

FITCH WIRE

Clarity on Novo Banco Capital Injections Could Help Portuguese Banks

Thu 07 Jan, 2021 - 11:33 AM ET

Fitch Ratings-Paris / London-07 January 2021: Clarity on the timing of any fresh capital injection for Novo Banco S.A. could improve the backdrop for Portuguese banks' funding and capital raising plans in 2021, Fitch Ratings says. We expect a capital injection if one is required, but prolonged uncertainty would damage investor sentiment towards the sector.

Novo Banco is the 'good bank' which took over some assets and liabilities from Banco Espirito Santo, S.A. after its 2014 collapse. In 2017, US private equity firm Lone Star acquired a 75% stake in Novo Banco, while Portugal's Resolution Fund retained 25%. The Resolution Fund provides additional capital if Novo Banco's drops below minimum levels, set with reference to the performance of certain designated assets, and other conditions are met under a Contingent Capital Agreement (CCA) approved by the European Commission.

Whether a capital injection under the CCA is needed in 2021 depends on Novo Banco's 2020 results, which have yet to be published. The CCA allows capital injections totalling EUR3.89 billion, of which nearly EUR3 billion has already been provided, most recently in May 2020 when the Resolution Fund injected EUR1.035 billion (about 0.5% of GDP). But in late November, opposition parties blocked the inclusion of a further potential EUR476.6 million capital injection in the 2021 state budget.

The Finance Minister and Prime Minister have said that the Portuguese authorities will meet their commitments under the CCA, underpinning our assumption that additional capital would be provided if needed. However, opposition parties have become more vocal in questioning the cost of Novo Banco support and a perceived lack of parliamentary scrutiny.

The minority government's failure to secure parliamentary approval for the potential capital injection in the state budget, and parliament's request that the Court of Audit review Novo Banco's losses that necessitated capital injections under the CCA since 2018, could lead to significant political and legal uncertainty. Rui Rio of the opposition Social Democrats has said his party would support an injection, subject to the outcome of Court of Audit's review. Novo Banco's management and Lone Star strongly dispute claims by some politicians that non-performing asset sales may have been structured to benefit Lone Star.

Uncertainty could persist for some months, at least until the Court of Audit reports and parliament examines its conclusions. The government could try and inject capital without parliamentary approval, using funds set aside in the 2021 state budget for unexpected expenses, but this would be politically controversial. It could include a capital transfer in a supplementary budget, but this would require parliamentary approval. It is unclear if Lone Star would take legal action if it believed the authorities were in breach of the CCA.

Persistent uncertainty around such issues could weaken investor sentiment towards Portuguese banks, especially if investors questioned the authorities' ability to abide by the CCA. Any increase in funding costs would erode the sector's profitability, which is already weak through lack of business diversification, high reliance on interest income, and strong domestic competition. We expect operating profit/risk-weighted assets for Fitch-rated Portuguese banks to drop from about 1.2% in 2020 to 0.9% in 2021, with the weakest banks being loss-making in both years.

Operating Profitability

%

Op. ROAE 1H20 (LHS)

Op. profit/RWAs 1H20 (RHS)

Op. ROAE avg. 2015-2019 (LHS)

Op. profit/RWAs avg. 2015-2019 (RHS)

Note: ROAE = return on average equity. RWAs = risk-weighted assets. BCP = Banco Commercial Portugues, CGD = Caixa Geral de D
Source: Fitch Ratings, banks

FitchRatings

The sector also faces potentially costly issuance of minimum requirements for own funds and eligible liabilities (MREL) resuming in 2021-2022 ahead of intermediary compliance dates. The Single Resolution Board recently estimated that Portuguese banks had an MREL shortfall of EUR10.7 billion at end-1H20, or 9.1% of their total risk exposure. EUR2.4 billion of this was in subordinated liabilities, which would be costlier to issue. Some banks have limited access to unsecured wholesale funding markets.

Extra funding for regulatory purposes will exacerbate profitability challenges, although banks may get extra time to meet MREL targets.

Capitalisation and Leverage

% at end-September 2020*

CET1 ratio (LHS)

Total capital ratio (LHS)

CET1 SREP requirement (LHS)

Leverage ratio (RHS)

Note: BCP = Banco Commercial Portugues, CGD = Caixa Geral de Depositos. CET1 SREP includes the Capital Conservation Buffer ;
Source: Fitch Ratings, banks

FitchRatings

Related Research: [Fitch Ratings 2021 Outlook: Western European Banks](#)

Contact:

Rafael Quina, CFA

Director, Financial Institutions - Banks

+33 1 44 29 91 81

Fitch Ratings Ireland Limited

60 rue de Monceau

750078 Paris

Julien Grandjean

Associate Director, Financial Institutions - Banks

+33 1 44 29 91 41

Kit Ling Yeung

Associate Director, Sovereigns

+49 69 768076 129

Mark Brown

Senior Director, Fitch Wire

+44 20 3530 1588

Media Relations: Louisa Williams, London, Tel: +44 20 3530 2452, Email:

louisa.williams@thefitchgroup.com

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH

RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and

updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers. For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001. Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

