EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 22 November 2011

on the recapitalisation of credit institutions by the State

(CON/2011/95)

Introduction and legal basis

On 9 November 2011, the European Central Bank (ECB) received a request from the Portuguese Ministry of State and for Finance for an opinion on a draft law amending and republishing Law No 63-A/2008 of 24 November, which adopted measures reinforcing the financial robustness of credit institutions in the context of the initiative for financial stability and liquidity supply (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the functioning of the European Union and on the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law relates to the Banco de Portugal (BdP) and to the rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose and background of the draft law

1.1 The draft law is one of the actions considered necessary under the Economic Adjustment Programme for Portugal, with a view to restoring confidence in the banking sector and achieving financial stability in the Portuguese economy.

1.2 The draft law will establish the conditions and procedures for providing temporary support from public sources to viable credit institutions to bolster the resilience of the banking sector. To achieve this goal, banks have been asked to further strengthen their capital buffers to raise core Tier 1 capital ratio to 9% by the end of 2011 and to 10% by the end of 2012. Subsequently, on 26 October 2011, the European Banking Authority (EBA) announced measures aimed at addressing the increase in systemic risk triggered by the sovereign debt crisis in the euro area. In particular, banks are required to strengthen their capital positions by building up a temporary capital buffer against sovereign debt exposures to reflect market prices by the end of June 2012. All credit institutions with a head office in Portugal, regardless of the legal form in which they were incorporated, may benefit from public recapitalisation on the basis of the draft law.

1 OJ L 189, 3.7.1998, p. 42.

1.3 Capitalisation may have recourse to financial instruments or resources eligible for Core Tier 1 capital, through (a) acquiring the credit institution's own shares or other equity stakes; (b) increasing the share capital through the issuance of (i) special shares to the State; or (ii) ordinary shares[2] to the shareholders and/or the public[3]; and (c) other financial instruments or resources eligible for Core Tier 1 capital under the applicable eligibility conditions. According to the draft law, the shares issued under the draft law are special shares, subject to the ordinary shares regime, except that they grant the State a priority dividend. The State may only exercise its voting rights in matters pertaining to amendments to the articles of association, mergers, split-ups, conversion or dissolution of the credit institution or other matters in which the law or the institution's by-laws require a qualified majority. The issuance of ordinary shares with voting rights is also envisaged by the draft law if the State's stake exceeds a certain threshold to be determined by the implementing legislation.

1.4 Access to public investment depends on the submission to the BdP of a recapitalisation plan by the credit institution. Such a plan must provide for the necessary and appropriate measures for that purpose, including the timetable, and demonstrate that the credit institution meets conditions of soundness and solvency thus allowing its activity to continue. The State may under certain conditions appoint one representative to the administration and supervisory bodies of the institution that should among others: (i) ensure verification of compliance with the recapitalisation plan and other obligations of the credit institution under the recapitalisation legal framework; (ii) prepare and send monthly situation assessment reports to the BdP and the Minister for Finance and inform them of any relevant facts. As long as a credit institution benefits from public investment, it will be subject to the terms, conditions and financial charges set out in the ministerial decision approving the recapitalisation operation.

1.5 In principle, recapitalisation will be voluntary, and public disinvestment is to occur within three years unless market conditions justify an extension by up to another two years. If a credit institution does not meet the required Core Tier 1 capital ratio and does not request recapitalisation on its own initiative, or if it does not submit a recapitalisation plan compliant with the BdP's guidelines, the latter may require the credit institution to submit a recapitalisation plan with recourse to public capital, under the control of the BdP. If the credit institution does not comply, the BdP may (i) appoint a transitional administration to run the credit institution, (ii) withdraw the institution's banking licence which will imply its winding-up, or (iii) apply any resolution measures foreseen in the Legal Framework for Credit Institutions and Financial Companies.

1.6 Provided that the credit institution ensures maintenance of a proper Core Tier 1 capital ratio, public disinvestment must take place within three years in accordance with the market conditions. During such time, the State may only dispose partially or entirely of its stake in the credit institution to shareholders of the institution on the date of disinvestment, and in accordance with pre-emptive

2 Referred to as 'common shares' under some legal systems.

3 The State may underwrite or guarantee the placement of the issue in whole or in part.

right rules. The shares constituting the State's stake will automatically convert to ordinary shares at the time of disinvestment. If public disinvestment does not take place within three years, or at any time in the event of non-fulfilment of a recapitalisation plan, the State will have increased powers. As a final rule, public disinvestment must occur within five years at the latest.

2. General observations

2.1 The ECB was not consulted on Law No 63-A/2008 which the draft law amends. Furthermore, the ECB understands that the current text of the draft law is evolving and that it may have to be amended in the light of future developments. Moreover, the ECB notes that the draft law will be implemented by means of a '*portaria*' (hereinafter the 'Ministerial Order') on which the ECB expects to be consulted in due time, due to the many important issues not yet contained in the draft law that it will address. It trusts that the observations contained in this opinion will be considered in connection with the drafting of the Ministerial Order.

2.2. The ECB welcomes the draft law and its approach directed at restoring the solvency of viable banks. The draft law delegates to implementing legislation the setting of the threshold above which the State may exercise the voting rights connected to its participation in the credit institution. The ECB understands that even in this case, the beneficiary credit institution must be a viable bank. To the extent that special shares with limited voting rights constitute a special class of shares not envisaged by the Companies Code, the ECB invites the Portuguese authorities to consider specifying in the draft law, instead of the Ministerial Order, the shareholding threshold that would result in the conversion of a certain portion of shares held by the State from special shares, with limited voting rights attached, into ordinary shares with full voting rights. This would be beneficial to legal certainty and transparency.

2.3 The draft law defines the 'State' for the purpose of the draft law as including any entity whose capital is fully held by the State[4]. Under this wide definition, the State's capital injection into the credit institution could also be undertaken by a State-owned company such as another publicly-owned bank. As any such entity could be a competitor of the State-supported institution, the ECB questions whether this was the legislator's intention.

2.4 Finally, the draft law should specify that any recapitalisation from public resources will be made exclusively by means of a cash transfer, other than by means of new bonds or other debt instruments issued by the State which can be used as collateral in credit operations with the BdP.

3. Nature of the shares to be issued under the draft law

3.1 The draft law provides that the special shares are subject to the ordinary share regime under the Companies Code, but that they do have special restrictions attached to them while temporarily held

4 Article 22 of the draft law.

by the State[5]. However, the ECB understands that the special shares are to be treated as another class of shares and that attached to the special shares will be the right to appoint one non-executive director to the Board of the institution according to Article 14(2) of the draft law. If that is the case, the State as the special shareholder will not be in the same position as the other ordinary shareholders as regards the rights it can exercise. In view of the credit institution now having different classes of shareholders, its statutes may need to be amended. It will also be necessary for the voting and other rights and powers of the non-executive director to be further specified.

3.2 Article 14(1)(a) provides that the credit institution covered by the public investment is subject to a Ministerial decision with regard to the use of means provided within the scope of strengthening the equity capital, in particular the contribution of such credit institution to financing the economy and small and medium-sized enterprises. The ECB understands that this provision intends only to set out general obligations and should not lead the State to direct the allocation of credit by such credit institution. In particular, the credit institutions covered by the public investment should retain the ability to prioritise lending to the productive sectors of the economy, and not, for instance, State-owned undertakings. To the extent that this provision may be understood as allowing the State to interfere with the day-to-day business of the credit institution, it is inconsistent with the State's special shares carrying limited voting rights aimed at ensuring that the State does not intervene in the day-to-day business of the credit institution. If this provision was to be retained in the draft law, the ECB recommends clearly confining its scope to the adoption of guidelines of a general nature, to eliminate the possibility of interpreting this provision as requiring the recapitalised credit institution to finance a specific entity and a specific amount of such financing.

4. Shareholder rights

4.1 The draft law derogates from certain provisions of the Companies Code. It is important for fundamental shareholder rights not to be infringed while the credit institution is still being supervised as a going concern and the conditions for its resolution have not been triggered[6]. It is also particularly important, in a period when markets are unsettled, for current shareholders of institutions which may need to be recapitalised under the draft law to have legal certainty as to their rights under the recapitalisation regime. In this respect the ECB appreciates that the draft law requires the capital increase and the recapitalisation plan to be submitted to and approved by the shareholder meeting[7]. Nonetheless the Portuguese authorities are invited to consider further clarifying a number of relevant provisions with a view to Directive 77/91/EEC[8].

5 Article 4 of the draft law.

6 See Title VIII of the Legal Framework for Credit Institutions and Financial Companies as it currently reads.

7 Articles 4(5) and 9(2) of the draft law.

8 Second Council Directive 77/91/EEC of the Council of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formulation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ L 26, 31.1.1997, p 1).

4.2 The draft law specifies that an increase of capital by subscription for special shares may only take place under certain conditions, which could be read as setting aside the procedure of the Companies Code regarding the issuance of subscribed shares[9].

4.3 Furthermore, the draft law appears to empower the shareholder meeting to mandate the institution's Board to take any decision regarding implementing measures under the draft law, including increasing capital by any amount required[10]. The ECB considers that if the maximum amount of the increase is laid down by the credit institution's statutes, and there is no legislatively prescribed maximum, the shareholders' agreed maximum amount should be respected[11].

4.4 Under the draft law, in the event of a shareholder meeting convened specifically for the approval of the recapitalisation plan, the convocation must be issued to shareholders not later than 14 days before the meeting[12]. Under Directive 2007/36/EC[13] such reduced convocation period is only available if the company 'offers the facility for shareholders to vote by electronic means accessible to all shareholders' and that the shareholder meeting has taken a decision on the matter which meets the conditions set down in the Directive[14].

4.5 Finally, the ECB notes that Article 8(3) appears to go further than necessary to safeguard pre-emptive rights of the existing shareholders. According to Directive 77/91/EEC, the aim of pre-emptive rights is to offer shareholders the right to acquire new shares in proportion to their existing shareholdings. The ECB sees no compelling reason to rule out the possibility of selling shares to third parties after the pre-emptive rights of existing shareholders have been exhausted by means of law. Furthermore, to the extent that the draft law departs from the Companies Code, it may be necessary to specify the time frame during which the existing shareholders may exercise their pre-emptive rights according to Article 8(3).

5. Other issues

5.1 The ECB understands that the recapitalisation plan referred to in the draft law[15] is synonymous with the restructuring plan that will be required from the State-supported institution by the European Commission in compliance with its State aid rules.

5.2 The draft law provides that acquisition by the State of shareholdings or assets in credit institutions will not be considered a concentration of companies[16]. The draft law should clarify how this provision relates to the exclusive competence of the Commission to assess Union-wide mergers. The draft law further provides that insofar as public intervention is maintained under the draft law,

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9 Article 4(4) of the draft law.

10 Article 9(4) of the draft law.

11 See Article 25(2) of Directive 77/91/EEC.

12 Article 10 of the draft law.

13 Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ L 184, 14.7.2007, p. 17)

14 See Article 5 of the Directive.

15 Articles 9 and 12 of the draft law.

16 Article 20(1) of the draft law.

certain aspects must be considered. This provision should be further clarified, as it is currently unclear what it addresses.

5.3 The ECB notes that the Ministerial Order implementing the draft law will specify the methods for determining the purchase price of the shares to be subscribed by the State. The ECB recommends that the delegated authority, in laying down the relevant rules to determine the fair value, should abide by the general principles of lowering the taxpayers' burden and ensuring reasonable expectations of State remuneration in compliance with the relevant Union law.

5.4 Finally, under ordinary circumstances the State must divest its special shareholding in the credit institution within three years[17]. The ECB considers that this period could also be more closely aligned with the European Commission's developing practice as regards the duration of a restructuring plan[18]. Finally, the ECB recommends extending the scope of Article 17, which refers to the bank solvency support facility (EUR 12 billion) under the Economic Adjustment Programme of Portugal as the sole source of public financing to be used for the purposes of capital increase under this draft law. Such provision may prove to be too restrictive, in case other sources of public financing could be usefully relied on.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 22 November 2011.

[signed]

The President of the ECB

Mario DRAGHI

17 Article 24 of the draft law.

18 See Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, (OJ C 195, 19.8,2009, p. 9), in particular paragraph 15.