

FITCH WIRE

Novo Banco Action Highlights Bridge Bank Retransfer Risks

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Fitch Ratings-London-11 January 2016: The Bank of Portugal's decision on 29 December to transfer EUR1.9bn of senior bonds out of the Novo Banco bridge bank and back to Banco Espírito Santo (BES), which is to be liquidated, shows bridge bank investors can face legacy retransfer risks until resolution is concluded, says Fitch Ratings.

In our opinion, the handling of Novo Banco's resolution process raises questions about how future bank resolutions might be dealt with in the EU, particularly because the timeframes could prove quite lengthy. The Novo Banco experience also means that any future ratings we might assign to bridge banks might be constrained to reflect legacy retransfer risks to investors until that risk is sufficiently remote.

Novo Banco, housing failed BES's "good" assets and liabilities, was established in August 2014 and is fully owned by Portugal's Resolution Fund. When announcing resolution proceedings, the Bank of Portugal had said that "unsubordinated bonds issued by BES will be repaid by Novo Banco at their maturity date, as customers' claims on those bonds have been transferred to Novo Banco." Subordinated bonds remained with BES. The Bank of Portugal also said that it could transfer assets and liabilities between Novo Banco and BES at any time during the resolution process, and this has now taken place. But full closure of the resolution process dragged out over 16 months.

From the outset, Bank of Portugal made it clear that it intended that Novo Banco would be sold to private shareholders. But efforts to sell the bank proved unsuccessful. Results of a stress test published by the European Central Bank in November 2015 highlighted that Novo Banco would face a EUR1.4bn capital shortfall under an adverse stress scenario, although it met minimum capital requirements in the baseline scenario. Stress tests were based on end-2014 financial statements but the bank's financial situation subsequently weakened and it reported net losses of EUR252m for the six months ended 1H15, further

weakening capital adequacy.

The re-transfer of the five senior bonds announced in December 2015 addresses the bank's solvency shortfall and this might support renewed efforts to find a buyer.

We do not rate Novo Banco. But if we did, we would probably have viewed the retransfer of the bonds into BES as a restricted default of Novo Banco and its Issuer Default Ratings would have reflected this.

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