The Good, the Bad and the Ugly:

The fall and resolution of Banco Espírito Santo

"We usually say that first comes the interest of our country, second, that of the institution and, only in third, that of shareholders"

– Ricardo Espírito Santo Silva Salgado, CEO 1992-2014[i]

Ona hot Sunday night,August 3rd, the Portuguese central bank, Banco de Portugal (BdP), announced the resolution of BancoEspírito Santo (BES), which had fallen in disgrace after, a few days earlier, posting a €3.6bn loss in 2014Q2. The size of the losses consumed most of the existing capital base. Once the European Central Bank (ECB) made the decision to revoke BES's status as a counterparty for refinancing operations and requested that the bank paid back about €10 billion in ECB loans, BdP was forced to recognise BES' inability to make such repayment and put the bank under resolution.

The resolutioninvolved the separation of BES between a good and a bad bank. BES' sound assets and most liabilities were transferred toa "transition bank", or "good bank", which got fresh capital in the amount of €4.9bn from the Portuguese "Bank Resolution Fund". The century and half old BES was to be liquidated, keeping only those assets deemed "toxic" in its balance sheet. This "bad bank" also retained all liabilities to qualified shareholders, the bank's initial equity as well as BES' subordinated bonds. These were ugly news for those who had invested on thatsummer's BES rights issue. Or even those, including Goldman Sachs, who took long positions on the stock a few days before. How could the *Espírito Santos*(ES), the oldest banking dynasty of Portugal, have broughtthe bank to its knees?

Espírito Santo: the origins[ii]

José Maria doEspírito Santo e Silva was born in Lisbon on 1850, to unknown parents. As was commonplace throughout Catholic societies, being an unwanted baby,he was dropped off at the door of the nearest convent. According to legend, he was actually the son of a nobleman and his father not only funded the boy's education, but also provided a loan for him to kick-start his adult life. It is no legend that by 1869, aged 19 years, José Maria owned a small shop where he dealt in currency exchange and sold lottery tickets. Later he moved on to real estate investments, asset management and commercial banking.

By 1911, now a much respected and influent Lisbon banker, José Maria finally bought out the position of the only remaining associate in their commercial banking and securities trading firm. "Silva, Beirão, Pinto & Cia." became "J.M. Espírito Santo Silva" – the first firmto bear his name. In 1915 his son José Ribeiro took charge of the business after his father's unexpected death. In 1920, he oversaw a new transformation, as it became *BancoEspírito Santo SARL*. During World War I, the Portuguese economy struggled.With strong inflation,

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the Escudo lost value very quickly, but the ES weathered the storm. In the early 1930's the bank escaped relatively unscathed a serious banking crisis. The bank grew steadily, but after Ricardo, José Ribeiro's younger brother, took over as leader, it really took off. In 1937, they merged with another bank, creating *BancoEspírito Santo e Comercial de Lisboa*(BESCL), who became the leading privately-owned bank in Portugal. Ricardo, by then, becamea close personal advisor to Oliveira Salazar, the sombre dictator who had just risen to power, and used his influence to grow the bank's business.

During World War II, Portugal maintained a "neutral" status, which made it a safe haven for Europe's aristocracy and top businessmen to safeguard their assets and, often, their lives. Ricardo was not only a shrewd banker but also, with the help of his wife, Mary Cohen, a masterful hostess, welcomed to his home many aristocrats and industrialists seeking refuge in Portugal, including the Duke of Windsor. Ricardo, whom the allies suspected of pro-German tendencies, made the most of Portugal's status, and during the war period, BESCL's stock quadrupled in value.

Ricardo would eventually die young, in 1955, and was succeeded by abrother, Manuel RibeiroEspírito Santo, who would continue along the same tone, further developing international connections to wealthy families, such as the Rockefellers and Firestones, and to nobility, like the future King of Spain JuanCarlos and his father. In the 1960s, a golden era for the Portuguese economy dawned after its entrance in the European Free Trade Agreement (EFTA). BESCL continued to grow, beginning to channel cash into several different businesses, from textiles to oil and gas. Under the authoritarian regime of Salazar, most business decisions were in one way or another very conditioned by central government, and assets in all business fields were highly consolidated around a handful of large, well-connected conglomerates. For the large part, these were controlled by three traditional business and banking dynasties: the Mellos, the Champalimauds and the EspiritoSantos.

Manuel died in 1973, and was succeeded at the helm of the bank by his son Manuel Ricardo (see family tree in **Exhibit 1**). The left-wing military coup that took place in Portugal in April 1974, deposing Salazar's successor, would bring about chaotic, tense times, with many, if not all, of the country's capitalists being stripped of their assets and either jailed or forced to flee abroad.

On 11th March 1975, navy officers, with the help of some unionised bank employees friendly to the communist revolutionaries, took control of the bank's headquarters, barged into a board meeting, held the managers at gunpoint and sent them to jail. The bank, as well as all the major companies owned by the family, would soon be nationalised. In a couple of days, all (except three foreign-owned) banks had the same fate.Among the workers who returned back to normal work a week later was a bright young upstart: Ricardo Espírito Santo Salgado, a young employee who was destined to make a tremendous impact on his family's banking empire. But he also soon joined his family in exile.

Exile and rebirth

After being bailed out of jail in June 1974, the heads of the Espirito Santo group fled the country. As soon as SeptemberManuel Ricardo organized a “family” meeting in London with five other members. This was the first meeting of what would become the group’s *“Conselho Superior”,* an unofficial institution where strategic decisions were made on a consensus basis, by representatives of the major branches of the family tree.The plan, then, was to leverage what they had left in order to rebuild their lost empire. They would have little assets of their own to begin with, but they benefited from their widespread international reputation and the support of former customers. One of the first measures was to create a holding company to ultimately centralize all the assets they would build upon, with roughly equal stakes to each of the six: Luxembourg-based *Espírito Santo International* (ESI).

Over the ensuing years, business was based in Switzerland, Brazil and London, mostly around small private banking operations.Two additional overseas holdings were created: *Espírito Santo Resources* (ESR), to harbour non-financial interests, and *Espírito Santo Financial Group* (ESFG). By 1984, political conditions were ripe for the ES to begin their return to Portugal. Badly in need of capital, after a very tough decade since the revolution, Portugal’s politicians, led by Socialist prime-ministerMárioSoares, called upon the country’s estranged capitalists. In 1985, the Espirito Santo'sinvested on small investment bank and, the year after, they set up *BancoInternacional de Crédito*(BIC), a retail bank, in partnership with CréditAgricole (CA).

A couple of years later, a wave of reprivatisation began. Hand in hand with Credit Agricole, in 1990 the ES repurchasedtheir former insurance company, *Tranquilidade,* and, finally, in July 1991, BESCL was partially back in the family’s hands.Tragically, Manuel Ricardo would not witness theirtriumph: he died in March 1991.The eldest of the group –AntónioRicciardi– took the lead. Ricardo Salgado, though the youngest of the pack, was widely recognised as the most capable banker in the family. Ricciardi came up with a power division agreed upon by everyone: he would become the senior leader (chairing the top holding). Ricardo would manage their interests in financial services and AntónioEspiritoSantoall the others.

Initially, only 40% of BESCL’s capital was privatised. Through a purpose-built holding, BESPAR, 25%-owned by *CréditAgricole*, and directly through ESFG, the family owned over half of that, about 23% of the bank’s equity. The remainder was privatised next year. As it was scattered by many different investors the 35% stake the ES were finally left with gave them full control over the bank: overall, between the family, their French partners and a Luxembourg bank that also joined them, they spent just under 65bn Escudos (about €650m[iii], adjusted for inflation) to guarantee a majority stake in BES. Salgado took over as CEO. After 15 years of state ownershipBESCL was left with just 8% of the Portuguese banking market by assets.

Growth

By the mid-1990s privatisation of most of the other nationalised banks had taken place, leaving only *CaixaGeral de Depósitos* (CGD), by far the largest, in the hands of the State. As the Portuguese economy grew steadily, banks also grew their business (**Exhibits 2**and **3**), but *BancoComercialPortuguês* (BCP) was standing out, benefiting from the strong investment BCP's founders had made in its organic growth. However, consolidation movements would dramatically change the sector throughout these years, and BCP was the most aggressive of the pack. By 1995, ten years after inception, with the hostile acquisition of the much larger *BancoPortuguês do Atlântico*, it had takensecond place, right after CGD.

Meanwhile, BESCL grew much more slowly and organically. Itrefrained from engaging in costly acquisitions, as the cash generated by the banking business was used to grow the ES conglomerate (broadly known as *GrupoEspírito Santo* – GES). Additionally, the group's overall debt burden prevented it from transactions that would require further capital increases at the bank, which would had to be financed by further debt at their Luxembourg-based holdings.

Similarly to them, the Mellos and the Champalimauds also tried to rebuild their empires, but were ultimately unable to do so: by the early 2000s, the former had sold off their bank to BCP and the latter's financial services assets were divided, in different moments, between Santander, BCP and CGD.As Portugal entered thenew millennium, of the three historical banking dynasties, only the Espirito Santos remained.

The GES group

As Salgado boasted about BES' "organic growth strategy", GES continued to grow around BES towards other business lines, with major investments in several businesses, including hotels, real estate, transport, construction and development, among others. The bank, in turn, also sought to expand internationally, becoming the Portuguese bank with the largest international network, covering Switzerland, where it expanded BanquePrivéeEspirito Santo, Miami, Libia, Panama and several offshore locations (see **Exhibit 4b**). Tranquilidadealso pursued a very aggressive organic growth strategy and reached second place in Portugal's insurance.

One country caught the ES' attention. Theoretically a communist regime, oil and diamond rich Angola welcomed this capitalist family back to a country where it had firm interests in colonial times. A holding company, ESCOM, dominated by BES, controlled investments in diamond mining, real estate, agriculture, among others. In 2002 BES transformed its blooming banking business in Angola into a full-grown retail bank, BancoEspírito Santo Angola (BESA), the first European bank to be awarded a banking license in post-colonial times.

In Portugal's banking, BES sat comfortably in third place throughout the 2000s, as a failed hostile takeover bid by BCP over BPI in 2005, and the ensuing drama, hindered the ability of either to grow.But the sprawl of GES was not devoid of hiccups. In 2002, BES broke with its auditor of many years, PWC, opting instead for KPMG. The rumour on the street was that PWC was under pressure to hide problems at the top holdings, namely the leverage of ESI, but nothing ever came to light.

In September 2009, a shift in corporate structure of GES took place with the creation of Rioforte, a new holding that would absorb most of the non-financial assets, replacing ES Resources (**Exhibit 4**). Backed by loans from friendly institutional investors, but still wholly owned by ESI, it was meant to open the way to bringing fresh capital into GES'sincreasingly fragile non-financial subsidiaries, who took a much greater toll during the crisis than the bank itself.

Economic and financial crisis

The major Portuguese banks managed rather well through the market turmoil of the 2007-8 global financial crisis. They had little exposure to the complex credit products related to the subprime crisis in the USA. However, most banks were heavily exposed to real-estate related loans and the crisis had a tremendous impact on that sector, although much smaller than in countries who faced significant real-estate bubbles, such as Spain. Some banks had considerable exposures to European sovereign-debt, mostly Portuguese. By November, 2008, the Government nationalised the small *BancoPortuguês de Negócios*, a smaller lender that had failed dramatically amidst an accounting fraud scandal, mostly unrelated to the global crisis. In any case, all in all, banks' financials were not particularly hit (**Exhibit 3**). During 2009, things continued to run more or less smoothly, despite a slight rise in non-performing loans.

Aturn for the worse would come the following year. The EU/IMF bailout of Greece in May 2010 marked the beginning of the European sovereign debt crisis. Portugal was out in the twin-deficit cold: its government was running a massive deficitand the country's external position was very poor and still worsening. As sovereign spreads and CDSs spiked (**Exhibit 5**), banks all but lost access to financial markets, becoming increasingly dependent on ECB funding.

The shift in external investor sentiment towards "peripheral" countries seemed to be structural, and as sovereign yields stayed high, after much political resistance. Portugal's credit rating suffered considerable cuts, and the "haircuts" now imposed on Portuguese banks pledging their country's sovereign debt in ECB refinancing operations made impossible for them to continue supporting their Government's financing. In May 2011 Portugalentered a 3-year "adjustment programme", in return for a €78bn bailout from a so-called "troika" of official lenders (IMF, ECB and the EU).

The Portuguese banking system,just as the economy in general, was highly leveraged at the time, with high loan-to-deposit ratios (**Exhibit 6**). Recession hit SME loans, a segment where BES was heavily involved. Unemployment also made a significant impact in consumer and mortgage loans, other areas of BES involvement. The subsequent real-estate crisis affected another area where BES was market-leader. A section of the measures in the "programme" targeted banks, forcing them to deleverage and toimprove solvency in accordance with a pre-defined calendar. At the same time, the road to Basel III, and more stringent capital requirements, was paved. Accounting for this, €12bn of the bailout money was earmarked for bank recapitalisations. Sooner or later, most banks would eventually use it.Of the largest banks, only BESavoided state aid and the conditions attached to it, including the Government's increased access to the bank's information.

In fact, BES had undertaken a €1bn rights issue scarce months before, allowing it to up its Core Tier One (CTI) ratio to a level close to 11%, above the minimum 10% BdP ruled Portuguese banks should reach by the end of 2012 (**Exhibit 7**). It was not an easy sell, but Salgado's team was determined to succeed, meeting over 150 potential buyers in a Europe-wide roadshow. The BES international reputation helped the rights issue to succeed. After the resolution it emerged that BES, through ES Panama, lent €300m to ESI allow it to participate in that offer.

Ricardo Salgado:the leader

"I was among the first to arrive at the bank, and the last to leave. (...) I spent 70% of my weekends at work, to the great sacrifice of my family"

– Ricardo Salgado[iv]

Ricardo Espírito Santo Silva Salgado was born in Cascais, Portugal, in June 1944, the eldest son of Maria, daughter of Ricardo Espirito Santo, and João Roma Salgado. Cascais, a seaside resort on the outskirts of Lisbon, had long been the main base for most of the ES, and his childhood was spent there in frolic. As a teenager, however, he moved to Lisbon, having spent most of his time around the upper-class Lapa district, where he finished both high school and university (where he studied Economics) followed by a year of military service in the navy.

His beginnings at BES were fairly humble, managing the economic studies team. By then, it was tradition that clan members had to prove themselves valid to be able to progress, rather than being promoted solely on the basis of 'pedigree'. Ricardo's intelligence and hardworking ethics made him quickly rose up the ranks at the bank and by 1973, already led the credit department, where he initially stayed after the revolution. Tolerated by the workers, he stayed, but not for long, as he fled the increasingly hostile environment of post-revolution Portugal, leaving the country at a time most of his family members were persecuted and some even arrested.

Salgado was, by then, a modern workaholic. He would typically arrive at *Avenida da Liberdade*headquarersbefore 8 a.m. and leave around 10 p.m. Such long hours were not just for show: over the years, his control and power over not only the bank, but also extended to other branches of his family's empire. He was not only the CEO of BES: he chaired and/or was executive head at many of its subsidiaries. At BES, he also was the head of the credit committee, the ALCO[v], and, within the executive committee, he was responsible for the accounting department and investor relations. He was also executive chairman at ESFG[vi], and board member at ESI and other group entities.

Moreover, the 25-strong board of directors at BES was chaired by Alberto de Oliveira Pinto, a former executive chief at CGD, born in 1932, and at ESI, the chairman was still the then 96 years old AntónioRicciardi. The BES Board included many ES family members, representatives of Credit Agricole and seven "independent" directors (about 28% of the total) personally appointed by Salgado. After the resolution was passed, one non-executive board member of BES described the board meetings as a "mere formality", almost a Chairman's monologue for approval of the items on the agenda, where not even Mr Salgado spoke much and little or no questions were asked[vii].

But its not only at BES or GES that Mr Salgado seemed all too powerful: In 2011, the newspaper *Jornal de Negócios*, elects Mr Salgado as the most powerful man in the Portuguese economy. His ties with successive governments and influences all around the corporate sector had made BES a omnipresent bank, being market leader in project finance (where government-sponsored public-private partnerships dominate) and corporate lending.

Banking Union and Asset Quality Review

“We’re on the path to Banking Union, and there’ll be no room there for family banking groups”

– Ricardo Salgado[viii]

Att a European Council summit in June 2012, European leaders decided to build a “Banking Union”. This would be based on three “pillars”: a “single rulebook”, meaning a unified legal framework for capital requirements, deposit guarantee schemes and other aspects throughout the EU; a “single resolution[ix] mechanism” (SRM), whereby the legal framework to address bank failures is the same across member states, and a European fund is created to provide capital to distressed “systemic”, cross-border banks and a “single supervisory mechanism” (SSM), where bank regulation is centralised in the ECB, who supervises major banks directly, only delegating to national central banks for smaller institutions.

After many negotiation rounds and legal groundwork, the so-called SSM Regulation[x] was released, announcing the ECB would "carry out a comprehensive assessment, including a balance-sheet assessment of all major banks, in liaison with the national central banks, before taking over their supervision on November 4th 2014". This would become known as

the Asset Quality Review (AQR).

A strong idea behind the Banking Union was to reframe the way bank failures are handled around the concepts of *resolution* and *bail-in*. This came in the form of the EU Bank Recovery and Resolution Directive (BRRD)[xi]. From 1st January 2016, when BRRD must be fully implemented in Member States, shareholders, bondholders and even unsecured depositors must bear full losses (by order of seniority) before public funds may be injected on a troubled bank. Until then, and from 1st August 2013, a new version of the so-called Banking Communication[xii] applies, requiring some subordinated debt and all of the equity to be bailed-in in order for public rescue funding to be allowed under state aid rules.

Discreetly, in preparation for and as part of the AQR, during 2013, BdP began to investigate possible issues hidden away in satellite companies' balance sheets which could materially affect that of BES. These probes were already taking place due to a series of activities that stemmed from financial sector measures agreed with the "troika", namely, in a programme named ETRICC2[xiii], with the help of auditors *PwC.*

"Ring-fencing" around the tip of the iceberg

"When (…) I was told [ESI's debt] was €6bi, I almost died. I had no idea."

– Ricardo Salgado[xiv]

Rumours about financing difficulties at some of GES holdings started when it was revealed by mid 2013 that a small treasury mutual fund managed by BES' asset management subsidiary, *Espírito Santo Liquidez*, mostly placed with BES clients, had an exposure to GES group of €1.6bn out of total assets little in excess of €1.8bi. The securities markets regulator, CMVM, intervened and imposed a maximum exposure of mutual funds to group-related assets to 20% of total assets. BES quickly unwinded this off-balance sheet exposure to GES, but few people at the time questioned how had GES refinanced this debt. However this later gave the bank some undesired international exposure via a *Wall Street Journal* feature in December[xv].

In late September 2013, BdP requested a full audit report on ESI. Preliminary data was made available on November 26th 2013: its liabilities were in fact about €1.5bn higher than initially disclosed. It would soon surface that liabilities had been underestimated since at least 2008, but this was the first time BdP had any indication of such issues with the Luxembourg-based holding[xvi]. But surely, years of declining BES share prices whose acquisition through subsequent rights issues had been financed with debt certainly had to take a toll.

At the time, being the holding at the head of a banking group, ESFG was under BdP's supervision and had to comply with banking prudential regulation and supervision. But the holdings controlling ESFG were not subject to any prudential supervision (see **Exhibit 4**). BdP then sought to begin a "ring-fencing" strategy to immunize BES and its customers from any GES assets. Soon, it would surface that ESI and other subsidiaries' debt seemed to be

everywhere, not only on BES and ESFG's balance sheets, but also been placed to customers, via BES' retail channels through private placements that did not require CMVM's intervention. In a letter to ESFG's Board, led by Salgado, BdP requested that if a host of ring-fencing measures to isolate BES from GES was not taken within a month, they would have to record a large impairment on their exposure to ESI and Rioforte, asking for their auditors, KPMG, to provide an estimate for that impairment. ESFG and BES were also requested to create internal independent committees to analyse all transactions with related parties[xvii].

In January, a more complete version of the ESI audit review was sent by KPMG to BdP. It turned out not only there was much previously unrecorded debt, but assets were also grossly overvalued (**Exhibit 8**): as a result, instead of the originally recorded positive €136m, ESI had negative equity of €2.4bn. The report also detailed that of ESI's €6.3bn debt[xviii], €4.9bn was held by BES and its customers. Another €1bn was owed to ES Financière and ES Panama (ESFG subsidiaries). It would later surface that most of ES Panama' assets were notes and bonds issued by GES entities. In turn, this subsidiary was mostly funded by BES. None of this information was made public at the time. Additionally Rioforte also had about €3.1bn in debt, with a part of it also held by BES and its clients.

BdP then decided that ESFG would become responsible to redeem BES non-qualified retail clients who acquired commercial paper issued by the GES group. For that purpose an escrow bank account was set at ESFG funded by BES, and a €700m provision in recorded in ESFG 2013Q4 accounts[xix]. That loss meant ESFG was then below the regulatory Core Tier 1 minimum (10% + 50 bp as a "buffer" to account for possible write-downs with the completion of the AQR). BdP ordered ESFG to increase solvency levels and that a series of corporate structure changes were to be undertaken. Among these was the ruling that all non-financial GES companies had to stop bearing the "Espírito Santo" name to avoid confusion with the ES financial group. None of this was public at the time, except for some vague rumours. There were only slight indications that the problems in group holdings might be significant: notably, a family feud: in November, José Maria Ricciardi, CEO of BES' investment bank (BESI) and a board member at BES, challenged his cousin's leadership claiming to have "lost trust" in his management due, among other things, to a €14m "gift" or "consulting fee" received by Salgado from a customer, a construction and development tycoon, related to past business in Angola[xx].

Slightly later, in March 2014, with more and more news starting to trickle down, some customers tried to liquidate investments in ESI and Rioforte commercial paper, finding their requests denied.

BES Angola

Meanwhile, problems which had already begun to surface in Angola, had, during 2013, become worse. BESA was a highly leveraged bank, with a LTD ratio of about 220%. It had credit exposures of about €5.7bn, of which €3.5bn were funded by loans from its parent BES.

A year earlier, in 2012, Álvaro Sobrinho, the long-time Angolan BES employee who was chosen to lead BESA from its foundation, was replaced as CEO, "moved" to chairman, and then dismissed in the bank's 2013 shareholders' meeting, which preceded a USD 500m rights issue. It had surfaced that there had been many problems with the credit function – for instance, Sobrinho had named his sister-in-law as chair of the credit committee – including loans made to unknown parties and loans whose documentation had been lost. This had gone, until then, largely unbeknownst to BES headquarters[xxi]. This information would also not become public until much later. Salgado then met with the President of Angola, who subsequently issued a two-page decree serving as a state guarantee against USD 5.7bn (€4.2bn at the time – about 70%) of BESA's loan book.

BESA was audited by KPMG's Angolan office. In its audit report's for 2012 and 2013 KPMG says that due to IT problems it was impossible to verify the adequacy of the bank's loan loss provisions. However in the 2013 report this is transformed from a "reservation" in 2012 to a mere "emphasis", with the argument that most of the loans were guaranteed by an irrevocable Presidential guarantee[xxii].

On 14th January 2014, a Goldman Sachs research note sets a 12-month target of €1.55 (28% up) for BES stock, with "improving margins in Angola" as a key valuation driver.

2014 rights issue

"Of the ten capital increases we have done since the reprivatisation [of BES], this was by far the most successful"

– Ricardo Salgado[xxiii]

On February 13th, at the press conference in which BES' 2014 annual report was presented, Salgado mentioned a capital increase was a possibility in the near future, while rejecting resorting to the €6bn of "Troika" bail-out funds still available to banks: "*We have been nationalised once, in 1975, and we would not like to go through that again*", he said[xxiv]. BES had recorded a €0.5bn loss, and had a slight capital shortfall according to phasing-in Basel III rules[xxv]. On 15th May, BES announced a €1.045bn rights issue, at a price of €0.65, at a time the stock was trading at €1.06. The 375-page prospectus was only approved by CMVM after many versions were submitted, the supervisor insisting that information on every possible risk were included. Significantly, the prospectus was the first document where the bank publicly disclosed the existence of accounting issues and a very poor financial situation at ESI (**Exhibit 9**).

In the following days rumours about the issues at ESI grew. Salgado gave an interview a week later, trying to ensure investors that the problems in the non-financial holdings were serious but constrained, and would not affect BES. The bank's shares' shares tumbled more than 20% after the issue was announced, but recovered partially over the ensuing couple of weeks (**Exhibit 10**). Indeed, supported by an impressive underwriter syndicate (**Exhibit 13**),

the offer was very successful, attracting new investors for the bank. As in 2012, Salgado himself took to the road show, but unlike 2012, most shareholders, including ES and Credit Agricole, sold rights and took significant dilution (**Exhibit 12**).

Downfall: chain of events

Over the days after the completion of the rights issue, though, reports begin to surface on demands for governance changes at BES and shares continued to fall. Later, Salgado meets with the government and requested support for GES, which is denied. Weeks before, he had already asked for the government's blessing for a loan to GES by a syndicate led by CGD and BCP, which was also denied. Government sources would over the next few weeks repeatedly deny the possibility of direct public funding for BES, while claiming that BES was solid while GES was not. On the 13th a financial officer at ESI who had been blamed by Salgado for the accounting issues, claims in an interview that the bank's CEO was aware of the ESI's hidden debt. A week later, Salgado, under pressure from BdP, announces the intention to step down. Speculation grows as reports mention BdP pressure for all board members and directors related to the family to leave.

On July 3rd, ESFG announces that its exposure to GES entities had increased by more than two-thirds, to €2.4bn, in order "to support the reimbursement of GES commercial paper held by BES retail clients"[xxvi]. A couple of days later, a new executive committee is announced by the BES board: Vítor Bento, a former BdP director and CEO of SIBS[xxvii], was to be named as CEO, effective in the next shareholders' meeting.

In the morning of July, 10th, CMVM suspended trading on ESFG's securities due to overwhelming selling pressure. This was due to rumours of it failing payments on commercial paper sold to private banking customers in Switzerland and more detailed information on the irregularities at ESI and BESA. BES stock dropped 17% before also being suspended from trading. This created havoc in European stock markets where a major sell-off occurred at the end of that day. At night, BES issued a statement with details on its exposures to group entities. (**Exhibit 14**).

Trying to restore confidence, on Sunday July 13th, BdP forces the exit of Salgado and AmílcarPires, the bank's CFO. Bento and his small team, who had the support of both BdP and Salgado, entered the field ahead of the shareholders' meeting planned for 31st July, but all other board and executive committee members remained in place. On 18th and 22nd, ESI and Rioforte, respectively, file for creditor protection in Luxembourg, after defaulting on commercial paper. Curiously, on the 23rd, BES shares climb over 15% as Goldman Sachs and a US hedge fund increase their holdings to over 2% of its equity. On Friday, 25th, it was ESFG's turn to file for creditor protection. On that morning Salgado was detained by police at home, for questioning in an unrelated money laundering and tax fraud investigation. He was later released on bail of €3m. Meanwhile, BES' Q2 results' presentation, due that day, was

postponed. Shares fell 8%.

2014Q2 results

On Monday, 28th July, reports surface that losses at BES might be above expected, in the €3bn range. KPMG provides the final Q2 data to BdP in advance, indicating that capital ratios were below minimum requirements. BdP gives BES a 48-hour deadline to show that it can raise capital to compensate for the shortfall. The bank's management hopes for a government injection of capital at BES.

On Wednesday 30th July, night, BES' new management finally posts Q2 results: an after tax loss of €3.58bn[xxviii], mostly due to impairments on GES and BESA exposures, losses on own bonds repurchase and SPE/SPV operations (**Exhibit 15**). Bento announces a forthcoming capital increase. BdP, at this point, suspends executive board members responsible for risk, audit and compliance, issuing a statement about "*recently discovered (…) gravely damaging management practices in the past few weeks*" and replaces the bank's audit committee (See **Exhibit 16** for the governance structure of BES).

Unbeknownst to the public, during July BES had repurchased from customers €1.5bn of its own debt instruments, in heavy loss-making operations: these long-dated zero-coupon bonds, were originally been issued and sold at a significant discount to a Swiss asset manager, Eurofin. This, in turn, sold them at higher prices to SPV's who financed the purchase with securities placed with BES clients. Some of these clients requested reimbursement, claiming that liquidity was assured for their investment. Thus, these bonds who were accounted on the BES liabilities side below fair value, were now being bought back at fair value (and above market value)[xxix] generating an after-tax loss close to €900m. Similar operations had already taken place during the preceding months, accounting for a part of the provisions in Q2 results. Other operations also infected BES further, such as two "comfort letters" (guarantees) provided to Venezuelan state oil funds in the end of June a USD 335m investment they had made in ESI debt[xxx]. All in all, BES had lost during July about €3.35bn (after tax).

Then, some deposits (close to €2bn) were withdrawn, as customers grew wary with all the speculation. By then, short on the collateral pool necessary for repo operations with the ECB, BES had been forced to resort to the ELA[xxxi] lifeline to the tune of €3.5bn. That night, the ECB executive committee calls BdP, warning that BES would lose counterparty status[xxxii] the following day. This meant a legal obligation to immediately return any ECB funds loaned to the bank, by then a total of €10bn. BdP managed to negotiate a slight extension, and it was decided that a harsh measure would only take place the following Monday. But BES' fate was, by then, already sealed.

The resolution: the Good bank, the Bad bank and the Ugly news

In fact, BdP had started making preparations, days before, for an eventual extreme solution. The existing EU Directives and Portuguese Law allowed for a direct capital infusion of Government funds into BES. Under that “transition regime” before EBRRD’s full implementation, a "burden sharing" had to be enforced, i.e., losses had to be imposed on the existing equity and subordinated debt before publicfunds could be used. The Government still had enough “Troika bank bail-out” funds that could be used for that purpose.

It is not exactly clear how and who made the final decision to go for a resolution, instead. Having in the previous days exchanged contacts with the European Competition Authority, who must authorise any state aid to private firms in member states, on Thursday night the resolution was decided by BdP. Only Friday at 3.12pm did BdP informed CMVM letting them know there was “material information on BES due to be released soon”. Shares plummeted that day and finally hit rock bottom (€0.101) at 3.34 pm, before finally being suspended 15 minutes later, at €0.120, raising suspicions at CMVM that there was ongoing “insider’s trading”. Sunday night, BdP announced the resolution of BES.

BES was stripped of most its assets and liabilities and became a “bad bank”. It kept only GES related credit exposures as well as a few international subsidiaries (Libya, Panamá and Angola, see **Exhibit 17**). On the liability side stayed all responsibilities (including deposits) to BES Directors, ES family members and to qualified shareholders. All the subordinated debt and the bank’s equity also stayed at the bad bank (**Exhibit 18**). According with the resolution rules, then BdP must conduct a “liquidation analysis” of BES on the day before the measure was applied and determine the liquidation value for each class of claim. Under such rules, no class must be left worse offunder a resolution than it would in a liquidation of the bank.

The new, or "good" bank, designated NovoBanco (NB)received all the remaining BES’ assets, liabilities and rights. However, to avoid giving the claimants on the "bad bank" a high recovery rate, the about €3.6bn in loan to BESA was also transferred to the new bank. It became wholly owned by the Portuguese *resolution fund*[xxxiii](RF), who provided it with €4.9bn in capital. Theoretically, RFs work as insurance systems, funded by regular yearly contributions of all of the country’s banks. In practise, however, the Portuguese one had little capital of its own, as it was only created in 2012. The operation was in fact mostly funded by the government, who provided a loan to the fund(**Exhibit 19**).

Novo Banco is to be sold, with the proceeds going to RF, its 100% owner. If these are insufficient to repay the state loan, other banks would theoretically be liable to repay any shortfall to the government, even if the legal and institutional mechanisms through which that might be enforced remain unclear. Since most banks expect Novo Banco to be sold much below book value, this was also a piece of very ugly news for the banking system as a whole. On the other hand, under the resolution rules, any surplus made on the sale of NB would be transferred to the “bad bank” and added to the funds available to redeem its liabilities and

(unlikely) equity owners.

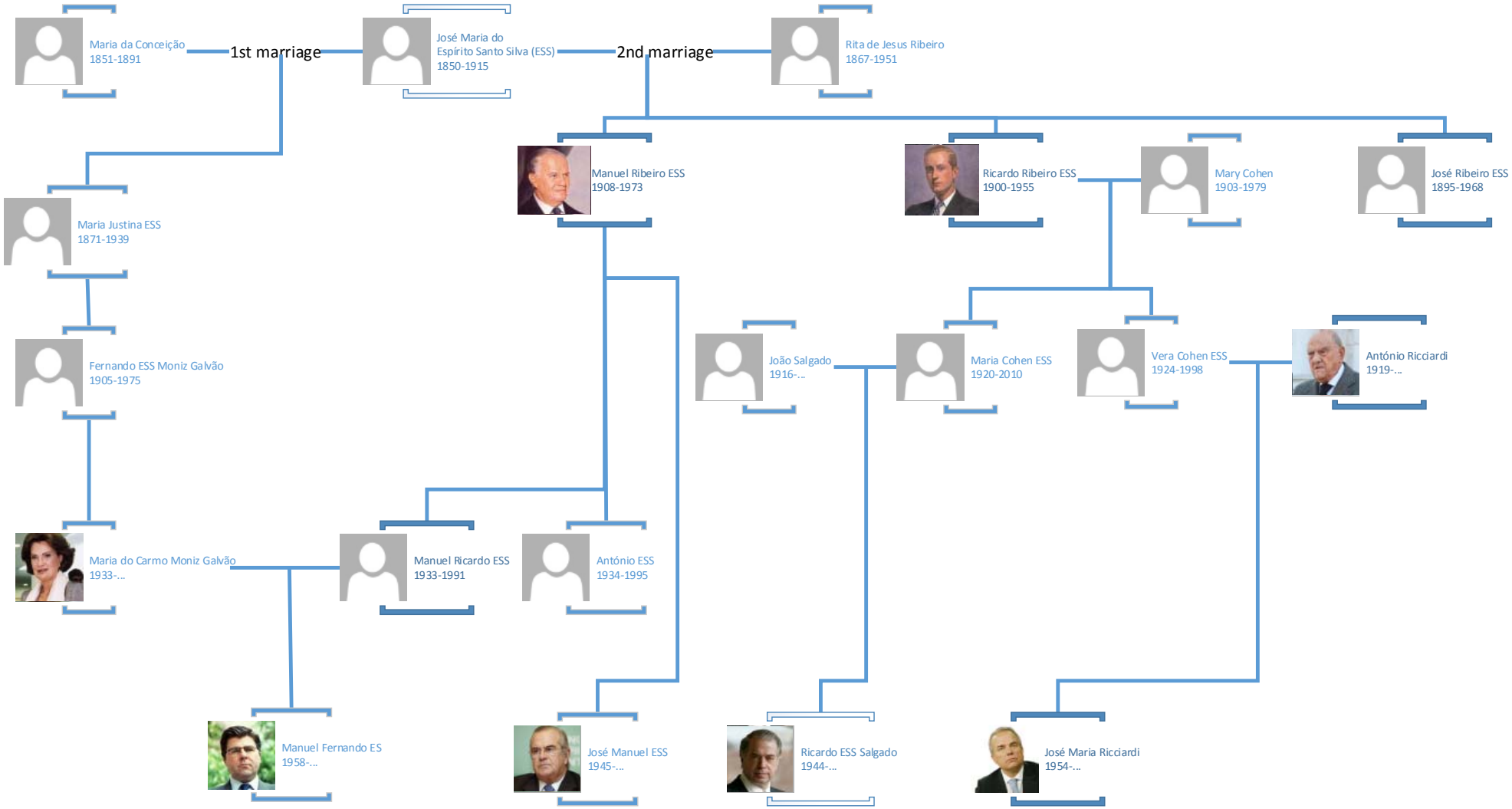
This separation between "good" and "bad" bank meant ugly news for the subordinated bondholders, whose recovery rate was now totally dependent of the recovery rates on the GES assets that remained at BES. These were also ugly news to all these retail non-qualified investors who have purchased GES commercial paper at GES branches. Clients could not understand which bank, good or bad, was responsible to repay them, if any. Also ugly was the news that the mentioned escrow account had been used to repay qualified investors, not them, and that the collateral provided, Tranquilidade, invested heavily on Rioforte commercial paper[xxxiv].

These were even uglier news to all shareholders, especiallyCréditAgricole, who had to cope with a €0.7bn write-off. And certainly it was the ugliest possible event for all these who had participated in June's the rights issue.

A few days after the resolution, Angola revoked the guarantee it provided to BESA's loans, and this bank also went through a restructuring process.

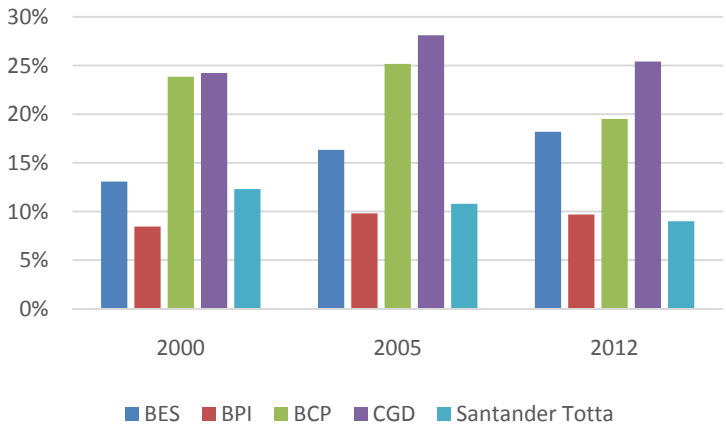
Exhibits

Exhibit 1. Selected portions of the Espírito Santo family tree



Sources: BES; Geneall; "O ÚltimoBanqueiro" (See endnote *i*); Press sources

Exhibit 2. Market shares (by total assets) of Portuguese banking sector



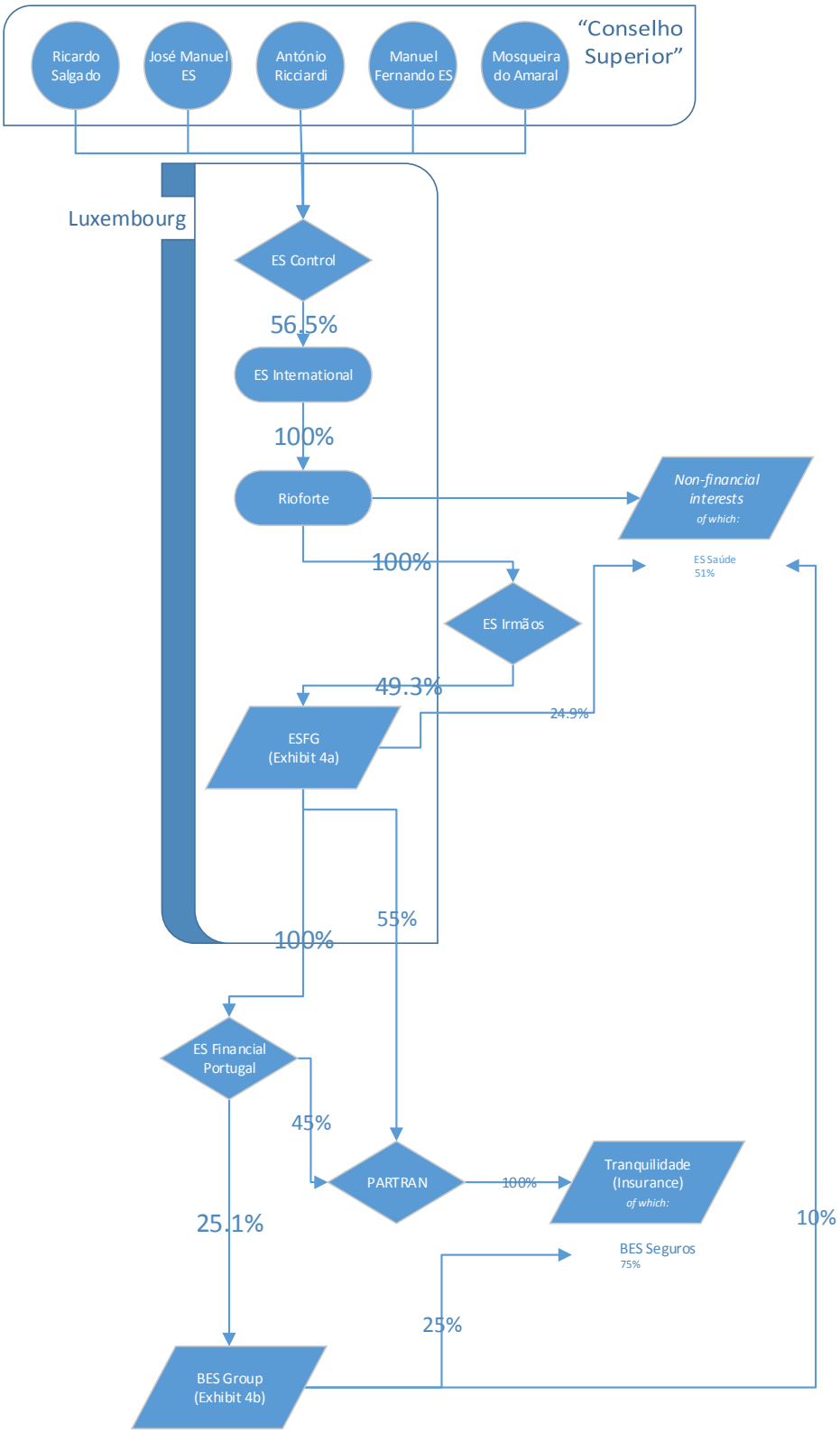
Sources: Company data/CMVM; Bureau Van Dijk (Bankscope); Banco de Portugal; Own calculations

Exhibit 3. Portuguese domestic banks consolidated headline financials, 2007-14

	2013	2012	2011	2010	2009	2008	2007
Selected income statement indicators							
Net interest income	*3,983*	*4,970*	*6,200*	*6,012*	*5,969*	*7,013*	*6,504*
Operating costs	*5,314*	*5,554*	*5,844*	*5,921*	*5,721*	*5,833*	*5,647*
Impairments	*4,985*	*5,921*	*5,818*	*2,878*	*2,931*	*3,592*	*1,419*
Net income	-2,733	-1,235	-1,516	917	452	-220	2,511
Selected balance sheet indicators							
Available for sale financial assets	55,206	51,189	44,448	46,616	35,386	21,505	22,640
Gross credit to clients	233,066	248,483	246,496	261,992	270,345	268,200	242,513
Of which: Overdue	*16,295*	*15,179*	*12,137*	*9,603*	*8,915*	*5,632*	*4,022*
Liabilities to central banks	51,126	56,179	50,723	49,157	19,419	14,407	5,731
Liabilities to other banks	46,883	61,247	74,602	81,125	74,316	74,303	72,362
Deposits and other liabilities to clients	253,164	251,027	244,431	230,558	218,478	217,870	195,604
Debt securities issued	41,184	56,600	75,029	89,061	116,807	94,219	97,333
Solvency indicators							
Regulatory capital ratio	11.9%	11.3%	8.6%	8.3%	7.8%	6.6%	7.0%
Core Tier I (BIS II) ratio	12.3%	11.5%	8.7%	7.4%	*N/A*	*N/A*	*N/A*

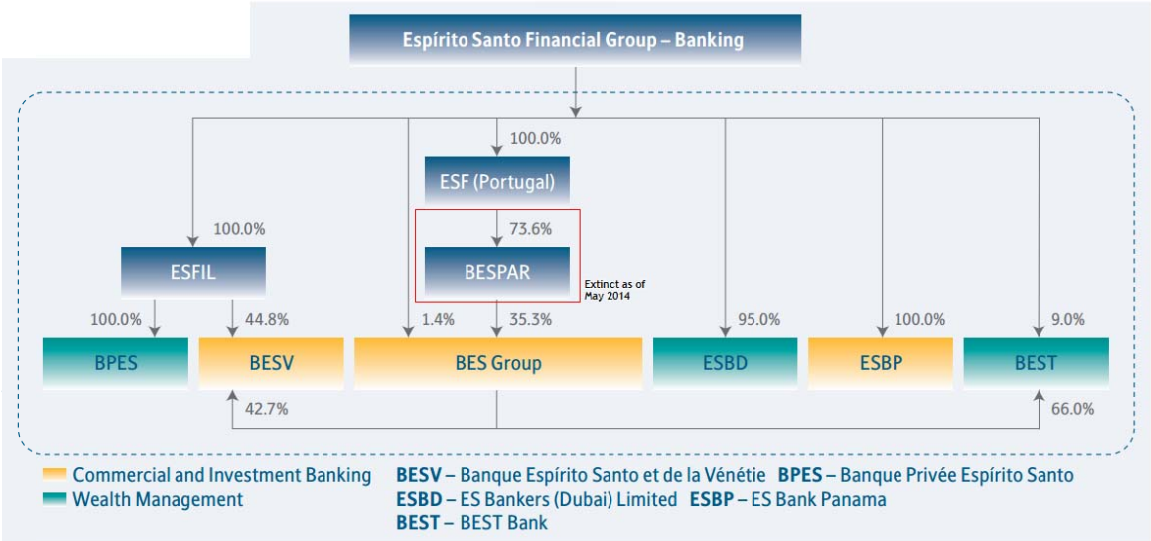
Note: N/A = not available.
Source: Banco de Portugal

Exhibit 4. Simplified GES/BES corporate structure, 2014



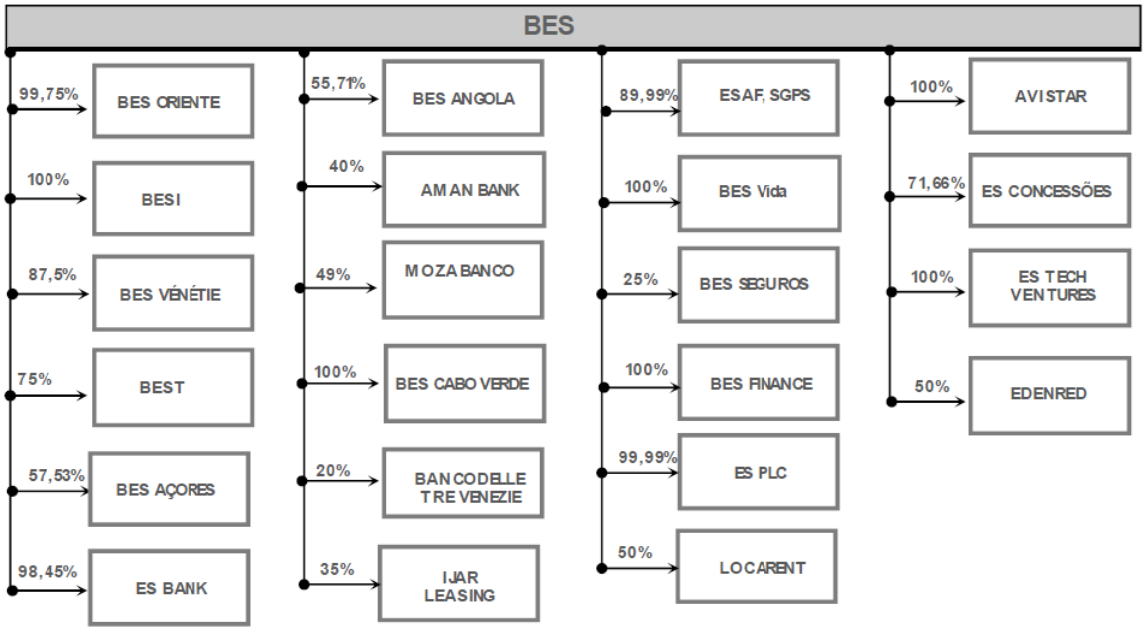
Note: "Conselho Superior" members all held similar stakes in ES Control, close to but under 20%; except for the case of Manuel Fernando, who represents his mother's stake, Maria do Carmo Moniz Galvão ES (in fact the largest shareholder with 19.4%).
Sources: BES; ESFG; BPI Equity Research; Press sources

Exhibit 4a. *ESFG banking subsidiaries*



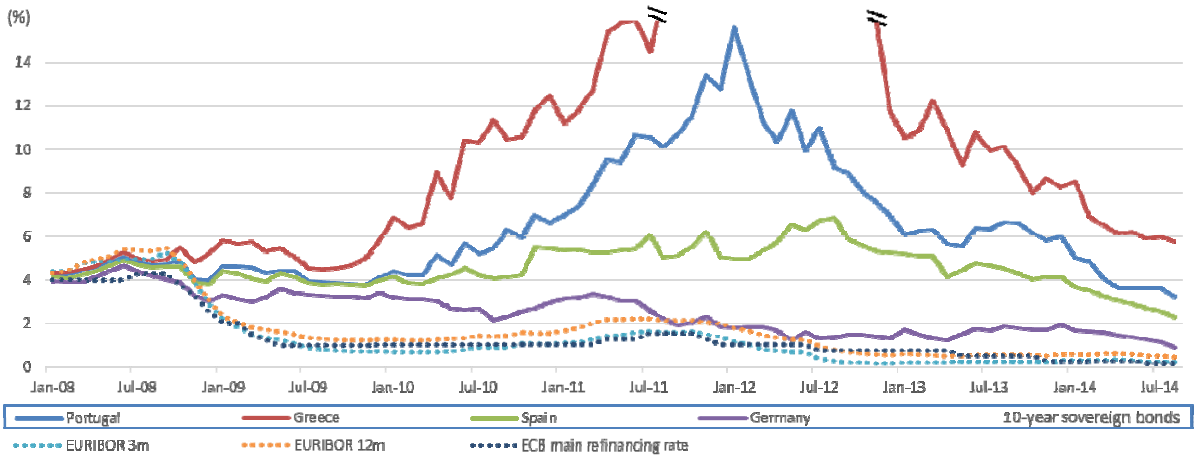
Source: ESFG

Exhibit 4b. *BES Group subsidiaries, 2014*



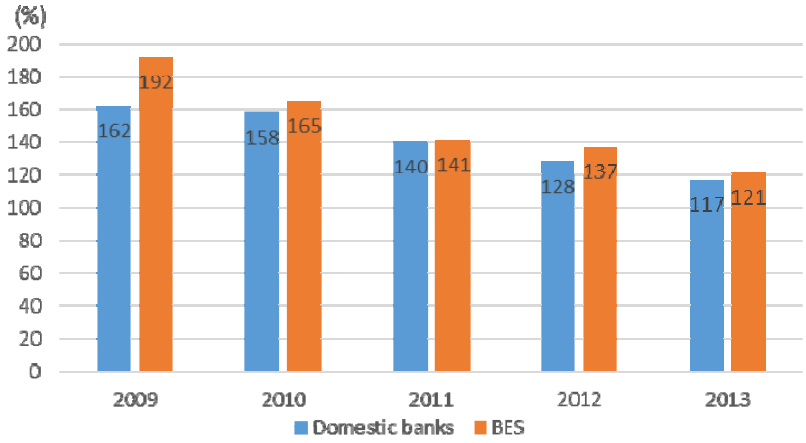
Source: BES

Exhibit 5. Sovereign yields and money market rates, 2009-14



Source: Bloomberg

Exhibit 6. Loan-to-deposit ratio, Portuguese domestic banks vs. BES, 2009-13



Source: BES; Banco de Portugal

Exhibit 7. BES selected financial indicators, 2009-14

	30-06-2014	31-03-2014	31-12-2013	31-12-2012	31-12-2011	31-12-2010	31-12-2009
Key balance sheet indicators							
Total assets*	93.419	96.150	93.342	97.765	98.589	105.540	105.917
Net assets	80.216	82.817	80.608	83.691	80.237	83.655	81.702
Gross credit to clients	51.281	51.001	49.722	50.399	51.211	55.713	50.531
Deposits	35.932	36.242	36.831	34.540	34.206	30.819	25.447
Debt securities issued	11.476	12.666	11.920	15.424	18.452	24.110	33.101
Solvency indicators							
Risk-weighted assets	60.169	62.268	57.332	61.681	65.385	65.097	68.802
CETI/CTI capital**	3036	6079	6084	6471	6020	5416	5232
(Total equity)	4244	7017	7049	7733	6192	6859	6344
CETI/CTI ratio**	5,0%	9,8%	10,6%	10,5%	9,2%	7,9%	8,0%
Tier I ratio	5,0%	9,8%	10,4%	10,4%	9,4%	8,8%	8,3%
Regulatory minimum***	8,0%	8,0%	10,0%	10,0%	9,0%	8,0%	8,0%
Liquidity indicators							
ECB funds (net)	7.432	8.346	5.414	6.897	8.677	3.929	-1.760
Repoable assets	21.593	23.783	20.912	22.256	18.881	10.823	5.553
LTD ratio	126%	129%	121%	137%	141%	165%	192%
Credit quality indicators							
Overdue loans**** / Gross loans	6,4%	6,0%	5,7%	3,9%	2,7%	2,0%	1,6%
Credit provisions / Gross loans	10,5%	7,2%	6,8%	5,3%	4,2%	3,4%	3,1%
Cost of risk	8,3%	2,2%	2,0%	1,6%	1,2%	0,7%	1,1%

	Year-to-date						
	30-06-2014	31-03-2014	31-12-2013	31-12-2012	31-12-2011	31-12-2010	31-12-2009
Summary income statement							
Net interest income	*287,0*	*269,9*	*1.034,5*	*1.180,5*	*1.181,6*	*1.164,0*	*1.200,9*
+ Fees and commissions	*332,9*	*151,9*	*693,4*	*828,4*	*790,5*	*806,9*	*717,9*
= Retail banking income	619,9	421,8	1.727,9	2.008,9	1.972,1	1.970,9	1.918,8
+ Trading and other income	*-356,0*	*154,7*	*172,1*	*569,5*	*-21,9*	*432,9*	*530,6*
= Banking income	263,9	576,5	1.900,0	2.578,4	1.950,2	2.403,8	2.449,4
- Operating costs	*594,8*	*286,4*	*1.137,0*	*1.149,1*	*1.129,2*	*1.123,1*	*1.006,1*
= Net operating income	-330,9	290,1	763,0	1.429,3	821,0	1.280,7	1.443,3
- Provisions	*4.253,5*	*380,6*	*1.422,8*	*1.199,4*	*848,3*	*533,6*	*708,8*
= Income before taxes	-4.584,4	-90,5	-659,8	229,9	-27,3	747,1	734,5
- Income tax	*-843,5*	*6,1*	*-145,2*	*110,7*	*-31,1*	*43,7*	*109,8*
- Minority interests	*-163,7*	*-7,4*	*2,8*	*23,7*	*112,6*	*146,5*	*53,0*
= Net income	-3.577,3	-89,2	-517,4	95,5	-108,8	556,9	571,7

*Total assets = Net Assets + Asset Management + Other off-balance sheet assets + Securitised Credit
** Values refer to Common Equity Tier I (CETI) ("phased-in" BIS III) in 2014, Core Tier I (CTI) (BIS II) before
*** Set in terms of Tier I capital until 2010; CTI until 2013; and CETI (BIS III) in 2014
**** Loans on which a payment is overdue for more than 90 days

Note: The "fully loaded" BIS III CETI ratio was, as of 31.03.2014, 8% and would be 9.6% post-2014 capital increase. As of 30.06.2014, it was 4.1%.

Values in millions EUR. Source: BES (Prospectus rights issue 2014; Annual report 2011); BPI Equity Research

Exhibit 8. ESI 2013Q3 headline financials from KPMG Jan14 special report

	30 Sep 2013	
	First reported	Adjusted
Assets	7,823.3	5,575.7
Liabilities	7,687.3	7,941.6
Equity	136.1	- 2,365.9

Values in millions EUR.
Note: ESI was not independently audited. The special report by KPMG was prepared at the request of BdP for ETRICC2.
Source: KPMG/"Expresso"

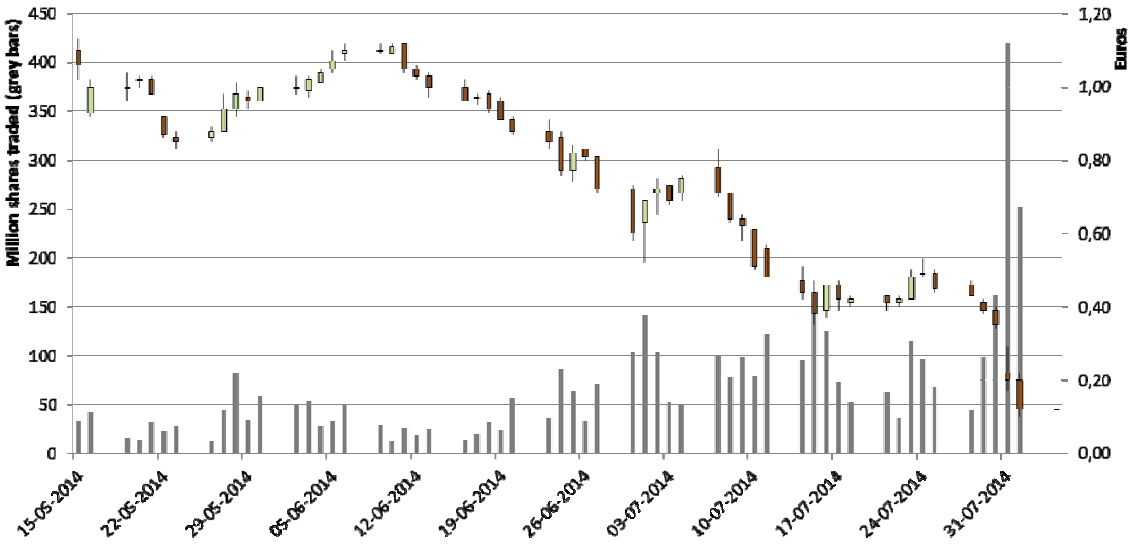
Exhibit 9. Selected pages of 2014 rights issue prospectus

Reputational risks for the BES Group associated with a potential deterioration or perceived deterioration of the financial position of Espírito Santo International, S.A. or its subsidiaries:

ESI has started a reorganization and deleveraging programme regarding its group that is aimed at rebalancing its financial position and its accounts have been subject to audits. Certain debt instruments, including commercial paper, issued by ESI and certain of its subsidiaries have been subscribed by BES clients (both institutional and retail investors). At 31 December 2013, the total amount of these debt instruments that remained outstanding was €3,035 million, of which €1,565 million was held by retail investors and €1.470 million was held by institutional investors. As at 30 April 2014, the amount of debt instruments held by retail clients was €516 million, while the amount held by institutional investors was €732 million. As at 19 May 2014, the amount of debt instruments held by retail clients was €395 million, while the amount held by institutional investors was €564 million.

Source: BES

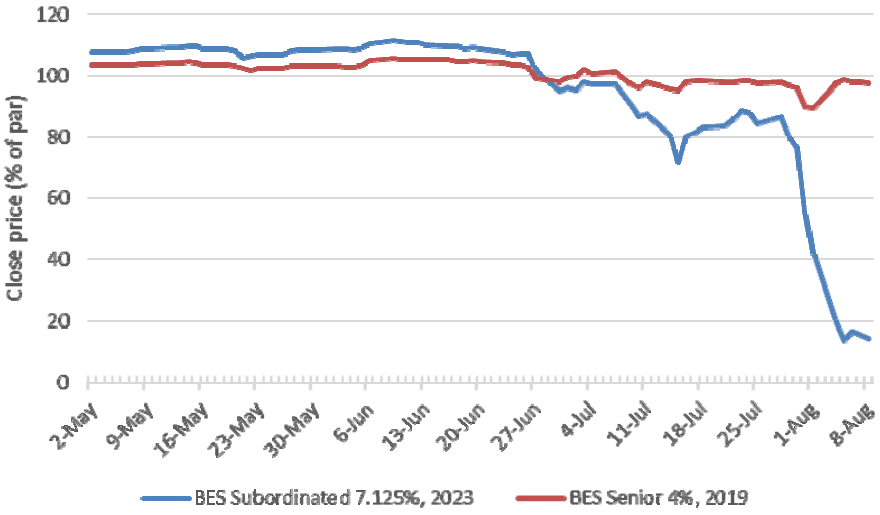
Exhibit 10. BES.LS stock: daily open, close, maximum and minimum prices; volume



traded; May-August 2014

Source: Yahoo! Finance

Exhibit 11. BES.LS bond prices, January-August



Source: Bloomberg

Exhibit 12. Syndicate of underwriters in 2014 rights issue

15% each

Morgan Stanley	JP Morgan
UBS	Merrill Lynch
Citigroup	Nomura

1% each

Societé Génerale	Mediobanca	KBC Securities	
Crédit Agricole	Santander	Commerzbank	
Banca IMI	ING	KBW	BBVA

Source: BES (rights issue prospectus)

Exhibit 13. BES qualified stakes

	% of BES equity	
	30-06-2014	31-12-2013
BESPAR	-	35.29%
ESFG (Luxembourg)	6.00%	1.38%
ESFG (Portugal)	19.05%	-
Portugal Telecom	2.06%	2.09%
Crédit Agricole (France)	12.19%	10.81%
Silchester (UK)	4.70%	5.67%
BlackRock (US)	4.65%	2.00%
Capital Group (US)	4.23%	4.14%
Bradesco (Brazil)	3.91%	4.83%
Others	43.21%	33.79%

Source: BES (Q22014 report)

Exhibit 14. BES exposures to GES 2013-14

Direct exposures*	As reported in			
	10th July	Q2 report		
	30.06.2014	30.06.2014	31.03.2014	31.12.2013
Rioforte and subsidiaries	*234.2*	*270.8*	*69.6*	*101.7*
ESFG and subsidiaries	*934.4*	*927.6*	*416.2*	*301.3*
Opway, ESCOM, and others	*71.2*	*373.4*	*321.5*	*298.2*
Total (excl. insurance)	1239.8	1571.8	807.3	701.2
Tranquilidade and subsidiaries	*304.6*	*226.2*	*203.8*	*301.1*
Total	1544.4	1798	1011.1	1002.3

Indirect exposures**	As reported in					
	10th July	Q2 report				
	30.06.2014	30.06.2014			31.03.2014	31.12.2013
Type of client	Total	Total	Institutional	Retail	Retail	
ESI and similar	*766*	*766*	*511*	*255*	*762*	*1565*
Rioforte and subsidiaries	*1882*	*1882*	*1496*	*386*	*544*	*565*
ESFG and subsidiaries	*251*	*251*	*0*	*251*	*172*	*186*
ESCOM and ES Tourism	*208*	*208*	*0*	*208*	*206*	*206*
Total	3107	3107	2007	1100	1684	2522

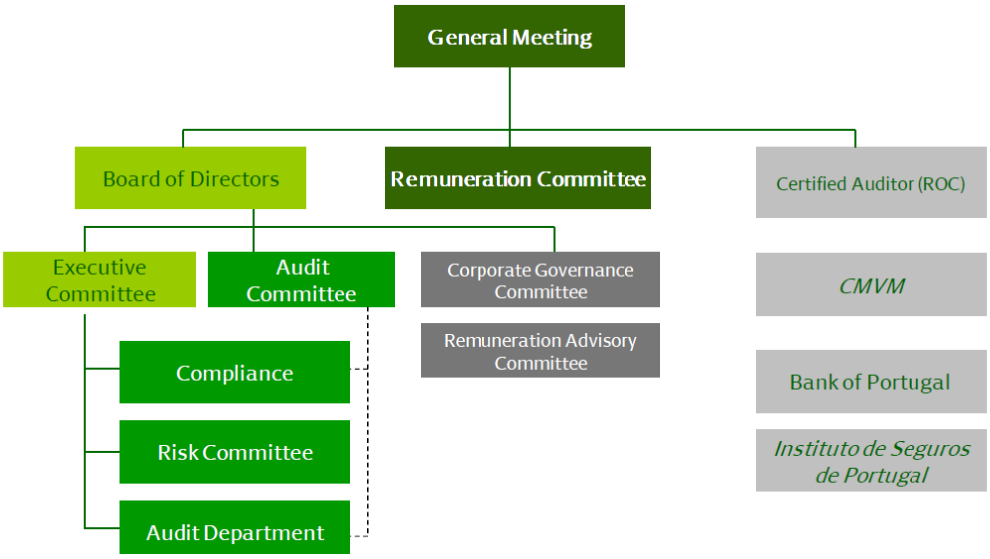
* Debt issued by the aforementioned entities and held by BES
** Debt issued by the aforementioned entities and subscribed to by BES clients
Values in millions EUR. Source: BES (Q22014 report)

Exhibit 15. Breakdown of special events' effects on BES income as reported on Q22014

	Year-to-date 30.06.2014	Special events in 2014					Year-to-date 30.06.2014
	Reported	GES Exposure	Issued bonds and SPE/SPV	BESA	Credit risk adjustments	Other impairments*	Before special events
Summary income statement							
Net interest income	*287.0*			*-247.2*			*534.2*
+ Fees and commissions	*332.9*						*332.9*
= Retail banking income	619.9			-247.2			867.1
+ Trading and other income	*-356.0*	*-9.6*	*-491.0*		*-75.4*	*-20.4*	*240.4*
= Banking income	263.9	-9.6	-491.0	-247.2	-75.4	-20.4	1,107.5
- Operating costs	*594.8*						*594.8*
= Net operating income	-330.9	-9.6	-491.0	-247.2	-75.4	-20.4	512.7
- Provisions	*4,253.5*	*2,062.3*	*757.8*	*3.7*	*383.6*	*181.3*	*864.8*
= Income before taxes	-4,584.4	-2,071.9	-1,248.8	-250.9	-459.0	-201.7	-352.2
- Income tax	*-843.5*	*-339.0*	*-368.4*	*73.8*	*-111.0*	*-22.0*	*-76.9*
- Minority interests	*-163.7*			*-143.8*			*-19.9*
= Net income	-3,577.3	-1,732.9	-880.4	-180.9	-348.0	-179.7	-255.4

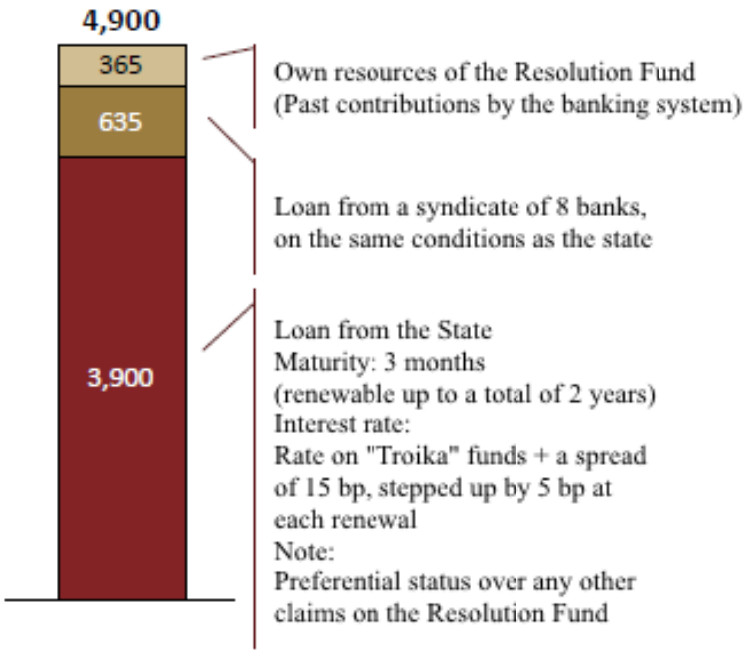
* Impairments refer to stakes in PT (€106.1m); Aman Bank of Libya (€10.2m); Real estate funds (€85.4m)
Values in millions EUR.Source: BES (Q22014 report)

Exhibit 16. BES Corporate Governance tree



Source: BES (Corporate Governance report 2013)

Exhibit 17. Resolution financing structure



Values in millions EUR. Source: Banco de Portugal

Exhibit 18. Resolution liability distribution

All liabilities and off-balance-sheet items of BES were transferred to Novo Banco, S.A. except:

- All subordinated debt instruments (€1.1bn)
- Claims (deposits, securities or other) from "related parties", including:
  - Shareholders with controlling stakes i.e. ≥ 2%
  - Board members and auditors, considered responsible for the difficulties at BES by BdP
  - Entities meeting any of the above criteria at any time during the two years before the resolution
  - Family members or proxies of any persons meeting any of the above criteria
- Claims and guarantees related to BES/GES entities (excluding those relative to BES subsidiaries transferred to NB)

Note: all contracts and agreements with workers and external service providers were also transferred to NB.

Source: BdP; NB; BPI Equity Research

Exhibit 19. Resolution asset distribution

All assets, rights and licenses of BES were transferred to Novo Banco, S.A. except:

- Loan exposures to GES entities except:
  - Loans to ESFG
  - Loans to BES subsidiaries
  - Loans to Tranquilidade and subsidiaries
- Equity stakes in BESA, Aman Bank (Libya), ES Bank (Miami)
- €10m in cash-equivalents for liquidation procedure expenses (staff, legal duties, etc.)

Note: Assets under the management (AUM) of BES also became managed by NB.

Est. value of NB assets as of Aug. 4th 2014: **€72,465m**.

Source: BdP; NB; BPI Equity Research; Press sources

Notes and references

[i] Gago, Maria João and Maria João Babo (2014). *O Último Banqueiro*. Lisbon: Lua de Papel. (p.82)

[ii] Main references: "Espírito Santo: A história de um império familiar", *Diário Económico* newspaper, 15th November 2013; Damas, Carlos Alberto (2002). "José Maria do Espírito Santo e Silva, de cambista a banqueiro, 1869-1915". *Análise Social*, vol. xxxvn (164), pg. 851-878.

[iii] (p. 29 *O Último Banqueiro* and D. Económico *July 2014*); value is inflation-adjusted (source: PORDATA/Statistics Portugal).

[iv] Ricardo Salgado at a parliamentary hearing on December 9th 2014

[v] Asset-Liability Committee, responsible for overall financial and risk management of the bank.

[vi]BES' direct parent holding. Through BESPAR (a vehicle which harboured the stakes of the ES and CA in BES), it was considered to control the bank, and was the reference entity under BdP supervision (BES was its controlled subsidiary) and subject to prudential capital ratio rules. In May 2014, BESPAR was extinct – CA and ESFG owned stakes directly in BES instead – and the BdP supervision perimeter was thus restricted to BES.

[vii] Nuno Godinho de Matos, interview to *Jornal i*, 5/9/2014.

[viii] "BESgate. Como Ricardo Salgado adivinhou o fim" *i* newspaper.

[ix]*Resolution* is defined by the European Commission (EC) as "the restructuring of a bank by a resolution authority, through the use of resolution tools, to ensure the continuity of its critical functions, preservation of financial stability and restoration of the viability of all or part of that institution, while the remaining parts are put into normal insolvency proceedings" (EC Memo 14/297). In Portuguese legislation, in line with European guidance, such resolution tools consist of transferring part or all of the bank's activity either to another bank or to a purpose-built "bridge bank".

[x]The legal document, released by the European Council, laying down the implementation framework for the SSM (Council Regulation no. 1024/2013, of 15th October 2013).

[xi] Directive 2014/59/EU adopted by the European Parliament on 15 May 2014, provides essentially uniform EU-wide rules for bank resolution, in which the aforementioned SRM will function.

[xii] Communication 2013/C 216/01 adopted by the European Commission on 30th July 2013. Replaces the "2008 Banking Communication" i.e. Communication 2008/C 270/02 of 25th October 2008. These are part of a group of several rulings by the Commission, broadly known as the "Crisis Communications", regarding state aid in the EU in the context of policy responses during the financial crisis of 2008 and the ensuing Eurozone economic and financial crisis.

[xiii]*Exercício Transversal de Revisão da Imparidade da Carteira de Crédito,* i.e. Comprehensive review of credit book impairments. BdP, in September 2013, began ETRICC2, where it sought to individually audit a sample of major credit clients of major banks, reviewing their business plans and accounts.

[xiv] "Salgado tentou envolver família na ocultação do passivo do GES" *i* newspaper.

[xv] "Espírito Santo Engages in Financial Gymnastics to Survive Crisis", *Wall Street Journal*, 12th December 2013.

[xvi]The forensic audit to BES failure determined that the total ESI debt directly placed with BES and its clients exceeded largely the book value of that company's liabilities.

[xvii] It later emerged that both the Board's Risk Committee and the ALCO both set limits to exposures the BES group. However, such limits were ignored in practice and largely

exceeded. It also emerged that many loans to GES group companies violated the banks own credit risk policies.

[xviii] This considers not only ESI but also an additional €0.8bn owed by small subsidiaries, such as ES Irmãos, the remainder of ES Resources (which was being wound down at the time), and others.

[xix] The provision was only recorded at the ESFG level because this entity issued a guarantee against the risky ESI notes held by BES clients, with its stake in Tranquilidade, the insurance company, provided as collateral to BES for the funding of the escrow account.

[xx] News about such "gift" emerged during a police investigation on a Swiss banker who managed offshore accounts on behalf of Portuguese clients. Mr Salgado was caught on this transaction but took advantage of a special law for the repatriation of offshore money, paid the corresponding taxes and got clear of any criminal charges.

[xxi] A large portion of Angolan loans was not recorded in the BES loan book according to the same internal ratings system as all the others, having to rely on aggregate information provided by BESA management.

[xxii] KPMG's audit report on BES Angola published together with the 2013 annual report.

[xxiii] "Ricardo Salgado: «Foi o aumento de capital com mais sucesso desde 1992»", *Jornal de Negócios* newspaper, 11th June 2014

[xxiv] «Não queremos ser nacionalizados outra vez», *Lusa* press agency, 13th February 2014

[xxv] The Basel III agreements (and the CRD III/CRD IV European implementations thereof foresee a "phasing-in" stage (up to 2019) where its various stipulations enter gradually into force: minimum solvency levels increase in small increments every year, and the same is true for the stringency of capital instrument eligibility and deductions rules. In Portugal, the former were anticipated by BdP; the latter were *phased-in* more gradually.

[xxvi] ESFG communication to the market, 3rd July 2014

[xxvii]SIBS is a joint-venture responsible for managing the interbank ATM and card payment system infrastructure ("Multibanco") in Portugal.

[xxviii] The true loss exceeded €4.2bn. The difference between the two figures was accounted as "deferred tax assets".

[xxix]Note that these were zero-coupon bonds with very high maturities (40 years) – thus particularly difficult to accurately value – which had been placed through Eurofin, a small Luxembourg securities trading firm led by a former employee of GES, AlexandreCadosch. The repurchased bonds were purportedly meant to be traded for assets held by other clients in Switzerland and Luxembourg, specifically, preference shares of SPVs that financed GES entities such as ESI.

[xxx] "A investigação interna do BES às cartas assinadas por Salgado", *Sábado* magazine, 20th January 2014

[xxxi]*Emergency Liquidity Assistance* is defined by the ECB as «the provision by a Eurosystem national central banks of (…) central bank money (…) to solvent [banks] facing temporary liquidity problems, without such operation being part of the single monetary policy». This is generally used when banks run out of eligible collateral.

[xxxii] License to engage in monetary policy operations (repos and longer-term operations)

[xxxiii] In the preceding years with the progressive implementation of new bank resolution rules, "resolution funds" such as this were created in most Eurozone countries. In Portugal, as in most cases, it is a public entity, managed by BdP.

[xxxiv] The insurance company Tranquilidade would later be sold by Novobanco for €50m, €650m short of the total amount it was supposed to guarantee.