

# NEW MEASURES TO STRENGTHEN THE RESILIENCE OF THE FINANCIAL SYSTEM

Decree-Law 140-A/2010, which was published on 30 December 2010, transposes three EU Directives into Portuguese law to introduce a set of changes to the RGIC – Portugal’s general framework for credit institutions and financial companies – and to Decree-Law 104/2007 of 3 April. At the time, Decree-Law 104/2007 introduced new rules on the adequacy of capital.

The clear objectives of this new piece of legislation are expressly set out in its preamble. It aims to: (i) make Portuguese financial institutions more resilient; (ii) make the recognition process for rating agencies more demanding; (iii) improve and strengthen the powers of regulatory authorities; (iv) make operations carried out by branches in Portugal of foreign financial institutions more transparent and easier to supervise; and (v) establish stricter rules for securitisation of credit operations.

Some of the changes introduced merit special attention for the impact they will have on the way financial institutions go about their work.

### Quality of core capital

In the chapter that addresses the strengthening of the resilience of financial institutions, the legislation establishes new rules on the quality of core capital of financial institutions. In doing so, it provides that the elements that make up core capital must be distinguished, in terms of quality, on the basis of their respective characteristics of permanence, level of subordination,

capacity and timeliness of the loss absorbency and the possibility to defer or cancel its payment.

In addition, express provision is also made for the possibility of the Bank of Portugal, on the basis of the financial situation and solvency of institutions, to require the: (a) suspension of the redemption of instruments with a specific maturity date; (b) substitution of redeemed instruments by instruments of equal or superior quality; (c) cancellation of the payment of income from instruments; and (d) conversion of instruments that might be eligible for core funds under the greater limit for instruments of superior quality.

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It should also be noted that, as a consequence of the approval of this piece of legislation, the Bank of Portugal has recently published Notice 9/2010 which puts this new rule on securitisation operations into effect and it also clarifies the scope and material impact that the new measure will have on the structuring of these types of operations.

## Limits on risk concentration

The new law enshrines the regulatory authority of the Bank of Portugal over the establishment of limits on risk concentration - this authority was previously only established generically. In doing so, the law makes it clear that, when setting such limits, the Bank of Portugal must seek to reduce the risk of losses that have an adverse effect on the solvency of credit institutions as a result of excessive exposure to a single client or group of linked clients or any other form of exposure or group of exposures that result in an excessive risk concentration.

## Specific requirement on capital

As a complement to the rules on core capital, the new legislation also allows the Bank of Portugal to impose a specific capital requirement, which exceeds the legally established minimum, on credit institutions that do not meet certain requirements. Those requirements are in respect of internal organisation and control, the issues of risk concentration limits and risk management mechanisms.

## Regulation of significant branches

In respect of the strengthening of the regulatory authority of the Bank of Portugal in relation to institutions operating in this country, the new legislation introduces the concept of the "significant branch". The logic behind this is to allow the Bank of Portugal to supervise the activity of these institutions more closely through the imposition of enhanced obligations to provide information.

Despite the fact that, technically, the "significant branch" concept should be seen a vague concept that must be determined on a case-by-case basis in accordance with the respective circumstances, the law set out three

indicators that should serve as a base parameter for the potential designation of a branch as "significant". This means that a branch may be designated as significant: (a) if its market share in Portugal, in respect of deposits, exceeds 2%; (b) if it is probable that the suspension or closure of the credit institution's operations would have a negative impact on the liquidity of the markets and on the systems for payment, compensation and liquidation in Portugal; and (c) if the size and importance of the branch in terms of the number of clients in the context of the Portuguese banking or financial system justifies closer regulation by the Bank of Portugal.

It should be noted that the legislation also provides that the designation of a branch as "significant" is not dependent on a joint decision of the Bank of Portugal and the state regulatory authority of the Member State of origin. The Bank of Portugal can make this decision alone if no agreement can be reached.

## Securitisation

As far as securitisation transactions are concerned, the new law establishes as a rule applicable to institutions that do not act as the issuing or sponsoring institution that these institutions may only assume the credit risk of a securitisation position - whether or not this is included in its business portfolio - if the issuing or sponsoring institution has expressly disclosed the fact that it will maintain a permanent substantial liquid economic interest in of at least 5%.

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