

The banking capitalization act ("**Banking Capitalization Act**"), approved by Law no. 4/2012, of 11 January 2012, has set forth the terms and conditions under which Portuguese credit institutions may have access to public funds necessary to comply with the *Core Tier 1* ratio.

This law was widely discussed between the Government, the *Banco de Portugal* and the National Banks Association. Pursuant to this Banking Capitalization Act, all credit institutions with head office in Portugal may access to this capitalization regime until 30 June 2014.

The access to the public funds will be granted subject to the principles of (i) necessity and proportionality, (ii) capital compensation and guarantee, and (iii) minimization of the competition distortion's risk.

The legal procedures for the request and approval of capitalization measures have been further regulated in the Governmental Order nr. 150-A/2012 of 17 May ("**Banking Capitalization Regulation**").

NECESSITY AND PROPORTIONALITY

The public investment in credit institutions is deemed to be subsidiary and, therefore, should be considered as a last option for the credit institution to comply with the capital requirements.

The public investment in credit institutions must be structured as a temporary measure, to be reverted as soon as the credit institution ensures that the *Core Tier 1* capital is duly maintained. Any dividends that exceed the "adequate remuneration" that the public capital will require shall be mandatorily applied to the public divestment.

The Banking Capitalization Act foresees that the public divestment will take place in no more than five years. Upon such date, the shares or securities held by the Portuguese State will be automatically converted in ordinary shares of the relevant credit institution. If the public capitalization was made through a direct participation in the credit institution share capital for the entire five years' period, the remaining shareholders may acquire the shares *pro rata* to their shareholding.

Any interim measures filed against any acts practiced under this regime are deemed prejudicial to the public interest and, therefore, will not suspend its effects.

CAPITAL COMPENSATION AND GUARANTEE

The public investment will be made through the Public Budget resources, including those granted within the Memorandum of Understanding entered into with the EFSM/IMF.

The capitalization must be made with recourse to financial instruments accepted as *Core Tier 1* capital, including through:

- (a) Acquisition of own share capital held by the credit institution; and



- (b) Share capital increase of the credit institution, which may be subscribed by the relevant shareholders and / or by the public, in this case with full or partial underwriting or committed placement by the Portuguese State (which may act with or without a financial intermediary).

If the investment is made through the acquisition or subscription of shares (“**Capitalization Shares**”), they will be considered special shares, subject to the ordinary shares regime but with a priority dividend that justifies an “adequate remuneration”. Such remuneration shall be determined considering the European Union rules and principles, and based on objective and transparent criteria to be further developed in a resolution of the Minister of Finance that shall take into account, namely:

- (a) The shares market price;
- (b) The adequate and sufficient discount applicable to capital injections, by reference to the public investment amount in relation to the *Core Tier 1* equity funds existing at the investment date and to the percentage of the special shares with no voting rights; and
- (c) The risk assumed by the Portuguese State, having in account, amongst other factors, the terms and conditions set forth in the Capitalisation Plan.

In relation to (a) above, if the shares are traded in a regulated market, the market price shall correspond to the average quotation value during the 30 days preceding the earlier of the following dates: disclosure of the Capitalization Plan to the market in accordance with the Portuguese Securities Code or disclosure by the Government of the availability to analyse the conditions applicable to the recapitalization. If the shares are not traded in a regulated market, the market price shall be determined by two independent experts appointed by the Government, in accordance with an appropriate valuation method.

In relation to (b) above, when the capitalization is made by way of a shares issuance or purchase, the value of such discount must be approved by the Government on a case by case basis, considering the inherent risks and at a rate not lower than 35% of the shares market value, or, in relation to shares whose voting rights may be fully exercised by the State, at a rate not lower than 25% of such market value. Should the capitalization be made via the subscription or purchase of other *Core Tier 1* financial instruments, they shall be subscribed at their nominal value.

PRIORITY DIVIDEND

In capitalizations made by way of subscription of share capital, the priority dividend affected to the State shall entail the payment of the amount that would be allocated to it, had the company approved the distribution of 30% of yearly distributable profits, even if the credit institution does not approve the distribution or approves a distribution of less than 30%. In case such distribution affects the *Core Tier 1* own funds requirements applying to the credit institution, the amount of the dividends paid shall be reduced in the necessary amount in order to ensure compliance with those requirements.

In capitalizations made by way of subscription of other *Core Tier 1* financial instruments, the priority dividend shall be determined on a case by case basis by the Government, in accordance with the rules and recommendation of the EU bodies, according to which the same shall be in an interval between 7% and 9.3%, depending on the level of similarity between the financial instruments and ordinary shares. Independently of the specific remuneration approved for other *Core Tier 1* financial instruments, the same shall be increased in 0.25% per year within the two subsequent years and in 0.50% in each further additional year until the divestment. Should the payment of the dividends in cash result in a breach of the *Core Tier 1* requirements, the credit institution shall deliver ordinary shares instead, at a discount as approved by the Government in accordance with the recommendations of the EU bodies.



DIRECTORS AND AUDITORS REMUNERATION

During the investment period, the remuneration of directors and auditors of credit institutions shall comply with the requirements laid down in the Decree-Law nr. 104/2007, of 3 April, as amended by the Decree-Law nr. 88/2011, of 20 July, which has implemented in Portugal the Directive 2010/76/UE on, inter alia, the supervisory review of remuneration policies.

In addition, the whole of the directors and auditors shall not benefit of a fixed and variable remuneration which is higher than 50% of the average remuneration earned within the 2 years preceding the capitalization, save if such remuneration is inferior to the remuneration in force in credit institutions whose share capital is directly or indirectly held at 100% by the Portuguese state, case in which this will be the amount payable.

DIVESTMENT

As soon as the conditions set forth in the Capitalisation Plan are met ("**Compliance Date**"), the Portuguese State will have to divest, bearing in mind the market conditions, the guarantee and remuneration of the capital and the credit institution financial stability.

If the Portuguese State divestment is made through the sale of its participation in the first five years upon its acquisition (or while no material default has occurred on the Capitalization Plan), such sale shall have to be made to the remaining shareholders, subject to their pre-emption right. However, upon the occurrence of a material default on the Capitalization Plan prior to the Compliance Date, the Portuguese State will be entitled to freely dispose of the shares to a third party.

The valuation of the shares sale price shall be made by the Government in accordance with various criteria and following an advice from at least a first class international financial institution. Should the shares not be listed on a regulated market, their valuation shall be made by at least two independent experts in accordance with an appropriate valuation methodology.

The shares will be automatically converted into ordinary shares upon disposal by the Portuguese State.

If the capitalization is made through subscription of other *Core Tier 1* financial instruments, on the divestment date they shall be repaid in cash at their subscription/purchase value or, if such repayment causes a breach of *Core Tier 1* requirements, converted into ordinary shares of the credit institution, at a value determined by the Government in accordance with the EU bodies recommendations.

MINIMIZATION OF THE COMPETITION DISTORTION'S RISK

During the first five years, and provided that no material default has occurred on the Capitalization Plan, the Portuguese State will not be entitled to exercise the voting rights of the Capitalization Shares that do not exceed a threshold to be determined by the Minister of Finance, which, according to the Banking Capitalization Regulation, corresponds to 50%. This limitation shall not apply to matters for which the law or the by-laws require a qualified majority decision (e.g. by-laws amendment, merger, spin-off). The Portuguese State will however be allowed to exercise its voting rights of the Capitalization Shares exceeding the above referred threshold.

The Capitalization Shares acquired by the Portuguese State will not be considered in the calculation of the mandatory takeover duty trigger.

PROCEDURE



In accordance with the Banking Recapitalization Act and Regulation, upon acknowledging the necessity of more capital funds, the credit institution's board of directors shall present a Capitalization Plan to the *Banco de Portugal* detailing the necessary measures, the proposed schedule and evidencing that the institution meets the conditions to continue performing its activity, namely:

- (a) General information about the credit institution (including the shareholder structure, internal organization, business plan, relevant markets where it operates, geographic location and structure of the group).
- (b) Description and analysis of the reasons which lead to the submission of the capitalization request, including the measures adopted by the credit institution with a view to mitigate the risk of such low capitalization;
- (c) Updated data on the financial situation, ratios, liquidity indicators, assets and risk coverage;
- (d) Updated report on the financial situation of the institution (including the short and medium term risks and an assessment of the hypothetical outcome of the credit institution not implementing the capitalization);
- (e) Description of the features of the financial instruments to be issued within the context of the capitalization operation which are eligible as *Core Tier 1*;
- (f) Description of the management strategy to be adopted during the capitalization period, in particular regarding the contribution for financing the economy, including families and small/medium enterprises;
- (g) Implementation agenda, including the corporate governance adjustments to be introduced, in particular the appointment of independent directors, management and control mechanisms as well as plans envisaging a reduction of structural costs;
- (h) Description of the dividends distribution policy and of the remuneration payable to directors and auditors as well as any other people being assigned management tasks for the period of duration of the capitalization;
- (i) Estimated period of the capitalization, data demonstrating the financial balance to be achieved in the future as well as divestment plan;
- (j) Identification of contributions of other parties, including the shareholders, for reinforcing the *Core Tier 1* own funds (at least with reference to the legal form and amount of such contributions);
- (k) Measures to address eventual additional requirements resulting from stress tests;
- (l) Consent for disclosure of data by the Bank of Portugal to the Government, which is relevant for the appreciation of the request;
- (m) Confirmation that the board of directors is able to assume the necessary undertakings within the plan;
- (n) Copies of the minutes of the resolutions approving the Capitalization Plan.

The *Banco de Portugal* shall send its proposal of decision to the Minister of Finance, who shall then consult the relevant credit institution. After this procedure, and based on the proposal from *Banco de Portugal*, the Minister of Finance shall determine on the capitalization operation, setting out the relevant terms and conditions of the public investment and divestment. The Minister of Finance shall communicate the Capitalization Plan and the government order approving it to the competent EU bodies in order to confirm that the same does not breach the state aid requirements laid down in EU legislation.

The Capitalization Plan will have to be approved by simple majority of the credit institution's shareholders meeting, with no minimum quorum required.

If a credit institution does not fulfil with the minimum *Core Tier 1* ratio and does not present a Capitalization Plan (with recourse to private or public funds) or does not comply with such plan, the *Banco de Portugal* may request such institution to present a Capitalization Plan. Should the credit institution not comply with such request, the *Banco de Portugal* may step in the credit institution by appointing a provisory management for the institution, cancel its banking authorization or apply for reorganisation proceedings.



CAPITALIZATION PLAN PERIOD

During the period of public investment under the Capitalization Plan, the credit institution shall comply with the terms and conditions set out by the Portuguese State, including:

- (a) Finance the economy, namely the families and small and medium enterprises;
- (b) Adopt good corporate governance principles, such as the increase of independent directors;
- (c) Limit or suspend the variable remuneration of the members of the management and supervisory boards;
- (d) Implement measures to avoid competition distortion;
- (e) Eventually increase the contribution to the deposit guarantee fund;
- (f) Adopt mechanisms to allow the divestment in market conditions, securing the capital invested and its “adequate remuneration”;
- (g) Obtain the prior consent from the Minister of Finance to pay interests or dividends, except if complying with legal obligations;
- (h) Consult the Minister of Finance before deciding whether to exercise a call option right on a capital instrument;
- (i) Implement reductions on structural costs.

The Portuguese State will be entitled to appoint one non-executive member for the management and/or a member for the supervisory board to follow up and supervise the compliance of the Capitalization Plan. Upon a material default on the Capitalization Plan, the number of appointed members may increase, to a number of members (including executive) *pro rata* to its shareholding in the credit institution share capital.