INFORMATIVE NOTE

BANKING AND FINANCE

STRENGTHENING OF THE FINANCIAL SOUNDNESS OF CREDIT INSTITUTIONS

On 11 January 2012 the Portuguese Parliament approved Law 4/2012 which introduces the third change to Law 63-A/2008 of 24 November, as amended by Laws 3-B/2010 of 28 April 55-A/2010 of 31 December. The new law establishes measures to strengthen the financial soundness of credit institutions in the context of the initiative to boost financial stability and enhance liquidity in the financial markets.

STRENGTHENING OF THE CORE TIER 1 RATIO

Under the law, which has now been approved, the strengthening of the financial soundness of the credit institutions is brought about through capitalisation operations using public investment. The aim is to comply with the core tier 1 equity capital ratio. However, while the new law retains the principles of necessity and proportionality, return on and guarantee of invested capital and minimisation of the risks of distortion of competition as the guidelines for use of public investment, there is also a clear and innovative determination in relation to the earlier legislation. This determination is that, whatever its holding in the share capital of the credit institution may be, the State may not exercise power or control over the institution. Indeed, the fact that the strengthening of the financial soundness of a determined credit institution is achieved through capitalisation operations using public investment does not imply - or cannot now imply – a simultaneous strengthening of the powers of the State in this credit institution. This rule only allows for one exception in situations of a material relevant breach of the recapitalisation plan (see below). In these cases the States powers are, indeed, increased. This new law also extends the period for using public investment for credit institution capitalisation operations until 30 June 2014.

PUBLIC INVESTMENT AND THE RECAPITALISATION PLAN

Under the law, access to public investment now depends on the presentation by the credit institution of a recapitalisation plan that establishes the measures which are necessary and appropriate to put it into effect. The plan must also set out the time frame for its implementation and the proof that the institution is financially sound enough to carry on with its activity. The plan, which is approved by the general meeting of the institution that will benefit from it, must contain a series of elements relating to the objectives, forms, terms and conditions for its implementation and must be submitted to the Bank of Portugal for analysis.

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The law also makes it possible for the Bank of Portugal to intervene if a credit institution has a level of core tier 1 capital below the minimum established, either by requiring the presentation of a recapitalisation plan a using public capital or, ultimately, appointing provisional management for the institution, revoking its authorisation or imposing other measures for resolution.

Equally important is the innovative provision of, within a maximum of five years, allocating any distributable amounts generated in the financial year as dividends, to public disinvestment. This is achieved through the acquisition of own shares, withdrawal of shares with reduction of share capital, through other financial instruments or through the disposal of the State's holding to the shareholders of the credit institution on the date of disinvestment. In the latter case, the special shares are converted into ordinary shares of the credit institution. What was, prior to this law, a power of the credit institutions now undeniably takes the form of a duty.

Law 4/2012 of 11 January 2012 is available here.