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The Management of the Bank Crisis in Portugal - Law and Practice

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THE MANAGEMENT OF THE BANK CRISIS IN PORTUGAL – LAW AND PRACTICE*

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JOSÉ ENGRÁCIA ANTUNES

Abstract

The Portuguese banking system was until very recently ignored. As happened with the banking systems of other small economies, it was a common belief of both politicians and regulators that it was just too small to matter to the outside world. Today, after the financial crisis on 2008, we know better. If there is something to be learnt with the globalisation of economic and financial markets, it is precisely the relevance of the "butterfly effect", by reminding us that even a tiny event can start a chain reaction and have large and wide-reaching effects. This paper aims at briefly describing some recent crisis episodes of the Portuguese banking system, the existing regulatory framework for the management of a bank crisis, as well as the lessons to be drawn from its application.

I. THE BANK CRISIS IN PORTUGAL

1. The Crisis of the Portuguese Banking System

1.1. The Portuguese Banking System

I. The Portuguese banking system has undergone major transformations during the last decades[1]. After the revolution of 1974, all private banks in Portugal were nationalized and submitted to heavy state control and regulations (e.g., credit ceiling, deposit and interest rates fixed administratively). From the mid 80's, with Portugal joining the European Union, banking activity was progressively reopened to private enterprises and the legal framework for financial activity was liberalized: as a result, the

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[1] For an overview of the Portuguese banking system, *see* VALÉRIO, Nuno/ NUNES, A. Bela/ BASTIEN, Carlos/ SOUSA, R. Martins/ COSTA, S. Domingos, *History of the Portuguese Banking System*, Volume 2, Banco of Portugal, Lisbon, 2010.

banking sector experienced significant changes, expanding from a mere 16 banks in 1983 to 45 banks in 1995.[2]

II. During the late 90's and the first decade of the 21st century, the Portuguese banking sector experienced a *significant expansion in size, number and profitability*. Prior to the global financial crisis of 2008, Portuguese banks were spread all over the country (the third highest branch density in the EU, only behind Spain and Cyprus) and enjoyed one of the highest rate of return on equity (with an average rate of 15%). This strong revenue performance was also followed by a concentration in the banking industry, giving rise to the formation of *five major banking groups*, one being public ("CGD – Caixa Geral de Depósitos) and the others being private ("BES – Banco Espírito Santo", "BCP – Banco Comercial Português", "BPI – Banco Português de Investimento", and "BST – Banco Santander Totta").[3]

1.2. The Origins of the Crisis

I. The high levels of expansion and profitability of the Portuguese banking system were based, however, on a set of high-risk factors. Firstly, was the *overreliance on wholesale funding*. As a matter of fact, the predominant business model for Portuguese banks then was based on wholesale funding, relying on interbank lending and bonds, rather than on a retail-oriented model, based on customers' deposits (with one of the highest loan-to-deposit ratios in the euro area, increasing from 100 percent in 1999 to 172 percent in 2008)[4]. Secondly, was the *concentration and misallocation of credit.* In seeking to retain profitability, Portuguese banks dramatically increased their credit portfolios, which were heavily concentrated in the real estate and construction sectors (loans rocketed from EUR 8.4 billion in 1999 to EUR 26.1 billion in 2008, accounting for 70%

[2] BANK OF PORTUGAL, *Annual Report 1996,* Lisbon, 1996. *See* also CANHOTO, Ana, *Portuguese Banking: A Structural Deposit Competition in the Deposits Market,* in: 13 "Review of Financial Economics" (2004), 41-43.

[3] BANK OF PORTUGAL, *Annual Report (1996 to 2004),* Lisbon. *See* also BARROS, Fátima/ MODESTO, Leonor, *Portuguese Banking Sector: a Mixed Oligopoly?*, in: 17 "International Journal of Industrial Organization" (1999), 869-886; CARVALHO, Margarita, *Fusões e Aquisições no Setor Bancário*, Master Dissertation, Minho, 2007.

[4] FERREIRA, P. Botelho, *Rethinking the Portuguese Banking Sector in a Post-Crisis Context*, Master Dissert., Lisbon, 2014. For instance, in 2009, BES, one of the largest Portuguese banks, had a loan-to-deposit ratio of 192% (ROCIO, Joana, *A Medida de Resolução Aplicada ao BES,* 5, Diss., Lisbon, 2015).

of the total credit portfolio by 2008). Finally, was the *concentration of ownership*. The ownership of the major Portuguese banks was highly concentrated in the hands of large economic groups, which was likely to induce lending activity to less productive industries (namely, construction) and to expose the banking sector to the performance of those industries as well as to their major shareholders.[5]

II. *The global financial crisis in 2008 brought to light those hidden vulnerabilities of the Portuguese banking system*. The banks' excessive reliance on wholesale funding resulted in low levels of liquidity, which were only overcome thanks to ECB funding. The credit misallocation in the real estate and construction sectors exposed them to the crash in those industries, with the subsequent climb of non-performing loans resulting in huge impairment losses; and concentred ownership gave rise to mutual negative inputs between the financial and the economic systems, exposing banks to the crisis of their major shareholders. Governance problems also played a role: failures in risk management and auditing procedures of banks, mismanagement scandals, and soft supervision, certainly contributed to the crisis of the banking system in Portugal.[6]

III. On top of this, the financial crisis quickly evolved into a *sovereign debt crisis*, with large feedback repercussions in the banking system[7]. This was due to a large set of severe circumstances, which, by occurring more or less simultaneously, generated a perfect storm in the Portuguese economic-financial system. Amongst the causes, it should be pointed out, were the large exposures of Portuguese banks to domestic public debt (which could be used as collateral in repo transactions with the ECB), the massive amount of state aid to rescue banks (increasing the public debt level), the fragmentation of Eurozone financial markets (escalating the sovereign debt interest rates of peripheral economies, such as Portugal, with boomerang effects over the banking system itself), and the massive credit deleverage and capital strengthening of Core Tier 1 ratios (which caused in turn a liquidity and credit crunch which affected the overall performance of the economy, thus aggravating the problem of non-performing loans).

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[5] INTERNATIONAL MONETARY FUND, *Portugal Second Post-Program Monitoring Discussion* (IMF Country Report nº 16/300, 5 August 2016).

[6] BANDEIRA, Paulo, *Consolidation and the Evolution of Governance Models in Portuguese Financial Institutions,* in: Sérgio, Anabela (ed.), "Banking in Portugal", 21-38, Palg. Macmillan, Basingstoke, 2016.

[7] SÉRGIO, Anabela/ SOUSA, A. Rebelo, *The Impact of the Financial Crisis on Portuguese Banks: The Problem of Portuguese Sovereign Debt*, in: Sérgio, Anabela (ed.), "Banking in Portugal", 9-20, Palgrave Macmillan, Basingstoke, 2016.

2. The Banks in Crisis

I. As a result, several Portuguese banks experienced difficulties, and subsequently underwent various types of legal solutions: these banks were "Banco Português de Negócios" (2008), "Banco Privado Português" (2010), "Banco Espírito Santo" (2014), and "Banco Internacional do Funchal" (2015).

2.1. The BPN Case

I. The *"Banco Português de Negócios" (BPN)* was a privately-owned Portuguese bank. Founded in 1993, it entered into a crisis due to mismanagement practices, which resulted in a malpractice-related hidden debt of EUR 1.8 billion.

II. In spite of its small market share in the Portuguese banking system (1.8 percent in terms of total assets), BPN was *nationalized* by the Portuguese Government allegedly to prevent the risk of some systemic impact (Law 62-A/2008, of 11 November). This case also had some political implications, as the then Portuguese President and some of his political allies maintained personal and business relationships with the bank and its CEO, who was eventually charged with and arrested for fraud and other crimes. The role of the supervisory authority, the Bank of Portugal, was also under scrutiny, as it was argued that the crisis of BPN was also due to gross negligence in performing its supervisory functions. In 2011, after being stripped of many of its debts and bad loans, BPN was sold to the Angolan bank BIC for EUR 40 million[8]. According to a 2016 report of the "Tribunal de Contas", a public entity responsible for reviewing the legal issues on public expenditure, fthe nationalization of BPN has involved, so far, a cost of EUR 590 million to the Portuguese State.[9]

[8] BANK OF PORTUGAL, *Financial Stability Report 2008*¸ 131, Lisbon, 2009. On the BPN case, *see* also CORDEIRO, A. Menezes, *A Nacionalização do BPN,* in: I "Revista de Direito das Sociedades" (2009), 57-91; FERREIRA, D. Saramago, *A Nacionalização do Banco Português de Negócios: Análise da Lei n.º 62-A/2008, de 11 de Novembro*, in: III "Revista de Direito das Sociedades" (2011), 169-186.
[9] TRIBUNAL DE CONTAS, *Relatório de Acompanhamento da Execução Orçamental*, 53, Report nº 3/2016, of 16 August 2016.

2.2. The BPP Case

I. The *"Banco Privado Português"(BPP)* is a privately-owned Portuguese bank with head offices in Lisbon. Founded in 1996, and specialising basically in investment banking, it went into difficulties due to the problems relating to the demarcation between its asset management operations on behalf of customers and its activity in drawing in deposits, covering a considerable part of its banking and financial contracts.

II. Curiously, by invoking reasons similar to those which had justified the nationalization of BPN – that is, its small market share (less than 1 per cent) and its highly specialized business –, the Portuguese authorities took a different course of action, ordering the *liquidation* of BPP in 2010, considering the small systemic risk involved and after verifying the impossibility of recapitalization and recovery efforts of this institution. As a result, the Bank of Portugal nominated a liquidation committee at the same time that a loan of EUR 450 million, underwritten by the Portuguese State, was provided by a banking consortium to cover withdrawals of deposits and the repayment of the loans of BPP. In the meantime, the former CEO and other members of the board were prosecuted criminally and civilly for mismanagement and fraud that damaged hundreds of clients for an estimated EUR 41 million. After several years, the liquidation of BPP is still an unfinished business.[10]

2.3. The BES Case

I. The *"Banco Espírito Santo" (BES)* was once the oldest and one of the largest Portuguese banks. Created at the end of the 19th century as a family-owned financial institution, BES was the second major private bank in Portugal, operating in 25 countries, with net assets estimated at EUR 80 billion, more than 2 million clients, and an average market share of 20.3%. It was also the second largest listed Portuguese bank, the ninth largest contributor to the PSI-20 (the main Portuguese stock index) and an important

[10] BANK OF PORTUGAL, *Financial Stability Report 2008*, 131, Lisbon, 2009. On the BPP case, especially in regard of the investment management service contracts, *see* FRADA, M. Carneiro, *Crise Financeira Mundial e Alteração das Circunstâncias: Contratos de Depósitos vs. Contratos de Gestão de Carteiras*, in: 69 "Revista da Ordem dos Advogados" (2009), 633-695. On a preliminary ruling attesting the validity of the Portuguese State aid to BPP, *see* the decision of the European Court of Justice of 5 March 2015 (case C-667/13, "Estado Português versus Banco Privado Português").

component of a larger, diversified corporate group, with international reach, ultimately owned by the family Espírito Santo ("Grupo Espírito Santo" or GES).[11]

II. On 30 July 2014, BES announced to the market record losses of EUR 3.5 billion, reflecting seriously detrimental acts of mismanagement, as well as intragroup exposures issuing from the violation of previous determinations of the Portuguese supervisory authority establishing ring-fencing prohibitions amongst entities of GES. Facing the imminent suspension of its counterparty status with the ECB, and given the systemic risks involved to the overall banking system, the Portuguese resolution authority (Bank of Portugal) decided to apply to BES *a resolution measure in the form of the bridge institution tool*, which was speedily approved by the European Commission and which essentially split the bank in two. BES was left behind as a "bad bank", with the equity (EUR 3.7 billion) and liabilities to subordinated creditors (EUR 927 million), as well as other toxic assets, contingent liabilities and claims of related parties; whereas the rest of its balance sheet, including deposits, senior debt obligations and healthy assets, were transferred into a newly created bridge institution, named "Novo Banco" (NB) (the "good bank")[12], whose share capital of EUR 4.9 billion was fully subscribed and held by the "Portuguese Resolution Fund" (PRF). The resolution measure was taken with the objective of ensuring the continuity of the services provided by BES, the stability and public confidence in the financial system, and the protection of the interests of its depositors and clients while safeguarding the interests of taxpayers and public funds.[13]

III. The BES case is remarkable in several aspects. [14]

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[11] As of June 2014, BES was 25% owned by "Espirito Santo Financial Group" (ESFG), a subholding company of the GES owned in 49.3% by "RioForte", which in turn was fully owned by the holding company "Espírito Santo International" (ESI), which in turn was owned in 56% by the head of the group "Espírito Santo Control" (ESC).

[12] The business name of the bridge bank, "Novo Banco", means literally "new bank".

[13] BANK OF PORTUGAL, *Deliberation of 3 August 2014* (in: https://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Documents/Deliberation_3_Aug_2014_8pm.pdf).

[14] On the BES case, *see* AZEVEDO, M. Luísa, *Contributo para o Debate Sobre o Regime Jurídico Aplicável Aquando e Após a Medida de Resolução Aplicada ao BES*, in: 51 "Cadernos do Mercado de Valores Mobiliários" (2015), 119-126; BARBOSA, M. Miranda, *A Propósito do Caso BES: Algumas Notas Acerca da Medidas de Resolução*, in: 58 "Boletim de Ciências Económicas" (2015), 187-240; MONCADA, L. Cabral, *Os Poderes de Resolução do Banco de Portugal e o Banco Espírito Santo*, in: 6"Jurismat - Revista Jurídica do Instituto Superior Manuel Teixeira Gomes" (2015), 99-124; ROCIO, Joana, *A Medida de Resolução Aplicada ao BES,* Diss., Lisbon, 2015; SANTOS, P. Lopes/ PINHO, P. Soares, *Banco Espírito Santo: Asset and Liability Management During the Financial Crisis*, Nova School of Business & Economics, Lisbon, 2015.

First of all, it can be seen as an *early test case* for the EU's Bank Recovery and Resolution Directive (BRRD), which Member States were only bound to adopt by January 2015. According to some views[15], certain aspects of the content of this decision could actually be seen as contradicting the spirit of the BRRD that entered into force later on.

Secondly, this resolution decision involved complex issues relating to the perimeter of the assets, liabilities, off-balance sheet elements, and assets under management that were excluded from the transference to the "good bank" NB, and therefore left behind in the "bad bank" BES, giving rise to *massive litigation,* both in national and international courts. By the beginning of 2016, there were 458 claims in the Portuguese courts where, invariably, the plaintiff's central complaint related to the selection of assets and liabilities made by the resolution authority. Likewise, in 2015, Goldman Sachs International (GSI) filed a claim under the English commercial courts relating to the decision of the Portuguese resolution authority not to transfer to the bridge bank an outstanding liability of 835 million dollars originating in a facility agreement concluded between BES and OAK Finance, a special purpose vehicle of GSI[16]. A set of international institutional investors also threatened legal action against a subsequent decision of the same resolution authority, to transfer back to BES five senior bonds valued at nearly EUR 2 billion, on the grounds that it violated the "pari passu" principle.[17]

Thirdly, while aiming to impose the financial burden of the resolution on the private sector (the failed bank's shareholders and creditors, and ultimately the banking sector as a whole), it is still uncertain whether or not the resolution of BES will involve a cost for taxpayers and public funds. Although NB was capitalized by the national resolution fund, the PRF, only a very small part of it was actually financed by the PRF's own funds consisting of contributions of other member institutions and the banking sector as a whole (EUR 377 million), the remaining part came from a senior loan granted by the Portuguese State. However, the prospects of that loan being fully repaid by the Resolution

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[15] FAIA, Ester/ DI MAURO, Beatrice, *Cross-Border Resolution of Global Banks,* 11, European Economy Discussion Papers (n.º 11), Brussels, 2015.

[16] BANK OF PORTUGAL, *Deliberation of 22 December 2014* (in: https://www.bportugal.pt/en-US/OBancoeoEurosistema/Esclarecimentospublicos/Documents/Deliberation20151229_Perimeter.pdf). On the preliminary court ruling of the English Court, see *Goldman Sachs International v. Novo Banco*, in: [2015] EWHC 2371 (Comm).

[17] BANK OF PORTUGAL, *Deliberation of 29 December 2015* (in: https://www.bportugal.pt/en-US/OBancoeoEurosistema/Esclarecimentospublicos/Documents/Deliberation20151229_retransfer.pdf).

Fund are becoming slimmer, as the disappointing ongoing bidding for NB renders unlikely any reimbursement and it is rather doubtful whether the PRF's banking members are actually able to make the necessary exceptional financial contributions.[18]

2.4. The BANIF Case

I. The *"Banco Internacional do Funchal"* (BANIF) was a Portuguese private bank with its head offices in Madeira. Founded in 1988, BANIF was the head of the seventh largest Portuguese banking group, with net assets of EUR 12.7 billion and deposits of EUR 6.2 million, it was also the market leader in the Azores and Madeira, with market shares above 30% in deposits and loans.

II. The background to BANIF's collapse is still wrapped in some mystery. In January 2013, BANIF had undergone a recapitalization, which included a contribution from the Portuguese State of EUR 1.1 billion (of which EUR 700 million were in the form of special shares and EUR 400 million in hybrid instruments, the so-called "CoCo" bonds) and a capital increase by private investors in the amount of EUR 450 million. The bank faced difficulties in promptly repaying the public contributions, failing to reimburse a EUR 125 million tranche that matured in December 2014. On top of this, the approval of the public recapitalisation operation, which was temporarily agreed by the European Commission, was dependent on the endorsement of an accepted restructuring plan: after a number of restructuring plans were successively rejected, the European Commission opened in July 2015 an investigation process of the State aid to BANIF. Finally, in the wake of a bizarre and dizzying course of events during five days of December 2015 – which included breakings-news of an imminent bank collapse (resulting in a run on the bank with depositors withdrawing EUR 1 billion) and an urgent voluntary process for sale of the bank (which has apparently failed) –, the Portuguese authorities decided to intervene.

III. On 20 December 2015, the Bank of Portugal determined the application to BANIF of a *resolution measure in the form of the sale of business* tool. According to the

[18] See also INTERNATIONAL MONETARY FUND, *Portugal: First Post-Program Monitoring*, 26 (IMF Country Report nº 15/21, December 16 2014).

resolution decision, the business of BANIF and the majority of its assets and liabilities were to be sold to "Banco Santander Totta" for EUR 150 million. At the same time, an asset management vehicle, named "Oitante, S.A", was specifically created in order to receive and manage the problematic assets of BANIF with a book value of EUR 2.2 billion. The creation of this special purpose vehicle, whose equity capital was fully subscribed by the Portuguese Resolution Fund (PRF), involved an estimated public support of around 2.2 billion intended to cover future contingencies (of which 489 million was from the PRF and around 1.7 billion directly from the Portuguese State). The purchaser bank "Santander Totta" also received a further EUR 746 million in bonds issued by "Oitante", guaranteed by the PRF and counter-guaranteed by the Portuguese State. As a result, the liabilities of the PRF have increased significantly, as further financial support from the banking sector will be necessary in the future.[19]

2.5. What's Next?

I. This succession of events of distress and collapse of Portuguese banking institutions raises a legitimate doubt as to whether similar cases could appear in the near future.

II. The "Caixa Geral de Depósitos" (CGD) is the largest bank in Portugal, with the highest domestic market shares in key areas such as customer deposits, loans and advances to customers, mortgages, insurance, mutual funds and real estate leasing (11.4%) and with net assets of more than EUR 100 billion (being the 109th largest of the world's major banks). Recently, in August 2016, the European Commission and the Portuguese Government agreed in principle on the recapitalization, on market terms, of CGD, envisaging an injection of up to EUR 2.7 billion in state funds and nearly as much in debt and equity.[20]

[19] BANK OF PORTUGAL, *Deliberation of 20 December 2015* (https://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Documents/Deliberacao20151220_23h45_EN.pdf). On the BANIF case, *see* Wall Street Journal, *Portugal's Failed Lender Banif Snapped Up by Santander*, December 21 2015; INTERNATIONAL MONETARY FUND, *Portugal: Third Post-Program Monitoring*, 12 (IMF Country Report nº 16/97, March 15, 2016).

[20] FINANCIAL TIMES, *Portugal and EU Reach Deal to Recapitalise Caixa Geral de Depósitos*, of 25 August 2016.

III. According to some viewers, this capitalization of the state-owned CGD may be an indicator of larger non-performing loan problems in other Portuguese banks as well[21]: whereas the gross domestic product of Portugal at the end of 2015 was estimated at EUR 179.3789 billion, the amount of bad loans in Portuguese banks by February of 2016 reached EUR 17.984 billion, thus representing around 10 per cent of the Portuguese GNP. Moreover, there are concerns about the impact of this state-owned bank on the public balance sheet, and thus, through an inescapable vicious circle, on the credit ranking of the Portuguese State and banks[22]. The continuous depreciation of Portuguese banks' stock – which has reached in some cases dramatically low prices (e.g., each share of " Banco Comercial Português" (BCP), that was once valued at over four euros, is presently negotiated at around one cent)[23] – also seems to confirm that the turmoil in the Portuguese banking system might not yet came to an end.

II – THE LAW OF BANK CRISIS IN PORTUGAL

1. Historical Evolution

1.1. The Pre-Crisis Law

I. The crisis of banks and financial institutions in Portugal was, until recently, a rare and rather improbable event: before the global financial crisis of 2008, the last Portuguese wave of banking collapse dates to almost one century ago, during the 30's[24]. No wonder, thus, that the existing legal framework, prior to the crisis, was limited, outmoded and inadequate.

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[21] INTERNATIONAL MONETARY FUND, *Portugal Staff Report for the 2016 Article IV Consultation and Fourth Post-Program Monitoring Discussions*, 12 (IMF Country Report nº 16/300, 5 August 2016).
[22] REUTERS, *DBRS Cautious over Portugal's CGD Recapitalization Plans,* of 25 August 2016.
[23] In order to make it more attractive to investors, the General Meeting of BCP approved recently a reverse stock split without decrease of the share capital, in the proportion of 75 old shares exchanged for 1 new share, after the Portuguese legislator have admitted the regrouping of shares (Decree-Law 63-A/2016, of 23 September).
[24] MENDES, J. Amado, *A Empresa Bancária em Portugal no séc. XX: Evolução e Estratégias*, in: 11 "Gestão e Desenvolvimento" (2002), 39-56. There were in the meantime, however, some isolated cases of bank being compulsorily liquidated on grounds of fraud (v.g., "Caixa Económica Açoreana, S.A."): cf. CANOTILHO, J. Gomes/ CASTRO, P. Canelas, *Constitucionalidade do Sistema de Liquidação Coactiva de Estabelecimentos Bancários,* in: 23 "Revista da Banca" (1992), 57-87.

II. This legal framework was basically provided for in two legislative pieces: a specific legal regime applicable to the *liquidation* of credit institutions (Decree-Law 30 689, of 27 August 1940, later on replaced by Decree-Law 199/2006, of 25 October) and a rudimentary set of reorganization and recovery measures (provided for by Articles 139 and ff. of the "General Law of Credit Institutions and Financial Companies" of 1992, abbreviated GLCI).[25]

III. In the wake of the collapse of BPN (2008), the Portuguese legislator enacted two further laws specifically aiming to cope with the banking crisis: the Law 62-A/2008, of 11 November, relating to nationalization of private legal persons, and the Law 63-A/2008, of 24 November, relating to measures to reinforce the financial resilience of credit institutions.[26]

1.2. The Reform of 2012

I. This situation changed radically with the *"Memorandum of Understanding on Specific Economic Policy Conditionality"* signed on 1 September 2011 between the Portuguese Republic, on the one side, and the European Commission (EC), the International Monetary Fund (IMF), and the European Central Bank (ECB), on the other ("Troika Memorandum"). According to its rules 2.12 and 2.13, "the Portuguese authorities are amending legislation concerning credit institutions in consultation with the EC, the ECB and the IMF before end-November 2011 to, inter alia, impose early reporting obligations based on clear triggers and penalties (...). The amendments will introduce a regime for the resolution of distressed credit institutions as a going concern under official control to promote financial stability and protect depositors. The regime will set out clear triggers for its initiation, and restructuring tools for the resolution authorities shall include recapitalization without shareholder pre-emptive rights in accordance with the relevant

[25] On the pre-crisis legal framework, *see* LABAREDA, João, *Pressupostos Subjetivos da Insolvência: Regime Particular das Instituições de Crédito e Sociedades Financeiras,* in: "Coletânea de Estudos sobre a Insolvência", 103-141, Quid Juris, Lisboa, 2009; MATIAS, A. Saraiva, *Saneamento e Liquidação de Instituições de Crédito: Novas Perspetivas do Direito Comunitário*, in: 61 "Revista da Ordem dos Advogados" (2001), 279-348.

[26] On those laws, *see* FERREIRA, D. Saramago, *A Nacionalização do Banco Português de Negócios: Análise da Lei n.º 62-A/2008, de 11 de Novembro*, in: III "Revista de Direito das Sociedades" (2011), 169-186; SANTOS, L. Máximo, *As Medidas de Combate à Crise Financeira em Portugal*, in: 2 "Revista de Finanças Públicas e Direito Fiscal" (2010), 95-117.

EU framework, transfer of assets and liabilities to other credit institutions and a bridge bank".[27]

II. Following those commitments, the Portuguese legislator undertook a major reform of its "General Law of Credit Institutions and Financial Companies" (hereinafter *GLCI*): this reform, enacted by the Decree-Law 31-A/2012, of 10 February, is commonly known as the *"Reform of 2012"*. The Reform of 2012 introduced a brand new legal framework concerning the prevention and management of crisis of credit institutions. As it shall be seen in further detail, this new regime, laid down in Title VIII of the GLCI and developing over 80 norms (Articles 139 to 153-U), provides three new fundamental legal instruments, which correspond to distinct stages of intervention of increasing intensity, by the supervisory authority, in distressed credit institutions. These are the corrective intervention (Chapter II: Articles 141 a 144), the provisional management (Cap. III: Article 145) and the resolution (Chapter IV: Articles 145-A a 145-O).[28]

III. Thus, in a similar fashion to what happened in other European countries – such as the United Kingdom (with the revisions introduced in the "Financial Services Act" of 2010), Ireland (with the "Credit Institutions [Stabilisation] Act" of 2010), or in Germany (with the "Gesetz zur Restrukturierung und geordneten Abwicklung von Kreditinstituten" of 2010) – the national regulation of the bank crisis in Portugal was somewhat pioneering, as it preceded by some years the intervention of the European Union legislator itself.

1.3. The BRRD, the SRM Regulation and the EBU

I. The third and last stage in the evolution of the Portuguese law on bank crisis was brought about by the EU legislator, with the enactment of successive regulatory instruments that were implemented by the Portuguese legislator.

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[27] In: http://www.imf.org/external/pubs/ft/scr/2011/cr11279.pdf. On the relevance of the "Troika Memorandum" to the evolution of Portuguese banking law, *see* CÂMARA, Paulo, *A Renovação do Direito Bancário no Início de um Novo Milénio,* 58ff., in: "O Novo Direito Bancário", 11-70, Almedina, Coimbra, 2012.

[28] On this new law of bank crisis, *see* SANTOS, L. Máximo, *O Novo Regime de Recuperação de Instituições de Crédito: Aspetos Fundamentais,* in: III "Revista Concorrência & Regulação" (2012), 203-237; SILVA, M. Duarte, *Os Novos Regimes de Intervenção e Liquidação Aplicáveis às Instituições de Crédito*, in: "O Novo Direito Bancário", 373-437, Almedina, Coimbra, 2012.

II. Firstly, the *"Bank Recovery and Resolution Directive" (BRRD)* of 2014[29], aimed at achieving a common framework of rules guiding all 28 Member States' intervention in banking crises, was implemented in Portugal by the Decree-Law 114-A/2014, of 1 August, and Decree-Law 114-B/2014, of 4 August. This resulted in significant changes to the rules contained in Title VIII of the GLCI.

III. Secondly, while providing the basis for harmonization of bank resolution across the European Union, the BRRD also made available the regulatory framework for a Single Resolution Mechanism (SMR) implemented in the Eurozone by the *Single Resolution Mechanism Regulation* of 2014[30]. This SRM Regulation, that partially repeats the BRRD, has been designated to operate alongside it.

IV. Finally, the evolution of Portuguese banking law in this field, as in the past, is likely to continue in the future to be deeply intertwined with the development of the *European Banking Union (EBU)*, which complements the Economic and Monetary Union (EMU). The EBU's regulatory architecture is based on three main pillars:[31] the "Single Supervisory Mechanism" (SSM), provided for by European Regulation 1024/2013, that places the European Central Bank (ECB) as the central prudential supervisor of financial institutions in the euro area (including around 6000 banks)[32]; the "Single Resolution

[29] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 201, establishing a framework for the recovery and resolution of credit institutions and investment firms (in: OJ L 173, 12.6.2014, pp. 190–348); also Commission Delegated Regulation (EU) 2015/63 of 21 October 2014, supplementing Directive 2014/59/EU with regard to ex ante contributions to resolution financing arrangements**.** On the BBRD, the literature is already gargantuan: "ex multi", *see* KENADJIAN, Patrick/ DOMBRET, Andreas, *The Bank Recovery and Resolution Directive: Europe's Solution for "Too Big To Fail"?,* Walter de Gruyter, Berlin/ Boston, 2013; GLEASON, Simon/ GUYNN, Randall, *Bank Resolution and Crisis Managament,* 161 ff., Oxford University Press, Oxford, 2015.

[30] Regulation (EU) 806/2014 of the European Parliament and of the Council of 15 July 2014, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (in: OJ L 225, 30.7.2014, pp. 1-90)**.** On the SRM Regulation, *see* FREITAS, João, *Um Mecanismo de Resolução para a União Bancária: Fundamentos e Configuração*, in: "Relatório de Estabilidade Financeira", 81-113, Banco de Portugal, 2014; also ZAVVOS, George/ STELLA, Kaltsouni, *The Single Resolution Mechanism in the European Banking Union: Legal Foundation, Governance Structure and Financing*, in: M. Haentjens/ B. Wessels (eds.), "Research Handbook on Crisis Management in the Banking Sector", 117-149, Elgar Publishing, Cheltenham, 2015; WYMEERSCH, Eddy, *Banking Union: Aspects of the Single Supervisory Mechanism and the Single Resolution Mechanism Compared*, ECGI Working Paper Series in Law, 2015.

[31] On that regulatory architecture, CASTAÑEDA, Juan/ MAYES, David/ WOOD, Geoffrey, *European Banking Union: Prospects and Challenges*, 114ff., Routledge, New York, 2016; WYMEERSCH, Eddy, *The European Banking Union: A First Analysis,* Financial Law Institute, Working Papers, 2012/07.

[32] Council Regulation (EU) 1024/2013 of 15 October 2013, conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (in: OJ L 287, 29.10.2013, pp. 5-13).

Mechanism" (SRM), provided for by the said Regulation EU/806/2014, which applies to banks covered by the SSM, with the aim of ensuring the orderly resolution of failing banks with minimal costs for taxpayers and public funds, allowing furthermore for resolution to be managed through a Single Resolution Board and a Single Resolution Fund, financed by the banking sector[33]; and the "European Deposit Insurance Scheme" (EDIS), which aims at providing protection for deposits below EUR 100.000 of all insolvent banks in the euro area, supported by a close cooperation between the EDIS and national deposit guarantee schemes.[34]

V. Although, at a secondary level, special attention must also be paid to the regulations and *orders* ("Avisos") enacted by the Bank of Portugal concerning the recovery, resolution, and liquidation of banks: for instance, the Order 13/2012, of 18 October, governing the formation and functioning of bridge banks.

2. Legal Avenues for the Management of a Bank Crisis

I. In the event of financial distress involving a credit institution, namely a bank, the following legal forms of management of the crisis situation are available under Portuguese law: a) early intervention; b) recapitalisation; c) nationalisation; d) resolution; and e) liquidation.

II. Of course, all these legal avenues for managing a bank crisis are of a *public nature*, assuming therefore that other forms of private intervention – that is, based on private solutions proceeding from the bank's shareholders (e.g., private recapitalization via share capital increase) or the market (e.g., mergers, split ups) – cannot be found in a timely manner. On the other hand, the above mentioned public-oriented solutions are not all alike, as they have different "rationales" and triggers. Whereas some have an "ex ante" or preventive nature – they are aimed at preparing for actions in future crisis scenarios

[33] *See* also Council Implementing Regulation (EU) 2015/81 of 19 December 2014 specifying uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the Single Resolution Fund.

[34] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions "Towards the completion of the Banking Union" (COM/2015/0587 final). On deposit guarantee schemes, *see* generally CLARKE, Blanaid, *Deposit Guarantee Schemes*, in: Haentjens, M./ Wessels, B. (eds.), "Research Handbook on Crisis Management in the Banking Sector", 355-365, Elgar Publishing, Cheltenham, 2015.

("living wills") or coping with impending breach of requirements to maintain a banking licence by a bank which is nonetheless still viable ("early intervention") – others have an "ex post" or reactive nature – by applying to situations of insolvency or imminent insolvency, that cannot be avoided otherwise, and aiming at preserving the bank's systemically important functions while at the same time restoring the viability of all or of part of the distressed bank ("resolution"). They all have, nevertheless, something in common: they belong to a sort of *creeping "grey zone"* situated at the intersection of prudential banking regulation and supervision, on the one side, and common insolvency and reorganization law, on the other.

2.1. Prevention Stage, Early Intervention, and Recovery Measures

I. As a way to anticipate a bank crisis, the law provided for a *prevention* stage where both banks and banking authorities are vested with the right and duty to take some preparatory steps to minimise the risks of a potential future crisis: the main instruments are the recovery plan and the resolution plan ("living wills"). On the one hand, banks are required to draw up *recovery plans* ("planos de restruturação") setting out a "menu" of arrangements and measures to enable them to take early action to restore their long-term viability in the event of a material deterioration of their financial situation (Articles 116-D to 116-I of the GLCI). On the other hand, the resolution authority is required to prepare ex ante, in cooperation with other resolution authorities and the concerned banks themselves, comprehensive *resolution plans* ("planos de resolução") setting out options for resolving each envisaged bank (or the bank group) in a range of different possible scenarios, including details on the application of resolution tools and ways to ensure the continuity of its critical functions, in order to minimize the cost of resolution to public funds (Articles 116-J to 116-N of the GLCI).[35]

[35] A central feature of a resolution plan consists of identifying and assessing the potential hurdles or barriers when carrying out a certain resolution, including a summary of the key elements of the plan, and a demonstration of how critical functions and core business lines could be legally and economically separated to the extent necessary from other functions, so as to ensure continuity on the failure of the bank (Article 116-D/4/c) of the GLCI). For a general overview of the recovery and resolution plans in the BRRD, *see* also SINGH, Dalvinder, *Recovery and Resolution Planning: Reconfiguring Financial Supervision and Regulation*, in: Binder, J.-H./ Singh, D. (eds.), "Bank Resolution: The European Regime", 1-14, Oxford University Press, 2015.

II. When a bank infringes or is likely to infringe the legal norms and regulations concerning the requirements for maintaining its banking license (namely, prudential and conduct-of-business requirements), the competent supervisory authority (the Bank of Portugal and, since 1 January 2016, also the ECB) is vested with the power to implement *measures of early intervention*. Portuguese law provided for a huge set of possible actions of this type, which may be systematized in four main groups: these are the corrective measures, the reorganization plan, the nomination of an audit committee, and a miscellany of other extraordinary measures[36]. The corrective measures ("medidas corretivas"), provided for in Articles 116-C and 141/1/c) of the GLCI, consist of a large set of concrete actions, such as, for example, to require the concerned bank to hold own funds in excess of the requirements set out in Regulation (EU) 575/2013, of 26 June; to require the reinforcement of the arrangements, processes, mechanisms and strategies concerning its governance and risk management; to restrict or limit its business, operations or network; to request the divestment of activities that pose excessive risks to its financial soundness; and so on. A second set of measures consists of preparing a so-called plan of reorganization ("reestruturação") to overcome problems, which is subsequently evaluated by the competent supervisory authority, the approval of which may be subject to conditions such as share capital increase or reduction and the disposal of shareholdings and other assets, among others (Article 142 of the GLCI). A third measure consists of the appointment of an audit committee ("comissão de fiscalização") that will be charged with oversight of financial reporting and disclosure and replace its equivalent organ in the intervened bank (Article 143 of the GLCI). Finally, a fourth type of early intervention consists of an assortment of extraordinary measures, involving rather numerous and disparate concrete actions, which might be undertaken by the competent supervisory authority. These include restrictions on the exercise of specific types of activity, such as the granting of credit and the investment of funds in specific types of assets or the taking of deposits, according to their type and remuneration; requirements for compulsory building-up of special provisions; prohibition or limitation of the distribution of dividends; and submission of certain transactions to the prior approval of the supervisory

[36] For an overview of earlier intervention measures, *see* BASTO, I. Pinto/ CARVALHO, M. Almeida, *O Novo Regime de Intervenção Corretiva: Administração Provisória: Resolução e Liquidação de Instituições de Crédito*, in: 33 "Actualidad Jurídica Uría Menéndez" (2012), 99-104; in a comparative perspective, SCHILLIG, Michael, *Resolution and Insolvency of Banks and Financial Institutions*, 194ff., Oxford University Press, 2016.

authority (Article 141/f) to z) of the GLCI).

III. Where those early intervention measures are deemed to be insufficient to recover the bank, there is a significant deterioration of its financial situation, or there are serious infringements of laws, regulations and bylaws, as well as serious administrative irregularities, the competent authority has a power of suspension or dismissal of one or several members of the management board or the supervisory board of the concerned bank (Article 145 of the GLCI), and, if necessary, the appointment a temporary or *provisional administration* ("administração provisória"). Following Articles 144/1/a) and 145-A of the GLCI, the interim administrators are appointed for a maximum period of one year (which may be renewed under exceptional circumstances), and may be vested with a set of special rights and duties indicated by the resolution authority (in addition to the general powers and obligations conferred by company law and by the articles of association to an ordinary administrator). Thus, for instance, interim administrators may have a veto right of a general meeting's resolutions which are likely to jeopardize the goals of the measures applied, a right to revoke any resolutions of the former administration, and a right to call the general meeting. Conversely, interim administrators have a duty to report to the competent authority on the distressed bank's financial situation and management, to observe the guidelines and strategic goals fixed by such an authority as to the performance of its temporary functions, and to submit for its prior approval numerous acts (including those performed in the exercise of the above mentioned special rights). Overall, the provisional administration is a hybrid mechanism of bank crisis management, positioned halfway between the pure "preventive" early intervention measures and "reactive" measures such as resolution and liquidation (see also Article 144 of the GLCI).

2.2. Recapitalization

I. Another form of management of distressed banks consists of *recapitalisation with recourse to public funding*, a form of bailout provided for by Law 63-A/2008, of 24 November (hereinafter "The Law of Recapitalization").[37]

[37] ABREU, J. Coutinho, *Financiamento Público de Bancos Privados,* in: "II Congresso de Direito da Insolvência", 115-120, Almedina, Coimbra, 2014; SANTOS, L. Máximo, *As Medidas de Combate à Crise*

II. The Law of Recapitalization aims at reinforcing the resilience of the banking sector by establishing the conditions and procedures for providing temporary public support to viable credit institutions having their head office in Portugal, namely in view of their compliance with the capital adequacy ratios ("maxime", Core Tier 1 ratio).

III. The recapitalization may be either voluntary or mandatory. In the former case (voluntary recapitalization), it is requested by banks themselves. Following the "Financial Assistance Program to Portugal" of 2012 (in the global amount of EUR 78 billion, including EUR 12 billion for bank recapitalization)[38], several Portuguese banks took a advantage of this tool, requesting their own recapitalization with public funds – amounting to EUR 3.5 billion in the case of BCP, EUR 1.65 billion in the case of CGD, and EUR 1.5 billion in the case of BPI (later on, in 2013, BANIF also benefited from a similar injection of public funds in the amount of EUR 1.1 billion). In the latter case (mandatory recapitalization), the Bank of Portugal may force a bank into a compulsory capitalization, refusal of which grants the supervisory authority the power to revoke the bank's operating license or to appoint a provisional board.

IV. According to this Law, the decision of submitting a bank to a mandatory recapitalization is incumbent on the Ministry of Finance, which is also responsible for establishing the terms and conditions for public investment and disinvestment, as well as the additional elements of the recapitalisation plan. Amongst the major obligations of the recapitalized banks, it should be pointed out, are the adoption of generally accepted principles of corporate management, the compliance with specific remuneration policies, and the nomination by the State of non-executive members to their board of directors and supervisory board. The recapitalization may assume the form of subscription of shares (granting a priority dividend) or other eligible financial instruments (namely, contingent convertible bonds, known as "CoCos"[39]).

Financeira em Portugal, in: 2 "Revista de Finanças Públicas e Direito Fiscal" (2010), 95-117. From an economic perspective, *see* AUGUSTO, Francisco/ FÉLIX, Sónia, *The Impact of Bank Recapitalization on Firms' Access to Credit: Evidence from Portugal*, Financial Stability Papers, nº 2, Lisbon, 2014.

[38] *See Portugal EU/IMF Financial Assistance Program 2011-2014,* Bank of Portugal, Lisbon, 2011 (https://www.bportugal.pt/enUS/EstabilidadeFinanceira/AEstabilidadeFinanceiraPAEF/OProgramaAssistenciaFinanceiraPortugal/Documents/Brochura_en.pdf).

[39] PINTO, A. Mota, *Os "Cocos" e a Recapitalização do Sistema Bancário Português*, in: 32 "Atualidad Uría Menendez" (2012), 117-119.

2.3. Nationalization

I. A rather peculiar form of management and public intervention in a bank crisis situation consists of *nationalization*, a form of bailout provided by the Law 62-A/2008, of 11 November, relating to nationalization of private legal persons.[40]

II. The pros and cons of this type of bailout instrument are well-known – endowing it with the typical ambivalent nature of "kill or cure" remedies. In principle, nationalisation is an effective remedy that makes it possible to contain systemic disruptions associated with financial difficulties of a credit institution, as it affords timely help to prevent default. However, like all invasive treatments, it also has negative side effects. Apart from being a sort of rigid instrument (considering that it may only be approved by the Parliament), it externalises the costs of bank failures to the society as a whole, as the State (and thus ultimately the taxpayers) assume full responsibility for all past and futures liabilities of the nationalized bank[41]. In any case, contrary to what happened in other European countries – where some of the largest banks were nationalized in full or partially, e.g., Fortis (2008), Hypo Real Estate (2008), Anglo-Irish Bank (2009), Bankia (2012)[42] –, the use of the nationalization tool in the post-financial crisis era by Portuguese authorities was restricted to the single case of a small, non-systemically relevant bank, the "Banco Português de Negócios" (BPN).[43]

III. It is worth noting that, contrary to the BRRD – *see* the public equity support (Article 57) and public temporary ownership (Article 58) tools [44] – Portuguese law has not incorporated formally in the resolution regime, described below, the measures of

[40] On these laws, *see* FERREIRA, D. Saramago, *A Nacionalização do Banco Português de Negócios: Análise da Lei n.º 62-A/2008, de 11 de Novembro*, in: III "Revista de Direito das Sociedades" (2011), 169-186; SANTOS, L. Máximo, *As Medidas de Combate à Crise Financeira em Portugal*, in: 2 "Revista de Finanças Públicas e Direito Fiscal" (2010), 95-117.

[41] Therefore, in the event that the nationalized bank incurs in unexpected losses, it is exclusively incumbent on the State to restore the institution's solvency levels; however, if the nationalized bank has a positive net worth, the State is forced by the law to compensate the bank's shareholders.

[42] On public bailouts through nationalization, *see* some empirical data by COLON, Thomas/ COTTER, John, *Eurozone Bank Resolution and Bail-In – Intervention, Triggers and Writedowns*, 11ff., UCD Geary Institute for Public Policy, Working Papers, 2015/01.

[43] On the BPN case, *see* I – 2.3.

[44] HADJIEMMANUIL, Christos, *Bank Stakeholders' Mandatory Contribution to Resolution Financing: Principle and Ambiguities of Bail-In*, 231, in: "ECB Legal Conference 2015: From Monetary Union to Banking Union, on the Way to Capital Markets Union, New Opportunities for European Integration", 225-248, European Central Bank, Frankfurt am Main, 2015.

nationalisation and recapitalization as two forms of extraordinary public financial assistance to a distressed bank.

2.4. Resolution

I. The most well-known avenue for management of a bank crisis is *resolution* ("resolução"). The bank resolution mechanism was introduced in Portugal in 2012, thus prior to the enactment of the BRRD itself. It was designed, fundamentally, as an alternative to traditional mechanisms of bank crisis management, aiming at avoiding the systemic contagion effects which are typically associated with ordinary liquidation and bankruptcy procedures, while at the same time minimising the fiscal costs which are typically associated with public recapitalization, nationalization and other bailout forms.

II. Given its particular importance, both in national and European terms, this legal avenue shall be analysed autonomously further in Sections 3 and 4.

2.5. Liquidation

I. Should none of the previous instruments be sufficient or effective in avoiding the insolvency of the distressed bank, and thus the respective authorisation is to be withdrawn, then the ultimate step in managing its crisis situation consists of a *judicial liquidation*.[45]

II. The legal regime for judicial liquidation of credit institutions is provided by Decree-Law 199/2006, of 25 October, which implemented the Winding-Up Directive of 2001[46]. This mandatory or compulsory liquidation has a judicial nature, being subject to the special rules laid down by that Decree-Law and, as a subsidiary, the general provisions of the Insolvency Code (Article 8/1). Overall, this special liquidation procedure has the typical features of a corporate bankruptcy (initiation by a court order, automatic stay

[45] *See* MATIAS, A. Saraiva, *Saneamento e Liquidação de Instituições de Crédito: Novas Perspetivas do Direito Comunitário*, in: 61 "Revista da Ordem dos Advogados" (2001), 279-348.

[46] There are two types of liquidation: *voluntary* liquidation, issuing from a general meeting winding-up resolution (submitted to the rules of corporate winding-up: cf. Article 35-A of the GLCI, Articles 6 and 7 of Decree-Law 199/2006), and *mandatory* liquidation, following the revocation of the banking licence by the competent supervision authority (Article 145-AQ of the GLCI).

blocking enforcement of individual creditors' rights, etc.), is moderated by a pre-judicial liquidation procedure (Articles 7-A to 7-D), and the prominent role is attributed to the Bank of Portugal in its capacity as supervisory authority (Articles 8 to 26).

III. In the post-crisis era, there was a single case in Portugal where a distressed bank went into judicial liquidation[47]: this was the case of "Banco Privado Português" (BPP)[48]. It has truly become a "mantra" of recent public banking lawyers to point out the shortcomings of this, traditional, "ex post" instrument in the particular field of financial institutions, in comparison with the new "ex ante" alternative instruments (recapitalization, nationalization, resolution). Liquidation procedures for banks are said to be macro-economically insensitive (since they are mainly focused on the individual interests of creditors, thus being oblivious to the impact that an immediate suspension of payments may have on the financial system and the real economy as a whole); and micro-economically inefficient (since they may be disastrous to unsecured creditors, including depositors who are not covered, who face additional liquidity risks associated with the fact that liquidation is a time-consuming process where a payout is not made until it is determined what and how many assets are available for liquidation)[49]. The Portuguese experience in the BPP case seems to confirm those caveats: this bank went into liquidation in 2010 and, after six years, its winding-up procedures are still unfinished.

3. The Resolution of Banks

3.1. Introduction

I. Resolution measures were introduced in the Portuguese legal order in 2012 and are applicable when the bank's financial and prudential situation has deteriorated, is close to an insolvency which cannot be otherwise timely avoided, and, has the potential to jeopardise the stability of the financial system. In a nutshell, resolution may be defined

[47] There are other liquidation cases under way, relating to banks that have been the object of resolution measures (namely, the case of BES, which licence has been already revoked by the ECB in july 2016, and of BANIF).
[48] On the BPP case, *see* above I – 2.2.
[49] On the inadequacies of traditional insolvency and liquidation procedures, *see* HÜPKE, Eva, *Insolvency – Why a Special Regime for Banks?,* in: International Monetary Fund, "Current Developments in Monetary and Financial Law", vol. 3, 471-514, Washington, 2005.

as a multi-tool and multi-goal mechanism for restructuring a failed or failing bank, envisaging usually (except in the case of bail-in) a transfer of the bank business, or a part thereof, to a separate entity, in view of ensuring the continuity of its critical functions, preserving financial stability, and protecting depositors, taxpayers and public funds.[50]

II. The term *resolution* ("resolução"), adopted in Portugal, as elsewhere, does not correspond to either any of its possible traditional meanings used by private lawyers (as a form of termination of contracts or a decision of a corporate body)[51], or even to the wider sense that it was used by public banking lawyers concerning some pre-crisis banking mechanisms ("special resolution regimes")[52]. Instead, in line with the concepts used by the BRRD and the SRM Regulation, "resolution" holds here the restrictive meaning of a very specific instrument of bank crisis management that, inspired by a complex set of idiosyncratic goals, principles, conditions and tools, aims at functioning as an alternative to other traditional instruments where systemic concerns cannot be properly addressed otherwise.[53]

III. The resolution regime is laid down in Title VIII (Articles 145-C to 145-AU) of the "General Law of Credit Institutions and Financial Companies" of 1992 (GLCI), as reformed by the Decree-Law 31-A/2012, of 10 February and by the Law 23-A/2015, of 26 March. Of relevance, are also the legal provisions of Title VIII-A (Articles 153-B to 153-U of the GLCI), relating to the Resolution Fund, and Title IX (Articles 154 to 173 of the GLCI), relating to the Deposit Guarantee Fund, of the same GLCI.

IV. According to Articles 5 and 99 of the SRM Resolution, since 1 January 2016, the tasks and powers of the Bank of Portugal, as the national resolution authority in

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[50] For Portuguese literature on the resolution of banks, *see* FREITAS, João, *Um Mecanismo de Resolução para a União Bancária: Fundamentos e Configuração*, in: "Relatório de Estabilidade Financeira", 81-113, Banco de Portugal, 2014; QUELHAS, J. Manuel, *Especificidades e Vicissitudes do Mecanismo de Resolução Bancária em Portugal: do Memorando de Entendimento de 2011 à Diretiva 2014159/UE e ao Regulamento (UE) n° 806/2014*, in: 57 "Boletim de Ciências Económicas" (2014), 2765-2818; SILVA, M. Duarte, *Os Novos Regimes de Intervenção e Liquidação Aplicáveis às Instituições de Crédito*, in: "O Novo Direito Bancário", 373-437, Almedina, Coimbra, 2012; XAVIER, P. Lobo, *Das Medidas de Resolução de Instituições de Crédito em Portugal – Análise do Regime dos Bancos de Transição,* in: V "Revista Concorrência & Regulação" (2014), 149-200.

[51] Critically, SANTOS, L. Máximo, *O Novo Regime de Recuperação de Instituições de Crédito: Aspetos Fundamentais,* in: III "Revista Concorrência & Regulação" (2012), 203-237.

[52] HADJIEMMANUIL, Christos, *Special Resolution Regime for Banking Institutions: Objectives and Limitations*, 3ff., LSE Working Papers, nº 21/2013.

[53] BINDER, Jens-Hinrich/ SINGH, Dalvinder (eds.), *Bank Resolution: The European Regime*, 38 and f., Oxford University Press, 2015.

relation to the application of a resolution measure to banks and other relevant credit and financial institutions (already under the supervision of the ECB, in accordance to Regulation EU/1024/2013, of 15 October), were transferred to the *Single Resolution Board (SRB)*. The SRB is now considered as the relevant resolution authority or, in the event of cross-border group resolution, the relevant group-level resolution authority.[54]

V. At an international level, a number of countries, on both sides of the Atlantic, have today their own specific regulatory framework concerning the management and resolution of a bank crisis. That is the case, in the United States of America, of the "Federal Deposit Insurance Company (FDIC) Receivership" and of the "Orderly Liquidation Authority" (OLA), provided for in Title II of the "Dodd-Frank Act". Likewise, thanks to the harmonization framework laid down by the BRRD, the vast majority of European countries also enacted their owns laws on the topic: e.g., the *"Banking Recovery and Resolution Order"* (BRRO) of 2014 in the United Kingdom, the *"Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen"* (SAG) of 2014 in Germany, the *"Ordonnance 2024"* of 2015 ("Adaptation au Droit de l'Union Européenne em Matière Financière") in France, the *"Decreto Legislativo nº 180"* of 2015 ("Quadro di Risanamento e Resoluzioni degli Enti Creditizi e delle Imprese di Investimento") in Italy, and the *"Ley 11/2015"* ("Recuperación y Resolución de Entidades de Crédito y Empresas de Servicios de Inversión") in Spain.[55]

3.2. Scope of Application

I. A resolution measure may be applied to the following five types of institutions:

a) *credit institutions*, namely banks, having their head office in Portugal;
b) *investment firms*, carrying out the activities of execution, on behalf of customers, of orders or dealing on own account in one or more financial instruments, or which

[54] The decisions of the SRB are previously subjected to a measure of control by the EU Commission, and the national resolution authority (in the present case, the Bank of Portugal) remains responsible for its implementation. For a comparative overview of the ECB-SSM and SRB-SRM, *see* WYMEERSCH, Eddy, *Banking Union: Aspects of the Single Supervisory Mechanism and the Single Resolution Mechanism Compared*, ECGI Working Paper Series in Law, 2015.

[55] To national reports of the legal systems of several European and non-European countries, *see* HAENTJENS, Matthias/ WESSELS, Bob (eds.), "Research Handbook on Crisis Management in the Banking Sector", 403 and ff., Elgar Publishing, Cheltenham, 2015.

are included in the same perimeter of supervision, on a consolidated basis, of a credit institution (Article 199-I/ 2 of the GLCI);

c) *parent corporations* having as a subsidiary one or more credit institutions or investment firms (Article 152 of the GLCI);
d) *branches* of credit institutions having their head office in non-European Union countries, or investment firms having their head office in non-European Union countries, carrying out the following activities: execution, on behalf of customers, of orders in relation to one or more of financial instruments, and dealing on own account in one or more financial instruments (Article 153 of the GLCI); and
e) *relevant companies for payment systems* subject to the supervision of Bank of de Portugal (Article 117-B/4 of the GLCI).

II. As with any other enterprises, banks are rarely organized as a single legal corporation, but often (if not always) in the form of a polycorporate group composed of several subsidiaries operating in different countries. Following the BRRD (Articles 87 to 92), Portuguese law also provides for a set of special rules concerning the *resolution of cross-border groups* in Articles 145-AG to 145-AK of the GLCI.[56]

3.3. Requirements

I. Since the resolution of a bank is a major event to shareholders, creditors, depositors and the financial system as a whole, and it is of utmost importance to ensure that the parameters of its application are consistently applied, Portuguese law establishes a set of resolution conditions triggering the application of a resolution tool. There are three of these *resolutions triggers,* of cumulative nature, which flag a sort of "point of non-viability" for a distressed bank : (a) the bank's failure or likelihood of failure; (b) the lack of a reasonable prospect of other alternative successful measures; and (c) the need and proportionality of the resolution measure (Article 145-E/2 of the GLCI).[57]

[56] To a general overview of the problem, *see* DAVIES, Paul, *The Resolution of Cross-Border Groups*, in: M. Haentjens/ B. Wessels (eds.), "Research Handbook on Crisis Management in the Banking Sector", 261-282, Elgar Publishing, Cheltenham, 2015.
[57] On the resolution triggers, *see* SILVA, M. Duarte, *Os Novos Regimes de Intervenção e Liquidação Aplicáveis às Instituições de Crédito*, 415ff., in: "O Novo Direito Bancário", 373-437, Almedina, Coimbra, 2012; XAVIER, P. Lobo, *Das Medidas de Resolução de Instituições de Crédito em Portugal – Análise do Regime dos Bancos de Transição,* 161ff., in: V "Revista Concorrência & Regulação" (2014), 149-200.

II. The first condition is the formal declaration by the resolution authority that "*a bank is insolvent or is likely to become insolvent"* (Article 145-E/2/a) of the GLCI). The insolvency or likelihood of insolvency is defined further in Article 145-E/3[58], meaning that a resolution measure may be applied to a bank, when one or more of the following circumstances exists: when a bank does not meet (or is at serious risk of not meeting) the requirements for its continued authorisation, when it has losses that will exhaust its capital stock, when its assets become lower than its liabilities, when it is not able to meet its obligations, or when extraordinary public financial support is required (except when this support, in order to prevent a serious disturbance in the economy or to preserve financial stability, takes the form of a state guarantee to back liquidity facilities or a state guarantee of newly issued liabilities, or of a recapitalization with public funds). In the assessment of this resolution requirement, of special relevance are, of course, the breach or risk of breach of the prudential ratios in terms of "Basel III", as well as the Capital Requirement Regulation (CRR) and Directive (CRD IV), which were implemented in Portugal by the Decree-Law 157/2014, of 24 October, and the Order of Bank of Portugal 6/2013, of 27 December[59]. However, it is perhaps just worth emphasising that this trigger contains after all a rather odd, self-contradictory, definition of insolvency or risk of insolvency, when implicitly considering as "solvent" for resolution purposes precisely those banks that are eligible as recipient of public financial assistance in the form of state aid granted under any of the above mentioned legal exceptions.[60]

III. The second condition is the *lack of a reasonable prospect that the bank insolvency or risk of insolvency may be avoided by timely alternative measures* (Article 145-E/2/b) of the GLCI). The underlying rationale is to ensure that resolution keeps its

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More extensively, in a comparative and international perspective, RANDELL, Charles, *Triggers for Bank Resolution*, in: "Too Big To Fail – Brauchen wir ein Sonderinsolvenzrecht für Banken?", 105-127, Walter de Gruyter, Berlin, 2012; SCHELO, Sven, *Bank Recovery and Resolution*, 91ff., Wolters Kluwer Law & Business, The Netherlands, 2015.

[58] By the way of reference to the failure to meet prudential capital requirements, to traditional balance-sheet and liquidity insolvency thresholds, and other rather complex conditions, similarly to Article 32/4 of BRRD and Article 18/4 of SRM Regulation.

[59] *See* MAGALHÃES, Manuel, *A Evolução do Direito Prudencial Bancário no Pós-Crise: Basileia III e CRD IV*, in: "O Novo Direito Bancário", 285-371, Almedina, Coimbra, 2012; SILVA, Amândio/ FERNANDES, Joel*, The Application of Basel III in Portugal*, in: 4 "The International Journal Research Publications" (2015), 16-26.

[60] On this particular, *see* also BINDER, Jens-Hinrich, *Resolution: Concepts, Requirements, Tools*, 47, in: Binder, J.-H./ Singh, D. (eds.), "Bank Resolution: The European Regime", 25-59, Oxford University Press, 2015.

nature as a last resort instrument ("ultima ratio"). As long as permitted by time constrains, all other possible alternatives to prevent failure must have been exhausted before turning to a resolution measure, including micro-private measures (namely, capital injections by shareholders), macro-private measures (namely, via institutional protection schemes or IPS)[61], public measures (e.g. recapitalization with public funds)[62], supervisory authority measures, namely early intervention (e.g. changes in business strategy, changes in the management structure, etc.)[63] or the exercise of powers of write down or conversion of relevant capital instruments (Article 145-I of the GLCI)[64]. From this perspective, it seems rather odd that the law treats early intervention and resolution as measures of bank crisis management that are neither mutually exclusive nor hierarchically interrelated, despite being independent. In fact, according to Articles 140 and 145-E/4 of the GLCI, the application of a resolution tool neither requires the previous adoption of any earlier intervention measure nor prevents its simultaneous application.[65]

IV. Even though there will be always some degree of discretion involved in the assessment of the legal requirements of a bank resolution, the law expressly subordinated it to the fundamental *criteria of necessity and of proportionality*. The resolution authority is allowed to apply a resolution measure only if there is no other, less onerous, procedure to accomplish the general regulatory goals of bank resolution ("necessity" standard)[66] and if the implementation of that measure is proportional or appropriate to achieve those goals ("proportionality" standard)[67]. Of course, this further requirement, aimed at reducing the

[61] Contrary to some other European countries (for instance, Spain, Germany, Austria, or Italy), Portugal does not have yet implemented such a system of bank self-protection. On this type of alternative measures, *see* SCHILLIG, Michael, *Resolution and Insolvency of Banks and Financial Institutions*, 222, Oxford University Press, 2016.
[62] *See* above II – 2.2.
[63] S*ee* above II – 2.1.
[64] Portuguese law expressly includes, among the alternative measures, "the exercise by the resolution authority of the powers provided for in Article 145-I", which relates precisely with the write down or conversion of relevant capital instruments. This confirms the hybrid nature of the latter type of measures, which may serve both as an "ex ante", alternative avenue for bank resolution as well as an "ex post", operative instrument of resolution itself (in the bail-in tool). *See* below II – 4.5.
[65] On this aspect, *see* SANTOS, L. Máximo, *O Novo Regime de Recuperação de Instituições de Crédito: Aspetos Fundamentais,* 213, in: III "Revista Concorrência & Regulação" (2012), 203-237; critically, SILVA, M. Duarte, *Os Novos Regimes de Intervenção e Liquidação Aplicáveis às Instituições de Crédito*, 416ff., in: "O Novo Direito Bancário", 373-437, Almedina, Coimbra, 2012.
[66] On these general objectives of the resolution legal regime, set forth in Article 145-C/1, *see* below II – 3.4.
[67] In a certain sense, one may consider these two standards of Portuguese law as a sort of functional equivalent of the *public interest* requirement, established in Article 32/1/c of BRRD and Article 18/1/c) of SRM Regulation. On this later requirement, *see* also bellow II – 3.4.

uncertainty that is inherent to an administrative decision involving some judgment, may in itself be the source of a new kind of uncertainty, as it may became the bone of contention between the resolution authority and affected parties, giving rise to overall litigation. As a matter of fact, taking into consideration the sheer technical complexity and time constraints which often surround the intervention of the resolution authority to a distressed bank, it appears that the underlying legal model of a fully-fledged, timely, cost-benefit analysis of the application of a resolution measure belongs with the tales of the brothers Grimm...[68]-[69]

3.4. General Goals

I. According to Portuguese law, the implementation of a resolution measure to a bank should be crucial to the pursuance of at least one of the following five goals: (a) to ensure the *continuity of its critical financial functions* and services to the financial and economic system (e.g., opening of deposit accounts, lending, provision of collaterals and payment services); (b) to prevent the occurrence of *adverse effects on financial stability*, especially by preventing contagion, including to market infrastructures, and by maintaining market discipline; (c) to protect *the State and taxpayers*, by minimising reliance on extraordinary public financial support; (d) to protect the *depositors* whose deposits are covered by the Deposit Guarantee Fund, as well as investors covered the Investors Indemnity Fund; and (e) to protect *clients' funds and assets*, i.e., the funds and assets held by banks on behalf and on account of its clients, as well as the delivery of related investments services (Article 145-C of the GLCI).

II. This rule is one of the crucial norms of the Portuguese legal regime, which establishes the fundamentals, scope and limit of the very juridical mechanism of bank resolution. It operates simultaneously as the "pole star" for the intervention of the resolution authority, and, as an ancillary to the interpretation and integration of an entire

[68] It is indeed symptomatic that, while the resolution of BES was decided by the Bank of Portugal in 3 August 2014, the opening balance sheet of the bridge bank NB was released only four months later, in 4 December 2014.

[69] Article 145-E/1/d of the GLCI provides a further condition, by allowing a resolution action over a distressed bank only if the alternative measure of its liquidation does not serve in a more effective and proportional way the accomplishment of the general regulatory goals of banking resolution itself. On the liquidation procedure, *see* above II – 2.5.

set of norms of the said legal regime that expressly refer to it (e.g., Articles 144/b), 145-E/2/d), 145-F/1, 145-H/5, 145-N/2, 145-P/4, 145-Q/4/a), 145-R/1, 145-U/1, 145-W/5, 145-Y/6/a), 145-AB/1, 145-AI/7/b), and 145-AQ of the GLCI). It is important to underline that these are alternative, not necessarily cumulative or compatible, legal purposes: notwithstanding the fact that a bank resolution is often dictated by several of such regulatory goals, the legislator allowed the application of a certain resolution measure to a distressed bank to be grounded exclusively in one of them[70]. Finally, the above mentioned regulatory goals are unequivocally goals of *public interest*. In spite of the omission of any express reference similar to the ones made by the European legislator (Article 32/1/c of the BRRD and Article 18/1/c) of the SRM Regulation)[71] and several national laws (e.g., in the "special resolution objectives" of sec. 8 of the UK "Banking Recovery and Resolution Order" or in the "Abwicklungsziele" of § 67 of the German "Gesetz zur Sanierung und Abwicklung von Instituten und Finanzgruppen"), this is a crucial, although open-ended, concept which obliges the resolution authority to weigh the advantages and costs associated with a resolution action in each particular case.

3.5. Guiding Principles

I. To complement the above-mentioned rule, Article 145-D of the GLCI establishes a set of *guiding principles* concerning the application of a resolution measure. When resolving a bank, the resolution authority should act in accordance with the following principles: a) the shareholders of the bank under resolution are the first to bear losses; (b) creditors of the resolved bank bear losses after shareholders, and in equitable conditions, in accordance with their credit ranking"; (c) no shareholder or creditor of the resolved bank may incur greater losses than would have been incurred if that bank had

[70] See the introductory sentence of Article 145-C/1 of the GLCI: "(…) with the purpose of fulfilling any of the following objectives". Cf. also XAVIER, P. Lobo, *Das Medidas de Resolução de Instituições de Crédito em Portugal – Análise do Regime dos Bancos de Transição,* 158, in: V "Revista Concorrência & Regulação" (2014), 149-200.

[71] Member States shall ensure that a resolution action "is necessary in the public interest" (Article 32/1/c)), that is, it "is necessary for the achievement of and is proportionate to one or more of the resolution objectives referred to in Article 31 and winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent" (Article 32/5). *See* also BINDER, Jens-Hinrich/ SINGH, Dalvinder (eds.), *Bank Resolution: The European Regime*, 48 and f., Oxford University Press, 2015; SCHILLIG, Michael, *The EU Resolution Toolbox,* 88, in: M. Haentjens/ B. Wessels (eds.), "Research Handbook on Crisis Management in the Banking Sector", 81-10, Elgar Publishing, Cheltenham, 2015.

been wound up; and (d) the depositors of the resolved bank are fully protected concerning the deposits covered by the Deposit Guarantee Fund.

II. This legal norm, along with the one previously mentioned on the goals of resolution, is probably the *key norm* of the Portuguese law of bank resolution. Just as common insolvency law, as the law applicable to distressed enterprises in general, is based on a set of fundamental principles (namely, recognition of rights accrued under general law prior to liquidation, creditors as beneficial owners of the assets of the insolvent entity, unsecured creditors rank "pari passu")[72], so is the law of bank resolution provided for in the GLCI, as a specific law applicable to distressed banking enterprises, construed and inspired also by a set or cluster of fundamental guiding principles of both a substantive and procedural nature. Contrary to European law (Article 34/1/d) and e) of the BRRD and Article 15/1 of the SRM Regulation)[73], Portuguese law is exclusively focused on principles concerning the allocation of losses among the different bank constituencies: these are the principle of *shareholder subordination*; the principle of *creditor ranking*; the principle of *no creditor worse-off*; and the principle of *full protection of covered deposits*[74]. Overall, this set of principles starts from the general tenets of a common insolvency procedure – the distribution of insolvency costs cascades or follows a hierarchy (in the reverse order of preference: shareholders, subordinated creditors, unsecured creditors, secured creditors) – while at the same time providing for some deviations and flexibility justified by the very specific goals of resolution – for instance, when establishing a general full preference in favour of depositors (Articles 145-D/1/d), 145/2, 166 to 164 of the GLCI) or when allowing the resolution authority to treat creditors of the same class differently (as long as it is equitable) (Article 145-D/1/b) of the GLCI) – and, conversely, establishing some safeguards – for instance, when ensuring that no

[72] On these general insolvency law principles, *see* GOODE, Roy, *Principles of Corporate Insolvency Law*, 4th edition, Sweet & Maxwell, London, 2011; on Portuguese insolvency law, EPIFÂNIO, M. Rosário, *Manual de Direito da Insolvência,* 14ff., 6ª edition, Almedina, Coimbra, 2014.

[73] Which is also concerned with principles of organizational nature, such as the replacement and the duty of assistance of the management of the bank under resolution, or the civil and criminal liability for the bank failure. On those governance principles, *see* also SCHELO, Sven, *Bank Recovery and Resolution*, 90ff., Wolters Kluwer Law & Business, The Netherlands, 2015.

[74] On those general principles, *see* SILVA, M. Duarte, *Os Novos Regimes de Intervenção e Liquidação Aplicáveis às Instituições de Crédito*, 42ff., in: "O Novo Direito Bancário", 373-437, Almedina, Coimbra, 2012; XAVIER, P. Lobo, *Das Medidas de Resolução de Instituições de Crédito em Portugal – Análise do Regime dos Bancos de Transição,* 165ff., in: V "Revista Concorrência & Regulação" (2014), 149-200.

creditors will suffer haircuts or losses beyond those they might have sustained in liquidation (Article 145-D/1/b) of the GLCI).

III. The principle of *shareholder subordination* is a paramount principle of both general insolvency law and the specific bank resolution law: being at the driving seat, and also as residual claimants, shareholders bear first the losses of the resolved bank. For instance, in the case of a bail-in tool, shareholders will have their claims reduced in order to absorb losses on the bank assets and restore its solvency, by way of reducing the bank's Common Equity Tier I and Additional Tier 1 capital (Article 145-I/1/a) of the GLCI); or, in the case of a bridge institution tool, any credit rights of shareholders owning an equity shareholding of 2% or more on the capital of the resolved bank may not be transferred to the bridge bank (Article 145-Q/3 of the GLCI).[75]

IV. The principle of *creditor ranking* is another fundamental, though complex, standard. According to the law, "creditors of the institution under resolution bear losses after the shareholders, and in equitable conditions, in accordance with their credit ranking" (Article 145-D/1/b) of GLCI). The determination of the creditors' ranking follows the common order of credit priority under normal insolvency proceedings: the hierarchy of loss bearing, in the general framework of the balance sheet of the resolved banks, includes the claims (apart from holders of Common Tier 1 instruments, i.e., shareholders) of holders of Additional Tier 1 instruments, of holders of Tier 2 instruments, of directors and senior executives, of other subordinated creditors, and of unsecured non preferred creditors. However, it should be emphasised that, contrary to common insolvency law based on the principle of equal treatment of creditors ("par condition creditorum"), an alternative principle of equitable treatment of creditors prevails: as an author put it, "there is a considerable difference between treating creditors identically and treating creditors equitably. Equitable does not mean identical" (Sven SCHELO)[76]. This means that, not only does the law not guarantee all creditors of the same class with absolute equal treatment, moreover it obliges the resolution authority to give creditors different treatment whenever this differentiation, while being economically fair

[75] Concerning the scope of protection of the European Convention of Human Rights in regard of the property rights of shareholders, *see* KERN, Alexander, *Bank Resolution: Balancing Prudential Regulation and Human Rights*, in: 9 "Journal of Corporate Legal Studies" (2009), 61-93.
[76] *Bank Recovery and Resolution*, 87, Wolters Kluwer Law & Business, The Netherlands, 2015.

or equitable, is required for the full accomplishment of the objectives, principles and rules governing a particular resolution tool: for example, applying different haircuts to creditors belonging to the same class (e.g., credits of small suppliers versus institutional investors) for systemic reasons, in order to avoid the contagion risk[77]. There are several illustrations of this "asymmetrical treatment" given by the law itself. Take, for instance, the powers of the resolution authority to select the liabilities to be transferred to different purchasers (in the sale of business tool: cf. Article 145-M/ 1 of the GLCI), to leave behind in the "bad" resolved bank some liabilities while transferring to the "good" bank other liabilities of the same class (in the bridge bank tool: cf. Article 145-Q/1, 3 and 5 of the GLCI), or to exempt certain eligible liabilities from write-down or conversion (in the bail-in tool: cf. Article 145-U/9 of the GLCI).

V. The principle *no creditor worse-off* – which, by the way, was not provided for in the former regime of 2012 (having been introduced only later on, with the Law 114-A/2014, of 1 August) – requires that no creditor shall incur greater losses than would have been incurred if the entity under resolution had been wound up under normal insolvency proceedings[78]. This principle applies universally, irrespective of the resolution tool at stake, and, in spite of its restrictive wording, it also applies to shareholders, who are thus also entitled to a compensation payment from the resolution financing arrangement should an "ex post" valuation determine that they have been treated worse in resolution than they would have been in a hypothetical counterfactual insolvency scenario. A relevant aspect concerns the consequences of the breach of such principle, which do not affect the juridical validity or block the efficacy of the resolution measures taken, but merely entitles the affected creditors or shareholders to receive a pecuniary compensation corresponding to the difference between the losses actually incurred in the resolution

[77] *See* XAVIER, P. Lobo, *Das Medidas de Resolução de Instituições de Crédito em Portugal – Análise do Regime dos Bancos de Transição,* 170, in: V "Revista Concorrência & Regulação" (2014), 149-200. A similar approach is also sustained in other countries, both European (BLIESENER, Dirk, *Interventionsmechanismen nach dem deutschen Restrukturierungsgesetz*, 149ff., in: "Too Big To Fail – Brauchen wir ein Sonderinsolvenzrecht für Banken?", 129-157, Walter de Gruyter, Berlin, 2012) and non-European (section 1129 (b) of the famous US "Chapter 11": cf. BROUDE, Richard, *Reorganizations Under Chapter 11 of the Bankruptcy Code*, Law Journal Press, New York, 2005).

[78] PRIETO, Flora, *No Creditors Worse-Off: Resolution Mechanism Update*, in: "Global Risk" (2013), 3-6; THOLLE, Christhoph, *Glaubigerschutz in einem Sonderinsolvenzrecht für Banken?*, in: "Too Big To Fail – Brauchen wir ein Sonderinsolvenzrecht für Banken?", 219-238, Walter de Gruyter, Berlin, 2012; WOJCIK, Karl-Phillip, *The Significance and Limits of the "No Creditor Worse Off" Principle for an Effective Bail-In*, in: "ECB Legal Conference 2015 - From Monetary Union to Banking Union, on the Way to Capital Markets Union", 253-275, European Central Bank, Frankfurt am Main, 2015.

proceeding and those they would have incurred under a normal insolvency proceeding (Article 145-H/14 to 16 of the GLCI).

VI. Finally, according to the principle of *full protection of covered deposits*, the application of a resolution measure does not affect the depositors covered by the Deposit Guarantee Fund who are protected by a statutory guarantee with a covered level of 100 000 euros (Articles 145-D/1/d), 164 and 166 of the GLCI)[79]. In the absence of such provision (which is also provided for by Articles 34/1/b) and 108 of the BRRD and Articles 14/2/d) and 79 of the SRM Regulation), depositors, though vested with a general credit preference (Article 166-A of the GLCI and Article 47/4/1) of the Code of Insolvency), could very well also absorb a part of the losses of the failed bank in the worst scenarios of patrimonial insufficiency. Such a principle, based on considerations of enhancement of financial stability, systemic risks and consumer protection, creates thus a sort of "super priority" in favour of that specific class of creditors (which does not exists in any other types of insolvent enterprises).[80]

4. The Resolution Tools

4.1. Introduction

I. According to existing Portuguese law, resolution authorities will have the following resolution tools to resolve a bank, when its trigger conditions are satisfied (Article 145-E/2 of the GLCI): (a) the *sale of business tool* ("alienação da atividade"), which consists of the sale of the whole or part of the business of the resolved bank to another credit institution authorised to carry on the activity in question; (b) the *bridge institution tool* ("instituição de transição"), which consists of the transfer of all or part of

[79] According to some views, this is a mandatory minimum threshold for depositors protection, that does not preclude the resolution authority, in the pursuance of the general objectives of a resolution (namely, financial stability and contagion prevention) and in the respect of the boundaries set forth by Article 165 of the GLCI (which refers to some particular cases of deposits excluded from the legal protection, v.g., deposits of shareholders owning 2% or more of the share capital of the resolved bank), to extend the protection to deposits above the coverage level. *See* XAVIER, P. Lobo, *Das Medidas de Resolução de Instituições de Crédito em Portugal – Análise do Regime dos Bancos de Transição,* 167ff., in: V "Revista Concorrência & Regulação" (2014), 149-200.

[80] Extensively on the rationales of the depositors protection on resolved banks, *see* KLEFTOURI, Nikoletta, *Deposit Protection and Bank Resolution*, 1ff., Oxford University Press, Oxford, 2015.

the resolved bank's business to one or more newly created "bridge bank", which is temporarily wholly owned by a public authority in order to facilitate its future sale to private entities; (c) the *asset separation tool* ("segregação de ativos"), which consist of the transfer of certain high-risk assets of the resolved bank to an asset management vehicle owned by a public authority; and (d) the *bail-in tool* ("recapitalização interna"), which consists of the write-down of the claims of unsecured creditors of the resolved bank or the conversion of debt claims into equity.

II. As previously remarked, in some extraordinary circumstances and providing that certain special conditions are met (namely, systemic risks), the resolution authority may also seek funding from alternative financing sources, through the use of government stabilisation tools such as nationalization ("public ownership" tool) and recapitalization with public funds ("bail-out" tool).[81]

4.2. Sale of Business

I. The *sale of business tool* ("alienação da atividade"), provided for in Articles 145-M and 145-N of the GLCI, entrusts the resolution authority with the power to sell the bank under resolution, without the consent of its shareholders, creditors, clients or any other procedural requirements: the sale of business may exercised in the form of both share deals (by selling any of its shares or other instruments representing the bank's ownership) or by asset deals (by selling all or any of its assets, rights and liabilities).[82]

II. It is important to mention that the sale must be conducted on *"commercial terms"* (Article 145-N/1 of the GLCI) – which means that the resolution authority shall market the instruments to be transferred in accordance with market value principles – and the resolution authority shall ensure the *"transparency of the process and the equitable treatment of interested third parties"* (Article 145-M/2 of the GLCI) – which means that, taking account of the necessity for a rapid resolution action, the sale operation, apart from

[81] On these two mechanisms of management of bank crisis, *see* above II – 2.2 and 2.3.
[82] In either cases, the fundamental purpose or "rationale" is to strip the resolved bank of those parts of its business that are deemed toxic or systemically sensitive, and to transfer the relevant relationships, including assets and liabilities pertaining to them, to a third party purchaser, as a way to ensure the continuity of the financial functions (FREITAS, João, *Um Mecanismo de Resolução para a União Bancária*, 99, in: "Relatório de Estabilidade Financeira", 81-113, Banco de Portugal, 2014).

being subjected to some procedural requirements (namely, providing access to relevant information concerning the resolved bank, avoiding conflicts of interest), should aim to maximise the sale price without undue discrimination between potential purchasers.[83]

III. The resolution authority is allowed to sell one or more business parts to one or more purchasers (Article 145-M/6 of the GLCI), to exercise the sale of business tool more than once in the course of resolution (Article 145-N/3/a) of the GLCI), and to transfer the property back to the resolved bank without the consent of the purchaser (retransfer power: cf. Article 145-N/3/b) of the GLCI).

4.3. Bridge Institution

I. The *bridge institution tool* ("instituição de transição"), which is provided for in Articles 145-O to 145-R of the GLCI, vests the resolution authority with the power to transfer, without the consent of the shareholders or third parties, all or a part of the shares, assets, rights and liabilities of the resolved bank ("bad bank") to a bridge institution ("good bank").

II. The *bridge institution* is created by a decision of the resolution authority (Article 145-P/1 of the GLCI), which is also vested with the power to decide on the content of its articles of association, the appointment and remuneration of the members of its management and supervisory boards, the selection of the shares, rights, assets and liabilities of the resolved bank to be transferred to it, and the termination of its operations (Article 145-P/1, 7 and 8 of the GLCI). Moreover, the bridge bank is wholly owned by the "Resolution Fund" ("Fundo de Resolução")[84] and is governed by a specific regulatory framework (Order of Bank of Portugal 13/2013), by its own articles of association, and, as a subsidiary, by general banking and corporate laws.

III. The *primary goal* of this tool is to ensure the continuity of all or some financial services and activities of the resolved bank while preparing for its future sale to private

[83] These requirements may be waived in exceptional circumstances, where this is necessary to achieve the accomplishment of the general regulatory objectives of resolution (Article 145-M/5 of the GLCI).
[84] The Resolution Fund is a public legal person, that was created by Decree-Law 31-A/2012, of 10 February (Articles 153-B to 153-U of the GLCI), which main purpose is to provide financial support for the implementation of resolution measures determined by the Bank of Portugal and which members are the very credit and financial institutions that may be subject to resolution measures.

parties, based on open and transparent marketing and on commercial terms, in accordance with the state aid framework, and within a short period[85]. The operation of the bridge institution shall be terminated with either the sale of all its assets, rights and liabilities to a third party, its merger with a third party, or with the expiry of its legal term (Article 145-R of the GLCI).

IV. As its regime is complex, two major aspects should be pointed out. One concerns the *power of the resolution authority to select* the assets, rights and liabilities that are to be transferred to the "good bank" and what is left behind in the "bad bank" (Article 145-Q of the GLCI, Article 10 of the Order of Bank of Portugal 13/2012). The exercise of this power of selection has to comply with the some limitations, namely, that the total value of liabilities transferred to the "good bank" may not exceed the total value of rights and assets transferred (Article 145-Q/7 of the GLCI), the credit rights of shareholders owning at least 2% of the capital of the "bad bank" or of members of its board of directors are excluded from transference to the "good bank" (Article 145-Q/3 of the GLCI), and the transfer is submitted to a fair and prudent valuation carried out by an independent entity (Article 145-H of the GLCI). The other aspect concerns the *"multidimensional" power of transfer* of the resolution authority, which is entitled also to effect a transfer back to the bad bank ("re-transfer"), a transfer of other rights, assets, or liabilities to the good bank ("new transfer") or a transfer of rights and liabilities of the good bank to an asset management vehicle ("a third party transfer") (Article 145-Q/4 and 5 of the GLCI, Article 12 of the Order of Bank of Portugal 13/2012).

4.4. Asset Separation

I. The *asset separation tool* ("segregação de ativos"), provided for in Articles 145-S and 145-T of the GLCI, assigns to the resolution authority the power to transfer certain distressed, high-risk assets of the resolved bank to an asset management vehicle, in view

[85] For this reason, the bridge bank may only operate for maximum period of two years, which may however be extended for one or more additional one-year periods due to some special reasons of public interest (namely, systemic risk), of continuity of critical financial functions or of permitting a projected merger or sale (Article 145-P/11 and 12 of the GLCI). After the expiry of this period, the operation of the bridge bank shall be terminated by liquidation.

of maximising their value through eventual sale or in a future orderly liquidation process.[86]

II. The *primary goal* of this tool is thus to remove the "rotten apples" from the resolved bank's balance sheet in order to facilitate its recovery or to preserve the stability of the financial system. This tool should be used when the liquidation of "bad assets" under an insolvency proceeding could have an adverse effect on financial markets, on the proper functioning of the resolved bank, or on the liquidation proceeds value (Article 145-T/2 of the GLCI). This tool may be used either individually (on a resolved bank) or in conjunction with another resolution tool (namely on a bridge institution) (Article 145-S/1 of the GLCI).

III. The *asset management vehicle* is created by a decision of the resolution authority (Article 145-S/5 of the GLCI), and is wholly owned by the "Resolution Fund" (Article 145-S/4 of the GLCI). Similar to what happens in the case of the bridge institution tool, the resolution authority is vested with the right to approve its articles of association, to appoint the members of its management and supervisory boards, to select the rights, assets and liabilities of the resolved bank to be transferred to the asset management vehicle, and to transfer back the rights, assets, or liabilities of this vehicle to the resolved bank (Articles 145-S/13, 145-T/1, 7 and 8 of the GLCI).

4.5. Bail-In

I. The *bail-in tool* ("recapitalização interna") is the last and the most recent resolution tool provided by Portuguese banking law (Articles 145-U to 145-Z of the GLCI): notwithstanding being the cornerstone of the BRRD (Articles 43-55) and of the SRM Regulation (Article 27), it was only introduced in Portugal by the Law 23-A/2015.[87]

[86] To a transatlantic example of this type of resolution tool, *see* THOMSON, James, *Cleaning up the Refuse from a Financial Crisis: The Case for a Resolution Management Corporation*, Federal Reserve Bank of Cleveland, Working Paper No. 10-15, 2010.

[87] *See* CARVALHO, M. Almeida/ BASTO, I. Pinto, *A Recapitalização Interna ("Bail-In" como Instrumento da Resolução de Instituições de Crédito)*, in: 42 "Actualidad Jurídica Uría Menéndez" (2016), 135-146. To further developments on the origins, international background and content of this tool in the context of the BRRD, *see* JOOSEN, Bart, *Bail In Mechanisms in the Bank Recovery and Resolution Directive,* Netherlands Association for Comparative and International Insolvency Law, Working Paper, 2014.

II. The bail-in tool is a resolution measure that entrusts the resolution authority with a set of powers of write-down and conversion of liabilities[88] in order to achieve one the following *two purposes*: (i) in a going concern scenario of the resolved bank (that is, where there is a reasonable prospect that the application of that tool, together with other relevant measures, e.g., business reorganisation plan, will achieve the general resolution goals and restore its financial soundness and long-term viability), to recapitalize the bank to the extent sufficient to restore its ability to maintain its banking license; alternatively, (ii) in a gone concern scenario (where there is no such prospect), to capitalize a bridge institution or a bank business issuing from a sale or asset separation operation as the case may be (Article 145-U/1 and 2 of the GLCI).[89]

III. This is by far the most complex resolution tool, both legally and technically. Concerning its *scope*, while it is up to the resolution authority to select the liabilities to be affected by the exercise of the write-down or conversion bail-in operations (Article 145-U/5 of the GLCI), this power of selection is simultaneously restricted and extended by the law. It is constrained in the sense that it may not apply to certain mandatorily non-eligible liabilities, such as covered deposits, secured liabilities (e.g., covered bonds), short-term liabilities arising from participation in payment systems and inter-bank liabilities, employee remunerations, certain trade creditors, tax and social security liabilities, etc. (Article 145-U/6 to 8 of the GLCI); but, it is also enlarged in the sense that the resolution authority may exclude certain eligible liabilities, namely, if they cannot be bailed-in on time, in order to ensure continuity of critical functions, to avoid a severe disruption of the financial markets, or to avoid value destruction that would increase the losses of other creditors (Article 145-U/9 to 11 of the GLCI).[90]

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[88] These powers include the power to reduce, including to reduce to zero, the principal amount of eligible liabilities of the resolved bank and the power to convert eligible liabilities into ordinary shares or other instruments of ownership of that bank (Article 145-U/1/a) and b) of the GLCI).

[89] This means, in line with the BRRD, that the bail-in mechanism is a multipurpose tool, as it "can play a role in going concern as well as in gone concern situations" (JOOSEN, Bart, *Bail In Mechanisms in the Bank Recovery and Resolution Directive,* 5, Netherlands Association for Comparative and International Insolvency Law, Working Paper, 2014).

[90] There are also special rules concerning liabilities issuing from *financial derivative instruments* (v.g., futures, options, swaps): namely, derivative liabilities are bail-inable only upon or after their closing-out (Article 145-V/5 of the GLCI) and are included in the total liabilities if netting rights of the counterparty are fully recognized (Article 145-Y/2 of the GLCI). On these particular liabilities under the BRRD, *see* BENZLER, Marc/ HISSNAUER, Christian, *Derivatives and Bail-in under the EU Bank Recovery and Resolution Directive,* in: BINDER, J.H./ SINGH, D. (eds.), "Bank Resolution: The European Regime", 77-92, Oxford University Press, 2015.

IV. Concerning the *application* of this tool, it should be pointed that a bail-in operation shall always be preceded by a prior write down and/or conversion to equity of relevant capital instruments (Article 145-U/4 of the GLCI) and shall always involve the assessment, on the basis of a fair and reasonable valuation, of the aggregate amount by which eligible liabilities should be reduced or converted in order to ensure that the net asset value of the resolved bank is equal to zero (Article 145-V of the GLCI). In order to prevent banks from shifting their liabilities into exempt debts and to ensure an appropriate level of loss absorbing capacity, there is a need to establish a minimum requirement for own funds and eligible liabilities (MREL), expressed as a percentage or ratio of the total liabilities and own funds that shall be determined on a case-by-case basis (Article 145-Y/1 of the GLCI), either on an individual basis or on a consolidated basis in the case of groups (Article 145-Z of the GLCI).

III. LESSONS FROM THE PORTUGUESE BANK CRISIS

I. The Portuguese banking system was until very recently ignored. As happened with the banking systems of other small economies, it was a common belief of both politicians and regulators that it was just too small to matter to the outside world.

II. Today, after the financial crisis on 2008, we know better. If there is something to be learnt with the globalisation of economic and financial markets, it is precisely the relevance of the "butterfly effect", by reminding us that even a tiny event can start a chain reaction and have large and wide-reaching effects. That is why there are always valuable lessons to be drawn from bank crisis episodes and experiences, irrespective of whether they concern large economies or small periphery countries.

1. The Financing Dimension

1.1. The Resolution of BES and BANIF

I. As mentioned previously, the cases of BES (2014) and BANIF (2015) provided the very first real test in Portugal of the virtues of resolution as a new instrument of bank crisis management.[91]

II. It should be pointed out that the effective financial contributions made by the national resolution fund (PRF), to support the implementation of resolution of those two distressed Portuguese banks represented an extremely minor, if not merely symbolic, portion of the overall financing needs involved in its implementation. In the BES case, the resolution financing amounted to EUR 4.9 billion, of which only EUR 377 million were actually paid by the PRF itself (i.e., from contributions paid by member institutions and the banking sector as a whole), while the remaining part came from a senior loan granted by the Portuguese State to be repaid by the Resolution Fund[92]. In the BANIF case, the resolution financing amounted to EUR 2.2 billion, of which only EUR 489 million were provided by the PRF, while the remaining EUR 1.7 billion were paid directly by the Portuguese State[93]. Moreover, the prospects of the State loans being fully repaid by the PRF are becoming slimmer, as the disappointing ongoing bidding for "Novo Banco" for two long years renders unlikely that reimbursement will occur and the low performance of the PRF's bank members renders doubtful their ability to make the necessary exceptional financial contributions.

1.2. The Resolution Fund: An Achilles' Heel?

I. These numbers call our attention to the vital importance of Resolution Funds in the overall regulatory framework of the resolution mechanisms, which are likely to became the Achilles heel of any present or future, national or supranational, successful legal system of bank crisis management, if not of a European Banking Union. To say the least, the small size and liquidity of national resolution funds cast serious doubts at the very heart of the resolution mechanism as a true alternative to traditional bail-out mechanisms and about its ability to support the achievement of its sacrosanct goals of public funds and tax payers' protection.

[91] *See* above II – 2.4 and 2.5.
[92] *See* above I – 2.4.
[93] *See* above I – 2.5.

II. This is an especially important lesson from the point of view of the upcoming Single Resolution Fund (SRF). While the estimated size is about EUR 55 billion[94], there are studies showing that the safety net provided by the resolution fund in a systemic crisis will require amounts up to ten times higher. According to Maria NIETO and Gillian GARCIA, the amount necessary for provisioning a resolution fund to finance a bank systemic crisis corresponds, on average, to up to 4% of the general gross domestic product of a country.[95] Considering that the GNP of the Eurozone countries was in 2015 EUR 10.5 trillion[96], this means that the adequate target size of the SRF should be something in the order of EUR 420 billion.

2. The Cross-Border Dimension

2.1. The "Goldman Sachs" Decision

I. On 30 June 2014, precisely one month before its collapse, BES concluded a Facility Agreement with OAK, a special purpose vehicle of Goldman Sachs International (GSI), in the amount of US$835 million, which contained an express choice of English law and exclusive English jurisdiction clause. On 3 August 2014, the Bank of Portugal, as the national competent authority, ordered the resolution of BES by creating a bridge bank, "Novo Banco" (NB), and transferring to it all the liabilities of BES, with the exception of certain "Excluded Liabilities", in accordance with statutory transfer restrictions. Later, on 22 December 2014, the Bank of Portugal issued a further ruling clarifying that the facility agreement with OAK had not been transferred to NB.

II. Shortly after the December ruling, the first installment under the facility agreement was due for repayment, but was not made. The principle dispute between the parties concerned whether or not the liabilities represented by such agreement were

[94] Gradually built up along eight years (2016-2023) and reaching the target level of at least 1% of the amount of covered deposits of all credit institutions within the Banking Union by 31 December 2023 (*see* https://srb.europa.eu/en/content/single-resolution-fund).

[95] *The Insufficiency of Traditional Safety Nets: What Bank Resolution Fund for Europe?*, 31, Paolo Baffi Centre Research Paper No. 2012-117, 2012.

[96] According to EUROSTAT data concerning the second quarter of 2016 (in:http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tec00001&language=en).

transferred to NB, that is to say, whether or not they fell within the category of excluded liabilities as defined by the Bank of Portugal decisions. The Claimant, GSI, issued proceedings in the English Commercial Court against NB for repayment of the loan under the terms of the Facility Agreement. The Defendant, NB, contested on the basis that the court had no jurisdiction either to determine the claims or, alternatively, to stay the proceedings, arguing the principle of mutual recognition of resolution measures set forth in Articles 66 and 117 of the BRRD and Article 2 of the Winding-Up Directive. [97]

III. In this case, the English court decided that it had jurisdiction to entertain the claim, by interpreting or applying narrowly the mutual recognition principle under the BRRD. The court began by pointing out, correctly, that this principle should be limited to the exercise of resolution tools and powers by the national resolution authority which are explicitly provided by the BRRD subject to the limits set out therein, therefore excluding the domestic law actions which fall outside that perimeter. On this ground, the court then embarked on a rather formalistic, almost byzantine, distinction between the Bank of Portugal's rulings of August and of December, by taking the view that the latter could not be considered as a "transfer" in the sense of Articles 66 and 40/7 of the BRRD, nor was it an exercise of the powers thereunder, as a result the December decision had no effect in English law.[98]

2.2. The Scope and Limits of Mutual Recognition

I. In an era of globalization, any resolution regime – actually, any legal regime aiming to cope with a bank crisis today – will be a waste of time, if not a pure deception, unless the resolution actions with cross-border repercussions are actually perceived by all involved parties (States, banks, counterparties, depositors, investors, etc.) as being immediate and effective.[99]

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[97] *Goldman Sachs International v. Novo Banco SA* [2015] EWHC 2371 (Comm). On this case, *see* also LEHMANN, Matthias, *Bail-In and Private International Law: How to Make Bank Resolution Measures Effective Across Borders,* 30 and f. (in: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2759763, also forthcoming in International & Comparative Law Quarterly, 2017).

[98] *Goldman Sachs International v. Novo Banco SA* [2015] EWHC 2371 (Comm), para. 89ff.

[99] On the tensions between bank resolution measures and traditional private international law, *see* LEHMANN, Matthias, *Bail-In and Private International Law: How to Make Bank Resolution Measures Effective Across Borders,* 30 and f. (in: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2759763, also forthcoming in International & Comparative Law Quarterly, 2017).

II. For that purpose, the adoption of resolution actions and the exercise of resolution powers by the national resolution authorities were covered by a general principle of *mutual recognition*, and are considered as "fully effective in accordance with the legislation of [the home] Member State throughout the Community without any further formalities" (Article 3/2 of the Winding-Up Directive, "ex vi" Article 117 of the BRRD). This framework was further complemented by specific norms of the BRRD concerning mutual recognition of crisis management measures with cross-border effects, providing for their effectiveness in host Member States, duties of assistance, and duties of preventing external legal interference (Article 66 of the BRRD). In particular, paragraph 6 of this article went even further by expressly stating that "the rights for shareholders, creditors and third parties to challenge, by way of appeal pursuant to Article 85, a transfer of shares, other instruments of ownership assets, rights or liabilities", as well as the "rights for creditors to challenge, by way of appeal pursuant to Article 85, the reduction of the principal amount, or the conversion, of an instrument or liability" has to be determined in accordance with the law of the home resolution authority.

III. The "Goldman Sachs" decision is one of the very first cases after the implementation of BRRD where the principle of mutual recognition of measures of the resolution authority of a Member State has actually been tested. Another similar case was decided by German courts in *"Bayerische Landesbank v. Hipo Alpe Adria"*[100]. In this case, in the wake of the failure of Austrian bank "Hypo Alpe Adria", it was disputed whether the decision of the Austrian resolution authority to write-down and reschedule certain liabilities (including the ones to the German Bayern LG amounting approximately to EUR 2.3 billion) that were transferred to the "bad bank" Heta Asset Resolution AG, pursuant to a specific law enacted to resolve the bank, could be recognized in Germany. The court refused to recognize such write-down and reschedule measures considering, among other reasons, that the Austrian law made no reference to the BRRD and its measures did not actually match the ones of the BRRD, the national authority's orders

[100] Urteil des Landgerichts München I, Aktenzeichen: 32 O 26502/12 (8 May 2015). *See* SIMMONS & SIMMONS, *The Three "Rs" – Recovery, Resolution & Recognition*, 23 November 2015.

went beyond the scope of the BRRD and, therefore, fell outside of Germany's obligation under the BRRD to give effect to measures taken by other resolution authorities.[101]

IV. The success of a bank resolution depends, to a large extent, on the courts of Member States recognizing and giving effect to the actions of another Member State's resolution authority. In the above judicial decisions, national courts have taken a narrow approach to the recognition obligations under the BRRD, although it is not yet fully clear from those decisions whether that approach was due to the specific circumstances of the cases or whether they will set a judicial precedent. In any case, it seems reasonable to conclude that a new factor of complexity and uncertainty has been thus introduced in the already rather complex resolution apparatus. While it is likely that resolution authorities will be forced in the future to scrutinize carefully the interplay between choice of law and jurisdiction contractual clauses and the decisions they make under the BRRD, nobody can actually exclude that the fate of the entire resolution edifice will ultimately be dependent on the "second guess" and idiosyncratic views of national courts about what is, or is not, a "resolution action".

3. The Operative Dimension

3.1. The Retransfer of BES' Senior Bonds

I. On 29 December 2015, the Bank of Portugal, acting as the Portuguese resolution authority, determined the retransfer of certain Portuguese law-governed senior unsecured bonds, worth around EUR 2 billion, from the bridge bank "Novo Banco" (NB), back to the resolved bank BES.[102]

II. As alluded to earlier, NB was created in August 2014 as a "good bank" into which all of BES's liabilities (including the above mentioned senior ranking liabilities) were originally transferred, except for those falling under the statutory exceptions[103]. However, more than one year later, considering the negative economic and financial

[101] In July 2015, the Austrian Government and the German State of Bavaria announced that they had reached an agreement that settles the legal disputes between Bayern LB and Heta.
[102] BANK OF PORTUGAL, *Deliberation of 29 December 2015,* in: https://www.bportugal.pt/en-US/OBancoeoEurosistema/Esclarecimentospublicos/Documents/Deliberation20151229_retransfer.pdf.
[103] *See* above I – 2.3 and III – 2.1.

situation of the "good bank" NB (which exhibited in November 2015 a shortfall of EUR 1.4 billion in an adverse scenario, according to ECB Banking Supervision stress tests), the Bank of Portugal decided to transfer back to the "bad bank" BES liabilities concerning five senior unsecured bonds subscribed by institutional investors, based on the pursuance of public interest, the safeguarding of financial stability, and the accomplishment of the purposes of the resolution measure.

3.2. The Scope and Limits of Resolution Powers

I. In order to apply the resolutions tools effectively, resolution authorities were granted an extensive set of resolution powers, both in European law (Articles 63-72 of the BRRD, Article 29 of the SRM Regulation) and national laws (e.g., Article 145-AB of the GLCI). Amongst the most prominent, is the *power to transfer* equity, assets, rights and liabilities of the resolved banks, regardless of the identity or approval of the concerned parties (e.g., shareholders, creditors, customers). As a rule, this power is paramount in order to achieve the general goals of most of the resolution tools, by ensuring the separation between performing and non-performing assets, as a way to permit the viable parts of the resolved bank to be acquired by a private third party (sale of business), to be temporarily insulated in a "new bank" able to maintain "business as usual" (bridge institution), or inversely to encapsulate toxic assets in a new entity in order to cleanse its balance sheet (asset separation).

II. The scope of those powers of transfer is very broad, indeed *"multidirectional"*: far from being confined to a simple right to effect a transfer of assets from the resolved bank to another entity, they also encompass the right of transferring back those assets to the resolved bank ("re-transfers") or of transferring other assets from it ("new transfers") (Articles 38/5, 40/6, 42/9 of the BRRD, Articles 145-N/3, 145-Q/4, 145-T/7 of the GLCI). Moreover, the scope of such powers of re-transfer is even more extraordinary when considering that they may be exercised without any time limit and without any substantiation (other than the fact that retransfer powers were expressly provided for in the original transfer resolution decision) (Article 40/7/a) of the BRRD, Article 145-Q/5 of the GLCI).

III. The retransfer decision of the Bank of Portugal of December 2015 raises a number of questions as to the *limits* of the powers of resolution authorities, but also about the internal practical consistency of the resolution mechanism itself. It is obvious that such powers are not unlimited, from a theoretical point of view, as their exercise has to be necessary and proportional to the achievement of the resolution objectives (e.g., continuity of critical functions, avoiding systemic risks, etc.) and to comply with the general guiding principles (namely, creditor ranking, equitable treatment); and it is quite understandable, in the case at hand, that the affected bondholders may fear that the retransfer powers were used as a legitimate back-door to circumvent such principles at their expense (as they will probably be faced with a liquidation value return)[104]. However, from a practical point of view, it is rather doubtful whether such a highly sophisticated resolution mechanism is not becoming a regulatory conundrum which places resolution authorities before a truly impossible task, if not on the verge of a nervous breakdown. As a matter of fact, it should be pointed out that it is the law itself to afford great leeway to resolution authorities, while framing its intervention with an assortment of open-ended concepts ("public interest" of resolution, "equitable treatment" of creditors) and heterogeneous objectives (often mutually conflicting in the cases at hand). It is, thus, likely that the Portuguese resolution authority will be faced with a real dilemma: either to exercise its power of retransfer, ensuring the viability of the bridge bank at a cost to some former creditors of the bad bank (i.e., the continuity of critical functions of the bridge bank and the protection or public funds at the cost of safeguarding some clients' funds and assets), or, alternatively, not to exercise such power, in which case the shortfall of the bridge bank could only be probably addressed with the help of taxpayers contributions (i.e., minimizing clients losses at cost of the public funds, if not of the success of the entire resolution action at all). "Tertium datur"?

[104] The selection of the affected liabilities was probably not be innocent, being influenced by the prior litigation in English courts involving an English law-governed loan also transferred from BES (*see* above III – 2). By choosing to retransfer to BES only certain specific Portuguese law-governed bonds, the resolution authority avoided thus any issues of recognition or jurisdiction by foreign courts, requiring bondholders to bring any judicial complaint, at least in the first instance, in the Portuguese courts.

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