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Update

Finance and Governance

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PART I - AMENDMENTS TO BANKING LEGISLATION

Transposition of the CRD V and BRRD II Directives

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1. Introduction and legal context:

On 10 December 2022, Law no. 23-A/2022 of 9 December ("Law") entered into force. The Law revises a wide range of banking and financial legislation, transposing Directives (EU) 2019/878 ("**CRD V**") on the access to banking activities and prudential supervision and (EU) 2019/879 ("**BRRD II**"), on the recovery and resolution of credit institutions and investment firms. The Directives aim to strengthen the mechanisms of supervision of the activity of credit institutions and their capacity to absorb losses in the event of possible resolution, respectively.

In what specifically concerns banking regulation, the Law amends ***(i)*** the General Regime of Credit Institutions ("**RGICSF**"), ***(ii)*** the liquidation regime of credit institutions and financial companies headquartered in Portugal and their branches created in another Member State, approved by Decree-Law no. 199/2006, of 25 October 2006 and ***(iii)*** the regime which establishes measures for the reinforcement of the financial soundness of credit institutions within the scope of the initiative for the reinforcement of financial stability and the availability of liquidity in the financial markets, approved by Law no. 63-A/2008, of November 24.

The Law introduces a significant banking reform promoted by the European Union, which consists, along with the CRD V and the BRRD II, of Regulations (EU) no. 806/2014 on the Single Resolution Mechanism ("**SRMR**") and (EU) no. 575/2013 on Capital Requirements ("**CRR**") ("*Banking Package*"). For this reason, the changes now introduced in the banking area are particularly reflected in the RGICSF, which determined its republication.

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2. Main amendments to the banking legislation

a. Transposition of CRD V

The modifications introduced in RGICSF due to the transposition of CRD V encompass a wide range of rules regarding the scope of prudential supervision, including matters related to the remuneration of employees whose activities have a significant impact on the risk profile of the credit institution, supervisory measures and powers, capital conservation measures and reinforcement of the principle of diversity in management bodies.

The remuneration policies regime in credit institutions is subject to a double review: on the one hand, it aims to ensure their neutrality. To this end, credit institutions are required to have remuneration policies and practices that are not only consistent with prudent risk management but also gender neutral. To this end, "gender neutral remuneration policy" is based on equal pay for male and female employees for equal work or work of equal value.

On the other hand, Remuneration policies are also reviewed by ensuring that their requirements meet requirements of proportionality and appropriateness to the size and structure of each credit institution. Under the principle "one size does not fit all", the obligations arising from the payment of the variable component of the remuneration of employees whose professional activities have a significant impact on the risk profile of the credit institution, and which generally impose a deferral in the payment of a substantial part of it (at least 50%) for a minimum period of four to five years, do not apply to credit institutions that are not large institutions and to employees whose variable component of annual remuneration does not exceed €50,000 and does not represent more than one third of their total annual remuneration.

At the same time, new rules are introduced to tighten the criteria for the application of additional own funds and to revise the rules on reserves and conservation measures, reinforcing their scope and effectiveness. To this end, the Law introduces a renewed set of provisions aimed at identifying the situations in respect of which Banco de Portugal shall require compliance with additional own funds in excess of the requirements set out in Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013. These provisions are justified by the fact that the requirement of compliance with additional own funds requirements is directly linked to possible events generating restrictions at the level of the institution, such as those related with interest or dividend payments by a credit institution to shareholders or holders of Tier 1 additional own funds instruments.

Also by virtue of the transposition of CRD V, a new paragraph was introduced to article 2-A of the RGICSF (paragraph z), importing a new concept of "Group" to the regulation of the banking sector, referring to the provisions of Decree-Law no. 158/2009 of 13 July, which approves the National

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Accounting Standards System ("SNC"). Thus, the determination of the existence of a Group relationship is henceforth disconnected from the ascertainment of the existence of a corporate affiliation relationship and is now assessed through the consolidation accounting criterion.

Finally, it should be noted that with respect to the procedures for ***(i)*** refusal and revocation of authorization for credit institutions, ***(ii)*** the exercise of management and supervisory bodies for lack of suitability and ***(iii)*** disqualification for supervening reasons, these are now subject to a decision period of 180 working days. The establishment of this deadline thus amends the general rule in the Administrative Procedure Code, which provides for a general decision period of 90 or 120 working days, depending on whether the proceedings are of an ex-officio or private initiative nature.

b. Transposition of BRRD II

The transposition of BRRD II implies, in banking regulation, for the introduction of new rules in the areas of credit institutions resolution, as well as the promotion of mechanisms available to resolution authorities to better deal with this events.

Firstly, ir highlights the revision of the regime on Minimum Requirement for own funds and Eligible Liabilities (MREL). Within the broad revision of the rules aimed at strengthening the resilience of credit institutions, of note is the introduction of an amount of own funds and eligible credits corresponding to 8% of total liabilities, including own funds, applicable to institutions (and subsidiaries) of global systemic importance - "G-SIIs".

Also of note is the revision of the regime for the contractual recognition of internal recapitalization. In this context, it is intended that credit institutions include in their instruments and contracts a clause in which the creditor recognizes that its credit may be subject to the reduction or conversion powers and accepts the production of the respective effects (excluding contracts that constitute a deposit, among others). The revision now undertaken aims, among other objectives, to provide greater certainty in cases of cross-border resolution, including in relation to creditors whose activity is not regulated by European Union law.

Finally, of particular interest is the introduction of a nominal minimum amount for the distribution of instruments to non-professional investors. From now on, own funds instruments, with the exception of Common Equity Tier 1 instruments, debt instruments that are payable after common claims and before subordinated claims in the event of the insolvency of the credit institution (as defined in Decree-Law no. 199/2006, of 14 August 2006), and also instruments of eligible subordinated claims, may only be distributed to non-professional investors if (***i***) the total amount of the investment does not exceed 10% of the total portfolio of financial instruments and (***ii***) the investment amounts to at least € 10,000.00.

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