

EMEA DC Statement 3 March 2016

The DC met on Wednesday 2 March 2016 to continue its discussions regarding whether there is any Successor (as defined in the Updated 2003 Definitions and the 2014 Definitions, as applicable) in respect of Novo Banco, S.A. (the **Reference Entity**) as a result of the transfer of certain obligations of the Reference Entity to Banco Espírito Santo, S.A. on or about 29 December 2015 (the **Transfer**).

The DC determined that no entity had as a result of the Transfer succeeded to more than twenty-five per cent of the Relevant Obligations of the Reference Entity and that the Reference Entity continued to exist. In accordance with Section 2.2(a)(v) of the Updated 2003 Definitions and Section 2.2(a)(v) of the 2014 Definitions, the DC resolved that there was no Successor in respect of the Reference Entity as a result of the Transfer for the purposes of both Updated 2003 Transactions and 2014 Transactions.

Capitalised terms used but undefined in this statement have the meaning given to them in the Credit Derivatives Determinations Committees Rules (January 20, 2016 Version) (including in the Updated 2003 Definitions and the 2014 Definitions, as defined therein).

Background

- (a) On 3 August 2014, the Board of Directors of the Bank of Portugal (**BoP**), in its capacity as the Portuguese Resolution Authority, ordered the adoption of a resolution measure (the **Resolution Measure**) with respect to Banco Espírito Santo, S.A. (**BES**) pursuant to the General Law on Credit Institutions and Financial Companies (*Regime Geral das Instituições de Crédito e Sociedades Financeiras*) approved by Decree-Law No 298/92 of 31 December 1992, as amended.
- (b) Pursuant to the Resolution Measure, a substantial portion of the assets, liabilities, off-balance sheet items and assets under management of BES (as selected by BoP) was transferred to the Reference Entity on 3 August 2014. The Transferred Bonds (as defined below) were originally issued by BES but were transferred to the Reference Entity (such that the Reference Entity was substituted as the obligor in respect thereof) as part of this original transfer.
- (c) On 29 December 2015, the Board of Directors of BoP, in its capacity as the Portuguese Resolution Authority and pursuant to the power expressly provided for in the Resolution Measure, amongst other actions ordered the re-transfer (effective immediately) of five senior bonds governed by Portuguese law (the **Transferred Bonds**) from the Reference Entity to BES such that BES was substituted as the issuer of the Transferred Bonds and the Reference Entity ceased to have any continuing obligations in respect thereof.¹

The Successor determination

The Successor determination required the DC to determine (a) the universe of Relevant Obligations in respect of the Reference Entity immediately prior to the Transfer and (b) what portion of such Relevant Obligations were transferred to BES, as the potential Successor. The remainder of this statement sets out the DC's reasons for its determination.

In the period following the Transfer, the most up-to-date published financial information in relation to the Reference Entity, in addition to information available on Bloomberg, was contained in the Interim Report and Accounts for Novo Banco Group, first half 2015 (dated 30 June 2015) (the **Half-year Financials**).² Given that the Half-year Financials were prepared as at 30 June 2015, the DC had previously decided that it was prudent to wait and make further attempts in order to establish up-to-date information on the outstanding principal amount of the Relevant Obligations of the Reference Entity, including in particular its central bank

¹ See BoP announcement of 29 December 2015 (the **BoP Announcement**), English translation available at <https://www.bportugal.pt/en-US/OBancoeoEurosistema/ComunicadoseNotasdeInformacao/Pages/combp20151229-2.aspx>

² Available at <https://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=760354&fext=.pdf>

funding, before making a determination.³ The Reference Entity published on 24 February 2016 a press release and accompanying unaudited financial information prepared as at 31 December 2015 (the **Unaudited Year-end Financials**)⁴, and the DC has also considered these in its determination. In addition to these sources, and on the basis that they alone did not make clear the form of certain debt obligations of the Reference Entity, the DC also sought clarification from BoP and the Reference Entity in relation to the extent and nature of such obligations in order to establish whether they constituted Relevant Obligations, as described below. Each of BoP and the Reference Entity has confirmed that the information provided by it and contained in this statement may be made publicly available.

The DC made this determination in respect of Updated 2003 Transactions and 2014 Transactions. The Successor provisions in respect of each are substantively similar, with some minor differences as noted below.

Relevant Obligations in respect of the Reference Entity

In addition to the Transferred Bonds, the DC identified the following categories of debt obligation of the Reference Entity from the Half-year Financials, the Unaudited Year-end Financials and information available on Bloomberg:

- (a) government-guaranteed bonds;
- (b) covered bonds;
- (c) “deposits and other funds” from central banks (as described in the Half-year Financials and the Unaudited Year-end Financials);
- (d) zero-coupon bonds (which bear no coupon but whose nominal value rises throughout their term in accordance with a specified accretion formula);
- (e) other bonds; and
- (f) loans.

The DC considered each of these categories in order to establish the full extent of the Relevant Obligations of the Reference Entity immediately prior to the Transfer.

Transferred Bonds

These constituted Relevant Obligations of the Reference Entity immediately prior to the Transfer. The aggregate outstanding nominal amount of the Transferred Bonds was specified in the BoP Announcement and the Unaudited Year-end Financials to be approximately EUR1,941,000,000. Bloomberg, alternatively, showed their outstanding nominal amount to be EUR2,168,000,000 at the relevant time. The DC sought clarification from BoP on this discrepancy. BoP confirmed to the DC that the outstanding nominal amount of the Transferred Bonds immediately prior to the Transfer was EUR1,941,000,000, and that this figure excluded the Transferred Bonds that were held by the Reference Entity immediately prior to the Transfer (which had a nominal amount of approximately EUR227,500,000). Therefore, the DC concluded that EUR1,941,000,000 represents the outstanding nominal amount of the Transferred Bonds for the purpose of calculating the Relevant Obligations of the Reference Entity as published in the BoP Announcement.

The DC took the view that debt obligations of the Reference Entity that were held by the Reference Entity itself could not be said to be “outstanding”, on the basis that the Reference Entity had no obligation to repay any money where it held its own debt obligations. As such, any such debt would not count as a Relevant

³ See EMEA DC Statement of 21 January 2016, available at <http://dc.isda.org/documents/2016/01/emea-dc-meeting-statement-21-january-2016.pdf>

⁴ Entitled “Novo Banco Group Activity and Results in 2015, available at <http://www.novobanco.pt/site/cms.aspx?srv=207&stp=1&id=776187&fext=.pdf>

Obligation within the meaning of Section 2.2(f) of the Updated 2003 Definitions and the 2014 Definitions, respectively. Furthermore, the 2014 Definitions expressly state that Bonds or Loans held by the Reference Entity shall be excluded from constituting Relevant Obligations.

Government-guaranteed bonds

Bloomberg showed the outstanding principal amount of the government-guaranteed bonds of the Reference Entity shortly after the date of the Transfer to be EUR3,500,000,000. This is consistent with the Unaudited Year-end Financials, which also confirm that the maturity of the government-guaranteed bonds of the Reference Entity was extended.⁵ The Half-year Financials state that all of these government-guaranteed bonds had, as at 30 June 2015, been acquired by the Reference Entity's group,⁶ and the Unaudited Year-end Financials do not suggest anything to the contrary. This arrangement has also been confirmed to the DC by the Reference Entity. The government-guaranteed bonds therefore did not constitute Relevant Obligations of the Reference Entity.

Covered bonds

Bloomberg showed the outstanding principal amount of the covered bonds of the Reference Entity shortly after the date of the Transfer to be EUR3,740,000,000. BoP confirmed to the DC that the covered bonds were held by the Reference Entity, and also confirmed that they were used to collateralise certain of its central bank funding arrangements. Because the covered bonds were held by the Reference Entity, they did not constitute Relevant Obligations of the Reference Entity.

Deposits and other funds from central banks

As noted in the EMEA DC Statement of 21 January 2016, the Half-year Financials stated that the Reference Entity had certain "deposits and other funds" from central banks.⁷ Given the size of these obligations, the outstanding nominal amount of the Transferred Bonds and the size of the Reference Entity's other debt obligations, the DC had previously noted that whether this central bank funding constituted Relevant Obligations may be determinative in establishing whether there was any Successor.

The DC was provided with the Bank of Portugal Instruction no. 3/2015 (BO no. 5 of 15 May 2015) (the **BoP Instruction**),⁸ which includes at Annex XIII thereto template forms of FX swap, repo and collateralised term loan instrument (the **Loan Instrument**) under which BoP may provide funding. It was not clear from the Half-year Financials or the Unaudited Year-end Financials which of these forms the central bank funding took (or indeed if it took another form altogether, such as a deposit). It was not apparent, therefore, whether the central bank funding (or indeed any obligations of the Reference Entity used to collateralise it) would constitute Relevant Obligations. The DC therefore sought clarification from BoP and the Reference Entity as to the nature and extent of these obligations. BoP confirmed to the DC that ECB funding has been provided to Portuguese entities in the form of the Loan Instrument, and the Reference Entity confirmed that its funding operations from the ECB are secured by pledges and are not in the form of repos.

The Loan Instrument is in the form of a credit agreement that the DC's Portuguese counsel advised would constitute a Loan (as defined in the Updated 2003 Definitions and the 2014 Definitions, as applicable). The best information available to the DC is therefore that the "deposits and other funds" from the ECB are made in the form of the Loan Instrument and, accordingly, the entire outstanding principal amount of such financing would constitute a Loan. The DC therefore determined that the ECB funding would constitute Relevant Obligations.

The consolidated balance sheet to the Unaudited Year-end Financials state that the aggregate outstanding balance of all of the Reference Entity's central bank funding was EUR7,632,794,000 as at 31 December

⁵ Unaudited Year-end Financials, page 6

⁶ Half-year Financials, note 37, page 145

⁷ Half-year Financials, note 34, page 142; the consolidated balance sheet to the Unaudited Year-end Financials (at page 26) similarly includes a line item for "deposits from central banks".

⁸ Available in Portuguese at <http://www.bportugal.pt/sibap/application/app1/docs1/historico/textos/3-2015i.pdf>

2015. Based on the notes to the Half-year Financials, the DC understood this line item to represent deposits and other funds from the European System of Central Banks (including the ECB) as well as other central banks. The Unaudited Year-end Financials suggest that as at 31 December 2015 net borrowing from the ECB stood at approximately EUR7,040,000,000,⁹ and the DC accordingly understood at least this amount to have been made available to the Reference Entity under the Loan Instrument at or around the time of the Transfer. It is not clear to the DC whether the remaining EUR592,794,000 of central bank funding was made under a similar form to that of the Loan Instrument, and therefore was not clear whether such central bank financing would constitute Relevant Obligations. However, in any event, this remaining EUR592,794,000 was not determinative to the overall Successor outcome. The DC therefore excluded such funding from the calculation of the Reference Entity's Relevant Obligations, as set out below.

The DC noted further that using the equivalent figure from the Half-year Financials (i.e. EUR5,928,209,000 as at 31 June 2015)¹⁰ resulted in no change to the outcome of the determination.

Zero-coupon bonds

In relation to the zero-coupon bonds, the DC was of the view that the liabilities of the Reference Entity immediately prior to the Transfer were most accurately represented by their accreted amount at such time. This is because the accreted amount, in accordance with the definition of Relevant Obligations, is the amount that most closely reflects the principal amount "outstanding" at such time.¹¹ The zero-coupon bonds' nominal value, which represents the Reference Entity's liabilities as at scheduled maturity, should not be taken into account for the purposes of the Successor determination, which is a question of the size of the Reference Entity's liabilities as at the date of the Transfer. This approach is consistent with the treatment of Accreting Obligations under the Updated 2003 Definitions and the approach to an obligation's Outstanding Principal Balance under the 2014 Definitions.

Bloomberg showed the aggregate nominal amount of the zero-coupon bonds of the Reference Entity shortly after the date of the Transfer to be EUR6,425,367,000, which was consistent with the figure stated in the Half-year Financials (once securities that had matured since 30 June 2015, the date in respect of which the Half-year Financials had been prepared, were excluded).¹² Assuming that the accretion formula in each zero-coupon bond was as per the industry standard, which the DC noted was the case for a number of the zero-coupon bonds whose terms it had seen, the DC estimated that the aggregate accreted value of the zero-coupon bonds immediately prior to the Transfer was approximately EUR679,000,000.

Other bonds

Bloomberg showed the outstanding principal amount of the other debt securities of the Reference Entity shortly after the date of the Transfer to be EUR3,703,407,000.¹³ It was not clear what amount, if any, of these were held by the Reference Entity or its Affiliates. The lack of clarity on this question was not determinative, as noted below.

Loans

The DC noted a loan of EUR1,024,952,000 stated in the Half-year Financials.¹⁴ The Unaudited Year-end Financials did not contain a more up-to-date figure for this loan. It was not clear what form this loan took and was therefore not clear whether it should be included as a Relevant Obligation. There may be other

⁹ Unaudited Year-end Financials, Financial Highlights, page 25

¹⁰ Of all of the Reference Entity's central bank funding as at 30 June 2015, the Reference Entity confirmed that EUR5,640,000,000 represented ECB funding.

¹¹ The definition of Relevant Obligations in the Updated 2003 Definitions and the 2014 Definitions requires only Bonds or Loans which are "outstanding" immediately prior to the transfer to be taken into account.

¹² Half-year Financials, note 37, page 147

¹³ This is broadly in line with the outstanding principal amount of debt securities issued as at 31 December 2015, as stated in the consolidated balance sheet in the Unaudited Year-end Financials (EUR4,224,658,000). Note 37 to the Half-year Financials indicates that this figure would include securitisation notes. As these notes were neither issued nor guaranteed by the Reference Entity, the DC was of the view that these would not constitute Relevant Obligations.

¹⁴ Half-year Financials, note 35, page 143

undisclosed loans that would constitute a Loan for the purposes of Relevant Obligations, but the DC was not aware of any.

Total outstanding principal amount of Relevant Obligations

In summary of the above, the best publicly available information on the total outstanding principal amount of the Relevant Obligations of the Reference Entity immediately prior to the date of the Transfer was as follows:

- (a) Transferred Bonds: EUR1,941,000,000;¹⁵
- (b) Loans from central banks: EUR7,040,000,000;¹⁶
- (c) zero-coupon bonds: EUR679,000,000;
- (d) other bonds: EUR3,703,407,000; and
- (e) other loans: EUR1,024,952,000.

As it was not clear whether the EUR1,024,952,000 loan set out in the Half-year Financials constituted Relevant Obligations, the DC determined that the Relevant Obligations of the Reference Entity was either EUR13,363,407,000 (excluding such loan) or EUR14,388,359,000 (including such loan). Further, either figure may be an over-estimate, on the basis that a portion of the EUR3,703,407,000 of other bonds may have been held by the Reference Entity immediately prior to the Transfer (and therefore any such portion should be excluded from constituting Relevant Obligations).

Portion of Relevant Obligations transferred

The outstanding nominal amount of the Relevant Obligations transferred was EUR1,941,000,000. Taking the outstanding principal amount of the Relevant Obligations of the Reference Entity to be EUR13,363,407,000 and EUR14,388,359,000 in turn, the portion of Relevant Obligations transferred was either 14.5 per cent. or 13.5 per cent. respectively. Even if the amount of “other bonds” in limb (d) above is an over-estimate on the basis that some of them may have been held by the Reference Entity immediately prior to the Transfer, this does not affect the determination: even assuming the entirety of this category of obligations was held by the Reference Entity (which, for the avoidance of doubt, the DC did not think was the correct approach), the portion of Relevant Obligations transferred would be no higher than 20.1 per cent.

Conclusion

The DC therefore determined that the portion of the Relevant Obligations transferred was less than twenty-five per cent. of the Relevant Obligations of the Reference Entity and, accordingly, resolved that there was no Successor in respect of the Reference Entity as a result of the Transfer.

Other issues considered

The DC considered a number of other issues during the course of its discussions which were ultimately not determinative. In particular, before the DC established that the ECB funding had been made under the Loan Instrument (and so constituted a Loan), the DC considered what the position would be if such funding had been made available under a repo arrangement.

The purchase price under a traditional title-transfer repo arrangement would not constitute Borrowed Money for the purpose of either the Updated 2003 Definitions or the 2014 Definitions, and so would not be a Bond, Loan or Relevant Obligation. Similarly, as noted above, the DC took the view that debt obligations of the

¹⁵ This figure excludes the nominal amount of the Transferred Bonds held by the Reference Entity immediately prior to the Transfer.

¹⁶ This figure excludes central bank funding other than ECB funding, as the DC could not ascertain what form the non-ECB funding was in.

Reference Entity that were held by the Reference Entity itself would not constitute Relevant Obligations, on the basis that the Reference Entity's lack of obligation to repay any money in such circumstances meant that such obligations could not be said to be "outstanding". However, in circumstances where the Reference Entity holds its own debt obligations but then transfers them to a counterparty under a repo (i.e. they constitute the purchased securities transferred in exchange for the purchase price), the DC was of the view that such debt obligations would (assuming they otherwise fulfilled the relevant definition) become Relevant Obligations upon their being transferred. Whereas a debt obligation held by the Reference Entity itself does not give rise to any obligation to repay, and hence should not be considered outstanding, the Reference Entity has a real liability once another party becomes entitled to such claim. In a case where an entity transfers its own bonds to a repo counterparty, the repo counterparty (and any subsequent transferee) would have the right to be repaid under such bonds. So while the purchase price under a repo will not constitute a Relevant Obligation, there are circumstances in which the obligations provided by an entity in consideration for the payment thereof may constitute Relevant Obligations instead.