



Financial Industry Alert

ALERT

The Nationalisation of Banco Espírito Santo – The Aftermath

The Bank of Portugal announced on Sunday 3 August 2014 that it applied its powers under the Decree law No 31/2012 of 10 February 2012 (the "**Resolution Law**") to split Banco Espírito Santo ("**BES**") into a "good bank" and "bad bank" (the "**Restructuring**") and to transfer certain of BES "good" assets and liabilities to "Novo Bank".

Following the release by BES of its half year results, it was apparent that the financial stability of BES was more questionable than many had suspected. A rapid decline in BES's share and subordinated bond price followed and on the weekend of 2 and 3 August, the Bank of Portugal must have come to the conclusion that its earlier plea for a private sector recapitalisation was unrealistic. On 3 August, the Bank of Portugal publicly announced the split which left certain assets with BES, which also retained the subordinated debt. The senior bonds and many of the quality assets of BES were transferred to Novo Bank.

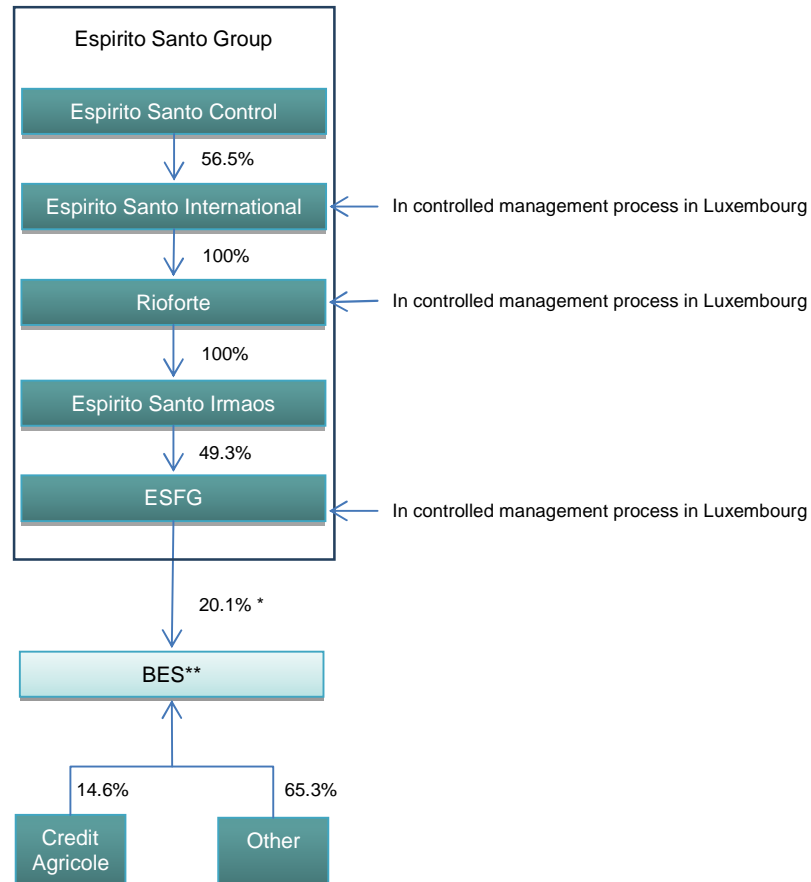
In view of the European Central Bank's ongoing asset quality review, the BES case was seen as a test case in Europe. This client alert looks at some of the recent history of the Espírito Santo group and BES and considers what will happen in the aftermath of the nationalisation of BES and following the filing by certain Espírito Santo holding companies for controlled management (gestion contrôlée) in Luxembourg. Specifically, this client alert considers:-

- i) the background and recent history relating to BES and the Espírito Santo group;
- ii) the limited legislative tools available to the Bank of Portugal under the Resolution Law;
- iii) what the effects of the use of the Resolution Law will have on BES stakeholders; and
- iv) what the next steps are likely to be in relation to Espírito Santo International ("**ESI**"), Rio Forte Investments ("**Rio Forte**") Espírito Santo Financière SA ("**ESFIL**") and Espírito Santo Financial Group ("**ESFG**") that have filed for a controlled management process in Luxembourg.

Background

BES, one of Portugal's best known banks, is associated with the Espírito Santo family which indirectly owns a 20% stake in BES through ESI and its subsidiaries. BES gave every appearance of navigating the banking crisis with relative success given that it did not seek to draw down on any of the funds made available in the Troika programme for Portugal. However, its exposure to the Espírito Santo group, amongst other things, has caused significant financial woes for BES.

A simplified group structure is set out below. ESI's 20% stake in BES is held indirectly by ESFG which is 49% owned by Espirito Santo Irmaos SGSP ("**ES Irmaos**"), which is itself 100% owned by Rio Forte, a 100% owned subsidiary of ESI (together the "**Espirito Santo Group**").



*Note: Shareholding is held through an intermediate entity
 **Prior to nationalisation

Recent Events

An external audit of ESI was conducted at the request of the Bank of Portugal between 30 September 2013 and 31 December 2013, which found that there were "material irregularities" with respect to ESFG's financial reporting. This announcement triggered a series of events as well as a high volatility in trading at ESFG and BES.

Whilst ESFG only held a 20% stake in BES, Moody's lowered BES's Ba3 long term debt and deposit rating in June 2014 which was stated to be triggered, amongst other things, by the bank's corporate governance shortcomings and a statement in the 2013 annual report of ESFG that it had made a €700 million provision in its accounts relating to certain commercial paper issued by ESI and Rio Forte, to BES clients. The €700 million provision was said to relate to a guarantee provided in relation to commercial paper issued to the retail clients of BES.

This acted as a catalyst to accelerate the replacement of BES's CEO following pressure from the Bank of Portugal seeking to distance BES from the irregularities in relation to ESI and its subsidiaries.

A series of events then followed which added to the woes of the Espirito Santo Group and to BES, namely:-

1. On 15 July 2014, Rio Forte failed to pay €847 million to Portugal Telecom in relation to short term commercial paper issued by Rio Forte. As a result, Portugal Telecom, which was in merger discussions with Brazil's Grupo Oi, was forced to take a reduced stake in relation to the proposed merger;
2. On 16 July 2014, ESFG sold a 4% stake in BES taking its holding to just over 20%;
3. On 18 July 2014, ESI filed for a controlled management (gestion contrôlée) procedure under Luxembourg law to seek protection from its creditors;
4. On 22 July 2014, Rio Forte filed for a controlled management followed shortly by ESFG on 24 July 2014;
5. On 25 July 2014, Ricardo Espirito Santo Salgado, the former CEO of BES, was arrested on charges of tax evasion and money laundering;
6. On 25 July 2014, Mr. Amílcar Carlos Ferreira de Morais resigned from the board of BES;
7. On 30 July 2014, BES published its half year results following which its share price and subordinated debt significantly dropped;
8. On 30 July 2014, the Bank of Portugal suspended the voting rights of the qualified shareholdings of ESFG and Espirito Santo Financial (Portugal) – SGPS S.A ("**ESF Portugal**") in BES and suspended the members of the management bodies responsible for audit, compliance and risk management as well as members of the Audit Committee of BES;
9. On 1 August 2014, Espirito Santo Financière a subsidiary of ESFG filed for controlled management;
10. On 3 August 2014, the Bank of Portugal used its powers under the Resolution Law to dispose of certain assets and liabilities of BES to create a "good bank" and "bad bank" leaving behind, amongst other things, the subordinated debt with BES.

Exposure to the Espirito Santo Group

The half year results of BES disclose a net loss of €3.6 billion, largely due to exposures of BES to the Espirito Santo Group, and did not rule out additional losses as further investigations are carried out in relation to BES loan books and its transactions with the Espirito Santo Group.

The results allude to questionable conduct in relation to certain exposures to the Espirito Santo Group. In particular, in the second quarter of 2014, BES increased its exposure to ESFG and its subsidiaries to a total of €927.6 million.

It is disclosed that in June alone, BES increased its exposure to ESFG and its subsidiaries by €120 million, in relation to transactions which were not approved by the related parties committee or by the bodies within the bank that have the powers to approve such transactions. The majority of this increased exposure was reported to be due to further drawings on credit granted within existing commercial relations to reaching €533 million. Notably, much of this exposure is not collateralised. The report also indicates that BES's exposure to Rio Forte increased to €270 million in the first half of 2014.

As a consequence of this and other exposures BES created a €823 million provision for impairments in relation to the Espirito Santo Group of companies.

A press release issued on 30 July 2014 by the Bank of Portugal confirmed that it has suspended certain voting rights of certain shareholders within the Espirito Santo Group and suspended certain members of the management bodies within BES. Moreover, the Bank of Portugal confirmed that the ongoing financial audit commissioned by the Bank of Portugal will assess the individual responsibilities, including those of the former CEO, CFO and those members of the Executive Board who resigned in the interim from their posts and that if the practice of illicit acts be confirmed, the relevant administrative or even criminal actions will be pursued.

The ESFG Commercial Paper Guarantee

Earlier in July, speculation relating to BES's exposure to the Espirito Santo Group companies forced BES to issue a statement on 10 July 2014 setting out its exposure to the Espirito Santo Group. In that statement, details of commercial paper issued by the Espirito Santo Group companies via BES to BES's commercial and retail clients were disclosed. The half year figures confirm that approximately €1.1 billion of such commercial paper had been issued to BES's retail clients and €2 billion was held by its institutional clients. A portion of such commercial paper (€700 million) issued to BES's retail clients was purportedly guaranteed by ESFG, however, there is a question mark over the recoverability under the guarantee as ESFG is now in a controlled management process in Luxembourg. Prior to the measures being taken under the Resolution Law, BES confirmed that it would reimburse its retail clients to whom it sold the commercial paper. However, the claims of such retail clients appear to have been left behind in the "bad bank" of BES.

A significant holder of the commercial paper issued by Rio Forte was Portuguese Telecom, in which BES holds an equity interest. Partly as a consequence of Rio Forte's failure to make payment under its commercial paper issued to Portuguese Telecom, BES had to recognise an impairment of €106 million in relation to its investment in Portuguese Telecom.

Other suspect transactions were disclosed in the half year results in relation to certain special purpose entities owned by BES which appear to have bought bonds issued by the BES group as well as certain letters issued by BES to ESI. It is stated that the current board members in office as of 30 June 2014 were not aware of such transactions.

Following the appointment of a new CEO, new management attempted to clear the air with full disclosure of all suspect transactions in order to draw a line between the current management regime and the previous way the bank has been managed. Indeed, the half year report states that BES intended to take "all measures within its reach...to ensure that the Bank is reimbursed for the losses caused as a result of any potential illegal behaviour that is identified". Notably, it seems that liabilities relating to any fraudulent activity have been left with BES.

Exposure to BES Angola

Prior to the publication of the half year results there was significant market speculation regarding BES's exposure to its Angolan subsidiary ("**BESA**") in which it holds a 55.7% stake. It is reported that BESA suffered a loss of €355.7 million for the first half of 2014, just over half of which is attributed to BES's balance sheet by reason of its shareholding in BESA.

It is understood that BES had also provided a €3 billion short term liquidity line of credit to BESA which has now been transferred to Novo Bank. A guarantee was reportedly signed by the Angolan government which guaranteed 70% of the loan portfolio of BESA. However, following the intervention by the Bank of Portugal, on 4 August 2014, BESA was placed into administration by the National Bank of Angola. It is understood that the guarantee granted by the Angolan government has been revoked. The announcement by the National Bank of Angola on 4 August 2014 states that the administrators of BESA will take control of the business for one year who will work with the old administrators "to

evaluate the bank's situation from up close and find out the anomalies". It was also confirmed that that €3.8 billion will be injected into BESA by the State.

The action taken to allow the business of BESA to be operated by administrators for one year contrasts the quick and decisive action taken by the Portuguese government taken in relation to BES. It could, therefore take some time to understand whether any value will be recovered by Novo Bank in relation to the credit line transferred to it under the Resolution Law and whether there is any value in BES's equity stake in BESA (the latter is likely to have limited if any value).

The Good Bank / Bad Bank Split

The press release from the Bank of Portugal of 3 August 2014 confirms that the deterioration of BES required an "immediate and very urgent intervention" by the Bank of Portugal. The Resolution Law (described below) was therefore used to implement a resolution measure to separate the "problem assets" of BES, which have been left in BES, and the other assets and liabilities of BES which have been transferred to Novo Bank.

It is understood that the current shareholders of BES remain as shareholders and the bank's subordinated creditors have also been left behind in BES. Certain other "problem assets" such as BES's investments in BESA, Espirito Santo Bank and Aman Bank and claims against the Espirito Santo Group are believed to have been left with BES. Notably, any liabilities relating to the Espirito Santo Group have been left in BES, namely:-

- (i) liabilities to: (a) shareholders of BES holding or who held for a period of 2 years preceding the transfer; (b) members of the management or supervisory boards, certified auditors, audit firms or persons with similar status in a control or group relationship with BES; (c) persons or entities that have been shareholders or who have performed the functions or provided the services referred to in the preceding four years, whose action or failure to act caused the financial difficulties experienced by BES, or which helped to aggravate that situation; (d) the spouses, relatives by consanguinity or by affinity in the first degree or third parties acting on behalf of the persons or entities referred to in the foregoing subparagraphs; (e) persons responsible for facts related to BES, or that have profited from these facts, directly or through a third party, which have caused its financial difficulties or helped to aggravate that situation, due to action or failure to act in the performance of their functions, according to Banco de Portugal's understanding;
- (ii) any obligations towards entities within the Espirito Santo Group;
- (iii) any obligations towards guarantees in relation to liabilities of the Espirito Santo Group;
- (iv) liabilities for fraudulent intentions, fraud situations, breaches of regulatory, criminal or administrative provisions;
- (v) liabilities relating to the trading, financial intermediation and distribution of debt instruments issued by entities within the Espirito Santo Group.

All assets and liabilities save for those expressly excluded by the Bank of Portugal, including deposits, senior bonds, banking agencies and employees have been transferred to Novo Bank.

In relation to Novo Bank, it is understood that an injection of €4.9 billion was made via a loan from the Portuguese government, which is underwritten by the Portuguese resolution fund. There has been a recent press report that a consortium of Portuguese banks have agreed to lend €800 million to reduce the government's share of the recapitalisation.

Value in BES?

The question arises as to the value that can now be extracted in relation to BES by its shareholders and subordinated creditors. The outcome in relation to BESA and the unravelling of any transactions between BES and the Espirito Santo Group will determine whether there will be a likely recovery for subordinated bondholders of BES or whether there is likely to be a zero return. In the event that the return to subordinated creditors is likely to be less than would have been recovered as a liquidation it is expected that compensation will be sought and potential litigation could ensue as a result. It is not currently clear whether any form of consideration will be payable by Novo Bank to BES for its assets other than the adoption of certain liabilities. This could be a determining factor with respect to any likely recovery of subordinated bondholders. Other value drivers for any recovery for remaining investors in BES is the equity value of BESA (which is likely to be minimal (if any) following the appointment of administrators), any recovery it may have in respect of loans or receivables to affiliate entities, any recovery it may attempt to make in respect of misfeasance claims against its previous management and any claims under directors' and officers' liability insurance policies. All of these factors are highly uncertain but it is expected that as with Lehman Brothers, the failed Icelandic banks and the failure of MF Global, an active secondary market will be established and a market will emerge in BES debt claims. The next steps for BES appear to be winding down and ultimately liquidation.

Whilst the implementation of the resolution measure has left a significant amount of uncertainty with respect to any value available to subordinated bondholders (and our assumption is that shareholders are unlikely to make any recovery), it has at least from the public's point of view, drawn a line under the opaque management structure of BES and should give depositors comfort that their money is not at risk.

The Resolution Law

On 15 May 2014, the EU Parliament issued the EU Bank Recovery Resolution Directive (Directive 214/59/EU) ("**BRRD**") which aims to resolve issues highlighted by the banking crisis with respect to whether the tools available on a national level are adequate to deal with failing banks. Despite Germany taking a lead in implementing BRRD a year early, the directive does not need to be implemented at State level until 2016. Portugal has not yet adopted the BRRD and therefore, the Bank of Portugal had limited tools at its disposal to rescue BES.

Under the Resolution Law only two measures are specifically stated to be at the disposal of the Bank of Portugal, namely, the total or partial sale of assets and liabilities of the distressed institution or the creation of a bridge bank and the transfer of all or part of the assets or liabilities to the bridge bank. Therefore, any more subtle interventions by the Portuguese government, such as the conversion of subordinated debt into equity or the dilution of existing equity holders would have required a change of law, a consent solicitation process with bondholders or other processes to compromise the subordinated debt such as a scheme of arrangement in relation to the English law bonds.

Under the BRRD a Member State will have additional tools such as an ability to write off subordinated debt or to convert subordinated debt into equity, which would at least give subordinated creditors a potential for some recovery should the bank continue to perform profitably in the future. However, given the limited tools available to the Bank of Portugal under the Resolution Law, and given the uncertainty surrounding the extent of BES's financial exposures to the Espirito Santo Group and to BESA it is questionable as to whether the outcome would have been any different under the BRRD.

The measures under the Resolution Law may be used where the institution in question is at serious risk of not meeting its requirements for the maintenance of its licences, and when the implementation of such measures is considered imperative for the purpose of achieving at least one of the following objectives:-

- i) ensuring the continuity of essential financial services;

- ii) preventing systemic risk;
- iii) safeguarding public funds and taxpayer's interests; and
- iv) safeguarding depositors' confidence.

The Resolution Law states that where an institution is considered at risk of not meeting its requirements to maintain its licences if one of the following situation occurs or when sufficient reasons exist to suggest they may occur in the short term:-

- i) the institution has losses which may exhaust its capital stock;
- ii) the institution's assets have become lower than its liabilities; and
- iii) the institution is unable to meet its obligations.

Accordingly, the Bank of Portugal will have concluded four main consequences of BES's financial situation which resulted in a need to implement a procedure under the Resolution Law and transfer, in part, the assets and liabilities of BES to Novo Bank as a "bridge loan", namely:-

- i) BES's Common Equity Tier I Capital Ratio was 3 percent below the minimum regulatory level;
- ii) BES's access to monetary policy and to liquidity provided by the Eurosystem had been suspended;
- iii) BES was facing increasing cashflow pressure was being generated;
- iv) depositors' confidence was deteriorating as a consequence of negative public perception and a collapsing share price. This led to the suspension of transactions on 1 August 2014 with a risk of contaminating other institutions within the Portuguese banking system; and
- v) as a result of uncertainty surrounding BES's balance sheet, a private capitalisation solution was unfeasible.

The Bank of Portugal

Questions have to be asked as to how the problem with BES did not come to light sooner that would have possibly enabled the Bank of Portugal to take somewhat less draconian action.

The Bank of Portugal requested the audit of ESI in 2013. On 11 July 2014, the Bank of Portugal published a press release reminding that it is "important to recall that the financial situation of GES's (*Espirito Santo Group*) non-financial arm was detected in a horizontal audit carried out at the end of 2013" and "following the conclusion of the audit, several measures were determined by Banco de Portugal to ringfence BES Group's financial position against the risks arising from GES's non-financial arm. This audit was the last of a cycle...which allowed the main Portuguese banks' credit portfolios to be reviewed in detail". Notwithstanding the action taken by the Bank of Portugal to push through a new governance plan in relation to BES, the question arises as to why the full extent of BES's woes were not recognised sooner as part of the audit process and why action could not have been taken sooner to protect BES's shareholders and subordinated debt holders.

Stakeholder considerations

Subordinated bondholders, shareholders and other stakeholders affected by the actions taken by the Bank of Portugal under the Resolution Law will now be considering their options.

One question that arises is whether there are any potential legal challenges to the nationalisation of BES. Whilst the measures do not directly affect the rights of subordinated bondholders against BES, the statement by the Bank of Portugal states that measures taken will not trigger an acceleration event under any contract, as a matter of Portuguese law. As certain of the subordinated bonds issued by BES are governed by English law, bondholders may question whether the measures taken under the Resolution Law would be recognised and enforceable under English law. However, we consider that bondholders will need to find a way of circumventing one little known but important European Directive. The Credit Institutions (Reorganisation and Winding Up) Regulations 2004¹ (the "**Regulations**") enacted the Directive of the European Parliament and of Council of 4 April 2001 on the reorganisation and winding up of credit institutions² (the "**Directive**") under English law. The Regulations have the effect that a "directive restructuring measure" or "insolvency proceedings" of financial institutions in other EEA member states shall have effect in the UK.

The definition of a directive reorganisation measure means measures which are intended to preserve or restore the financial situation of a credit institution and which could affect third parties' pre-existing rights, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims. It would seem that given the nature of the actions taken under the Resolution Law, the transfer of BES's assets and liabilities to Novo Bank might be considered to fall within the definition of a "restructuring measure" and be recognised as a matter of English law. We assume that there will be no further payments by BES under the subordinated bonds triggering an inevitable event of default, following which we expect that bondholders will seek to take action under their bonds, thus preventing any immediate right to accelerate the subordinated bonds as a result of the transfer to Novo Bank.

We would expect claims to be brought in Portugal over the collapse. For example, subordinated bondholders will be considering whether they have been left with significantly less value than would have been likely in a liquidation of BES, in which case, they may seek to obtain compensation or challenge the measures taken under the Resolution Law. Such challenges may take the form similar to that witnessed in Cyprus brought by Greek depositors and bondholders of Laiki Bank and the Bank of Cyprus who have brought action under the ICSID investment arbitration proceedings against Cyprus. We would expect subordinated creditors and shareholders of BES to consider possible challenges under the administrative courts of Portugal on constitutional grounds, possibly including arguments that the measures taken by the Bank of Portugal amounted to an expropriation which was not in the public interest and which has not provided fair compensation (a requirement pursuant to article 62 of the Portuguese constitution).

It is also likely that retail clients of BES who purchased commercial paper issued by the Espirito Santo Group will be looking for recourse against BES. Also, claims against BES management for misfeasance and the possible challenge to transactions entered into between BES and the Espirito Santo Group are likely to be the subject of much scrutiny. Such claims will likely be dealt with in the ultimate liquidation of BES.

The successful €1.045 billion rights issue occurred in May, and the nationalisation which wiped out the equity value of BES occurred in early August. It is to be expected that investors will be making prospectus liability claims in these circumstances, which may be directed at BES but also at parties who were involved in approving the prospectus.

Credit Default Swaps

The holders of credit default swaps ("**CDS**") have also paid close attention to rulings by an ISDA panel relating to BES. Market participants initially asked the ISDA determinations committee for Europe (comprised of 15 dealers and other

¹ (SI2004/1045)

² (2001/24/EC)

major market participants) to decide whether a “bankruptcy” credit event had occurred in relation to ESFG under the 2003 ISDA Credit Derivatives Definitions (the “**CDD**”). On 4 August 2014, the committee confirmed that such an event had occurred in relation to ESFG as a result of it filing for controlled management in Luxembourg, meaning that CDS relating to ESFG will be triggered. However, this determination will have little market impact, as the amount of net notional outstanding on CDS referencing ESFG is minimal—and is dwarfed by the over US\$900 million referencing BES.

Following the Portuguese State’s intervention, market participants then asked the same determinations committee to rule as to whether: (i) a “bankruptcy” credit event under the CDD had occurred as a result of the measures taken under the Resolution Law to transfer certain of the assets and liabilities of BES to Novo Bank; and (ii) a “succession event” had occurred. The committee first decided, on 6 August 2014, that a bankruptcy credit event had not occurred and then decided, on 8 August 2014, that the transfer did, in fact, constitute a succession event.³

The rulings of the determinations committee are significant because credit protection payments on CDS with respect to which BES is the “reference entity” will not be triggered. Rather, because a succession event has occurred, such CDS will now refer to Novo Bank as the reference entity. As a result, those who purchased a CDS as protection on BES’s subordinated debt are left with an instrument that can only be triggered if circumstances arise in relation to Novo Bank that would give rise to a credit event. This is unlikely—as Novo Bank is well capitalised with a clean balance sheet—which means that such purchasers of protection have been left with a worthless instrument.⁴

Unfortunately for subordinated debt CDS holders, certain deficiencies relating to bank “bail-ins” in the CDD have been addressed by a new set of ISDA Credit Derivatives Definitions.⁵ However, these definitions will not become effective until September 2014, and even then only with respect to new trades unless parties agree to amend their existing trades (either bilaterally or through a multilateral industry protocol).

What next for ESI, Rio Forte and ESFG?

As noted above, each of ESI, Rio Forte, ESFIL and ESFG have filed for controlled management (gestion contrôlée) in Luxembourg.

Controlled management is a process by which a Luxembourg entity applies for protection from creditors to formulate a plan for the restructuring of the company which is then submitted for creditor approval. The first step, however, is for an appointed judge to prepare a report as to the financial position of the company and to consider the viability of the controlled management process and to determine whether a bankruptcy is more appropriate. Given the complexity of the situation there could therefore be a status of hiatus until such report is prepared.

Following preparation for the report into the financial position of the company, the court may grant the application for controlled management, and appoint administrators (the “**Commissioners**”) to conduct the business of the company

³ The committee initially met on 5 August 2014 to consider whether a succession event had occurred with respect to BES. However, the committee unanimously decided to postpone its decision “to allow time to seek further information regarding the percentage of relevant obligations transferred” to Novo Bank.

⁴ There may be limited situations where parties have not agreed to be bound by decisions of the ISDA determinations committees. In such cases, purchasers of protection may be able to argue that the measures under the Resolution Law did, in fact, give rise to a bankruptcy credit event. Also, given the financial status of BES detailed in the half yearly results, such purchasers could argue that BES “became insolvent or is unable to pay its debts” prior to the occurrence of the succession event.

⁵ For additional information on these new definitions, see [Orrick Derivatives in Review](#), published 20 March 2014.

and to oversee a restructuring or a controlled realisation of the company's assets or the court may reject the application in which case a bankruptcy is the likely outcome.

The Commissioners will then prepare a plan for the reorganisation and realisation of the company's assets. The plan will be submitted to the creditors of the company for approval. Creditors are also given the ability to submit to the court their comments, validation or refusal of the plan. If more than 50% of the creditors (in number) representing more than 50% in value of the company's creditors approve the plan it must then be approved by the court. If it is not approved, additional time may be granted for a revised plan to be prepared. If approved by the creditors and the court, the plan will then become binding.

Creditors of the various entities will likely require all recent transactions involving group entities to be closely scrutinised. In particular, the acquisition by Rio Forte of ES Irmaos from ESI may be considered as a target as a transaction that would be the subject of scrutiny, particularly in light of the allegations of suspect transactions being conducted at various levels.

Conclusion

Shareholders (particularly those who funded a sizeable rights issue in May) and subordinated bondholders will be carefully considering their options, although the key question is whether there is any value at all left within the shell of the "bad bank" to fund a recovery on the subordinated bonds (at this stage it would be difficult to see any recovery for the equity). To add to the woes of investors, it appears that CDS holders may have now found that their CDS have not been triggered by the implementation of the restructuring measures and the reference entity for the purpose of the CDS is Novo Bank, which is now a well capitalised bank following a €4.9 billion injection from the Bank of Portugal.

With respect to ESI, Rio Forte, ESFIL and ESFG the full financial picture is unlikely to become clear until the Commissioners publish their respective reports. Unless it is determined more rapidly that a controlled management is not an appropriate process for those entities it seems that there may be a lull in the saga.

This has been a test for the Portuguese resolution regime. Whilst depositors' money is safe and contagion has been limited, shareholders and subordinated bondholders will be feeling very sore at this point, and we expect litigation, on constitutional grounds, in relation to the May rights issue and in respect of how BES and the holding companies have been managed. Finally, questions will be asked as to how the regulators did not manage to prevent the bank from entering into so many related party transactions and how the situation has been handled by the authorities.

If you wish to discuss this matter further or any of the issues highlighted above, please contact [Stephen Phillips](#) or [Scott Morrison](#) of Orrick's London office.

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