

Has a Government Intervention Credit Event occurred with respect to Novo Banco SA?

2014 ISDA Credit Derivatives Definitions

Brief in support of “Yes”

A Government Intervention Credit Event has occurred with respect to Novo Banco SA under section 4.8 (a) (iii) and 4.8 (a) (iv).

1. Our understanding is that it is not under debate that the criteria set out in the first paragraph of 4.8 (a) are satisfied. The action described by the Publically Available Information affects one or more Obligations in an aggregate amount greater than the Default Requirement as a result of action taken or an announcement made by a Governmental Authority pursuant to, or by means of, a restructuring and resolution law or regulation ... in a form which is binding.

2. Although there is a reasonable argument that would suggest that 4.8 (a) (i) (D) is satisfied we focus on 4.8 (a) (iii) and (iv) as these are easier to determine.

(iii) a mandatory, conversion or exchange

(iv) an event which has an analogous effect to any of the events specified in Sections 4.8 (a) (i) to (iii)

3. Prior to the Government action, bondholders of the affected securities held securities with Novo Banco as the obligor. As a result of the action under a resolution law

bondholders have now been mandatorily swapped into a bond with Banco Espirito Santo as the obligor. What bondholders own has clearly changed. It is a different security with a claim against a different entity. This is clearly a “conversion” of the security into something different from what it was based on any plain English understanding of the word “conversion”. Alternatively this is an “exchange” from one security (where Novo Banco is the obligor) to another security (where Banco Espirito Santo is the obligor).

4. Some commentators have suggested that because the securities might continue to have the same ISIN identifier for market purposes they are therefore the same security but that is clearly a weak argument. What bondholders own has fundamentally changed – their security has been “converted” into another security with a claim against a totally different entity or they have been “exchanged” into another security with a claim against a totally different entity. The ISIN identifier is not relevant. We believe that a reasonable interpretation concludes that 4.8 (a) (iii) is satisfied.
5. If we run a thought experiment along the following lines: Assume that instead of what occurred the Portuguese authorities had instead more explicitly mandatorily exchanged the affected bonds into new bonds issued by Banco Espirito Santo with otherwise the same terms. i.e. assume that they used the words mandatory exchange in the PAI and that the Annex at the bottom had a column for old ISIN and old obligor Novo Banco and a column for new ISIN and new obligor Banco Espirito Santo. In this thought experiment it is our belief that no-one would have the slightest doubt that this constitutes a “mandatory exchange”.

6. What has actually occurred has exactly the same effect as what is described in the thought experiment. Bondholders in both cases previously held a bond with Novo Banco as an obligor and now hold a bond with Banco Espirito Santo as an obligor. There is no difference of any sort, in form or in substance, between the effect of what occurred and the effect of what would have occurred under the “more explicit” mandatory exchange thought experiment described above. Note 4.8 (a) (iv) only requires “an event which has an analogous effect to” and what has occurred has “exactly” the same effect as the thought experiment. As such, even if you do not believe that 4.8 (a) (iii) is satisfied, 4.8 (a) (iv) is satisfied as what occurred has at least an analogous effect to a mandatory exchange or conversion.