European companies

Banco Espírito Santo split in €4.9bn rescue

Shareholders and bondholders left holding toxic assets

Peter Wise in Lisbon AUGUST 4 2014

Banco Espírito Santo has been split into "good" and "bad" banks as part of a €4.9bn rescue of the distressed Portuguese lender that protects taxpayers and senior creditors but leaves shareholders and junior bondholders holding only toxic assets.

The rescue, which will destroy much of the value of investments made by equity and subordinated debt holders, is seen as a test case for a tougher stance by EU regulators, who have promised to protect taxpayers from the cost of bailing out mismanaged banks.

BES's healthy assets have been acquired by a small Portuguese bank rescue fund bolstered by EU and IMF loans left over from Portugal's international bailout, Carlos Costa, governor of the Bank of Portugal, said on Sunday night.

A total of €4.9bn in fresh capital is being injected into this "good bank", which will subsequently be offered for sale, Mr Costa said.

It has been renamed "Novo Banco", meaning new bank, and will include all BES's branches, workers, deposits and healthy credit portfolios.

The European Commission said the plan was in line with EU state aid rules. All deposits, senior debt and most assets will be transferred to Novo Banco, while shareholders and subordinated creditors will remain in the "bad bank", which is to be wound down.

The Commission said "a disorderly resolution of BES could create a serious disturbance in the Portuguese economy", adding that the creation of Novo Banco, as a "bridge bank" was a suitable remedy.

"Nothing will change for clients," said Mr Costa, who described the rescue as the best way to protect depositors and financial stability.

"The key uncertainties that have been hanging over the institution for some time have now been removed," said Vítor Bento, who was appointed chief executive of BES on July 14 and now becomes chief executive of Novo Banco. "The bank is now stronger and safer that it was before."

The finance ministry said the bank rescue would not involve any cost to taxpayers. The remaining EU and IMF bailout loans to Portugal being used in the rescue would have to be repaid regardless of their application.

BES shareholders will be left in control of the "bad bank", where regulators will deposit what they deem to be the lender's toxic assets. These mainly relate to its exposure to the crumbling business empire of the Espírito Santo group, its main shareholder, as well as the bank's Angolan subsidiary.

The rescue plan was hammered out over the weekend after BES reported a catastrophic first-half net loss of €3.58bn and impairments totalling €4.25bn.

The record loss, caused mainly by BES's exposure to Espírito Santo group, wiped out the bank's capital buffers, dangerously weakening its solvency ratios and causing its shares to plummet.

The rescue will draw on €6.4bn left over from funds loaned to Portugal by the EU and the IMF during the country's recent three-year international bailout and specifically set aside to assist banks.

The Commission said €4.4bn of these leftover funds will be used to bolster a small Portuguese rescue fund, known as the bank resolution fund, which was set up in 2012 after the global financial crisis to assist troubled banks. It is financed by compulsory contributions from all the country's lenders. The fund is currently estimated to total about €380m.

Under the plan, the resolution fund will take control of the healthy bank and later offer it for sale. Proceeds from the sale will be used to reimburse the loan to the fund from Portugal's remaining EU and IMF bailout loans.

Regulators will continue to investigate potential wrongdoing by BES's former management in the aftermath of the rescue. The central bank has said members of the previous executive board would face "regulatory and, potentially, criminal consequences" if a "forensic audit" found they were responsible for "illicit acts".

Portuguese regulators and officials from the so-called "troika" – the EU, the IMF and the European Central Bank – that oversaw Portugal's bailout programme could also face scrutiny from opposition Portuguese legislators who have called for an inquiry into what went wrong at BES.

Portugal's stock market watchdog, the CMVM, suspended trading in BES shares on Friday pending a statement from the board on the future of the bank, which is Portugal's largest listed lender by assets.

The shares fell 42 per cent on Thursday and a further 40 per cent on Friday. Since a €1.04bn capital increase in June, the bank's stock has lost 89 per cent of its value.

The central bank last week ordered BES to raise new capital after it reported that its record loss had wiped out a capital buffer of €2.1bn and halved its core tier one capital ratio, a vital measure of financial strength, to 5 per cent, below the regulatory minimum of 7 per cent.

Mr Costa and Vítor Bento, BES's new chief executive, have said private investors are willing to acquire stakes in BES and inject capital as part of a "comprehensive capitalisation plan", for which BES has contracted Deutsche Bank as an adviser.

But analysts said potential investors were likely to have grown more wary after it emerged from first-half results that the bank could face other potential impairments relating to its exposure to the Espírito Santo group and not yet fully accounted for, and further potential losses from its Angolan banking unit.

With additional reporting by FastFT