwC, and was taken into account in the preparation of the opening balance sheet of Novo



Banco, published on 3 December 2014. The evaluation determined that the value of the assets transferred to Novo Banco was lower than the adjusted book value used to determine the corresponding amount of liabilities of BES to be transferred to Novo Banco, by the Decision of 3 August.

10. In addition, since the Decision of 3 August and the audit mentioned in paragraph 3, Novo Banco has been recording significant impairments in its assets and adverse adjustments in its accounts that are due to events predating and/or risks created before 3 August 2014. Had these events been known and these impairments and adjustments been identified prior to 3 August 2014, they would have resulted in a lower adjusted net book value being attributed to the corresponding assets of BES and, accordingly, a lower amount of liabilities being transferred to Novo Banco.
11. In its accounts for 31 December 2014, Novo Banco recognized impairments and negative adjustments relating to events predating 3 August 2014 of approximately Euros 699 Million. In its accounts for the first half of 2015, Novo Banco recognized further impairments and negative adjustments relating to events predating 3 August 2014 of approximately Euros 270 Million.
12. Banco de Portugal anticipates that Novo Banco may need to recognize further impairments and negative adjustments in its annual accounts for 2015.
13. It must also be stressed that this transfer falls within the purpose underlying the decision of the European Commission no. SA.39250 (2014/N) – Portugal, of 03.08.2014, and ensures the observance of its terms.
14. In light of the above, the true level of losses of BES as at 3 August 2014 were not fully absorbed by the shareholders and creditors of BES and the level of liabilities transferred to Novo Banco on 3 August 2014 was excessive given the actual value of the corresponding assets transferred to Novo Banco. Therefore, a re-transfer of certain liabilities from Novo Banco to BES of approximately Euros 2 Billion through



the exercise of the Re-transfer Power is necessary and proportionate in order for BES's losses, which were only detected after Novo Banco's opening balance sheet, to be borne in the terms provided for in RGICSF. It is also extremely necessary, urgent and pressing to exercise the Re-transfer Power, as set out in this decision, in order to ensure the continuity of critical functions and to avoid a significant adverse effect on the financial system of Portugal.

Non-subordinated debt instruments issued by BES and transferred on 3 August 2014 to Novo Banco

15. The bond issuances which are re-transferred from Novo Banco to BES, in accordance with the foregoing recitals, are set out in Annex I to this decision.
16. Banco de Portugal considers that the selection of these series of bonds (notes) is justified in the public interest and proportionate to the risks being addressed for the following reasons:
 - a. These are bonds (notes) which were originally issued by BES directly to qualified investors, under article 30.^o of the Portuguese Securities Code (*"Código dos Valores Mobiliários"*), and not to retail investors, in addition to having been issued with denominations of Euros 100,000 and therefore typically not targeting small investors, even in the secondary market;
 - b. This selection contributes significantly to maintaining the trust of most investors, namely non-qualified investors, therefore ensuring to the greatest extent possible the conditions for the continued operation of Novo Banco without further disturbances or adverse impact on the system's stability;
 - c. In addition, the differentiated treatment between bondholders in non-subordinated debt and other types of senior creditors, holding unsecured



credits, in what concerns burden sharing of the institution under resolution, is a course which has been followed in other EU Member States and approved at EU level; and

- d. Burden sharing by retail investors, depositors, trade creditors, derivative counterparties, inter-bank liabilities or other categories of liabilities towards senior creditors, holding unsecured credits, would substantially adversely affect the franchise of Novo Banco and/or its stability and/or the stability of the Portuguese banking system.

Under the provisions in the RGICSF and paragraph 2 of Annex 2 to the Decision of 3 August, the Board of Directors of Banco de Portugal decides the following:

- A) All rights and liabilities of Novo Banco under the non-subordinated debt instruments listed in Annex I to this decision (excluding those held by Novo Banco), together with all liabilities, contingencies and off-balance sheet items to the extent they relate to those debt instruments, including (i) the issue, marketing and sale of those notes and (ii) arising under the contractual documents or other instruments entered into or issued by the bank, including program or subscription documents, or any other acts of the bank, in connection with such instruments, prior, simultaneous or subsequent to the respective issues, are hereby re-transferred from Novo Banco to BES, with effect from the date of this decision.
- B) The Board of Directors of BES and the Board of Directors of Novo Banco shall take all actions required to implement and effect the re-transfers set out in this decision.
- C) The re-transfer ordered is not intended to confer on any counterparties and third parties any new rights nor to enable the exercise of any rights that in the absence



of such re-transfer would not exist or could not be exercised on or in relation to the assets, liabilities, off-balance-sheet items and assets under management of Novo Banco, BES or those thus transferred from Novo Banco to BES, including any rights of termination, resolution or rights to order early redemptions, close-out netting or netting/set-off, nor to result in (i) any default, (ii) change in conditions, rights or obligations, or (iii) subjecting to approval, or (iv) right to enforce guarantees, (v) right to make retentions or netting/set-off between any payments or claims under such assets, liabilities, off-balance-sheet items and assets under management.

- D) Approve the minutes of this decision with a view to its immediate implementation, under paragraph 4 and for the purposes of Article 34.6 of the Administrative Procedure Code.

The Board of Directors



Annex I

Notes re-transferred from Novo Banco to BES

ISIN	DESCRIPTION	CCY	Type
PTBEQBOM0010	Senior Notes NB 6.875% due July 2016	EUR	Senior
PTBENIOM0016	Senior Notes NB 6.9% due June 2024	EUR	Senior
PTBENJOM0015	Senior Notes NB 4.75% due Jan 2018	EUR	Senior
PTBENKOM0012	Senior Notes NB 4.0% due Jan 2019	EUR	Senior
PTBEQKOM0019	Senior Notes NB 2.625% due May 2017	EUR	Senior