



Brussels, 11.10.2017  
C(2017) 6896 final

<p>In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...]</p>		<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**Subject: State aid n° SA.49275 (2017/N) – Portugal**  
**Sale of Novo Banco with additional aid in the in the context of the 2014**  
**Resolution of Banco Espírito Santo, S.A.**

Sir,

The Commission wishes to inform the Portuguese authorities that, having examined the information supplied by your authorities on the measure referred above, it has decided not to raise objections to the measure for the reasons set out below.

## 1. PROCEDURE

- (1) On 3 August 2014, the Portuguese authorities put Banco Espírito Santo, S.A. and its subsidiaries (“BES”) into resolution with the immediate creation and capitalisation of a temporary credit institution, i.e. a Bridge Bank, subsequently named Novo Banco S.A. (“Novo Banco”, “the bank”)<sup>1</sup>, fully capitalized and owned by the Portuguese Resolution Fund<sup>2</sup> (“Fundo de Resolução”) (“Resolution

<sup>1</sup> All references in the present Decision to “Novo Banco” or “to the bank” are to be understood as being to the Bridge Bank mentioned in the 2014 Decision where the context so requires.

<sup>2</sup> The Resolution Fund was created in 2012, on the basis of Ministerial Order no. 420/2012, December 21, which established the Portuguese Resolution Fund Regulation; and the Decree-Law nr. 31-A/2012

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Fund”). By decision of 3 August 2014<sup>3</sup> (the “2014 Decision”), the Commission approved aid in this context.

- (2) In the framework of the procedure resulting in that decision, the Portuguese authorities provided a number of commitments<sup>4</sup>, including the sale of Novo Banco and the liquidation of the Bad Bank and of any parts of Novo Banco not sold within two years of the date of the 2014 Decision.
- (3) On 4 December 2014, the Resolution Fund launched a sale process for Novo Banco<sup>5</sup>.
- (4) On 15 September 2015, the Bank of Portugal announced publicly that the sale process of Novo Banco was suspended<sup>6</sup>, without accepting any of the three binding offers, as it deemed the terms and conditions of these offers unsatisfactory.
- (5) On 14 November 2015, the Single Supervisory Mechanism (“SSM”) of the European Central Bank (“ECB”), which is the lead supervisor of Novo Banco, announced the results of the Comprehensive Assessment<sup>7</sup>, which identified a capital shortfall of EUR 1.4 billion in the adverse scenario for Novo Banco.<sup>8</sup>
- (6) On 21 November 2015, the Resolution Fund submitted to the Commission preliminary information on possible approaches envisaged for Novo Banco, in response to the capital shortfall identified by the Comprehensive Assessment.
- (7) On 6 December 2015, the Portuguese authorities submitted to the Commission a draft Restructuring Plan, which they subsequently amended on 9 December 2015, setting out the strategy for Novo Banco, from the date of resolution of BES until 2020, with a view to the consolidation of Novo Banco towards becoming a profitable bank compliant with all regulatory requirements.
- (8) On 19 December 2015, the Portuguese authorities notified the extension of the Government Guaranteed Bank Bonds (“GGBBs”)<sup>9</sup> for Novo Banco and a set of revised commitments concerning notably Novo Banco. The notification also

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of 10 February 2012, for the purpose of providing financial assistance to the application of resolution measures adopted by the Bank of Portugal.

<sup>3</sup> SA.39250 (2014/N) - Portugal, Resolution of Banco Espírito Santo, S.A., OJ C 393/2014. 7.11.2014, p. 1.

<sup>4</sup> See Annex I to the 2014 Decision.

<sup>5</sup> Invitation to Submit Expressions of Interest for Novo Banco, by the Resolution Fund: [http://www.fundoderesolucao.pt/en-US/ofundo/Documents/Announcement\\_ENG.pdf](http://www.fundoderesolucao.pt/en-US/ofundo/Documents/Announcement_ENG.pdf)

<sup>6</sup> Press Release of Bank of Portugal on the Novo Banco sale process: <http://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Pages/comb20150915.aspx>

<sup>7</sup> The comprehensive assessment comprises two components: an Asset Quality Review (“AQR”) and a stress test. Note on the 2015 Comprehensive Assessment by the ECB Banking Supervision, available at: [https://www.bankingsupervision.europa.eu/pdf/ca/2015-11-14\\_note\\_comprehensive\\_assessment.en.pdf?903a66b1e1fcbd5ab4021d1dfa089819](https://www.bankingsupervision.europa.eu/pdf/ca/2015-11-14_note_comprehensive_assessment.en.pdf?903a66b1e1fcbd5ab4021d1dfa089819)

<sup>8</sup> Results of the comprehensive assessments 14 November 2015: [https://www.bankingsupervision.europa.eu/pdf/ca/PT-Novo\\_Banco-CA-DISCLOSURE.xlsx.pdf](https://www.bankingsupervision.europa.eu/pdf/ca/PT-Novo_Banco-CA-DISCLOSURE.xlsx.pdf)

<sup>9</sup> The GGBBs had been issued by Banco Espírito Santo, S.A. under the Portuguese Guarantee Scheme, which had been approved by the Commission on 29 October 2008 in case NN60/2008 and subsequently prolonged on a half-year basis. In 2015, the GGBBs could no longer be prolonged under the condition of the scheme, and therefore an individual notification and Commission decision for Novo Banco were required in order for the GGBBs to be prolonged.

requested the extension of the sale deadline for Novo Banco, by one additional year.

- (9) On 19 December 2015, the Commission adopted a decision on the Amendment of the 2014 Resolution of Banco Espírito Santo, S.A.<sup>10</sup> (“the 2015 Decision”), approving the extension of the GGBBs with one additional year, as well as the extension of the deadline to sell or wind-down Novo Banco by a further year, based on the revised commitments put forward by Portugal.
- (10) On 15 January 2016, the Bank of Portugal announced the launch of a new sale process of Novo Banco<sup>11</sup>.
- (11) Over the course of 2016 and early 2017, Portugal made several submissions to the Commission informing on the progress of the sale process.
- (12) On 20 February 2017, the Bank of Portugal announced that it had selected a potential investor, i.e. Lone Star (“the buyer” or “the acquirer”), to take part in a concluding round of exclusive negotiations, with a view to finalising the possible terms of the sale of Novo Banco<sup>12</sup>.
- (13) Over the course of March 2017, Portugal submitted preliminary information to the Commission concerning the sale transaction, potential new aid measures it would involve, and elements of a restructuring plan that the acquirer of Novo Banco would implement.
- (14) On 31 March 2017, Portugal informed the Commission that the sale of Novo Banco was about to be concluded, and put forward a set of preliminary commitments. In the same submission, Portugal informed the Commission that a full restructuring plan of the bank after the sale could not be presented at that date, and that it would be submitted, along with a full list of commitments, prior to the closing of the transaction, so as to allow the Commission to assess the viability of Novo Banco following the sale.
- (15) On 31 March 2017, the Bank of Portugal announced that it had selected Lone Star to complete the sale of Novo Banco and that the contractual documents of the transaction had been signed by the Resolution Fund<sup>13</sup>.
- (16) On 20 April 2017 Portugal submitted to the Commission the signed documentation for the sale transaction concerning Novo Banco.
- (17) On 5 May 2017, Portugal submitted to the Commission a draft restructuring plan for Novo Banco, prepared by Lone Star, aiming to prove the viability of the bank going forward.
- (18) Over the period of June-August 2017 several contacts took place between Portugal and the Commission services, to clarify questions around the draft

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<sup>10</sup> SA.43976 (2015/N) Amendment of the 2014 Resolution of Banco Espírito Santo S.A. (Novo Banco S.A.), OJ C 390/2016. 21.10.2016, p. 5.

<sup>11</sup> Bank of Portugal website: <https://www.bportugal.pt/en/comunicado/press-release-banco-de-portugal-re-launch-novo-banco-sale-process>

<sup>12</sup> <https://www.bportugal.pt/en/comunicado/press-release-sale-process-novo-banco>

<sup>13</sup> <https://www.bportugal.pt/en/comunicado/press-release-sale-novo-banco>

restructuring plan. Portugal submitted information to complement the draft restructuring plan on 30 June, 7 July, 20 July and 4 August 2017, with additional information and clarifications submitted up until the date of the notification (documents to be referred to in their entirety as “the restructuring plan”).

- (19) On 4 October 2017, Portugal notified new liquidation aid measures for Novo Banco, in the context of its sale.
- (20) By letter of 4 October 2017, Portugal agreed to waive its rights deriving from Article 342 TFEU in conjunction with Article 3 of Regulation 1/1958<sup>14</sup> and to have the present Decision adopted and notified in English.

## 2. DESCRIPTION

### 2.1. Description of the 2014 Decision, the 2015 Decision and of Novo Banco

#### 2.1.1. The 2014 and 2015 Decisions

- (21) In 2014, following a significant deterioration of BES<sup>15</sup> capital<sup>16</sup> the Bank of Portugal assessed various alternative options to the resolution of BES, but due to the absence of buyers, it considered the creation of a Bridge Bank to be the only remaining solution for safeguarding the stability of the financial system in Portugal. Therefore, on 3 August 2014, the Portuguese authorities notified to the Commission the resolution of BES and the immediate creation and capitalisation of a temporary credit institution: Novo Banco<sup>17</sup>.
- (22) A large part of BES's business activities were transferred to Novo Banco in accordance with the recommendation of the Bank of Portugal (“the 2014 Resolution Measure”). Novo Banco received assets and liabilities such as cash, retail deposits and performing loans, central bank funding, EUR 3.5 billion of GGBBs and T-Bills. Overall, it received EUR 64 billion of assets, and was capitalised by EUR 4.9 billion<sup>18</sup> via the Resolution Fund.
- (23) The remainder of BES became a so-called Bad Bank. In addition to the residual assets not transferred to Novo Banco, shareholders and subordinated creditors as well as claims by related parties (e.g. shareholders or board members) also remained in the Bad Bank.
- (24) The 2014 Decision approved resolution aid in light of, *inter alia*, the following commitments:
  - (a) Novo Banco would be sold within two years of the 2014 Decision, or wound down if a sale was unsuccessful;

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<sup>14</sup> Council Regulation No 1 determining the languages to be used by the European Economic Community, OJ 17, 6.10.1958, p. 385.

<sup>15</sup> A detailed description of BES is included in recitals (11) to (17) of the 2014 Decision.

<sup>16</sup> A detailed description of events leading to the resolution of BES is included in recitals (18) to (26) of the 2014 Decision.

<sup>17</sup> Novo Banco was created on 3 August 2014 pursuant to the Legal Framework of Credit Institutions and Financial Companies (approved by Decree-Law no. 298/92, of 31 December 1992, as subsequently amended).

<sup>18</sup> A description of the set-up and aid measures for Novo Banco is included in recitals (27) to (32) of the 2014 Decision.

- (b) The banking license of the Bad Bank would be revoked by no later than the end of the sale process of Novo Banco. In the meantime, the Bad Bank was to be orderly wound down under normal insolvency judicial proceedings.
- (25) On 19 December 2015, by means of the 2015 Decision, the Commission authorized the extension of the sale deadline for Novo Banco together with the extension of the maturities of the GGBBs with total notional value of EUR 3.5 billion<sup>19</sup> by one year.
- (26) The 2015 Decision was underpinned by a catalogue of revised commitments, replacing the one of the 2014 Decision. The new set of commitments aimed to ensure the minimisation of distortions of competition during the existence period of Novo Banco, which was being prolonged for one additional year by the 2015 Decision.
- (27) The key commitments revised at the time of the 2015 Decision included the following<sup>20</sup>:
- (a) Novo Banco would not price deposits above market average (as published by the Statistical Department of the Bank of Portugal, in accordance with the applicable regulation);
- (b) By [...] \* Novo Banco would comply with the following Key Performance Indicators (“KPIs”) at group level:
- Cost base reduced by EUR [100-200] million compared to the levels of 30 November 2015, excluding the costs deriving from restructuring such as from the reduction of full-time equivalents (“FTE”);
  - Number of FTE reduced by [800-1000] compared to the level of 30 November 2015;
  - Number of branches reduced to [500-600].
- (c) If by [...] Novo Banco still existed as a stand-alone entity, Novo Banco would comply with the following KPIs, at group level:
- Cost base reduced by EUR [200-250] million compared to the levels of 30 November 2015, excluding the costs deriving from restructuring such as from the reduction of FTE;
  - Number of FTE reduced by [1000-1500] compared to the level of 30 November 2015;
  - Number of branches reduced to [450-500].

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\* Confidential information.

<sup>19</sup> A description of the additional aid measures for Novo Banco is included in recitals (24) to (35) of the 2015 Decision.

<sup>20</sup> For the full list and text of the commitments, please refer to the letter Commitments by the Portuguese Republic dated 18 December 2015 annexed to the 2015 Decision (see footnote 10).

- (d) The banking license of the Bad Bank would be revoked by no later than the conclusion of the sale process of Novo Banco. The Bad Bank would enter into liquidation proceedings upon withdrawal of the authorisation which will occur by no later than two years after the Effective Date (the date of the 2014 Decision).
- (e) The existence period of Novo Banco was clearly limited in time and there were minimal conditions on the sale process and the acquirer to prevent a continuity in ownership with either the public authorities or the owners of BES prior to the 2014 Resolution Measure:
- Novo Banco will have sold all assets – core and non-core – or the Resolution Fund will have sold all shares in Novo Banco by no later than three years after the date of the 2014 Decision in an open, non-discriminatory and competitive process launched publicly by 15 January 2016 with the aim of signing a share purchase agreement by 2 August 2016. The split between core and non-core part of Novo Banco will be adjusted if the sale has not been concluded by a given date<sup>21</sup>.
  - In case the assets or the shares of Novo Banco have not been sold by no later than three years after the date of the 2014 Decision, Novo Banco in its entirety will cease new business and be put in wind down in the month that follows.
  - For the purpose of acquiring any parts of BES or Novo Banco, the Purchaser would not be previous qualified shareholders (above 2%), within the two years immediately prior to the setup of Novo Banco.
- (28) The withdrawal of the banking license for the Bad Bank occurred on 13 July 2016 when ECB notified BES of its decision to withdraw its license for the pursuit of banking activity<sup>22</sup>.

#### *2.1.2. Current state of Novo Banco*

- (29) Since its setup, Novo Banco has acted as a universal bank offering a diversified range of financial services, such as domestic commercial banking (including retail, corporate and institutional clients as well as private banking), international commercial banking, asset management and insurance.
- (30) At 30 June 2017 Novo Banco had assets with a net book value of EUR 50.1 billion, being the third-largest bank in Portugal by that criterion.<sup>23</sup> It had deposits of EUR 25.4 billion and net loans of EUR 32.2 billion supported by 5 706

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<sup>21</sup> The Commitments of the 2015 Decision set intermediary deadlines for the sale of Novo Banco on 31 October 2016, 31 January 2017 and 1 March 2017, which if not met would result in changes to the allocation of different business lines or units to Core or Non-Core. In particular, Commitment 5 in the Annex to the 2015 Decision provided that Spain and Asset management activities of Novo Banco will be moved to the Non-core Unit if Novo Banco shares are not sold entirely by 01.03.17.

<sup>22</sup> BES publication available at: [http://www.bes.pt/Comunicados/20160719%20fsd177303\\_uk.pdf](http://www.bes.pt/Comunicados/20160719%20fsd177303_uk.pdf)

<sup>23</sup> Novo Banco Institutional Presentation of August 2017, available at: <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=843578&fext=.pdf>.

employees and a network comprising 475 branches<sup>24</sup> in Portugal and abroad, including in London, Spain, Cayman Islands, Venezuela and Luxembourg, an offshore branch in the Madeira Free Trade Zone and five representative offices overseas<sup>25</sup>. EUR 40.8 billion (i.e. over 81%) of Novo Banco's assets at 30 June 2017 were in Portugal. The other significant international presences within the group were Spain (with EUR 2.9 billion), the United Kingdom (with EUR 3.4 billion) and France together with Luxembourg (totalling together EUR 2.8 billion)<sup>26</sup>.

- (31) In terms of capital, as of 30 June 2017, Novo Banco had a total regulatory capital of EUR 3.537 billion and a phased-in<sup>27</sup> Common Equity Tier 1 ("CET1") ratio of 10.9% and significantly lower than the EUR 5.142 billion with CET1 ratio of 13.5% as of 31 December 2015.
- (32) The capital of Novo Banco has gradually deteriorated due to the losses recorded over time: EUR 498 million in the August – December 2014 period, EUR 1.004 billion and EUR 837 million in fiscal years 2015 and 2016 respectively and EUR 290 million in the first half year of 2017<sup>28</sup>, mainly driven by provisions for impairments.

## **2.2. The sale process of Novo Banco**

- (33) As indicated in the 2014 Decision, the Portuguese authorities committed that Novo Banco would sell all the assets transferred to it, or the Resolution Fund would sell all of its shares in Novo Banco, no later than 24 months after the date of the 2014 Decision, i.e. by 2 August 2016 the latest. That date was extended by to 3 August 2017 by the 2015 Decision.
- (34) Novo Banco was to conduct an open, non-discriminatory and competitive sale process that would take place on market terms and seek to maximize the sales price for the assets and liabilities involved. If the assets were not be sold by that date, the Portuguese authorities committed to put Novo Banco in wind down in the following month.<sup>29</sup>

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<sup>24</sup> Novo Banco Group Activity and Results First Half 2017, p. 2, available at: <https://www.novobanco.pt/site/cms.aspx?srv=222&stp=1&id=af2c38ef-ff96-4c6e-a422-626beaba1d20>.

<sup>25</sup> The list of subsidiaries, subgroups and other entities consolidated in Novo Banco is reflected in the First Half 2017 Interim Report of Novo Banco Group, pp. 46-48, available at: <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=848600&fext=.pdf>.

<sup>26</sup> Based on the First Half 2017 Interim Report of Novo Banco Group, p. 94, available at: <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=848600&fext=.pdf>.

<sup>27</sup> NOVO BANCO Group's solvency ratios are calculated based on the rules stipulated in Directive 2013/36/EU and Regulation (EU) no. 575/2013, which define the criteria for access to the activity of credit institutions and investment firms and determine the prudential requirements for these institutions, and also in Regulation (EU) no. 2016/445, which determines the transitional (phased-in) arrangements for own funds set forth in Regulation (EU) no. 575/2013

<sup>28</sup> See footnote 24

<sup>29</sup> See commitment (7) in Annex I to the 2015 Decision.

### 2.2.1. *The first sale process*

- (35) On 4 December 2014, the Bank of Portugal opened the sales process of Novo Banco itself, by a public announcement<sup>30</sup>. Seventeen expressions of interest were submitted to the Bank of Portugal by 31 December 2014.
- (36) On 15 September 2015, the Bank of Portugal announced that the sales process was suspended without accepting any of the three binding offers it had received, as it deemed the terms and conditions of these offers not satisfactory.

### 2.2.2. *The second sale process*<sup>31</sup>

- (37) On 15 January 2016, the Bank of Portugal announced the launch of a new sale process for Novo Banco. Further detail was provided on 31 March 2016, when Bank of Portugal announced<sup>32</sup> the eligibility criteria for participating in the sale process of Novo Banco and, that in a first phase – in order to maximise the chance of a successful tender and the sale price – the below two simultaneous tracks would be followed:
- (a) A “Strategic Sale Process”, a direct and competitive sale process that targeted strategic investors which are credit institutions or insurance companies and/or entities which have qualifying holdings, directly or indirectly (under management), in credit institutions or insurance companies;
  - (b) A “Market Sale Process”, which, subject to legal and regulatory requirements, could be an institutional offer of the Bridge Bank’s shares targeted at institutional investors and/or a public offer of shares. This process could involve one or more “cornerstone investors”, who will enter into an agreement to purchase a certain number of shares prior to the public offer.
- (38) The eligibility criteria and the terms of the two tracks in the new sale process were published on 22 April 2016 via the website of the Resolution Fund<sup>33</sup>. The terms of the offer determined, *inter alia*, the evaluation criteria of the offers submitted that involves the following elements in a decreasing order of relevance:
- (a) the attractiveness of the financial proposal contained in the offer;
  - (b) the ability of the Prospective Strategic Investor to execute transaction documents and to complete the transaction;
  - (c) the willingness of the Prospective Strategic Investor to acquire all the assets offered for sale in the Proposed Transaction in accordance with the terms and conditions proposed by Banco de Portugal; and

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<sup>30</sup> See the press release of Bank of Portugal, available at: <https://www.bportugal.pt/en/comunicado/press-release-banco-de-portugal-first-phase-novo-banco-sa-sale-process>.

<sup>31</sup> Information presented herein is based primarily on documentation submitted to the Commission by Portugal in April 2017, including an overview of the process (documents titled “Overview of Project Kairos” 19 April 2017, prepared by the advisor to the process – Deutsche Bank, and “Descriptive Memorandum concerning the second sales process of Novo Banco”, prepared by the Bank of Portugal).

<sup>32</sup> See the press release of Bank of Portugal, available at: <https://www.bportugal.pt/en/comunicado/press-release-banco-de-portugal-novo-banco-sale-process>

<sup>33</sup> See the documents available on the website of the Resolution Fund, available at: <http://www.fundoderesolucao.pt/en-US/ofundo/Pages/AlienacaoNB.aspx>



- (d) the strategy and development plans for Novo Banco and any commitments undertaken by the Prospective Strategic Investor in connection therewith and the overall impact of the Proposed Transaction on competition and in the financial stability of the banking sector in Portugal.
- (39) The tender offer did not include any requirement for a minimum sale price.
- (40) In addition to the public tender offer, the financial advisor to the Bank of Portugal approached 40 potential investors<sup>34</sup> directly in April and May 2016 to give a presentation about Novo Banco.

#### 2.2.2.1. Strategic Sale Process

- (41) On 6 June 2016, the Bank of Portugal decided to invite all six prospective investors<sup>35</sup>, including Lone Star, that had expressed interest earlier to submit offers and provided them with both the invitation letter (“Process Letter”) and a document that had substantiated the rules applied to the submission and the evaluation of the offers (“Specific Terms”). The Specific Terms set 30 June 2016 as the deadline submitting binding offers.
- (42) On 21 June 2016, the Bank of Portugal in its decision authorized to two of the interested investors – [...]– to submit a joint proposal as a group.
- (43) According to Portugal, by 30 June 2016 four investors had submitted an offer in the “Strategic Sale Process”, including Lone Star. The offer of Lone Star related to the purchase of Novo Banco in its entirety, the offers of [...] included a carve-out mechanism and the remaining one offer from [...] was related to [...] certain selected assets of Novo Banco. The offers of Lone Star and [...] were subject to confirmatory due diligence and the offers from [...] were expected to be further clarified (e.g. no bid price was indicated in the offers) at the time. [...] did not submit any offer.
- (44) On 12 July 2016, the Bank of Portugal decided to authorise the prospective strategic investors which had submitted their offers to continue to access information concerning Novo Banco with a view to eliminate or to limit the constraints in their offers. These proceedings occurred from July until October 2016.

#### 2.2.2.2. Market Sale Process

- (45) According to Portugal, interest formalised in May 2016 by one new potential investor – [...]– to participate in the “Market Sale Process” of Novo Banco. Following an explanatory diligence with the potential investors under the “Market Sale Process”, the Bank of Portugal decided to make the terms of reference on 11 October 2016 more flexible with the aim to attract more investors.

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<sup>34</sup> As per documents mentioned in footnote 31

<sup>35</sup> The six interested investors were [...] and [...] “Lone Star”; and [...]

### 2.2.2.3. Convergence of the two sale processes

- (46) On 17 October 2016, the Bank of Portugal amended the Process Letters concerning the submission of the revised offers and set a final application deadline of 4 November 2016 for both of the tracks.
- (47) All four strategic investors submitted their revised offers ([...] only re-confirmed their previous offers, unchanged) as well as [...] which applied under the “Market Sale Process” track by the stipulated deadline.
- (48) Following the final application deadline, the offers of Lone Star and [...] related to the entire asset portfolio of Novo Banco with a proposal of an additional asset protection mechanism for selected assets, the offer of [...] included a carve-out mechanism, [...] proposal was related to selected assets of the bank and [...] submitted a purchase offer for over 50% of the shares under the market sale track.
- (49) On 4 November 2016, the Bank of Portugal announced<sup>36</sup> that five entities submitted their offers before the final application deadline.
- (50) At that time, according to Portugal, only the offers from [...] and Lone Star were binding and not subject to any further confirmatory due diligence. With each these two parties, the seller signed a Memorandum of Understanding (“MoU”) in November and December 2016, respectively, which fixed the preliminary agreements. The offer of [...] was still subject to a completed confirmatory due diligence. In the case of [...], even though the investors reiterated their previous offers submitted on 30 June 2016, according to Portugal, did not further elaborate and concretise their offers.
- (51) On 4 January 2017, after reviewing the applications, the Bank of Portugal announced<sup>37</sup> that from all the offers, Lone Stars' was considered to be the best placed to successfully conclude the negotiation process notwithstanding the possibility of an improvement of the offers from the remaining prospective purchasers<sup>38</sup>.
- (52) From the documentation provided, the “Market Sale Process” had meanwhile not progressed as [...] failed to provide evidence of funds<sup>39</sup> for the acquisition of Novo Banco and information on the acquisition structure prior to the required

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<sup>36</sup> See the press release of Bank of Portugal, available at: <https://www.bportugal.pt/en/comunicado/press-release-banco-de-portugal-novo-banco-sale-process-1>

<sup>37</sup> See the press release of Bank of Portugal, available at: <https://www.bportugal.pt/en/comunicado/press-release-banco-de-portugal-novo-banco-sale-process-2>

<sup>38</sup> As reasons, the Bank of Portugal cited the attractiveness of the financial proposal (in case the highest pre-capital injection valuation of the Resolution Funds' shares), the ability of the Prospective Strategic Investor to execute the transaction documents and to complete the transaction, the willingness of the Prospective Strategic Investor to acquire all the assets offered for sale and the strategy and development plans and commitments undertaken by the Prospective Strategic Investor in relation to financial stability of the banking sector in Portugal.

<sup>39</sup> As per documents mentioned in footnote 31.

deadline of 9 December 2016 according to the MoU and the efforts of [...] in February 2017 to involve a co-investor were not successful either.<sup>40</sup>

- (53) After 4 January, neither [...] have promoted new diligences looking at improving the offers previously submitted, that led to a conclusion by the Bank of Portugal that the offers from these investors were not susceptible of being selected until the offers are further specified and densified.
- (54) On 12 January 2017, the Bank of Portugal informed [...] which required further confirmatory due diligence that their binding and unconditional offer would be accepted until 15 February 2017. [...] could not complete its assessment before the given deadline and informed the Bank of Portugal that they would require substantially more time to complete their work.
- (55) Given that [...] was not successful in providing evidence of available funds to complete the acquisition and the other strategic investors either did not complete their confirmatory due diligences ([...]) or did not concretise and elaborate their offers ([...]) and ultimately did not sign an MoU with the seller – according to the Bank of Portugal – the offer from Lone Star was the one that best fulfilled the evaluation criteria of the Specific Terms. On 17 February 2017, the Bank of Portugal therefore informed the remaining investors about its preliminary decision of not selecting them, offering them to provide comments within 3 days. On 20 February 2017, the Bank of Portugal selected<sup>41</sup> Lone Star for a concluding round of exclusive negotiations. Since the non-selected investors did not submit any response within the 3 day hearing period, on 3 March 2017, the Bank of Portugal converted its preliminary decision into a final non-selection decision.
- (56) On 31 March 2017, the Bank of Portugal announced<sup>42</sup> that Lone Star was selected to conclude the sale process of Novo Banco.
- (57) Under the terms of the agreement, Lone Star will inject a total of EUR 1 000 million in Novo Banco (EUR 750 million at the transaction completion and EUR 250 million within a period of up to 3 years), and will hold 75% of the Novo Banco's share capital, leaving the Resolution Fund with a 25% shareholding.
- (58) The agreement between the Resolution Fund and Lone Star set a series of conditions precedent for the sale, mostly typical for such transactions (e.g. regulatory approvals). A key condition precedent agreed by the two parties of the transaction was the execution of a Liability Management Exercise (“LME”) targeting the senior unsecured bondholders of Novo Banco which was supposed to result in at least EUR 500 million of CET1-Equivalent Gains<sup>43</sup>.

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<sup>40</sup> [...] requested an extension in order to negotiate with a potential co-investor, [...] which Portugal allowed. However [...] later informed the Bank of Portugal that the contacts with [...] did not lead to a partnership.

<sup>41</sup> See the press release of Bank of Portugal, available at: <https://www.bportugal.pt/en/comunicado/press-release-sale-process-novo-banco>

<sup>42</sup> See the press release of Bank of Portugal, available at: <https://www.bportugal.pt/en/comunicado/press-release-sale-novo-banco>

<sup>43</sup> Defined by the Sale and Purchase agreement as the sum of: a) the amount of increase of Novo Banco's CET1 on the March 2017 financial statements and b) the reduction of aggregate interest expenses over five years starting from the first quarter following the completion of the LME.

- (59) On 4 October 2017, Novo Banco announced the results of the LME which has been performed under the sole responsibility of the Resolution Fund and the Bank of Portugal. On the same day, the Portuguese Authorities informed the Commission that – while the result of the LME fell short of the objective to generate capital in the form of a direct increase in capital and interest savings of at least EUR 0.5 billion – the seller and the purchaser have nonetheless accepted this outcome as fulfilling the condition precedent to the Share Purchase Agreement.

### **3. THE MEASURES**

#### **3.1. The 2014 measures**

- (60) The 2014 Decision approved liquidation aid for Novo Banco in the form of share capital of EUR 4.9 billion provided by the Resolution Fund, in exchange for which the Resolution Fund received common shares.
- (61) With the objective of stabilising the liability side of Novo Banco's balance sheet, the same decision also approved the transfer of EUR 3.5 billion of GGBBs from BES to Novo Banco. The GGBBs had been issued by BES under the Portuguese Guarantee Scheme. Correspondingly, they were deemed to be an existing aid measure, and not subject to approval in the 2014 Decision.

#### **3.2. The 2015 measures**

- (62) In its 2015 Decision, the Commission approved the extension of the deadline to sell Novo Banco, or to wind it down otherwise, by one further year, based on a revised set of commitments that replaced the commitments submitted in 2014.
- (63) At the same time, Portugal notified the extension of the maturity of the EUR 3.5 billion of outstanding GGBBs of Novo Banco, which had been taken over from BES. The extension could not be done under the Portuguese Guarantee Scheme, as the conditions of the scheme made it accessible only to credit institutions without capital shortfall. However, as announced on 14 November 2015 Novo Banco had a capital shortfall under the adverse scenario of the comprehensive assessment. Therefore, based on an individual notification by Portugal, the Commission approved the extension of the GGBBs.
- (64) The GGBBs gradually expired after the 2015 Decision and have not been prolonged further. Novo Banco's last bond issuance guaranteed by the Portuguese Republic, in the amount of EUR 1.5 billion, matured on 17 February 2017<sup>44</sup>.

#### **3.3. The 2017 measures**

##### *3.3.1. Measure 1: the Contingent Capital Agreement*

- (65) Due diligence by Lone Star of the top 44 assets and a number of granular core and non-core loans, for a total gross book value of around EUR [10-20] billion has [...] revealed significant uncertainties as regards adequacy in provisioning. As a result and as a part of the Share Purchase and Subscription Agreement and the

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<sup>44</sup> <https://www.novobanco.pt/SITE/cms.aspx?srv=222&stp=1&id=1a886739-5427-427f-9fd4-208a8e0b6a39&order=1&attach=No>

Shareholders Agreement<sup>45</sup>, Portugal set up a Contingent Capital Agreement (CCA)<sup>46</sup>, which allows Lone Star as buyer to reclaim funding costs, realised losses and provisions related to an ex-ante agreed portfolio of existing loan stock, subject to a capital ratio trigger and some additional conditions.

- (66) The calculation basis for CCA losses, i.e. the amounts that can be reclaimed by the Bank under the CCA, has three separate components:
- (a) Cumulative Net Impairment Losses and Net Sale Losses and expenses (including taxes on collateral realizations) related to the CCA Assets;
  - (b) Net Interest Swap payments in the height of EURIBOR 6m, floored at 0.00% + 2.00%, on the entire Interest Rate Swap reference amount; the Interest Rate Swap reference amount is equal to the Starting Reference Value of all CCA assets (corresponding to the net book value as of 30 June 2016) minus CCA Asset Losses already paid out and CCA Asset Realisations (which includes any interest and capital repayments or dividends, distributions or other returns received by Novo Banco in relation of the CCA Assets);
  - (c) If applicable, Third Party Management, Administration and Servicing Costs of the Assets; or Costs related to Incentive Schemes to Novo Banco employees engaged in the disposal of CCA assets in order to minimize losses.
- (67) The CCA takes effect retroactively from 30 June 2016. The Net Book Value of the assets under consideration as of 30 June 2016 is also taken as the Starting Reference Value. This is to take into account that Lone Star performed its due diligence on data from the first half year results of 2016.
- (68) The CCA expires on [...] (however, if the remaining percentage of the CCA-assets net book value is higher than a set target over the period [...], the duration extends to [...]).
- (69) The amount that can be reclaimed under the CCA is subject to the CCA cap of EUR 3.89 billion. That amount is reduced by the amount which the Resolution Fund has to provide in the course of the underwriting of the Tier 2 instruments (described as “Measure 2” below).
- (70) If however, at a later stage, the Resolution Fund sells (part of) the Tier 2 instruments acquired under Measure 2, the CCA cap is re-increased by the proceeds received (with the understanding that the CCA cap can never exceed EUR 3.89 billion).
- (71) Payments from the Resolution Fund to Novo Banco under the CCA are subject to a Minimum Capital Condition being satisfied. This means that no payments are made unless on given reporting dates, Novo Banco’s CET1 ratio has fallen below [8-13]% minus the Additional Capital Contribution Ratio, which is between 0 and

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<sup>45</sup> Amendment and Restatement Agreement in relation to the Share Purchase and Subscription Agreement relating to the share capital of Novo Banco, S.A. and the Shareholders Agreement dated 31 March 2017 as amended and restated on 24 July 2017 between Fundo de Resolução and Nani Holdings SGPS, S.A.

<sup>46</sup> [Closing Date] Contingent Capital Agreement between Novo Banco, S.A. and Fundo de Resolução

0.7 percentage points, depending on previous capital contributions made by Lone Star, expressed as a ratio to Lone Star's EUR 250 million additional commitment<sup>47</sup>. As a result, any CCA payment is contingent on Novo Banco's CET1 ratio falling below a trigger level that lies between [7.3-12.3]% and [8-13]%, the trigger being lower for as long as Lone Star has not made the additional capital contribution.

- (72) Payments are limited both to the cumulatively recorded CCA losses and to the amounts needed to restore the CET1 ratio back to the trigger level thus eliminating the Minimum Capital Condition.
- (73) In addition, the CCA does not apply to Liabilities resulting from the Resolution of 2014.
- (74) Payments under the CCA, which are always subject to the CET1 trigger mentioned in (71), are on an annual basis, applying netting between Novo Banco and the Resolution Fund, but reporting of the results on a line-itemized basis is due every quarter.
- (75) Asset realizations are retained by Novo Banco and on the CCA Maturity Date, a netting will be made of all CCA Net Losses minus payments of interest, dividends or distributions received by Novo Banco with respect to the CCA Assets (without double counting previous payments and nettings).
- (76) The Resolution Fund has the right within [...] years of the completion of the sale, transfer the entirety of the CCA assets to a third party at a price payable in cash that is the Starting Reference value of all CCA Assets plus all CCA Drawdowns minus all CCA Losses already paid to Novo Banco and all previous Asset Realizations.
- (77) As regards governance, under the CCA Novo Banco is to change its articles of association to include a Monitoring Committee of three people, two of which are appointed by the Resolution Fund and one independent member; Either the Resolution Fund or Novo Banco can request an opinion from the Monitoring Committee in relevant matters pertaining to the CCA assets. They will attend the Board Meetings of Novo Banco without voting rights.
- (78) Moreover, the Resolution Fund has, acting reasonably, the right to take all decisions in respect of the CCA assets until the "Governance Exchange Date"<sup>48</sup> and Novo Banco needs to inform the Resolution Fund in respect of most material credit management decisions with respect to these files.

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<sup>47</sup> Under the shareholders agreement, Lone Star has committed to inject EUR 750 million in capital at the moment of sale, and an additional EUR 250 million over a 3 year period. See also recital (57) As long as this additional capital increase has not been made, the CET1 level that triggers a contribution by the Resolution Fund under the CCA will be lower.

<sup>48</sup> The "Governance Exchange Date" means a year end date between [...], depending on the ratio of the then remaining aggregate net book value of the assets to the aggregate starting reference values. The higher the remaining ratio, the earlier the date. In addition, if CCA losses have exceeded EUR [...] and an independent valuer assesses that the loss amounts will exceed the CCA cap by more than EUR [...], the Governance Exchange Date becomes the date after receiving this assessment by written confirmation (which could thus be before [...]).

### 3.3.2. *Measure 2: the Tier 2 underwriting*

- (79) Novo Banco will issue, to the extent that additional capital is required, up to EUR 400 million of Tier 2 instruments to third party investors. It will make a best effort attempt in customary market conditions to place the instruments in the market at a yield of less than [...] % p.a.
- (80) If (a) Lone Star has injected the EUR 250 million additional CET1, (b) third party investors cannot be found at an interest rate of [...] % or less, and (c) a Total Capital Shortfall requiring a Tier 2 issuance has occurred, then the Resolution Fund will underwrite Tier 2 capital that Novo Banco can issue for a maturity of [...] years at a yield of [...] % per annum up to the amount necessary (but no more than EUR 400 million).

### 3.3.3. *Measure 3: the Capital Backstop*

- (81) In case the Supervisory Review and Evaluation Process (“SREP”)<sup>49</sup> total capital ratio of Novo Banco falls below the SREP total capital requirement, Portugal will provide additional capital only to the extent that the following measures remain unsuccessful in addressing the shortfall:
  - (a) Routine capital measures to be implemented by Novo Banco to make up the shortfall within the nine months following a breach;
  - (b) A request to the private owner to supply the necessary capital, which Portugal is allowed to match according to the conditions laid down in the Share Purchase and Subscription Agreement;
  - (c) A market call.
- (82) The additional capital to be provided by Portugal can take the form of either AT1 instruments or a public capital injection, to be decided by Portugal. If AT1 capital instruments will be used, they will be either issued to the market and carry a coupon that may be fully paid by Portugal or underwritten by Portugal directly.
- (83) If public money was used in the capital backstop, Portugal has committed to further reduce the perimeter of the Bank by [800-1100] FTEs and [90-120] branches in a new restructuring plan.

## **4. THE RESTRUCTURING PLAN OF NOVO BANCO**

- (84) Portugal has submitted a restructuring plan, prepared by Lone Star, to demonstrate the Bank's ability to return to viability by the end of the restructuring period (i.e. 31 December 2021 under the baseline scenario). The plan lays out a strategy for a comprehensive transformation of Novo Banco, encompassing six pillars:
  - (a) Wind-down of non-core assets;
  - (b) Restoring pre-eminence in the enterprise segment and focus on risk-and capital-adjusted profitability;

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<sup>49</sup> Supervisory Review and Evaluation Process – the assessment process of banks' capital and risks, carried out continuously by the SSM, and resulting in an individual SREP decision once a year.

- (c) Digitize and streamline the retail franchise;
  - (d) Reinforce efficiency of balance sheet management;
  - (e) Adjust the operational platform; and
  - (f) Strengthen the risk management model to improve solvency and resilience of the bank.
- (85) As a matter of priority, Novo Banco will review its key legal agreements and analyse its contracts to facilitate termination decisions related to the wind-down units. It will communicate timely to its clients and fine-tune its strategy for FTE redundancies or transfers to core units. Where needed, it will make a market value assessment to gauge the best options for disposal (in negotiation with potential buyers).
- (86) In line with its behavioural commitments, Novo Banco will review its internal pricing guidelines (*inter alia* by implementing a risk-adjusted return on capital (“RAROC”) / return on equity (“RoE”) based pricing tool for its front office) and consolidate the value proposition per client base. It will define and prioritize cross-selling initiatives with a focus on [...] clients. It will reduce large exposures as part of its overall strategy<sup>50</sup>.
- (87) The retail franchise digitization will be extended with a revision of priorities for the different retail customer segments.
- (88) As part of its asset liability management and short term balance sheet management strategy, Novo Banco will try to reduce its funding costs by [...]. In order to achieve this, a commercial strategy [...]. The bank will also implement a longer term strategy to obtain the right mix of liabilities.
- (89) The operational platform will undergo significant adjustments. The total FTE number will be reduced drastically through both natural attrition and redundancies. This will include a revision of the organizational model for central services. The branch network will also be reduced. The bank intends to exploit additional cost cutting opportunities in the IT structure and in procurement processes while supporting the necessary digitalization upgrades.
- (90) Finally, the risk management model will be strengthened: capital usage and measurement will be optimized through enhanced risk weighted assets (“RWA”) accuracy and the implementation of an internal rating based model for corporate exposures. At the same time, Novo Banco will define and implement an optimal non-performing loan (“NPL”) deleverage strategy. The bank will also revise its governance model and its Risk Assessment Framework.
- (91) The restructuring plan provided by the buyer through Portugal includes financial projections for the period 2017-2021, which were provided for both a base case and an adverse case scenario.

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<sup>50</sup> Novo Banco intends to capture selected enterprise clients with an intake of smaller and more profitable firms. In addition, since 2014, it has actively tried to reduce credit exposure to large tickets and distressed sectors with implementation of limits to credit underwriting, as part of a wider effort of asset portfolio deleveraging. Any new large loan (exposure bigger than EUR [...] million) will require extensive review and Risk Committee board approval.



- (92) On the revenues side, a key element of the plan is a strong growth projected for the net interest income, which is expected to [...] over the restructuring period. The forecast relies on two factors: a) a rise in interest revenue, driven by higher volumes and/or improved margins (depending on the strategies for the different client categories), and b) a decrease in interest expense, derived from a reduction of [...], along with [...], as foreseen in the short term balance sheet management goals of the plan.
- (93) On the operational cost side, the plan foresees a reduction of approximately [10-20] % in operational costs over the restructuring period, to be delivered mainly through branch and personnel optimizations. Novo Banco's Cost-to-Income ratio is expected to align with the current and expected peers' benchmarks in the Portuguese banking market. Potential deviations from the expected revenue or cost evolutions would be addressed through additional measures to ensure that the bank's performance is brought back within the parameters of the plan, as detailed below in section 5.2.3 on viability commitments in particular recitals (122) to (125).
- (94) A third major element of the plan is the substantial decrease in loan loss provisions, projected to go down from EUR 1.298 million in 2016 to EUR [150-200] million in 2021, implying a reduction of the cost of risk from approximately 375 bps to less than [70-80] bps. This is driven by two assumptions in the plan:
- (a) Loan loss provisions on the assets which are included in the CCA would be booked by the bank over the first [...] years of the restructuring plan, and hence in [...] there would be no more losses stemming from the CCA assets;
  - (b) For the remaining assets outside of the CCA, including the new loan production of the bank after 30 June 2016 (the cut-off date of the CCA analysis), the loan loss provisions will decrease by over [50-60]%. This assumption is underpinned in the plan by the description of the methodologies applied by Lone Star to i) assess the risk profile of the non-CCA assets of the bank, which are assessed in the plan as being of significantly better quality than the CCA assets, and ii) estimate the risk profile of the new loan production, deemed to be of even better quality.
- (95) The initial restructuring plan of 5 May 2017 included some summary financial projections. Subsequently, three more developed and updated sets of financial projections were submitted in the context of the discussions on the restructuring plan:
- (a) A “Central Case” (with two sub-scenarios reflecting whether or not a Tier 2 instrument issuance takes place or not) in a benign macro-economic environment;
  - (b) A “Worst Case<sup>51</sup>” (again with two sub-scenarios reflecting whether or not a Tier 2 instrument issuance takes place or not)<sup>52</sup>, again in a benign macro-

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<sup>51</sup> The name is somewhat of a misnomer, as the parameters of the adverse scenario are worse than what is called a “worst case” scenario. The naming of the scenarios is without prejudice to the Commission’s

economic environment which essentially differs from the Central Case in respect to the estimated losses of the CCA assets (approx. EUR [0-5] billion in the Worst Case, vs approx. EUR [0-5] billion in the Central Case)

- (c) An “Adverse Case”, which takes the Worst Case as a starting point (i.e. same amount of losses expected on the CCA assets) but alters it in line with a more pessimistic macro-economic environment leading to assumptions on the business operations of the bank which result in slightly lower income and profitability at the end of the plan<sup>53</sup>.
- (96) The projected utilisation of the CCA amounts to up to EUR [0-5] billion in the Central Case, EUR [0-5] billion in the Worst Case, and EUR [0-5] billion in the Adverse Case.

**Table 1 - Restructuring plan baseline scenario, main financial projections**

EUR million		2017	2018	2019	2020	2021
P&L	Net interest income	[...]	[...]	[...]	[...]	[...]
	Banking income	[...]	[...]	[...]	[...]	[...]
	Risk costs	[...]	[...]	[...]	[...]	[...]
	<i>out of which on CCA assets</i>		[...]	[...]	[...]	[...]
	Operating profits		[...]	[...]	[...]	[...]
	Net income		[...]	[...]	[...]	[...]
RoE (%)		[...]	[...]	[...]	[...]	[...]
Assets	Loans to clients	[...]	[...]	[...]	[...]	[...]
	Other credit & assets	[...]	[...]	[...]	[...]	[...]
	Total assets	[...]	[...]	[...]	[...]	[...]
	RWA	[...]	[...]	[...]	[...]	[...]
Liabilities	Central bank	[...]	[...]	[...]	[...]	[...]
	Deposits	[...]	[...]	[...]	[...]	[...]
	Debt securities	[...]	[...]	[...]	[...]	[...]
	Total liabilities	[...]	[...]	[...]	[...]	[...]
Equity		[...]	[...]	[...]	[...]	[...]
<i>Equity injections based on CCA agreement</i>		[...]	[...]	[...]	[...]	[...]
CET1 %		[10-20]%	[10-20]%	[10-20]%	[10-20]%	[10-20]%

assessment and are a mere consequence of them being produced at different steps in the discussion of the restructuring plan.

<sup>52</sup> These first two sets of financial projections were part of the submission of 20 July 2017.

<sup>53</sup> Submitted on 4 August 2017.

- (97) Based on the information received by the Commission, the restructuring plan and its financial projections also incorporated a prudent assessment of the expected impact of the LME (as described in recitals (57) - (59)).

## **5. POSITION OF PORTUGAL**

### **5.1. Existence of aid, its necessity and compatibility**

- (98) According to the Portuguese authorities, the notified measures are necessary to ensure the successful sale of Novo Banco to Lone Star.
- (99) The Portuguese authorities submit that Lone Star was chosen as the successful bidder for the acquisition of Novo Banco in an open, fair and transparent process.
- (100) The Portuguese authorities accept that the notified measures constitute State aid and request the Commission to verify that they are compatible with the internal market on the basis of Article 107(3)(b) of the Treaty on the Functioning of the European Union ("TFEU").
- (101) The Portuguese authorities submit that the applicable legal basis under which Novo Banco should be examined is represented by [Article 145-L "General principles"](#) and [Article 145-P "Setting up of the bridge institution"](#) of law 298/92, "[Legal Framework of Credit Institutions and Financial Companies](#)". The Portuguese authorities state that until the conclusion of the sale, Novo Banco remains a transitional institution, constituted under Article 145P, so that the respective legal framework remains fully applicable.
- (102) This signifies that the resolution of BES is considered ongoing and the respective legal framework remains applicable in regard to any measures undertaken by the Portuguese authorities in regard to Novo Banco. Therefore, the additional aid measures notified by Portugal in the context of the sale are to be considered in the framework of the ongoing resolution process.
- (103) The Portuguese authorities state that the final restructuring plan of Novo Banco on the basis of which the bank's viability is to be assessed is the plan of 5 May 2017, as amended by the submissions of 30 June, 7 July, 20 July and 4 August 2017, and includes all other additional information and clarifications to the plan provided up to the date of the notification.
- (104) The Portuguese authorities insist on the fact that the combined cash payment by the Resolution Fund under Measures 1 and 2 can in no case be larger than EUR 3.89 billion. If Measure 2 leads to a cash outflow from the Resolution Fund, the cash available under Measure 1 is reduced to ensure that the combined cash payment can at no point in time exceed the maximally committed EUR 3.89 billion.

### **5.2. Commitments by the Portuguese authorities**

- (105) The Portuguese authorities submitted the following commitments, as detailed in Annex I to the present Decision. Those commitments supersede those attached to the 2014 Decision and the 2015 Decision as of the date of the present Decision.



book of Novo Banco which will not exceed the level of [...] of EUR [20-30] billion up to [...].

- (112) The [...] business of Novo Banco in[...] shall be wound down by [...], including the requirement of an active client instruction to which portfolio investment and bank accounts the client money and securities are to be transferred.
- (113) [...] and [...] shall be divested as well as [...] (with the exception of [...]) shall be disposed of by [...]
- (114) [...] unit shall be used strictly as a booking centre and a debt-issuing vehicle. All other new business shall cease as of [...] from the date of the present Decision. [...] unit shall be wound down during the restructuring period and [...] all existing and outstanding bonds with a maturity longer than the restructuring period either be transferred to one of Novo Banco's other legal entities or [...].
- (115) [...] will be wound down. Investments in the context of value enhancing capital expenditures shall be permitted to ensure best-in-class work-out subject to a cap of 5% p.a. of Net Book Value of [...] at the beginning of the year. However, Net Book Value at year's end must be lower than the balance at the beginning of the year.
- (116) Novo Banco will reduce its exposure towards [...] during the restructuring period. Any additional exposures will be limited to financing for Portuguese clients' activity in [...] or fully cash-collateralised transactions. In order to mitigate compliance risks, Novo Banco will review and update its Know-Your-Client ("KYC") and Anti-Money-Laundering ("AML") procedures for [...] clients in particular within [...] of the present Decision.

#### 5.2.2. *Behavioural commitments*

- (117) Novo Banco will apply strict executive remuneration policies and will not pay to any employee, director or manager a total annual remuneration (wage, pension contribution, bonus) higher than 10 times the average salary of employees in the bank until 30 June 2020. After that date, bonus payments can be made only if targets in the viability commitments are met, in full compliance with the applicable EU law on prudential requirements
- (118) Novo Banco will comply with pre-tax RoE pricing of no lower than [7-10]% during 2018, no lower than [8-11]% during 2019 and no lower than [9-12]% during 2020 and 2021 and put in place new pricing tool to that effect.
- (119) Novo Banco will be subject to an acquisition ban, a dividend payment ban and an advertising ban during the restructuring period.
- (120) With respect to the continued presence of the Resolution Fund in the capital of Novo Banco, Portugal commits that:
  - (a) The Resolution Fund will irrevocably waive any non-economic rights from its continued 25% share-holding (such as voting or the right to appoint board members); it retains the economic rights including receiving free bonus shares as long as they do not increase the share-holding;

- (b) While the CCA is in place, the Resolution Fund retains the right to subscribe to one share for the purpose of each of the Resolution Fund's contingent capital obligations;
- (c) If a capital increase would harm the economic interest of the Resolution Fund, the Resolution Fund may participate pro rata to its existing shareholding, upon prior authorisation from the Commission. The voting rights of those shares will be subject to the same restrictions as in (a);
- (d) A CCA Monitoring Trustee will report on the management of the guaranteed assets only for informational purposes.

### 5.2.3. *Viability commitments*

(121) To ensure that risks are appropriately managed:

- (a) Novo Banco will rotate its auditor for the financial year [...] and will exercise prudence in its cumulative loan loss provisions and ensure that losses are taken; to that effect, a minimum cumulative amount of EUR [0-5] billion will be taken;
- (b) Novo Banco will comply with best lending practices, in particular avoid preferential treatment of a wide definition of connected borrowers, ensure that all exposures exceeding EUR [...] million will undergo a regular credit (re-)rating process and set up risk management systems allowing proper management reporting and risk management overview;
- (c) Novo Banco will refrain from proprietary trading beyond activities necessary for the normal operations of a commercial bank. It will set up specific Value-at-Risk limits for both treasury and market making activities and will distribute those conservatively among its activities so as to avoid any breaches.

(122) Furthermore, Novo Banco will adhere to strict cost to income ratio targets. In order to attain these, the bank will further reduce its FTE's gradually to about [4500-5000] (from 5 760 at year end 2016) and its number of branches to [350-400](down from 537 at year end 2016). Some of the FTE reductions will follow natural attrition, for some, additional redundancies are needed with associated restructuring costs.

(123) In addition, Novo Banco will find additional efficiencies on either income or cost (or a combination of both) to reach pre-provision income targets of EUR [450-500] million by [...]and EUR [750-800] million by [...]. If it does not comply with those targets and measures to cure prove insufficient, Novo Banco will implement additional FTE reductions and branch closures and the restructuring period with all its commitments will prolong until the targets are reached or reductions are implemented.

(124) Novo Banco commits to reaching a cost to income ratio of below [50-60]% by year end 2019, below [40-50]% by year end 2020 and below [40-50]% from year-end 2021 onward. If it were to fail those targets by [5-10] percentage points or more, additional FTE reductions and branch closures will be implemented.

- (125) Finally, in case the SREP total capital ratio of Novo Banco were to fall below the SREP total capital requirements, Novo Banco will make up the capital shortfall. If normal recapitalization attempts either through the market or by contributions of Lone Star (potentially matched pro rata by the Resolution Fund) fail, Portugal commits to supply the capital gap through the SREP total capital requirement for the given year through an ultimate back stop by means of the issuance of Alternative Tier 1 capital instruments or a capital injection. If recourse is taken to this back stop, Novo Banco will implement additional FTE reductions (up to [800-1100] FTE) and branch closures (up to [90-120] branches)<sup>54</sup>.

## 6. EXISTENCE AND AMOUNT OF STATE AID

- (126) Article 107(1) TFEU provides that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings is, insofar as it affects trade between Member States, incompatible with the internal market. Thus, in order for a measure to fall within the scope of Article 107(1) TFEU, four cumulative criteria must be met: first, the measure must involve the use of State resources and be imputable to the State; second, the measure must distort or threaten to distort competition by conferring an advantage on undertakings; third, the measure must provide a selective advantage to certain undertakings; and fourth, the measure must be likely to affect trade between Member States and distort competition.
- (127) The aid nature of the 2014 measures has been established by the Commission in its assessment in the 2014 Decision.<sup>55</sup>
- (128) The aid nature of the 2015 measures has been established by the Commission in its assessment in the 2015 Decision.<sup>56</sup>

### 6.1. The 2017 measures

- (129) The 2017 measures were decided by the Resolution Fund and the decision is therefore imputable to the Portuguese authorities.
- (130) Measure 1 contains a guarantee of the capital position of Novo Banco which is payable directly from the Resolution Fund. Measure 2 is an underwriting of a capital instrument which puts at risk the resources of the Resolution Fund which would be used to buy those capital instruments. Measure 3 contains a potentially significant capital commitment by the Republic of Portugal. All three measures are therefore putting at risk State resources.
- (131) All three measures provide a selective advantage to Novo Banco as they are available only to Novo Banco and ensure that the economic activity continues to be able to operate in the market. That fact is acknowledged also by Portugal. As

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<sup>54</sup> The additional FTE reduction and branch closure requirement with regards to the issuance of the Alternative Tier 1 instrument is incorporating the FTE reductions and branch closures already performed with regards to the commitments described in recitals **Error! Reference source not found.** and **Error! Reference source not found.**

<sup>55</sup> Recitals (54)-(63) of the 2014 Decision

<sup>56</sup> Recitals (74)-(77) of the 2015 Decision

Novo Banco is active in the financial markets both in Portugal as well as in Spain, those measures are liable to have an effect on trade and distort competition in the internal market.

- (132) On the basis of the foregoing, the Commission concludes that the 2017 measures constitute State aid in the meaning of Article 107(1) TFEU.
- (133) The Portuguese authorities do not dispute the existence of State aid in the notified measures.

## **6.2. The aid amount**

- (134) The aid contained in the 2014 measures was a recapitalization of the newly established bridge bank Novo Banco. The amount of capital aid was established in the 2014 Decision to be EUR 4.9 billion.<sup>57</sup> The EUR 3.5 billion of GGBBs were considered existing aid under the 2014 Decision.
- (135) The aid contained in the 2015 measures was liquidity aid in the form of the prolongation of the GGBBs to the amount of EUR 3.5 billion by one year.
- (136) Regarding Measure 1 of the 2017 measures, Portugal provides up to EUR 3.89 billion of a contingent recapitalization without remuneration or other compensation (e.g. change in ownership). The Commission considers this capital support to Novo Banco of up to EUR 3.89 billion.
- (137) Regarding Measure 2 of the 2017 measures, the maximum cash committed is EUR 0.4 billion which takes the form of the underwriting of a Tier 2 capital instrument issuance by Novo Banco.
- (138) The conditions of the underwriting are such that the Resolution Fund would subscribe to the Tier 2 capital instrument at [...] % annual coupon. The Portuguese authorities have provided arguments why they expect the actual market rate to be significantly lower at [5-10] % annually. That expectation is based on the price of the recent AT1 capital instrument issuance by Portuguese bank CGD and the market spread between AT1 and Tier 2 capital instruments on the basis of the current market situation in Portugal and the wider EU.
- (139) On the basis of that information, the Commission considers that in a situation where market participants would not be willing to subscribe at an at least marginally lower rate than [...] % and the Resolution Fund would have to subscribe to the Tier 2 instrument at [...] %, such a situation would likely imply that there would be no private market participants willing to engage in subscribing to the issuance at any price. The Commission therefore considers the aid is a further capital guarantee worth up to the full amount of EUR 0.4 billion.
- (140) The Commission recognises the arguments of Portugal that the effective cash outflow under the combination of the two capital guarantees will in no case be greater than EUR 3.89 billion. However, the Measures are structured in such a way that any money reclaimed, i.e. not used under the underwriting guarantee that is Measure 2, can be re-used as capital guarantee under Measure 1.

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<sup>57</sup> Recitals (30)-(32) of the 2014 Decision



- (141) In line with consistent State aid case practice, such a re-use of the guarantee frame implies that even while the State cannot be at risk of a cash payout of more than EUR 3.89 billion at any given point in time, from a State aid perspective, they are still separate measures. If a use of the EUR 0.4 billion underwriting guarantee would lead to a permanent deduction from the EUR 3.89 billion of CET1 guarantee, the Commission would be able to approve EUR 3.89 billion of State aid in Measures 1 and 2. However, a re-increase of the guarantee frame under Measure 2 following a successful exit from Measure 1 would have to be considered a distinct measure which under the current notification would also need to be approved at this stage. On that basis, the sum of aid provided under Measures 1 and 2 is up to EUR 4.29 billion of capital support.
- (142) Regarding Measure 3 of the 2017 measures, the Commission notes that Portugal has notified the measure “up to the maximum amount necessary to ensure long term viability, defined under the scenaria identified in the Commission's Decision where this commitment is attached to”. This allows the Commission to assess the limits of the measure.
- (143) On the basis of the restructuring plan provided by the Portuguese authorities and a prudent adverse scenario, it is possible to provide estimates of losses and offsetting gains in such a scenario. Taking into account the losses in all portfolios of Novo Banco in such a scenario and the initial capital situation and offsetting the current provisioning, the capital contribution by Lone Star, the pre-provision profits in such a scenario as well as the full EUR 3.89 billion of capital contribution under Measures 1 and 2, there are additional capital needs which are potentially high but remain within clearly framed bounds<sup>58</sup>.
- (144) Nonetheless, in such a scenario, Lone Star would be highly unlikely to provide further capital to Novo Banco. Lone Star's current commitment is EUR 1 billion and there are strong incentives for Lone Star to provide up to EUR [0-5] billion of additional capital as long as that would address the problem the bank might be facing in such a case because under the Share Purchase Agreement such a capital increase has the potential to dilute the 25% stake that the Portuguese Resolution Fund is currently retaining. Therefore, in an adverse scenario where the additional capital required was greater than what Lone Star would be willing to provide, Measure 3 would work successfully as a backstop mechanism.
- (145) On that basis, the Commission will consider aid in the form of additional capital support under Measure 3 to the extent necessary to ensure the solvency of Novo Banco in the Commission's adverse scenario.
- (146) In total, the amount of aid contained in the 2017 measures is up to EUR 4.29 billion of capital support plus the amount necessary to ensure solvency in the Commission's adverse scenario.
- (147) Taken altogether, the capital aid provided in the resolution of BES amounts to capital support of up to EUR 9.2 billion plus the additional aid contained in the capital backstop measure. Under those measures, the maximum total amount of capital support corresponds to roughly 23% of the RWA of EUR 47 billion at the time of resolution in 2014.

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<sup>58</sup> See Table 3.

### **6.3. The beneficiary of the measures**

- (148) As already concluded in section 6.1, the Commission considers the economic activities of Novo Banco, which are being sold and transferred to the buyer, as the beneficiary of the 2017 aid Measures, as the aid allows the continuation of those economic activities within the buyer. Without the support by Portugal, those activities would not find a buyer, would be left in the legal entities in insolvency, and would therefore cease to exist.
- (149) In order to exclude that the 2017 Measures entails State aid to the buyer, Lone Star, in line with points 79, 80 and 81 of the 2013 Banking Communication the Commission has to verify that the sales process has been fair, open, competitive and transparent, that the sale happens on market terms and that the offer chosen maximises the value of the assets and liabilities sold. The sales procedure is described in section 2.2.
- (150) Portugal puts forward that the process was entirely transparent and visible in the market. The Commission observes that the Bank of Portugal contacted 40 potential investors to maximize the number of potential investors.
- (151) As noted in recital (39), the public tender offer did not include a requirement for a minimum price, which implies that all investors who took part in the process had the opportunity to submit bids with a negative price, i.e. enter into negotiations with Portugal on additional aid measures that could accompany the sale.
- (152) The Commission took note that four investors showed interest in the tender by the initial deadline of 30 June 2016 that was set for the investors to submit their proposals. The deadline was subsequently extended by the Bank of Portugal until 4 November 2016 in order to maximize the number of applications resulting in one additional application.
- (153) The fact that five purchase offers were received suggests that the sales process has been competitive. Also, the extension of the deadline allowed ample time for the investors to conduct in-depth due diligence and adjust their offers accordingly.
- (154) At the same time, the Commission notes that despite this long period, the seller had received only two offers that did not require further due diligence, the bid from Lone Star and the MoU signed with [...]. Portugal submits that the possibility to carry out confirmatory due diligence was open until it had given exclusivity to Lone Star in February 2017. However, Portugal submitted that [...] had not been able to show the required funds as described in recital (52)
- (155) Therefore, the Commission concludes that the finally accepted offer was the most commercially advantageous of the available final offers from market participants.
- (156) From the perspective of the additional aid measures which are included in the sale to Lone Star, the Commission notes that, from the onset, the terms of the process did not require a positive price and that interested investors had several months for examining the bank and fine-tuning their offers.

- (157) The Commission notes that all offers via the “Strategic Sale Process” included addition support measures<sup>59</sup>. In addition the Loan Star bid offered the Resolution Fund an upside potential through a 25% participation and included a EUR 1 billion capital commitment.
- (158) Taking into account the above elements and circumstances, the Commission considers that the process was open, fair and transparent. On that basis, the Commission considers that the bid chosen was the best available and concludes that the buyer is not a beneficiary of aid.

## **7. ASSESSMENT OF COMPATIBILITY**

### **7.1. Legality of the aid**

- (159) The Portuguese authorities have sought the approval of the Commission before closing the transaction of the sale of Novo Banco to the acquirer, thereby complying with its notification obligation as set out in Article 108(3) TFEU and required under the 2014 and 2015 Decisions.

### **7.2. Legal basis for the compatibility assessment of the aid**

- (160) Article 107(3)(b) TFEU enables the Commission to find aid compatible with the internal market if it is “to remedy a serious disturbance in the economy of a Member State.” The Commission has acknowledged that the global financial crisis may create a serious disturbance in the economy of a Member State which can be addressed through State measures supporting financial institutions. This has been successively detailed and developed in the six Crisis Communications<sup>60</sup>, as well as in the 2013 Banking Communication.
- (161) Since the 2014, 2015 and 2017 measures are aimed at allowing the liquidation of BES through a sale of Novo Banco or its wind-down, the Commission will assess the compatibility of the 2014, 2015 and 2017 measures by reference to the 2013 Banking Communication.

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<sup>59</sup> As described in recital (48)

<sup>60</sup> Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis (“2008 Banking Communication”), OJ C 270, 25.10.2008, p. 8; Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition (“Recapitalisation Communication”), OJ C 10, 15.1.2009, p. 2; Communication from the Commission on the treatment of impaired assets in the Community financial sector, OJ C 72, 26.3.2009, p. 1. (“Impaired Assets Communication”); Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9. (“Restructuring Communication”); Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis (“2010 Prolongation Communication”), OJ C 329, 7.12.2010, p. 7 and Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis (“2011 Prolongation Communication”), OJ C 356, 6.12.2011, p. 7., Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis (“Banking Communication”), OJ C 216, 30.7.2013, p. 1.

### 7.2.1. Liquidation aid

- (162) When notifying the aid measures in the resolution of BES in August 2014, Portugal did not present a restructuring plan for Novo Banco to the Commission. Because no demonstration of the return to viability of Novo Banco had been provided at that time, the Commission assessed the compatibility of the aid measures under section 6 of the 2013 Banking Communication on liquidation aid. In 2014, the Commission took a compatible aid decision on the basis of BES being liquidated with Novo Banco being sold or wound down.
- (163) Points 71 to 78 of the 2013 Banking Communication set forth the compatibility conditions for aid measures in this context. Point 70 states that the Commission will assess the compatibility of measures aimed at resolving credit institutions on the same lines *mutatis mutandis* as set out in sections 2, 3 and 4 of the Restructuring Communication. Point 78 of the 2013 Banking Communication states that sections 3.1.2 and 3.1.3 must be complied with *mutatis mutandis*.
- (164) Points 79 to 82 of the 2013 Banking Communication, as well as the 2014 Decision, provide that it is possible to sell the economic activity of an entity having benefited from liquidation aid, where the sale is organised via an open and unconditional competitive tender and the assets are sold to the highest bidder.
- (165) Point 82 of the 2013 Banking Communication explicitly considers the possibility that an economic activity with a significant market share is sold in the liquidation process. In this case, the compatibility of liquidation aid will require an assessment of the restoration of viability through that market participant as well as an assessment of the need for measures to limit distortions of competition. In its viability assessment, the Commission will take into due consideration the size and strength of the buyer relative to the size and strength of the business acquired.
- (166) It is in this context that the Commission will consider the sale of Novo Banco with respect to the liquidation of BES.
- (167) First, the Commission notes that a number of business geographies and equity participations had already been left in the liquidation entity BES in the 2014 Decision. In this respect, the banking license of the liquidation entity BES has been withdrawn and the insolvency process been opened.
- (168) Novo Banco comprises the commercial banking business of BES. The investment banking arm BESI has already been sold separately prior to the 2015 Decision. The [...] business of BES which was incorporated in [...] has been either sold already ([...]) or has to be sold under the present Commitments by [...].
- (169) In addition, Novo Banco in its final form as envisaged under the present Commitments will have refocused its banking business on the [...]and will have significantly reduced its [...]business as well as terminated its engagements in centres of [...]and [...]such as[...],[...], [...], [...] and [...].
- (170) These further refocus of business will be the continuation of the size reduction process which started at the resolution of BES. Compared to the BES group at the

time of its resolution, which at 30 June 2014 had EUR 80.2 billion of assets<sup>61</sup>, Novo Banco as it stands today only represents 62%, as it had EUR 50.1 billion of assets in June 2017<sup>62</sup>, and at the end of the restructuring plan will represent [50-60]%, as it is expected to have EUR [40-50] billion of assets<sup>63</sup>.

- (171) Secondly, given the still significant market share of Novo Banco in the Portuguese banking market, the Commission has taken into account in its assessment that Novo Banco is sold to a non-banking entity and will therefore continue in the market as a stand-alone operator. Therefore, the Commission has performed a deep assessment of the restructuring plan, complemented by an analysis of loan tapes and selected loan files, in order to assess whether the sold activity can be restored to viability. This is further detailed in sections 7.4.1 to 7.4.4.
- (172) Thirdly, for the same reasons, the Commission considers that it will be important to ensure that measures are in place to limit distortions of competition from the continued presence of Novo Banco in the banking market. The Commission has assessed the measures taken in 2014 and 2015 in section 7.3.3 and in section (297) for the 2017 measures.
- (173) Finally, the Commission has assessed the limitation of the aid to the minimum in sections 7.3.2 and in 7.4.5.
- (174) On that basis, the Commission considers the sale and subsequent restructuring of Novo Banco as part of the break-up of BES following the resolution in 2014, leading to the dissolution and liquidation of BES in its entirety and can therefore be approved on the basis of liquidation aid for the resolution of BES and the entities resulting from that resolution.

#### 7.2.2. *Impaired Asset Communication*

- (175) Regarding the compatibility of Measure 1 of the 2017 measures, the Commission observes that losses that could lead to a claim under the CCA are limited to a pool of assets which is defined at the time of the signing of the SPA. Therefore, the measure appears to have characteristics of an impaired asset measure.
- (176) However, the Commission also notes that the losses resulting from the pool of assets do not lead to any direct claim on the resolution fund. A claim on the resolution fund exists only if the CET1 capital ratio of [8-13] % is breached and will extend only to remedying that breach. As such, the measure is more akin to an (unfunded) Contingent Convertible or Enhanced Capital Note, where any payout depends on breaching a capital trigger. The main difference appears to be that the capital trigger level is higher than on comparable market instruments, and that no remuneration is being paid in the form of a premium or a coupon.
- (177) Moreover, any losses that have been occurring in the pool of assets which can be potentially reclaimed through the CCA are available throughout the entire lifetime of the CCA<sup>64</sup>. Therefore, there is neither any direct temporal nor any direct causal

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<sup>61</sup> Recital (11) of the 2014 Decision

<sup>62</sup> Recital (30) of the current decision

<sup>63</sup> See Table 1 - Restructuring plan baseline scenario, main financial projections

<sup>64</sup> See recital (68)

link from a formal perspective between the losses that actually lead to a breach of the CET1 capital ratio of [8-13] % in a given year and the losses on the pool of CCA-covered assets apart from that the latter has to have already occurred earlier.

- (178) The Commission notes that the current CET1 capital ratio is already below the threshold. While this appears to be in contradiction with the previous recital, the current CET1 ratio does not take into account the immediate recapitalisation foreseen by Lone Star in the amount of EUR 750 million. Once that capital is taken into account, there will again be a buffer above the [8-13] % CET1 capital ratio threshold. That buffer restores the absence of a direct temporal or causal link between losses on the CCA assets and the breach of the CET1 capital ratio threshold.
- (179) Therefore, the Commission considers Measure 1 to be equivalent to a contingent capital measure, akin to recapitalisations in the form of contingent convertible bonds (“CoCos”), rather than an impaired asset measure in the meaning of the 2009 Impaired Asset Communication and will correspondingly not assess compatibility of Measure 1 on the basis of the Impaired Asset Communication.

### **7.3. Compatibility of the 2014 and 2015 measures**

#### *7.3.1. Burden sharing*

- (180) Based on the 2014 Decision, all shareholders and subordinated creditors of BES were left in the Bad Bank<sup>65</sup> and the Resolution Fund, 100% owned by the Portuguese State, became the sole shareholder of Novo Banco. Claims by related parties (that is to say shareholders and board members) of a non-contractual nature also remained in the Bad Bank. The Commission reiterated this assessment in the 2015 Decision.
- (181) As a result of the 2014 resolution action, the contribution of shareholders and of subordinated debt-holders was achieved and the State aid provided under the 2014 Decision did not benefit shareholders and subordinated debtholders, thereby minimising moral hazard.
- (182) It is to be noted that the new list of commitments is without prejudice to the burden-sharing by the equity, hybrid and subordinated debt holders of BES as provided for by the 2014 Decision. The contribution by claims by related parties (e.g. shareholders and Board members) of a non-contractual nature to the burden-sharing is not affected either.

#### *7.3.2. Limitation of costs to the minimum*

In the 2014 Decision, the Commission took note of the information provided by Portugal concerning costs that a counterfactual scenario, namely a disorderly resolution of BES, would have generated, estimated at the time by the Bank of Portugal to range between EUR [16-23] billion and EUR [19–28] billion in losses<sup>66</sup>. In addition, the Commission was informed of the minimum regulatory

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<sup>65</sup> Recital (89) of the 2014 Decision.

<sup>66</sup> Recital (75) of the 2014 Decision. Note also section 7.4.5 below with the reference to the report by Deloitte, which assessed the value of BES had it been put in insolvency in 2014.

requirements that the bridge bank had to comply with<sup>67</sup>. On that basis, the Commission assessed resolution aid to be limited to the minimum necessary.

### 7.3.3. *Assessment of distortions to competition*

- (183) In the 2014 and 2015 Decisions, the Commission approved the aid as compatible with the internal market on the basis of section 6 of the 2013 Banking Communication. Under those Decisions, any sale was to be subject to a successful viability assessment of the entity resulting from the sale in a final Commission decision; otherwise, Novo Banco was to be wound down. The viability assessment is the subject of section 7.4.1 and following.
- (184) In the assessment of liquidation aid, a key concern for the Commission is the minimisation of distortions of competition during the limited existence period of Novo Banco. As described in recital (26), the commitments put forward by Portugal together with the notifications of 2014 and 2015 allowed the Commission to conclude that distortions of competition remained limited.
- (185) Commitments submitted by the Member State in the notification of an aid measure form an integral part of the Commission decision on the measure. This also applies to the Commission's assessment of the 2014 and 2015 measures.
- (186) Therefore, the Commission will have to assess that the compatibility of those measures is preserved both throughout the period between when those measures were approved and the date of the present Decision as well as taking into account the commitments submitted by Portugal for the restructuring period of Novo Banco after it will have been sold.
- (187) More specifically, in its 2014 Decision, the Commission concluded that distortions from competition remained limited, also taking into account the commitments provided by Portugal at the time.
- (188) In December 2015 Portugal requested to extend the deadline for the sale of Novo Banco by one year. In its 2015 Decision, the Commission found that the compatibility assessment laid down in the 2014 Decision remained valid and took positive note of the strengthened commitments that Portugal had put forth together with this request, to address the distortions to competition until by the extended deadline Novo Banco would have been sold, requiring a new assessment as mentioned in recital (165), or wound down. For this extended period, the Commission considered in its 2015 Decision that the distortions of competition were limited.
- (189) Therefore, the continued compatibility of the 2014 measure will be assessed with respect to the commitments submitted by Portugal, which amended the 2014 commitments and were annexed to the 2015 Decision.
- (190) While the full set of commitments has been subject to monitoring, for the purposes of the present assessment the Commission examines the key quantitative commitments, listed in recital (26), which represented the main safeguards for

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<sup>67</sup> Recital (76) of the 2014 Decision.

limiting competition distortions (and which also include the commitments which have not been entirely fulfilled).

- (191) In regard to deposit pricing, Novo Banco was restricted from exceeding the market average, as mentioned in recital (27)(a). Nevertheless, the Commission was informed by means of the Monitoring Trustee reports (the most recent of which dated 11 August 2017 and concerning the reporting period up to 30 June 2017) that the bank had been pricing deposits above market average.
- (192) Correspondingly, the Commission notes that the deposit pricing limitation commitment has not been fulfilled. This has undermined the effectiveness of the measures limiting the competition distortions caused by the continued presence of Novo Banco in the market.
- (193) Going forward, the Commission notes the commitment that Novo Banco will limit new business with respect to risk-adjusted profitability to pre-tax RoE targets of [7-12] %.
- (194) The Commission considers that that commitment will implicitly ensure a more appropriate deposit pricing strategy going forward, as in order to achieve a RoE of above [7-12] %, the bank will have to place the funds attracted through those deposits in lending operations at rates which would cover the cost of funding and other costs at the same time (administrative costs, risk costs etc.). Since loan pricing is limited by the offers of competitors, the bank will not be able to apply very generous deposit interest rates, as it would then not be in a position to achieve the relevant RoE target or reduce business volumes and surrender market share.
- (195) On that basis, the Commission considers that the RoE commitment is appropriate to remedy any distortion in the deposit market in a relatively short time frame and will mitigate the effects of non-compliance with the deposit pricing limitation in a satisfactory manner.
- (196) The Commission takes note that based on the monitoring reports that it has received Novo Banco has complied with the commitments regarding cost base, FTE reductions and branch closures. As of 31 December 2016, Novo Banco had reduced its cost base at group level by EUR 204 million, exceeding the EUR 150 million target set out by the commitment, had reduced the number of FTEs by 1 312 compared to the 1 000 target and closed 116 branches, complying with the target of maximum 550 branches.
- (197) The Commission finds that based on the monitoring that it has performed that Novo Banco also complied with the commitment by 30 June 2017. It has reduced its cost base by EUR 264 million, beyond the EUR 230 million target, reduced the number of FTEs by 1 702, exceeding the target of 1 500, and reduced its number of branches to 475, as per the commitment.
- (198) For the Bad Bank, the commitments of the 2015 Decision foresaw deadlines as described in recital (27)(d). The Commission was informed, through the monitoring reports it has received, that on 13 July 2016 the European Central



Bank decided to withdraw the banking license of BES<sup>68</sup>. Accordingly, the Bank of Portugal, in connection with the Portuguese legal framework, requested the beginning of the judicial liquidation proceedings of BES. Therefore, the Commission notes that the relevant commitment has been fulfilled.

- (199) A key commitment for limiting distortions of competition was the limitation of the existence period of the Bridge Bank, and the minimal conditions on the sale process and the acquirer, as described in recital (27)(e).
- (200) As regards the existence period of the Bridge Bank, the Commission recalls that on 20 April 2017 it received the documentation for the sale transaction concerning Novo Banco<sup>69</sup>, which the parties signed on 31 March 2017. The committed deadline for the closing of the sale, prolonged under the 2015 Decision, had been set at three years after the date of the 2014 Decision, i.e. 4 August 2017. Considering that the sale process of the bank had been completed and the full legal documentation of the sale transaction had been signed considerably prior to that date, the Commission finds that the Commitment has been met.
- (201) Based on all available information, the acquirer selected by Portugal, Lone Star, has not been a previous qualified shareholder of BES, hence the corresponding condition set by the commitments of the 2015 Decision is met.
- (202) The Commission notes that, under the terms of the sale agreement, as described in recital (57), the acquirer Lone Star will hold 75% of the Novo Banco's share capital, leaving the Resolution Fund with a 25% shareholding, while the wording of the commitment provided that Novo Banco will have sold all assets or the Resolution Fund will have sold all shares in Novo Banco by the set deadline.
- (203) At the same time, the Commission acknowledges that, in the context of the present Decision, Portugal has committed that the Resolution Fund shall not exercise any of the voting rights corresponding to the 25% of the ordinary shares of Novo Banco that will remain in its possession and that such rights shall be irrevocably waived. Also, the Resolution Fund shall not appoint any members to the General and Supervisory Board or to the Executive Board of Directors or any other governing body of Novo Banco<sup>70</sup>.
- (204) Therefore, the Commission concludes that the Resolution Fund is in practice waiving all non-economic benefits from its shareholding, in particular any rights to take part in the control of the bank's direction of business, so that the Bank's activity will unfold in the same manner as if 100% of its shares had been sold to the acquirer<sup>71</sup>. In such a situation, the 25% shareholding by the Resolution Fund corresponds to only a participation right in any economic upside of the restructuring of Novo Banco.

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<sup>68</sup> As described in recital (28).

<sup>69</sup> As mentioned in recital (16).

<sup>70</sup> As mentioned in recital (120)

<sup>71</sup> The seller retains however some control over the work-out of those assets that are covered by the CCA until the Governance Exchange Date. As further detailed in recital **Error! Reference source not found.**, this does not impact on the course of the business of the bank.

- (205) The fact that the seller cedes any control rights over the Bank's direction of business puts the Commission in a position to find that the sale agreement that has been concluded with Lone Star ensures an outcome equivalent to the sale of all shares of Novo Banco. On that basis, the remaining 25% shareholding can be considered purely a form of deferred compensation for the seller as part of the overall sale price. Therefore the respective commitment is complied with.
- (206) The Commission notes that the sale process was launched by the deadline foreseen by the Commitments of the 2015 Decision, as mentioned in recital (10), and refers to section 6.3 of the present Decision with regard to the assessment of the sales process. On that basis, it can be concluded that the requirements of the commitment concerning the sale process have been met.
- (207) The commitments of the 2015 Decision foresaw that if assets or shares of Novo Banco were not sold by certain dates, the split between the Core and Non-Core Units would be subject to change. In particular, the buyer could have maintained [...] the booking centres in [...] if a sale had occurred prior to [...] 31 October 2016. [...] would have to be moved to the Non-core Unit if Novo Banco shares were not sold entirely by [...] 31 January 2017 and [...] would have to be moved to the Non-core Unit if Novo Banco shares were not sold entirely by [...] 1 March 2017.
- (208) Based on the monitoring reports it has received, the Commission took note that the transfer of [...] and [...] had not been executed by those deadlines. At the same time, the Commission notes that the negotiations regarding the sale were in an advanced state at that date. Reflecting the outcome of negotiations and the commercial strategy envisaged by the buyer, the present Commitments submitted by Portugal provide that [...] and [...] would remain in the Core Unit<sup>72</sup>. Moreover, under the present Commitments, [...] has been moved back to the Core Unit albeit subject to restrictions.
- (209) At the same time, the Commission notes that the Commitments of Portugal now include limitations on the size of the core loan book of Novo Banco up to [...], and on the total assets of the Non-core Unit until [...]. The Commission considers that those elements adequately replace the constraints created by the commitments of the 2015 Decision in respect to the division of different business lines between the Core and Non-Core Units and maintain the effect of limiting distortions of competition.
- (210) Finally, the Commission recalls that the 2015 commitments included a commitment not to provide any further aid to Novo Banco.
- (211) However, Portugal has notified new aid in the context of the sale of Novo Banco to Lone Star. Portugal has made the argument that the additional aid has to be considered as necessary to conclude the sale of Novo Banco, which was foreseen in the original 2014 resolution strategy for BES. With the notification of the sales agreement, Portugal has also submitted commitments limiting the distortions to competition during the restructuring period following the sale of Novo Banco.

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<sup>72</sup> As mentioned in recital (109).

- (212) In the 2014 and 2015 Decisions, the Commission considered that the respective commitments submitted by Portugal were sufficient to address the distortions of competition from the measures notified at that time<sup>73</sup>.
- (213) While the Commission did not expressly assess the presence of the commitment that no further aid was going to be provided to Novo Banco in the 2015 Decision, it did take comfort from its presence with respect to its assessment that distortions of competition remained sufficiently limited over time. In the absence of any additional aid granted, the relevant commitments under the 2015 Decision would have sufficed to ensure that distortions of competition due to Novo Banco's presence remained limited and would have remained limited even under new ownership.
- (214) However, Portugal has now notified new aid that it intends to grant in conjunction with the closing of the sale. It is the right of the Member State to notify aid which the Commission will then assess, taking into account the circumstances of the case at the time of notification.
- (215) Correspondingly, the Commission will have to assess that distortion of competition remain sufficiently limited in light of further aid granted post-sale.<sup>74</sup> However, the Commission considers that the granting of new aid in the context of the sale does not put in doubt its conclusions in the 2014 and 2015 Decisions that distortions of competition remain sufficiently limited during the existence period of Novo Banco.
- (216) With respect to the remaining commitments of the 2015 Decision, the Commission finds have been in their majority complied with, as explained above, and in the cases where breaches have occurred (in particular with regard to deposit pricing), the new commitments put forward by Portugal ensure sufficient safeguards against distortions of competition so as to mitigate the impact of the past commitment breaches.
- (217) On that basis overall, the Commission is in a position to maintain its positive assessment of the measures approved in the 2014 Decision as amended by the 2015 Decision.

#### **7.4. Compatibility of the 2017 measures**

- (218) As assessed already in section 7.3.1, full burden sharing has been implemented during the setup of Novo Banco and has not been undone through any subsequent measures.
- (219) In addition, the Commission notes that Novo Banco has not issued any hybrid or subordinated debt instruments since its inception in 2014. Therefore, the 2017 measures do not require further burden sharing under the 2013 Banking Communication.
- (220) The Commission notes that the notified Commitments replace the existing Commitments in their entirety. Therefore, the Commission has to assess and

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<sup>73</sup> See recital (187)

<sup>74</sup> See section (297)

ensure that the notified restructuring plan together with the Commitments to the present decision is apt to restore Novo Banco to long-term viability without further State aid while limiting distortions of competition in the banking market going forward.

#### 7.4.1. Viability assessment – basis

- (221) For the purpose of the viability assessment, the Commission recalls that it has to assess two key questions, namely that the bank returns to operational viability at the end of the restructuring period, i.e. that the bank will be in position to remunerate its capital adequately, and secondly that even in an adverse case, the bank is not depleting its capital base to a level that might raise concerns and would likely lead the bank to request further aid.
- (222) For the purposes of assessing the first question, the Commission points out that Portugal has submitted a restructuring plan backed by the acquirer which in the baseline scenario claims the return to operational viability of Novo Banco and which the Commission is assessing in section 7.4.3.
- (223) For the purposes of assessing the second question, the Commission notes that any adverse scenario will have an impact through two separate channels:
- (a) Through the quality of the portfolio of legacy assets and losses that could emanate from those assets; and
  - (b) Through a worse than expected performance on the ongoing business as forecast in the baseline of the restructuring plan.

The Commission is considering point (a) in the following section and point (b) in section 7.4.3.

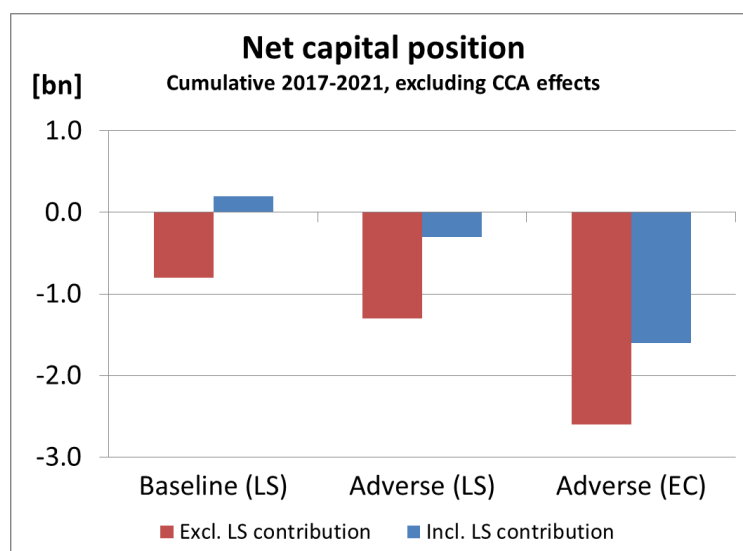
- (224) While the Commission notes that Lone Star has provided an adverse scenario, the Commission points out that it has made its own assessment of the situation in such an adverse scenario on the basis of its findings in the following sections. Table 3 shows the key performance indicators of Novo Banco's restructuring plan in the baseline and the two adverse scenarios.

Table 3 - Key performance indicators

<i>Novo Banco restructuring plan</i>	Baseline scenario	Lone Star Adverse scenario	Commission Adverse scenario
RoE 2021 <sup>75</sup>	[8-11]%	[6-8]%	[-5 - 0]%
CET1 ratio 2021	[10-20]%	[10-20]%	[5-10]%
Net capital position 2021, excl. CCA <sup>1</sup>	-0.8	-1.3	-2.6
CCA drawn	[3-4]	[3-4]	[3-4]

<sup>1</sup>Not counting equity injection by Lone Star

<sup>75</sup> Taking into account adjustments for DTAs as explained in recitals (240) to (243)



#### 7.4.2. Viability concerns – legacy issues

- (225) Novo Banco has a large portfolio of legacy assets, a number of which are of inferior credit quality or could readily deteriorate to inferior credit quality. In order to assess potential problems related to those assets, the Commission requested a complete loan tape of the bank as of 30 June 2016 and 31 December 2016. In addition, it requested the complete loan documentation of a small sample of 20 of those loans, stratified by client type and performance.
- (226) The Commission notes that Novo Banco appears to be suffering from significant deficiencies in its Management Reporting capabilities. The bank was not able to produce loan tapes with complete or correct information. In particular:
- (a) Default probabilities were provided for less than [...]% of all line exposures and zero in another [...]%; in some product areas, such as retail mortgages, only [...]% of lines had non-zero values; if provided at all, the meaning of credit ratings is unclear as is their last review date, making it impossible to use them to supplement the information on default probabilities;
  - (b) Loss given default estimates are provided slightly more systematically than probabilities of default. However, the numbers seem very much unreliable and cannot be verified because of the absence of collateral information;
  - (c) There is no information provided about whether or not a given exposure is collateralised or not; moreover, the bank was also unable to provide a collateral tape allowing the matching of collaterals to specific loans, let alone addressing second order questions such as cross collateralization of exposures or prior liens potentially further reducing collateral coverage.
- (227) The Commission points out that these findings are in themselves problematic as they point to severe issues with both IT systems and more importantly, risk management reporting capabilities.

- (228) The Commission also notes that the pricing information in the loan tape is uncorrelated to the probability of default or cost of risk<sup>76</sup>. This absence of correlation points to serious flaws in the business model or the business management of the bank.
- (229) In this respect, the Commission notes that those findings do not only pertain to the period prior to the BES resolution in 2014 but continue to impact the performance of Novo Banco under management by the Resolution Fund under the responsibility of the Bank of Portugal. Even new lending in 2016 after Bank of Portugal had already been in charge for more than one year shows significant deficiencies in all those categories.
- (230) The credit file review performed by the Commission fully confirms the findings in the loan tape, namely that past lending practices of BES have contributed to its demise. But it also indicates that even after the establishment of the bridge bank and under direct control of the Bank of Portugal, Novo Banco seems to have done little to remedy previous problematic lending practices or substandard credit risk management.
- (231) With respect to the credit file review, the Commission noted the following deficiencies:
- (a) In many credit files: absence of cash flow analyses or an indication of repayment capacity of the client (absence of income declaration or fiscal statements for retail clients, granting of Corporate and SME mortgages purely on the basis of the underlying collateral);
  - (b) Loan agreements with insufficient protection (e.g. under the form of covenants) against changing creditworthiness or changing credit circumstances;
  - (c) Loan documentation often inaccurate, incomplete or insufficiently updated, in particular credit file reviews lacked depth and sometimes misrepresented the factual situation;
  - (d) Presence of an example of “name lending” (loan granted as a favour);
  - (e) Inconsistent real estate collateral valuations, with practices often differing across branches or regions;
  - (f) Erratic pricing, not adhering to consistent Risk Adjusted Return objectives, both in the granting of new credits as well as in restructuring cases; and
  - (g) Deficient or inconsistent Credit Risk assessment ([...] % default probability to factoring, [...] % probability of default to a company with negative equity, no rating at all for “lack of financial information”, etc.).
- (232) Overall, the Commission's findings raise the issue about the quality of the legacy credit portfolio of Novo Banco. In particular, those findings would suggest that relying on the bank's loan tape for the assessment of lending quality of the legacy

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<sup>76</sup> Cost of risk would be probability of default times loss given default and provides a measure for the riskiness of a given exposure. Such riskiness should in general terms be reflected in the interest rate to be paid by the customer for the loan

credit portfolio could lead to a severe underestimation of the actual losses emanating from those assets.

- (233) The Commission notes that a significant part of the legacy assets is part of those assets where losses can be reclaimed through the CCA mechanism in case the bank falls below the applicable CET1 threshold of [8-13]%. Therefore, the CCA mechanism provides a significant risk shield against potential losses emanating from the legacy assets.
- (234) If losses were only to materialise in the loan book of CCA covered assets, then the CCA coverage of EUR 3.9 billion would correspond to a loss of [75-95]% of their gross book value (“GBV”). On the basis of high-level numbers by the Commission's valuation experts, this would seem a rather conservative valuation of those assets.
- (235) However, the Commission notes that there are some significant additional risks in the pool of assets covered by the CCA, in particular with regards to [...] and [...] . If risks were to materialise in those assets, the implied coverage would be lower and roughly in line with the losses that the Commission would expect in an adverse scenario.
- (236) On the part of the corporate loan book that is not covered by the CCA, the Commission has the impression from the information provided by the acquirer that losses emanating from the legacy assets might have been underestimated as safety buffers have been defined in particular towards historic default rates and work-out curves.
- (237) Given the situation of Novo Banco as a bridge bank with a limited capital layer, the Commission considers that such historical information is highly unreliable and likely to be biased with defaults recognised only if there is really no other solution and work-outs focusing on those assets where value is higher, thereby underestimating both parameters. The Commission's findings with respect to the loan tape and the loan file review corroborate that consideration.
- (238) On that basis, the Commission finds that in an adverse scenario, losses on the CCA assets are likely to reach EUR [3-4] billion and might in some instances be even higher, in particular depending on the situation in [...].
- (239) Not taking into account [...] where the Commission's valuation experts noted that the risk on the exposure is extremely difficult to quantify, the Commission considers that there are likely to be significant additional losses on the legacy portfolio in an adverse scenario. The losses on the CCA covered assets would likely be covered in full by the CCA, using the CCA up to [...], leaving no or a very limited buffer for losses on those assets which are not part of the CCA coverage. The Commission considers that those additional losses in an adverse scenario are insufficiently reflected in the Lone Star Adverse scenario.

#### *7.4.3. Viability – restructuring plan baseline*

- (240) The Commission has received a restructuring plan from Lone Star and the bank which shows a post-tax RoE of [6-9]% in the baseline scenario. Lone Star has made the argument that the RoE value is underestimated, due to the significant

amount of deferred tax assets (“DTA”) on the balance sheet of Novo Banco, which artificially increase the equity position.

- (241) The Commission has received a detailed break-down of the DTA currently on the bank's balance sheet. Out of a total of EUR [0.5-3.0] billion, EUR [...] billion refer to temporary differences with a State guarantee, EUR [...] billion refer to temporary differences without a State guarantee and EUR [...] billion refer to tax loss carry forward.
- (242) According to the bank's auditor, the amount of necessary profits to cover the first two positions is roughly EUR [1-6] billion. The amount of further profits required to use the tax loss carry forward DTA would require another EUR [5-10] billion of profits. Moreover, the period in which those DTA would have to be used is twelve years. On that basis and taking into account the projected earnings of Novo Banco, the auditor has stated that under International Financial Reporting Standards (“IFRS”), the DTA relating to tax loss carry forward should be de-recognised.
- (243) Taking into account such an accounting change would result in a RoE of [8-10]%.
- (244) Taking that RoE as a basis, the Commission notes that some of the assumptions underlying the plan as presented by Portugal and Lone Star are somewhat optimistic. In particular, the Commission notes that business growth is high, in particular in mortgages where volumes are projected to grow by roughly [10-20]% annualised, significantly above the expected overall market growth rate.
- (245) In corporate lending, the compound annual volume growth of [2-7]% is combined with a simultaneous increase in margins and fees while the cost of risk is to be reduced. Such a strategy is highly desirable but difficult to implement, in particular in a market like the Portuguese where competition is high.
- (246) Moreover, the Commission recalls the results from the credit file review which suggest a corporate culture where lending discipline has been lacking, e.g. showing lending decisions on the basis of matching more favourable rates by competitors in spite of not being warranted by the bank's internal client risk assessment. Such a corporate culture carries clear risks for a bank and may take considerable effort to change rapidly.
- (247) Finally, the Commission notes that the restructuring plan makes assumptions about an improvement in the situation of the bank comparing the plan for 2017 to the actual results of 2016. Such improvements are not obvious when compared to the recent historical performance of the bank.
- (248) On the basis of the preceding recitals, the Commission considers that the baseline scenario implies a successful implementation of breaking with the past banking culture and performance of Novo Banco and correspondingly carries some execution risk.
- (249) Considering operational viability in the baseline scenario and the concerns the Commission has expressed in the preceding recitals, the Commission acknowledges in a first step the argument put forward by Lone Star that given that a new private investor is taking over, the situation of Novo Banco going forward



cannot be assessed solely on the basis of the performance of the bank during the years since the 2014 resolution.

- (250) In that respect, the Commission also accepts the submission made by Lone Star and Portugal showing that the current financial situation of Novo Banco in 2017 up till now already shows improvements and lends support and credibility to some of the operational assumptions made for 2017 in the baseline scenario in the restructuring plan.
- (251) Finally, the Commission acknowledges fully that Lone Star is a private investor providing a significant upfront investment and who therefore has a clear interest to restructure Novo Banco and transform it in such a way that its investment is profitable. That gives Lone Star all incentives a priori to ensure that the baseline scenario will be implemented as projected.
- (252) The Commission considers that those considerations already provide it with some reassurance regarding the concerns that it has expressed further above, even before considering the Commitments Portugal has provided. Nonetheless, even small adjustments or underperformances in particular in the combination of volume growth and growth in profitability put forward in the baseline scenario could lead to a lower than projected RoE. Given that the current plan is only just achieving profitability in 2021 to the level that the Commission considers necessary to remunerate capital, the Commission considers that some level of uncertainty remains.
- (253) In that respect, the Commission considers positively the commitment that Novo Banco will find additional efficiencies, resulting in EUR [5-20] million additional profits in 2019 and EUR [10-30] million additional profits in 2021. That provides a post-tax RoE buffer of an additional [0.1-1.4] percentage points that the Commission considers sufficient in a slightly adapted and thereby more robust baseline scenario.
- (254) The Commission takes further confidence from the fact that if Novo Banco does not achieve those additional efficiencies in the envisaged way by the deadlines, the Commitment further provides for additional FTE reductions and branch closures which should generate those efficiencies.
- (255) Beyond the question of operational efficiencies, the Commission sees a risk that, without significant change in corporate culture, Novo Banco might be tempted to prioritise volume over profitability and appropriate risk management, in particular in a situation where the current combination of volume increase, profitability increase and risk reduction would turn out to be challenging to achieve.
- (256) Regarding that risk, the Commission highlights the commitment that Novo Banco will implement an RoE pricing tool, allowing it to monitor and limit new business with respect to risk-adjusted profitability and the commitment to implement related pre-tax RoE targets of [7-12]%. The Commission considers that commitment an effective measure to limit the risk of prioritising volume growth, in particular because it is coupled with effective monitoring by the monitoring trustee.
- (257) Even if certain execution risks were to materialise, the Commission considers that the Commitments provided ensure that the impact would be mitigated.

- (258) In this respect, the Commission points towards the commitment to implement countermeasures in case that the Cost-to-Income ratio is more than [5-15] percentage points above given target values defined in the commitments. If the implementation of those countermeasures is not successful within [...], further staff and branch reductions will become applicable. Under this Commitment, required staff and branch reductions are in such a case limited to up to [450-700] FTE and [40-60] branches.
- (259) In view of the fact that the first monitoring point is in [...], the Commission considers that the Lone Star as the new private owner has sufficient time to implement changes to produce the desired effects prior to the target dates. Moreover, the Commission takes confidence from the staggering of those measures. That staggering provides full incentives for the bank management to implement countermeasures which address the shortcomings of the performance compared to the plan.
- (260) The Commission further notes that the management remuneration will remain restricted unless the targets in the Viability Commitments are met, providing additional incentives to the decision takers to remedy any operational difficulties as quickly as possible.
- (261) The Commitment takes note of the presence of two provisions in the commitments that limit their applicability:
- (a) A general clause relating to material adverse events rendering all viability commitments ineffective; and
  - (b) A provision stating that the Cost-to-Income commitment should not apply in a situation where the entire Portuguese banking market sees the average Cost-to-Income ratio increase by more than [5-15] percentage points.
- (262) With respect to the first clause, the Commission notes that in such a case, all measures will need to be re-notified, rendering the present Decision moot.
- (263) With respect to the second clause, the Commission notes that the Cost-to-Income ratio as per the definition of the commitment only takes into account real economic and recurring income and costs. Therefore, it would seem highly unlikely for such an event to occur outside of a general and unexpected market stress, a situation in which the first clause would likely apply as well.
- (264) On that basis, the Commission can accept the presence of those limiting conditions.
- (265) Regarding loss recognition in the legacy portfolio and the corporate culture of Novo Banco which suggests that arbitrary lending decisions as well as suboptimal or absent risk management has been endemic in Novo Banco also under the ownership of Bank of Portugal, the Commission considers it necessary to clean up the balance sheet as soon as possible. This view coincides also with the view of the competent supervisor.
- (266) In this respect, the Commission notes that under the CCA, the Resolution Fund remains responsible for the work-out strategy of the bank with respect to the CCA covered assets. While this might somewhat mitigate the eventual loss coverage by

the Resolution Fund, it could prima facie have a negative impact on the clean-up of the bank's legacy portfolio.

- (267) The Commission considers that the fact that the Resolution Fund remains responsible for the work-out strategy of the CCA assets does neither forestall the clean-up of the balance sheet nor put at risk the viability of Novo Banco. Any potentially negative impact on Novo Banco is neutralised by the combination of factors that
- (a) Novo Banco remains fully responsible for the provisioning of the loans which are covered by the CCA and therefore has full flexibility to be as prudent as required while being covered under the CCA<sup>77</sup>;
  - (b) A commitment is present to prudent provisioning including a minimum cumulative loss provisioning. The combination of those factors gives some confidence to the Commission that the necessary clean-up of the balance sheet will occur within the restructuring period; and
  - (c) A commitment is present to change the auditor which lends additional support to the preceding two factors to ensure prudent provisioning management by the Bank.
- (268) While the Commission therefore considers that the presence of the Resolution Fund in the work-out strategy of the CCA assets presents no risk to viability of Novo Banco under the setup of the CCA and the present Commitments, the Commission points out that the present Decision is without prejudice to a State aid assessment of potential aid to clients of Novo Banco through the actions of the Resolution Fund in the management of the CCA assets.
- (269) Having assessed and highlighted the shortcomings of Novo Banco with respect to risk management, the Commission takes positively into consideration the commitment by Portugal that the bank will address those issues and implement a number of standard risk management practices, in particular:
- (a) Regarding credit risk, establishing a credit rating for each material exposure above EUR [0-5] million while upgrading risk management system to allow producing complete and accurate loan exposure tapes, with collaterals, collateral valuations and valuation dates including an enhancement of the loan documentation requirements;
  - (b) Regarding legal and compliance risks, introducing policies and monitoring for business with a wide definition of connected borrowers and, specifically, for any dealings with [...];
  - (c) Regarding market risk, ensuring relatively narrow value-at-risk (“VaR”) limits with respect to proprietary trading activity in the course of normal business.

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<sup>77</sup> Necessary provisions will be settled in cash under the CCA subject to the [8-13]% CET1 capital ratio threshold. However, if provisions were to turn out overly prudent and ultimately not required, there is a settlement mechanism at the end under which Novo Banco would have to repay any payments from the Resolution Fund under the CCA which turned out not to be required following the final outcome from the work-out strategy. However, such a repayment will not impact Novo Banco negatively either as it is supported by less than expected losses on the underlying assets.

- (270) Those commitments provide the Commission with confidence that Lone Star and the new management of Novo Banco will indeed have all incentives to ensure that past practices that have led to the significant problems of BES and later Novo Banco will not be propagated into the future but replaced with sustainable business practices.
- (271) In sum, on the basis of latest data, the Commitments provided and the presence of a private investor with a significant initial investment and a controlling shareholder position, the Commission accepts the baseline scenario as sufficiently robust to deliver the operational return of Novo Banco to viability.

#### 7.4.4. *Viability – restructuring plan adverse scenario*

- (272) Regarding the situation in an adverse scenario, the Commission notes that the combination of simultaneous volume growth and growth in per-volume profitability while at the same time improving the credit quality of the business – implying a limitation of the client segments with which new business is generated – is going to be more challenging than in the baseline scenario.
- (273) In that respect, the Commission has limited confidence in the adverse scenario provided by Lone Star and the Bank and considers that that adverse scenario does not reflect accurately the risks in such a situation. In such a scenario, a number of the assumptions present in the baseline scenario would have to be reconsidered and revised significantly<sup>78</sup>.
- (274) Based on more conservative assumptions appropriate for an adverse scenario, the Commission has made its own assessment regarding the extent and effects of an adverse scenario. In particular, the Commission considers that the combination of lower volume growth and higher cost of risk and related provisioning would lead to a significant reduction in earning potential and greater needs for loan loss provisioning in the new business compared to what had been assumed in the baseline scenario. Some key performance indicators and differences with the adverse scenario provided by Lone Star can be seen in Table 3.
- (275) On that basis, the Commission notes that even when taking into account the CCA mechanism from which no more than EUR 3.9 billion can be drawn as well as the maximally EUR 1.0 billion capital injection committed to by Lone Star, the net capital position in such a scenario is deeply negative.
- (276) Here, the Commission points out that it is only in a position to approve aid as compatible if the measure is adequately dimensioned in order to address the problems that the bank faces. In particular, it is the Commission's standard case practice that the capital position and income generating power of the bank has to be sufficient to withstand an adverse scenario.
- (277) However, the Commission points out that while Lone Star might have an interest in providing further capital in such a scenario, there is no firm commitment by Lone Star to do so.

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<sup>78</sup> See recitals (244) to (247)

- (278) Therefore, the Commission takes positive note of the commitment by Portugal to provide additional capital to the bank as an ultimate backstop in an adverse scenario. That capital can take the form of either a straight capital injection or of additional Tier 1 (“AT1”) instruments which are either sold in the market with a coupon guarantee by Portugal or subscribed by Portugal directly.
- (279) The Commission points out that Portugal has notified that measure “up to the maximum amount necessary to ensure long term viability, defined under the scenario identified in the [present] Commission Decision.” Moreover, the ultimate backstop is limited in time under the Commitments to the restructuring period.
- (280) The Commission has no indication that such a backstop would be necessary in a benign market environment such as the one underlying the baseline scenario. Even if capital was required in such a scenario, losses would be expected to be so low that Lone Star would have every incentive to provide further capital – in particular as that would put the Resolution Fund under pressure to provide capital, as well, or be diluted<sup>79</sup>.
- (281) However, in an adverse scenario, losses would be significantly larger as can be seen from Table 3 and the adjacent graph. If losses were to extend beyond a level where Lone Star would remain available for further capital contributions, a situation which the Commission considers a distinct possibility in its own adverse scenario, the present ultimate capital backstop provides the Commission with confidence that the necessary capital will indeed be provided in such a situation.
- (282) In a situation where additional capital needs would be such that capital would be required from the ultimate public backstop, , the Commission would expect that the baseline of the current restructuring plan would have to be amended as the baseline profitability targets would not have been reached and the additional staff and branch reduction become necessary. The Commission considers that the commitment to further cut FTE and close branches ([900-1100] FTE and [90-120] branches) as notified in a new restructuring plan will contribute both to controlling costs going forward as well as reducing market footprint and related distortions of competition.
- (283) Moreover, in such an adverse situation, while the mechanism would allow the bank to absorb losses through capital, the Commission would expect that the baseline of the current restructuring plan would have to be amended as the baseline profitability targets would not have been reached and the additional staff and branch reduction become necessary. Correspondingly, the Commission approves of the fact that the Commitment also includes the notification of a new restructuring plan to amend the version approved in the present Decision.
- (284) If the aid were to extend beyond the amount deemed necessary under the adverse scenario as defined by the Commission in the present Decision, a new notification would be required and the stand-still obligation would apply. The Commission assesses positively the fact that the commitment explicitly acknowledges that factor, as well.

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<sup>79</sup> Under the SPA, the Resolution Fund has the right to match a capital increase by Lone Star to the extent of its relative shareholding.

(285) In conclusion, the commitments provided together with the restructuring plan and the presence of that backstop allows the Commission to find the 2017 measures well dimensioned in order to restore Novo Banco under new ownership back to long-term viability while being limited to the minimum necessary as defined by the capital needs in the adverse scenario that the Commission has identified (see Table 3).

#### 7.4.5. *Limitation of the aid to the minimum*

(286) The Commission recalls that it is not only required to confirm that the aid provided in the notified scenario is limited to the minimum necessary but also that it would not be cheaper for the public authorities not to provide any aid, at all. The Commission approved the aid in the 2014 Decision on the basis of both those two factors: the minimum regulatory requirements that the bridge bank had to comply with and on the costs that a counterfactual scenario, namely a disorderly resolution of BES, would have implicated<sup>80</sup>.

(287) As assessed in section 6.3, the sale process that led to the selection of Lone Star's offer was open, transparent, non-discriminatory and competitive. It took place on market terms and was aimed at maximising the sale price.

(288) On the basis of that sale process, the Lone Star offer was selected as the offer presenting the best commercial terms for the sale of the bridge bank in spite of the fact that it results in a negative sale price overall. Therefore, that negative sale price has to be considered as minimising the costs linked to the sale of the bridge bank.

(289) The costs of a disorderly resolution of BES were estimated in 2014 by the Bank of Portugal at that time to range between EUR [16-23] billion and EUR [19-28] billion in losses<sup>81</sup>.

(290) That estimation of losses was later confirmed in a report commissioned by the Portuguese Resolution Fund and realized by Deloitte<sup>82</sup>, which estimated that the losses creditors would have suffered in a liquidation scenario of BES would have amounted to approximately EUR 22 billion.

(291) Since 2014, Novo Banco has registered losses totalling approximately EUR 2.55 billion, namely EUR 498 million at end 2014<sup>83</sup>, EUR 980 million at end 2015<sup>84</sup>, EUR 788 million at end 2016<sup>85</sup> and EUR 290 million at 30 June 2017<sup>86</sup>. As far as BES, the bad bank in liquidation is concerned, its latest financial statements, dating of end 2015<sup>87</sup>, indicate its losses would amount to EUR 5.2 billion.

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<sup>80</sup> Recitals (75) – (77) of the 2014 Decision

<sup>81</sup> Recital (75) of the 2014 Decision.

<sup>82</sup> Summary available at:

<https://www.bportugal.pt/sites/default/files/anexos/documentos-relacionados/comb20160706.pdf>

<sup>83</sup> 2014 Annual report: <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=758921&fext=.pdf>

<sup>84</sup> 2015 Annual report: <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=783894&fext=.pdf>

<sup>85</sup> 2016 Annual report: <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=837465&fext=.pdf>

<sup>86</sup> June 2017 interim report:

<https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=848600&fext=.pdf>

<sup>87</sup> 2015 Annual report [http://www.bes.pt/Comunicados/20160523%20fsd160713\\_uk.pdf](http://www.bes.pt/Comunicados/20160523%20fsd160713_uk.pdf)

As per recital (198), the licence of BES was withdrawn in 2016, and the entity is in liquidation.

- (292) Since the assets and businesses of Novo Banco and BES bad bank were an integral part of the pre-resolution BES entity which was examined in the Deloitte report, it can be argued that their losses would have in any case crystallized in a liquidation scenario of BES, and are therefore already factored in the EUR 22 billion loss estimation of the Deloitte report.
- (293) Therefore, an estimation of potential losses that would correspond to Novo Banco in its current form, in an alternative scenario to the ongoing resolution, would amount to over EUR 14 billion. Although the Deloitte report is based on information dating from the time of the BES resolution in 2014, there is no indication that the share of the losses corresponding to Novo Banco in its current form would have diminished. The persistent legacy problems<sup>88</sup> of the bank and its continued deterioration state since its setup<sup>89</sup> minimize the likelihood that an updated assessment would in the present reduce the amount of losses estimated by the Deloitte report.
- (294) The Commission hence considers the EUR 14 billion corresponding to Novo Banco in an alternative scenario to the ongoing resolution to be a reasonable estimate. This amount would by far exceed the amount of aid contained in the 2017 measures<sup>90</sup>.
- (295) Alternatively, the Deloitte report can be taken as a reference point for comparing, from an ex-ante perspective, the entirety of aid measures related to the resolution of BES to the losses that a counterfactual scenario to the resolution would have generated. From that perspective, the Commission finds that, had the combined measures of the 2014 Decision and the aid measures subject to the present decision<sup>91</sup> been notified and assessed at the time of the resolution, the total aid amount would be far exceeded by the EUR 22 billion loss estimated by the Deloitte report for a liquidation scenario.
- (296) On that basis, the Commission concludes that the State aid contained in the 2017 measures is both limited to the minimum required and necessary in order to conclude a sale of the temporary institution Novo Banco to a market buyer.
- (297) From the wider perspective of the financial burden on the Resolution Fund, the Commission notes that the maximum contribution by shareholders and subordinated debt holders required under State aid burden sharing rules had already been ensured at the time of the 2014 decision and the aid was correspondingly minimized as required under State aid rules.
- (298) However, it would have been fully in line with State aid rules to reduce the net cost to the Resolution Fund further by seeking a greater degree of loss participation from senior creditors. The degree to which senior bond holders were asked to participate beyond the minimum requirements under State aid rules (e.g. in the context of the LME that was carried out under the responsibility of Portugal) and the magnitude of losses that correspondingly had to be carried by

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<sup>88</sup> See section 7.4.2

<sup>89</sup> See recital (32)

<sup>90</sup> See section 6.2.

<sup>91</sup> See section 6.2 for their summary.

the Resolution Fund has been the sole decision and responsibility of the Portuguese authorities.

#### 7.4.6. *Limiting distortions of competition*

- (299) Under the 2017 Measures, Novo Banco will receive significant further aid on top of what has already been approved for the liquidation of BES in the establishment of Novo Banco in the 2014 and 2015 Decisions. Given Novo Banco's significant market share in the Portuguese banking market and the fact that it will continue as a stand-alone operator, Novo Banco's continued presence could lead to significant further distortions of competition.
- (300) In this respect, the Commission takes positive note of the commitments provided with respect to re-focussing Novo Banco on its core market in commercial banking. Relevant in this respect are (a) the committed sale of [...] by [...], finalising the exit from [...], (b) limitations on [...] and (c) the withdrawal from [...].
- (301) The limitations on [...] will ensure that Novo Banco's engagement in [...] will remain limited to a reasonable extent as required by an active collateral management in the course of normal banking activity without using State aid to enter the [...] business.
- (302) The Commitment to withdraw from [...] services will ensure that Novo Banco will cease offering [...] services and provide clients with an active choice of whether to maintain a retail account with Novo Banco or transfer their [...] relationship to a competitor.
- (303) Overall, those Commitments provide the Commission with confidence that distortions of competition in markets other than the core commercial lending franchise of Novo Banco will remain limited.
- (304) With respect to the core commercial lending franchise, the Commission notes positively the exit from [...] international] locations which are mainly linked to problematic businesses such as [...] as well as the limitation of risk with respect to [...].
- (305) Moreover, Portugal has committed that Novo Banco will not grow its core loan book during the first [...] years of the restructuring plan, leading to a further reduction in total assets of EUR [35-50] billion envisaged at the end of the restructuring plan corresponding to almost [...]% compared to the core banking business in the 2016 balance sheet (not counting the reduction due to the divestment of insurance businesses).
- (306) Finally, the Commission stresses the commitment by Portugal that Novo Banco will not provide loans with a pre-tax RoE of less than [7-10]% in 2018, [8-11]% in 2019 and [9-12]% in 2020 following. The Commission welcomes this commitment notably in light of the pricing policy for deposits set out in the restructuring plan<sup>92</sup>.

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<sup>92</sup> This can be evidenced from the submitted 4th August Follow Up to the Restructuring plan, page 5 (on capital and funding).



- (307) Deposit pricing above market conditions is particularly problematic from a State aid perspective if it does not lead to a concurrent increase in lending prices. An absence of that concurrent increase would imply that State aid is being used to finance higher prices, i.e. distortive behaviour on the deposit side. On the other hand, achieving higher remuneration on the lending assets to finance higher remuneration of deposits is a commercial strategy available to all market participants whether aided or not.
- (308) Therefore, the RoE commitment allows the Commission to consider that Novo Banco's commercial strategy is not based on distortive behaviour in the deposit market.
- (309) The Commission also takes comfort from the presence of standard behavioural commitments, namely an acquisition ban, a ban on paying dividends, an advertisement ban and a cap on remuneration lasting at least until 30 June 2020 but continues to affect bonus payments throughout the restructuring period if targets in the viability commitments are breached.
- (310) Taken together, those Commitments put the Commission into a position to consider that distortions of competition remain limited also in the core commercial banking franchise of Novo Banco.

## **8. Compliance of the 2017 measures with the provisions of Directive 2014/59/EU<sup>93</sup> on bank recovery and resolution**

- (311) Although Portugal has already transposed Directive 2014/59/EU into national law, the Commission needs to assess whether the measure violates indissolubly linked provisions of Directive 2014/59/EU.
- (312) That obligation is in line with the jurisprudence of the Union Courts, which have consistently held<sup>94</sup> “*that those aspects of aid which contravene specific provisions TFEU other than [Articles 107 and 108 TFEU] may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately to that their effect on the compatibility or incompatibility of the aid viewed as a whole must therefore of necessity be determined in the light of the procedure prescribed in [Article 108]*”.<sup>95</sup>
- (313) To ascertain whether a violation of a provision of Union law is indissolubly linked to the object of the aid, a relation of necessity has to be established. It means that the State aid measure has to be connected with a national measure in a way that necessarily breaches a specific provision of Union law which is relevant for the compatibility analysis under paragraphs 2 and 3 of Article 107 of the Treaty.

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<sup>93</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and EU No 648/2012, of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190.

<sup>94</sup> See *inter alia* Joined Cases C-134/91 and C-135/91 *Kerafina-Keramische v Greece* EU:C:1992:434, paragraph 20; Case T-184/97 *BP Chemicals v Commission* EU:T:2000:217, paragraph 55; and Case T-289/03 *BUPA and others v Commission* EU:T:2005:78, paragraphs 313 and 314.

<sup>95</sup> Case 74/76 *Ianelli v Meroni* EU:C:1977:51 paragraph 14.

- (314) The Commission notes that Novo Banco was created by the Portuguese Resolution Authority as a temporary institution, having put BES into resolution on 3 August 2014. The BES resolution action was taken under Portuguese national law and prior to the entry into force of Directive 2014/59/EU. According to Article 130(1) of Directive 2014/59/EU Member States were obliged to apply it only from 1 January 2015.
- (315) In its resolution decision of 3 August 2014 on BES<sup>96</sup>, the Bank of Portugal as the Resolution Authority created Novo Banco with the purpose to sell the assets and liabilities received to one or more parties. Under the commitments presented to the Commission, the existence period of Novo Banco was limited to two years in which it was to be either sold or wound down.
- (316) In the 2015 Decision, the Commission had already assessed compliance with indissolubly linked provisions of Directive 2014/59/EU. In that decision, the Commission made a distinction between the prolongation of the GGBBs and the prolongation of the sale period.
- (317) The Commission considered that the prolongation of the GGBBs approved in the 2015 Decision had not been foreseen in the 2014 resolution decision by the Bank of Portugal and could not be covered under the existing Portuguese liquidity guarantee scheme because of Novo Banco's capital shortfall at the time of approval.
- (318) Correspondingly, the Commission assessed the GGBB prolongation both from a State aid perspective and under considerations related to Directive 2014/59/EU, not to put in doubt the argument that the 2014 resolution action was ongoing but because it considered that fact not pertinent to the assessment of the GGBB prolongation in view of the absence of any related measure from the original 2014 resolution strategy.
- (319) Moreover, the Commission limited itself to assessing a question of merit without prejudice to procedural considerations. The question was if the aid measures envisaged in the 2015 decision, i.e. the prolongation of the GGBBs, could at all constitute a form of extraordinary public support which would trigger resolution pursuant to Directive 2014/59/EU. The Commission considered that, in any event, those measures fell under the exception of Article 32(4)(d)(ii) of Directive 2014/59/EU, so that the decision to declare the aid compatible with the internal market did not depend on the applicability of that Directive.
- (320) On the other hand, the Commission assessed the prolongation of the sale period only with respect to State aid considerations related to further distortions of competition related to the extended existence period of Novo Banco. As the sale itself was foreseen under both the 2014 Decision and the 2014 resolution decision by the Bank of Portugal, questions regarding the application of Directive 2014/59/EU were not considered relevant in that respect.

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<sup>96</sup> [https://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Documents/Deliberation\\_3\\_Aug\\_2014\\_8pm.pdf](https://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Documents/Deliberation_3_Aug_2014_8pm.pdf)

- (321) When notifying the 2017 Measures, the Portuguese authorities have invoked the continuation of the original resolution process (see recitals 143/144). The Commission considers that the fact remains that Novo Banco was instated as a bridge institution and its subsequent sale was initiated in the course of the 2014 resolution process.
- (322) In sum, the Commission considers that, although the 2015 Decision has authorised some adjustments to the resolution process as initially planned and approved further aid measures, and although further and more extensive changes would result from the notified measures, these changes have become necessary in the light of factual developments in order to implement the resolution process and do not fundamentally alter its nature. As the resolution process foreseeing the creation of a bridge institution and its subsequent sale was initiated in 2014, in order to preserve the unity and implementation of the initial resolution process, it should continue to be governed by the law applicable at the time, i.e. national law. This conclusion is not contradicted by the fact that, in the 2015 Decision, the Commission has examined whether the measures at stake indissolubly violated linked provisions of Directive 2014/59/EU. Indeed, in that context the Commission has considered that, in any event, those measures fell under the exception of Article 32(4)(d)(ii) of that Directive, so that the decision to declare the aid compatible with the internal market did not depend on the applicability of that Directive.
- (323) Therefore, in the present Decision, the Commission has not identified indissolubly linked provisions of Directive 2014/59/EU.
- (324) Within the limits of the approval of the present decision, Regulation (EU) No 806/2014 is not applicable either, as the institution in question, BES, was placed under resolution by the Portuguese authorities before the date of application of Article 7(2) of Regulation (EU) No 806/2014 that have conferred to the SRB the responsibility for the resolution of significant institutions. As the resolution process of this institution was set out by the national resolution authority in 2014, the conditions of the sale of Novo Banco therefore continue to remain under the responsibility of the national resolution authority and under national law.
- (325) This is without prejudice to the prerogative of the Commission to initiate infringement procedures against a Member State for breach of Union law, including breach of the provisions of Directive 2014/59/EU.

## 9. CONCLUSION

The Commission has accordingly decided to consider the State aid contained in the 2017 Measures as notified by Portugal in the context of the sale of Novo Banco to be compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union, and not to raise objections. The Commission further maintains that the State aid contained in the 2014 and 2015 Measures remain compatible as assessed and decided by the Commission in 2014 and 2015.

The Commission notes that Portuguese authorities exceptionally accept that the adoption of the Decision be in the English language.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: <http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

European Commission,  
Directorate-General Competition  
State Aid Greffe  
B-1049 Brussels  
[Stateaidgreffe@ec.europa.eu](mailto:Stateaidgreffe@ec.europa.eu)

Yours faithfully  
For the Commission

Margrethe VESTAGER  
Member of the Commission



## **Annex 1- Commitments by the Portuguese Republic**

The Portuguese authorities are about to conclude the sales process of Novo Banco S.A. (“Novo Banco”), the bridge bank created on 3 August 2014 pursuant to then Article 145-P of the Legal Framework for Credit Institutions and Financial Companies (approved by Decree-Law no. 298/92, of 31 December 1992, as amended subsequently), in the context of the resolution measure applied to Banco Espírito Santo S.A. (“BES”). The sale is part of the set of commitments submitted to the European Commission (“Commission”) prior to the decisions adopted by the Commission on 3 August 2014 and 19 December 2015 not to raise objections and considering the notified State aid as compatible with Article 107(3)(b) of the Treaty on the Functioning of the European Union (“TFEU”).

The Portuguese authorities hereby submit commitments together with the notification of the final restructuring plan for the entity resulting from the sale. Given that the restructuring plan together with the measures foreseen therein and in the present commitment letter cater for the various elements which underpin the viability of Novo Banco, it is understood that the bank will not access, after the date of the present letter, other State support measures for liquidity purposes, namely the Portuguese Guarantee Scheme<sup>97</sup>.

It is also understood that all previous commitments entered into by Portugal in relation to Novo Banco are replaced in their entirety by these commitments as of the date of the Commission decision to which these commitments are annexed. Any figures presented and referred to herein relate to consolidated group figures and net book values, unless otherwise specified.

### **I. Structural commitments**

- (1) The restructuring period shall last until 31 December 2021 (the “Restructuring Period”) unless otherwise specified in specific commitments.
- (2) Novo Banco has segregated its existing activities into two parts, the Core Unit and the Non-Core Unit. Those Units are not separate legal entities and funding, liquidity and solvency will be shared across both units.
  - a. The Core Unit comprise the following entities (excluding some specific assets and business lines described in Commitment hereafter): [...]
  - b. The Non-Core Unit shall include: [...]
- (3) Portugal commits that the size of the core loan book of Novo Banco will not exceed the level of [...] of EUR [...] up to [...].
- (4) The total assets of the Non-core Unit will not exceed EUR [...] at [...], EUR [...] at [...], EUR [...] at [...] and EUR [...] at [...]; targets stated exclude the value of [...] in all years. These assets will be managed with the objective of being

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<sup>97</sup> approved by the Commission in State aid case NN 60/2008 and subsequently prolonged on a half year basis

divested, liquidated or wound down, in an orderly manner but with a view to maximising their value.

- (5) [...] shall be divested by [...].
- (6) [...] shall be divested by [...].
- (7) [...] shall be divested or discontinued by [...].
- (8) [...] shall be wound down by [...]. The winding-down of [...] will imply the closure of [...] currently in place. To avoid the organised transfer of clients to another business unit, Novo Banco will send a termination letter to all of Novo Banco's [...] clients notifying them that the existing [...] service will be terminated (including all products that are currently not available to retail or corporate clients or favourable rates on existing products<sup>98</sup>) and asking for an active client instruction to which portfolio investment and bank accounts the client money and securities are to be transferred. For the avoidance of doubt, this does not preclude Novo Banco to communicate and offer its services outside of [...] to the same group of clients.
- (9) [...] shall be disposed of by [...].
- (10) [...] shall be wound down during the restructuring period. [...] shall either be transferred to one of Novo Banco's other legal entities wherever legally possible or an offer for voluntary swap be made to the current holders that is clearly economically advantageous for the current holders. If the voluntary swap has not been accepted in spite of being economically advantageous and it is not legally possible to transfer [...], Novo Banco shall not be considered in breach of this commitment. In any case, no new business shall be underwritten as from the date of the decision.
- (11) [...] shall be used strictly as a booking centre and a debt-issuing vehicle. All other new business shall cease as of [...] from the date of the decision.
- (12) [...] shall remain within the Non-core Unit as defined herein. For the avoidance of doubt, [...] will be considered part of the Core Unit. Investments in the context of value enhancing capital expenditures shall be permitted to ensure best-in-class work-out subject to a cap of 5% p.a. of Net Book Value of [...] at the beginning of the year. However, Net Book Value at year's end must be lower than the balance at the beginning of the year.
- (13) Novo Banco will reduce its exposure towards [...] during the restructuring period and will neither enter into new commitments nor refinance or roll-over existing commitments when they mature. For the avoidance of doubt, this shall not prevent Novo Banco from providing FX settlement, cash and cheque clearing and trade financing services to clients based in Portugal or Spain but exchanging with [...] or providing such services to [...] clients on a fully cash collateralised basis. However, Novo Banco will only accept [...] as counterparty risk on those services and only as long as the overall exposure at any given point in time during

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<sup>98</sup> For the avoidance of doubt, this includes products such as [...]. It does not refer to [...]. [...] need to be terminated at the earliest possible date.

the restructuring period will remain below the current exposure to [...]. Novo Banco will review and update its Know-Your-Client (KYC) and Anti-Money-Laundering (AML) procedures for [...] clients in particular within [...] of this decision. From [...] from this decision, it will not engage into new business with [...] clients prior to having completed this review and update and having reported on this review to the Monitoring Trustee

- (14) Should BES prior to the 2014 resolution or Novo Banco since then but prior to the present decision have engaged in contractual obligations related to financial instruments that conflict with any of the present commitments, any such contractual obligation will be brought to the attention to the Monitoring Trustee immediately when it becomes known together with an assessment of the impact and potential remedying measures if required for approval by the Commission. Such remedying measure shall take into consideration the severity of a breach of a commitment.

## **II. Behavioural commitments**

- (15) Remuneration: Novo Banco will apply strict executive remuneration policies and will not pay to any employee, director or manager a total annual remuneration (wage, pension contribution, bonus) higher than 10 times the average salary of employees in the bank until 30 June 2020. In the period between 30 June 2020 and the end of the restructuring period, annual remuneration payments above those limits can be made if Novo Banco does not breach any of the targets specified in the viability commitments. For avoidance of doubt, Novo Banco will in any case be able to pay deferred bonuses to its staff for performance during the restructuring period after the restructuring period has ended.
- (16) For the purpose of acquiring Novo Banco, the purchaser shall not be a previous qualified shareholder of BES (above 2%) within two years immediately prior to the setup of Novo Banco, as approved by the Resolution Decision, nor the Portuguese State.
- (17) Novo Banco will put in place an RoE-based pricing tool to ensure that the bank enters into new business (but not if the exposure is non-performing and without restructuring the borrower would be unable to repay the exposure) at a pre-tax RoE of no lower than [7-10] % during 2018, no lower than [8-11] % during 2019 and no lower than [9-12] % during 2020 and 2021. Novo Banco will comply with those RoE targets on a client relationship basis. If RoE management is not possible at the level of the client relationship, Novo Banco will implement those RoE targets on a per-deal basis. Novo Banco will indicate to the Monitoring Trustee which clients it monitors on a client relationship basis and which on a per deal basis for the purpose of this commitment. If not already existing, Novo Banco will immediately start with implementation of the tool post-closing to comply with the above RoE numbers and provide the relevant information to the monitoring trustee referred to in commitment (33). The tool will be in place by [...] for corporate clients and products, and [...] for retail client and products.
- (18) Novo Banco shall not acquire any stake in any undertaking, be it an asset or share transfer, until the end of the restructuring period. That ban on acquisitions covers both undertakings which have the legal form of a company and any package of assets that form a business. For the avoidance of doubt, this

does not include assets required for the daily activity of running a bank (e.g. office furniture, IT equipment, etc.), single assets required for normal business development (e.g. a new branch building in a given location, a new IT system, etc.) or portfolios of securitised assets.

- (19) The acquisition ban shall not apply to acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms, including the conversion of existing debt into equity instruments or any other work-out strategy which does not increase the exposure of Novo Banco but results in equity ownership, the enforcement of collateral or where the purchase price paid by Novo Banco for any acquisition is less than 0.01% of the balance sheet size of Novo Banco at the effective date of the commitment and where the cumulative purchase prices paid by Novo Banco for all such acquisitions starting with the effective date of the commitment is less than 0.025% of the total balance sheet size of Novo Banco at the effective date of the commitments. In addition, the acquisition ban shall not apply if a counterparty exercises a put option which pre-dates this decision in relation to GNB Não-Vida.
- (20) Novo Banco shall not pay dividend on ordinary shares until the end of the restructuring period.
- (21) Advertising ban: Portugal commits that the Novo Banco shall refrain from advertising that refers to state support and from employing any aggressive commercial strategies which would not take place without the support of the Portuguese Republic.

#### *Governance*

- (22) The Resolution Fund shall not exercise any of the voting rights corresponding to the 25% of the ordinary shares of Novo Banco that will remain in its possession and such rights shall be irrevocably waived. In the same manner, the Resolution Fund shall not appoint any members to the General and Supervisory Board or to the Executive Board of Directors or any other governing body of Novo Banco.
- (23) If the Resolution Fund no longer owns shares in Novo Banco while the CCA is in place, it has the right to subscribe to one share for the purpose of each of the Resolution Fund's contingent capital obligations. It also has the right to receive free shares issued by Novo Banco under bonus issuances, including capitalisation of reserves and dividend distributions. The distribution of free shares should not increase the shareholding of the Resolution Fund.
- (24) If capital increase would harm the economic interest of the Resolution Fund, i.e. reduce the value of its existing shareholding without equivalent compensation, the Resolution Fund may participate pro rata to its existing shareholding, upon prior authorisation from the Commission.
- (25) The rights related to all ordinary shares received or acquired by the Resolution Fund under commitments (23) and (24) shall be subject to the same restrictions as the initial shareholding under commitment (22).



- (26) One or more natural person(s) independent from all parties will be selected by the Resolution Fund with the sole task to provide to the Resolution Fund information confined to the risk associated with the obligations under the CCA (the “CCA Monitoring Trustee”). The CCA Monitoring Trustee would report on an aggregated basis but not on specific transaction or exposures apart from the guaranteed assets. The CCA Monitoring Trustee would have no rights of intervention other than requesting said information.

### III. Viability commitments

The commitments in this section are envisaged to ensure the viability of Novo Banco (the "Viability commitments"). All Viability commitments will cease no later than December 2021 unless otherwise specified in a specific commitment.

The Viability commitments shall not apply if a force majeure contingency outside the bank's control has occurred (e.g. war, terrorism, natural disasters, significant crisis or uncertainty in the Portuguese financial system and markets, impacting liquidity or access to funding for Portuguese financial institutions generally, resulting from national or international monetary, political, financial or economic conditions or securities markets or in currency exchange rates or interest rates, where the average Portuguese GB/German Bund spread is above 400bps or the average 5-year CDS spread of Portuguese banks exceeds 400 bps for at least a 3 month period during the financial year). In such a case, Portugal shall re-notify the measures to the Commission.

- (27) Novo Banco will reduce FTEs to no more than [4500-5250] on [...], [4250-5250] on [...] and [4000-5250] on [...] and the number of branches to no more than [350-475] on [...], on [...] and on [...].
- (28) In addition to (27), Novo Banco will find additional efficiencies on either income or cost side to reach a pre-provision income (net interest income plus net fee income minus operating expenses<sup>99</sup>) of EUR [300-500] million in [...] and EUR [500-800] million in [...]. If a shortfall is identified, Novo Banco will implement measures in the following fiscal year to cure that shortfall (i.e. reach a

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<sup>99</sup> Pre-provision income of EUR [...] in [...] and EUR [...] in [...] according to the original plan that was increased by EUR 15mn to EUR [...] in [...] and by EUR [...] to EUR [...] in [...] for the purpose of this commitment. For monitoring purposes, actual numbers will be compared to those numbers

Operating expenses are defined as staff costs, general and administrative expenses and Depreciation and amortisation per the prevailing latest audited annual consolidated accounts (31 December 2016, notes 15 and 17). Any restructuring costs such as related to staff reduction and increased IT expenditure as per the restructuring plan or any CCA offset-able charges shall be excluded for the purposes of this commitment.. Costs related to FTE and branch reductions above plan will in any case not be considered recurring costs.

Non recurring costs shall in principle be excluded. Those items include for instance costs related to staff reduction and increased IT expenditure, advisory or consultant fees for one-off projects (e.g. RoE implementation, amendments to KYC process)

Such adjustments shall be discussed between Novo Banco and the Monitoring Trustee to determine if an item is recurring.

Future changes in accounting standards are not to influence the definitions noted herein including the definitions of net interest income and net fee income.

pre-provision income of EUR [400-650] million in [...] if the [...] target was missed and EUR [500-800] million in [...] if the [...] target was missed). The measures to cure will be presented to the Monitoring Trustee within three months post breach. If curing is not successful, Novo Banco will reduce an additional [50-200] FTEs and [5-20] branches (if [...] is breached) or [100-400] FTEs and [10-40] branches (if [...] is breached) in the year that follows (under the conditions of this commitment, the maximum reduction required shall be [100-400] FTEs and [10-40] branches). The restructuring period with all commitments<sup>100</sup> will prolong until the conditions under this commitment are met.<sup>101</sup>

- (29) Novo Banco will reach a cost-to-income ratio (“C/I Ratio”)<sup>102</sup> of [50-60]% in FY 2019, [40-50]% in FY 2020 and [40-50]% from FY 2021 onwards. If the C/I ratio exceeds those targets by at least [5-10] percentage points in a given fiscal year *t*, Novo Banco will present measures to the Monitoring Trustee within three months to cure the shortfall to reach the C/I Ratio for year *t+1* as specified above to be implemented during the following fiscal year *t+1*. Should Novo Banco not be successful in curing the shortfall and not reach the C/I Ratio of the year following the breach, then the following commitments will apply:

C/I Breach size	Additional cost cut (compared to LSF restructuring plan)
[5-20] percentage points	[300-500] FTEs & [30-50] branches
above [5-20] percentage points	[450-600] FTEs & [45-60] branches

The additional FTEs and branch reduction will be fully implemented in [...] (i.e. the effect should be fully visible in the P&L statement by [...]).

This commitment shall not apply if the average C/I Ratio of the Portuguese banking market as reported by the Bank of Portugal has deteriorated by more than [...]percentage points in the given year.

<sup>100</sup> For the purpose of the prolongation of the restructuring period, commitment (15) is treated separately as specified in the text of commitment (15).

<sup>101</sup> For avoidance of doubt, conditions under this commitment are met either by complying with the specified target at the end of [...] or by complying with the specified target in [...] following the implementation of all remedial measures or, if Novo Banco is still in breach with the target in [...], as soon as the required additional FTE and branch reductions are implemented.

<sup>102</sup> For the purposes of calculating the cost-to-income ratio under commitment (27), the same definitions of income and costs apply as for commitment (26).

Under the conditions of commitments (28) and (29), the maximum reduction required shall be [450-600] FTEs and [45-60] branches. The restructuring period with all commitments<sup>103</sup> will prolong until the conditions under this commitment are met.<sup>104</sup>

- (30) In case the SREP total capital ratio of Novo Banco falls below the SREP total capital requirement, capital measures will be implemented by Novo Banco to make up the shortfall within [...]. If routine measures cannot restore the capital position to compliance, then the private owner will be asked to supply the necessary capital, which Portugal is allowed to match according to the conditions laid down in the Share Purchase and Subscription Agreement. Additionally, capital can also be generated through a market call.

If the capital supplied through the preceding measures is insufficient to comply with the SREP total capital ratio for the given year, the remaining gap will be closed as an ultimate backstop by means of issuance of AT1 instruments or public capital injection, to be decided by Portugal. If AT1 capital instruments will be used, they will be either issued to the market and carry a coupon that may be fully paid by Portugal ("the AT1 instrument") or underwritten by Portugal directly.

If the AT1 instrument is issued under this commitment or a public capital injection beyond the proportion of ownership is provided, then a reduction of [800-1100] FTEs and [90-120] branches will be required in [...] following the provision of the capital contribution and Portugal will notify a new restructuring plan for Novo Banco to the Commission for approval. Any reductions of FTEs and branches required and implemented under commitments (28) and (29) will be counted towards this reduction.

The issuance of AT1 instruments or public capital injection as an ultimate backstop forms part of the notified aid measures up to the maximum amount, necessary to ensure long term viability, defined under the scenaria identified in the Commission's decision where this commitment is attached. Portugal commits to notify to the Commission pursuant to Article 108(3) TFEU, prior to implementation, any additional aid beyond that level.

- (31) Novo Banco is rotating its auditor for the financial year [...] as part of its ordinary rotation procedures.

If Novo Banco's cumulative loan loss provisions (excluding CCA assets) between [...] and [...] is below EUR [0-5] billion, the delta between the EUR [0-5] billion and the cumulative losses recognised (the "Additional Provisions") shall be provisioned for in Novo Banco's accounts as of [...] unless the Additional Provisions are considered to not be in accordance with applicable IFRS framework by Novo Banco's auditor.

- (32) The Bank will comply with best lending practices. In particular it will observe the commitments with respect to connected lending, pricing and credit risk management.

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<sup>103</sup> For the purpose of the prolongation of the restructuring period, commitment (15) is treated separately as specified in the text of commitment (15).

<sup>104</sup> For avoidance of doubt, conditions under this commitment are met either by complying with the specified target at the end of [...] or by complying with the specified target in [...] following the implementation of all remedial measures or, if Novo Banco is still in breach with the target in [...], as soon as the required additional FTE and branch reductions are implemented.

#### a. Connected Lending

Within the Credit Policy of the bank, a specific section shall be devoted to the rules governing relations with connected borrowers<sup>105</sup>. The credit assessment of the connected borrowers, as well as the pricing conditions and possible restructuring offered to them, shall not be more advantageous compared to conditions offered to similar but unconnected borrowers and be performed/offered accordingly to Credit Policy (credit assessment and restructuring) and Commercial Policy (pricing conditions). Particular focus shall be on decisions regarding any restructuring and write downs of existing loans to connected borrowers as well as policies followed in the appropriateness, valuation, registration of liens and foreclosure of loan collateral. The restructuring of loans involving connected borrowers shall comply with the same requirements as for non-connected borrowers. Any lending, loan restructuring or other form credit extension of connected borrowers shall be reported separately, at least per loan asset class and connected borrower type. If necessary, Novo Banco will adapt its Know-Your-Client (KYC) and Client Adoption procedures in order to ensure that it is able to comply with part (a) of this commitment starting 6 months following the date of this decision.

#### b. Risk Management

- i. New and renewed loans shall be made on the basis of adequate comparative financial statements, income statements (including personal income statements in retail loans), cash flow statements, existing debt analysis or other pertinent statistical support. The bank will ensure that every new or renewed combined exposure exceeding [0-5] million EUR obtains a credit rating (implying a default probability) and an expected loss rate, which is reviewed at least once per annum. The bank will engage in an effort to re-rate all credit exposures exceeding [0-5] million EUR over the next [...] years and will from [...] rerate every exposure above [0-5] million EUR on an annual basis. Novo Banco shall not be considered in breach of this commitment if a random sample of a 50 exposures selected and verified by the Monitoring Trustee contains no more than two non-rated exposures. If non-rated exposures are found, Novo Banco will provide an explanation and a remediation plan to the Monitoring Trustee.
- ii. The bank will set up a risk management system that will allow producing a complete and accurate loan exposure tape. For each loan exposure, this will include at least all collaterals, collateral

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<sup>105</sup> For the purpose of this commitment, connected borrowers include relevant employees (i.e. risk takers which are identified in the Bank's Global Policy on related and connected parties in order to prevent conflict of interests and which are involved in the decision-making process of the Credit Policy), significant shareholders, directors or managers, as well as their spouses, children and siblings and any legal entity directly or indirectly controlled by relevant employees (as defined above), significant shareholders, directors or managers or their spouses, children and siblings. Political parties, Politically Exposed Persons or their spouses, children and siblings and any legal entity directly or indirectly controlled by them shall also be treated as connected borrowers in the Credit Policy for the above purposes. For as long as the Resolution Fund or entities under control of the Portuguese authorities hold, on aggregate, a shareholding of more than 25%, any public institution or government-controlled organization, any public company or government agency shall be considered as a connected borrower.

valuations, latest valuation dates and lien priority. Other essential information, such as the purpose of the borrowing and intended plan or sources of repayment, progress reports, inspections, memoranda of outside information and loan conferences, correspondence, etc., should be contained in the bank's credit files.

- iii. The bank will avoid any proprietary trading activity beyond what is necessary for the normal operations of a commercial bank.

The bank will set up a VaR limit for (i) treasury assets including market making and ALM and (ii) other market related activities including proprietary positions not related to (i). For (i) an equivalent of a 1-day, 99% VaR limit of up to [0-5]% of the bank's CET1 shall apply, for (ii) an equivalent of a 1-day, 99% VaR limit of up to [0-5]% shall apply. The bank will set up internal processes with a conservative division of limits across activities so as to ensure that no accidental breaches of these limits will occur. It will consistently update those limits at least on a quarterly basis, as a function of historical volatility and capital position. The bank will report on the implementation of these processes and the limits in vigour to the monitoring trustee.

Novo Banco will not make the remuneration of employees active in these areas dependent on the profitability of that activity<sup>106</sup>.

#### **IV. Monitoring Trustee**

- (33) One or more natural or legal person(s), independent from the Bank and not having worked previously with the Bank or the Portuguese authorities in matters connected to the Bank, proposed by Portugal and approved by the Commission and appointed and paid for by Novo Banco; the Monitoring Trustee will have the duty to monitor the full compliance with the Commitments on the basis of six-monthly reports (half year and full year) until the end of the Restructuring Period.

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<sup>106</sup> For the avoidance of doubt, this does not preclude Novo Banco from implementing claw backs on remuneration if required to do so by law.