

An examination of the Portuguese banking sector crisis

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Abstract

The purpose of this research is to analyse the trends in data from monetary financial institutions (MFIs) in Portugal compared to the Euro Area. The analysis principally focuses on the period after the subprime crisis, which started in 2007 in the USA. Moreover, this article exposes some interesting data about corporate governance in Portuguese banks (e.g. governance model, gender, board dimension, executive compensation, board members' qualifications). Of particular note is the fact that after the bail-out of Portugal in 2011, the Portuguese banking system started a process of downsizing evidenced not only by the reduction in the number of branches but also cuts to human resources. In terms of board characteristics, it is evident that the majority of Portuguese banks use the Latin model of corporate governance. Furthermore, only a small number of Portuguese banks are listed (a total of three were registered). Another aspect of note is the limited presence of women on boards of directors.

Keywords:

Board characteristics, Bank performance, Corporate governance, Boards of directors, Educational background, Portuguese banks.

JEL classification:

G38, G28, C12.

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La crisis del sector bancario portugués a examen

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Resumen

El objeto de este trabajo es el análisis de la evolución de determinados aspectos del sector bancario portugués a partir de la información proporcionada por instituciones monetarias financieras, así como su comparación con la eurozona, sobre todo tras la crisis de las *subprime* originada en Estados Unidos en 2007. Además, se ofrece información de interés relativa a la gobernanza corporativa de los bancos portugueses (por ejemplo, modelo de gobernanza, cuestiones de género, dimensión del Consejo, retribución de los ejecutivos, cualificación de los miembros del Consejo). Resulta particularmente interesante comprobar que, tras el rescate que tuvo lugar en 2011, el sistema bancario portugués comenzó un proceso reduccionista no solo en lo que se refiere al número de oficinas, sino también en el ámbito de los recursos humanos. Por lo que se refiere a las características de los consejos de dirección, la mayoría de los bancos portugueses apuestan por el modelo latino de gobernanza. Otros aspectos que merece la pena destacar son el escaso número de bancos portugueses que cotizan en bolsa y la poca participación de la mujer en los consejos de dirección.

Palabras clave:

Características del Consejo de Dirección, resultados bancarios, gobernanza corporativa, Consejo de Dirección, formación académica, banca portuguesa.

■ 1. Introduction

The global financial crisis, which started in the USA in 2007, created a number of macroeconomic problems in various Euro Area economies, including Portugal. That situation was a consequence of the fragilities demonstrated by certain Euro Area economies in 2007, including extremely high levels of public deficit, high levels of public debt and low levels of productivity.

Acharya and Steffen (2015) argued that the economic divergence between the core of Europe and the periphery caused a rapid widening in the yield spread of countries such as Portugal and encouraged many investors to start investing strongly in German bonds.

For their part, Pagano *et al.* (2014) pointed out that over the past 20 years in Europe the banking system has grown significantly and at greater rates than in other regions. They also argued that taking into consideration the actual size of the European banking system its marginal contribution to real economic growth tends to be zero or even negative.

In the case of Portugal, which is a small economy, the effects of the global financial crisis were enormous, resulting in a bail-out from the IMF/EU/ECB in 2011. Portugal has a high debt-to-GDP ratio of around 130% and most of its government debt is issued to foreigners. According to some analysts, this level of debt is unsustainable and problems may appear in the near future. Furthermore, although the centre of the Euro Area crisis is usually considered to be Athens, Lisbon could also be seen as a focal point.

As a case in point, there is the alarming situation on 30th December 2015, where five Portuguese bank bonds registered a loss of about 80 percent after the division of Banco Espírito Santo, into a “good” bank and a “bad” bank. This situation resulted in the retroactive confiscation of the assets of bondholders in Novo Banco and consequently significant damage to the Portugal’s credibility with foreign investors.

Another adverse episode in the Portuguese financial sector was the recent €2.26bn bail-out of Banif Bank, which once more demonstrates the fragility of Portuguese banks.

Furthermore, Crosignani *et al.* (2015) identified several situations that have characterized the Portuguese banking system in recent years. They are:

- The rise of securitization and non-traditional banking activities,
- The increasing isolation of domestic banks, and
- Foreign banks withdrawing from the market.

In this study, trends in the Portuguese banking system are analysed for the period following the crisis that started in 2007. To that end, aggregated data from monetary and financial institutions (MFI) operating in Portugal are used.

Furthermore, corporate governance models of banks are studied taking into consideration several aspects, such as:

- The type of corporate governance model,
- The number of members of the board of directors,
- The percentage of foreign directors,
- Directors' age,
- Directors' gender, and
- Executive compensation.

This study particularly emphasizes the Portuguese banks that suffered most during the crisis period, such as BPN (2008), BPP (2009), BES (2014) as well as Banif, which recently went bankrupt.

■ 2. Overview of the banking sector in Portugal

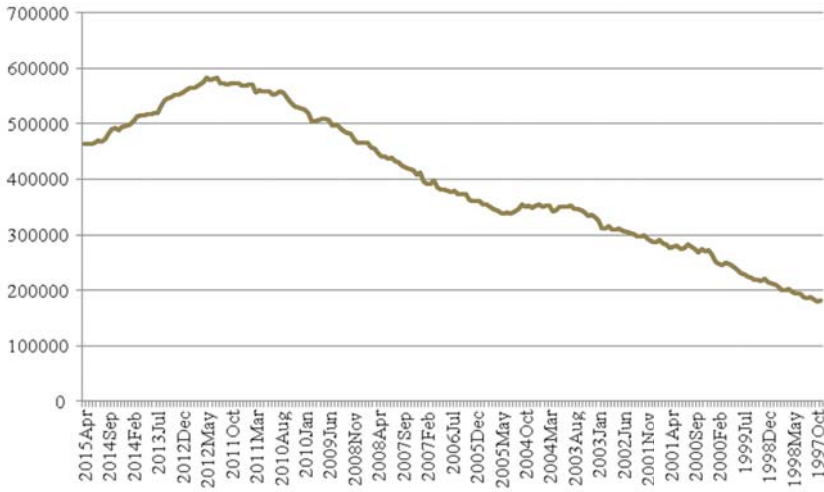
The main sources of data in this study are the balance sheets of monetary financial institutions dataset (MFI balance sheets), the dataset of the European Central Bank (ECB) and also the monetary financial institutions dataset from Banco de Portugal (BdP).

The ECB dataset is a monthly panel of relevant information about MFIs operating in the Euro Area either at country level or aggregate level for all Euro Area countries. For the present study, the relevant period was taken as October 1997 to April 2015.

In Figure 1 it can be seen that the total assets/liabilities of Portuguese banks registered a growing trend until May 2012, at which point the trend reversed. However, it is clear that the Portuguese monetary financial system registered strong growth in the last two decades, with total assets of about €181 billion in September 1997, reaching about €464 billion in April 2015.

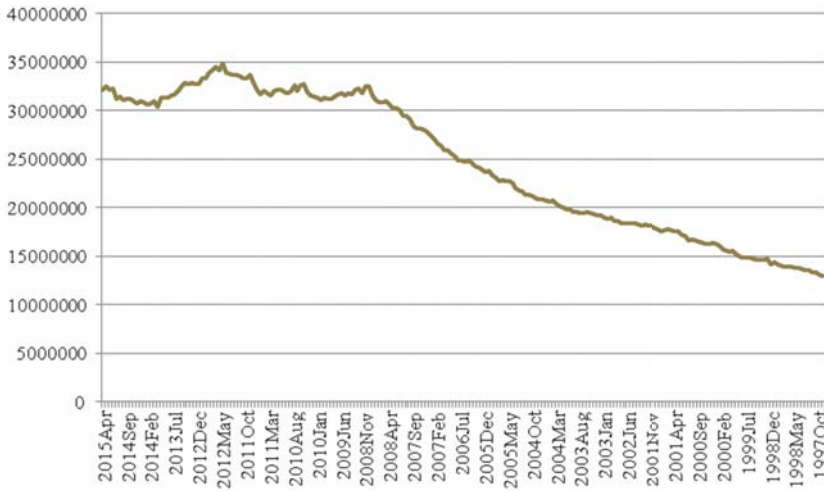
Comparing Figure 1 and Figure 2, some similarities can be found in the trends in total assets of Portuguese MFIs and those of Euro Area MFIs. In terms of the Euro Area, a marked growth in MFIs total assets was also registered. After the subprime crisis of 2007 there was a tendency for stability in this indicator.

■ **Figure 1. Total assets/liabilities of Portuguese MFIs (EUR millions)**



SOURCE: EUROPEAN CENTRAL BANK (ECB).

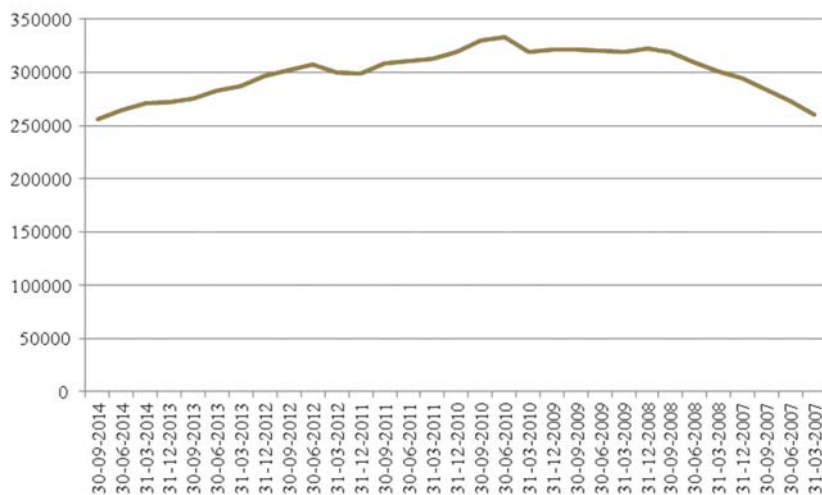
■ **Figure 2. Total assets/liabilities of Euro Area MFIs (EUR millions)**



SOURCE: ECB.

Figure 3 shows a trend in terms of a reduction in net credit to clients by Portuguese banks. This effect was constant after June 2012 and can be associated with the economic crisis in Portugal during 2011 and in the following years. The level of austerity imposed by the Troika (IMF, ECB and European Commission) had an impact on the level of wages and consequently a significant reduction in consumption.

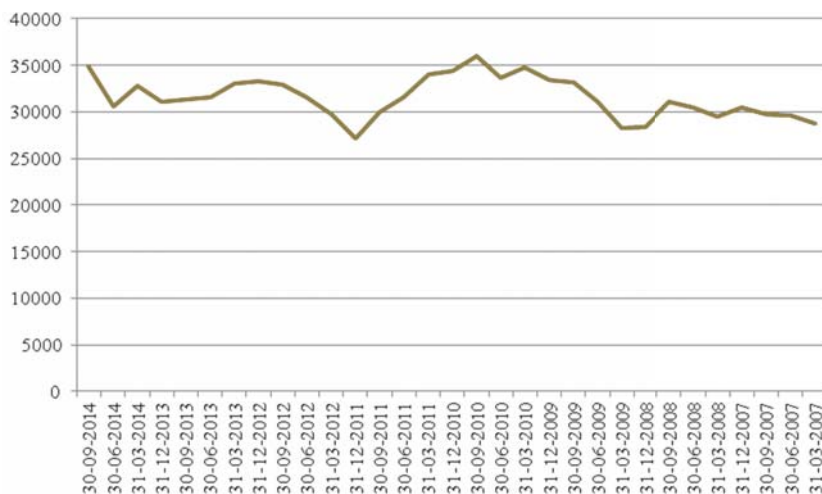
Figure 3. Net credit to clients of Portuguese banks (EUR millions)



SOURCE: BANCO DE PORTUGAL (BDP).

Portuguese banks suffered huge capital losses between September 2010 and March 2012 (Figure 4), which may be associated with the difficulties that some Portuguese banks faced during this period. The majority of Portuguese banks were recapitalized in 2011 and some, such as BPN, BPP, BES and Banif, found themselves in serious difficulties.

Figure 4. Portuguese banks' capital (EUR millions)

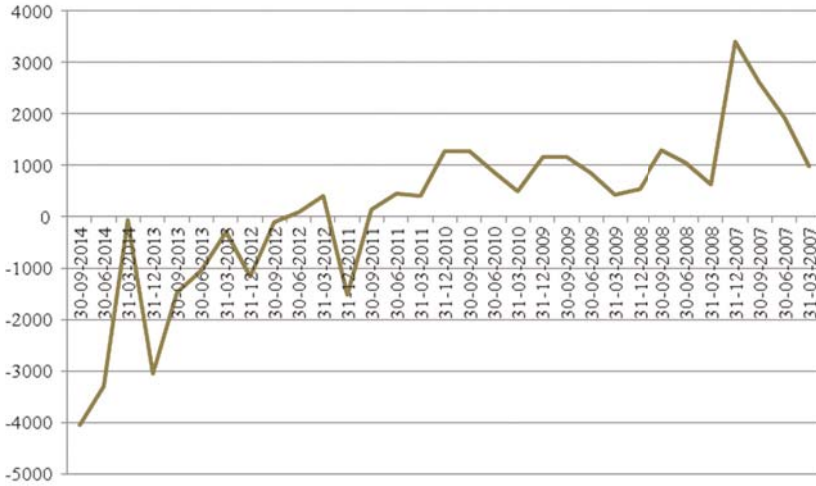


SOURCE: BDP.

Regarding the analysis of the profitability in terms of net income of the Portuguese banking sector (Figure 5), it was positive between 2007 and 2011. However, after

2011 the situation changed and the net income has been negative almost every year since. One explanation for this may be that the Portuguese banking sector is oversized. In addition, some Portuguese banks possessed shares in financial institutions from bailed-out countries such as Greece.

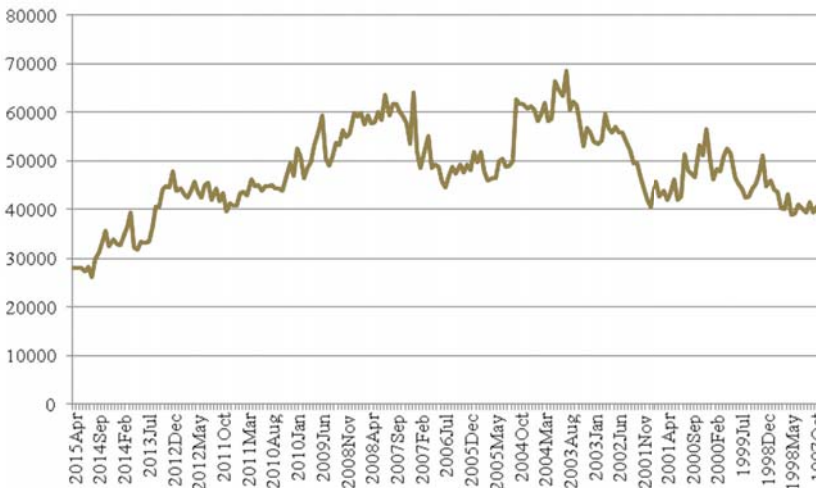
Figure 5. Portuguese banks' net income (EUR millions)



SOURCE: BDP.

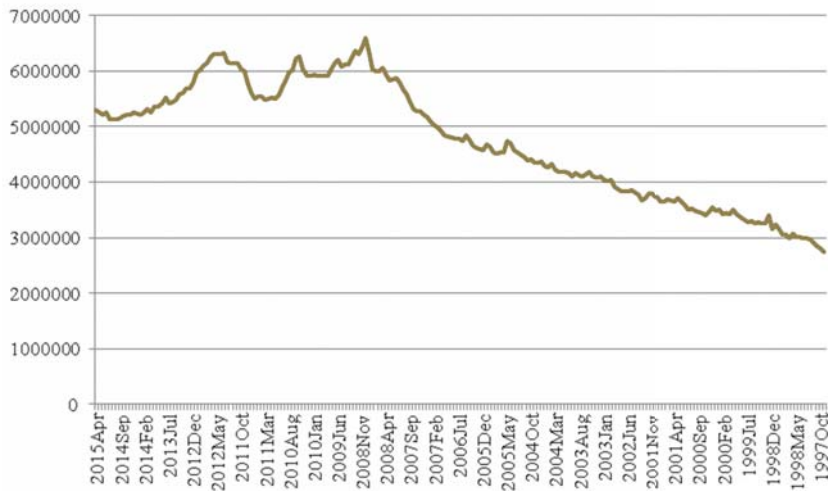
Portuguese MFIs have shown a significant reduction in loan amounts since 2007 (Figure 6). In terms of the Euro Area MFIs, a similar but less significant reduction in loans can also be seen (Figure 7).

Figure 6. Portuguese MFIs' loans (EUR millions)



SOURCE: ECB.

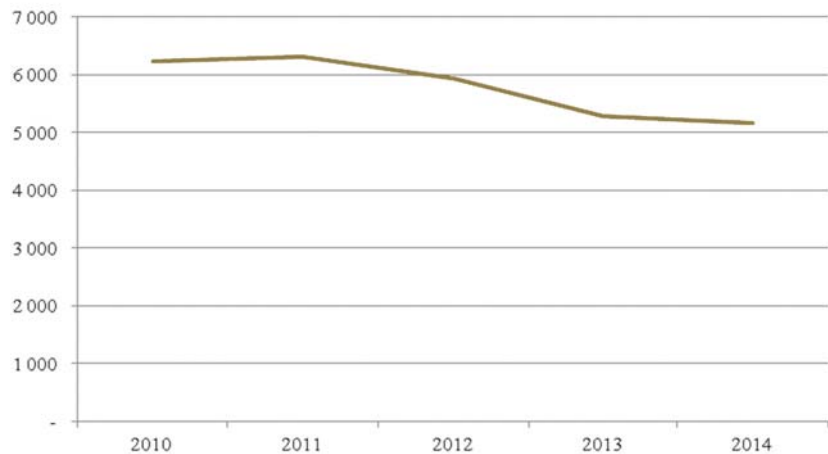
Figure 7. Euro Area MFIs' loans (EUR millions)



SOURCE: ECB.

After the 2011 bail-out, there was an important decline in the number of branches of Portuguese banks. In some situations, this reduction was imposed by the regulator (BdP) but in other cases it was a result of individual banks' strategy. In recent years, certain Portuguese banks had negative net profits, which obliged them to reduce their fixed costs. Moreover, the trend for using online banking services meant that fewer branches were needed (Figure 8).

Figure 8. Trend in the number of branches of Portuguese banks

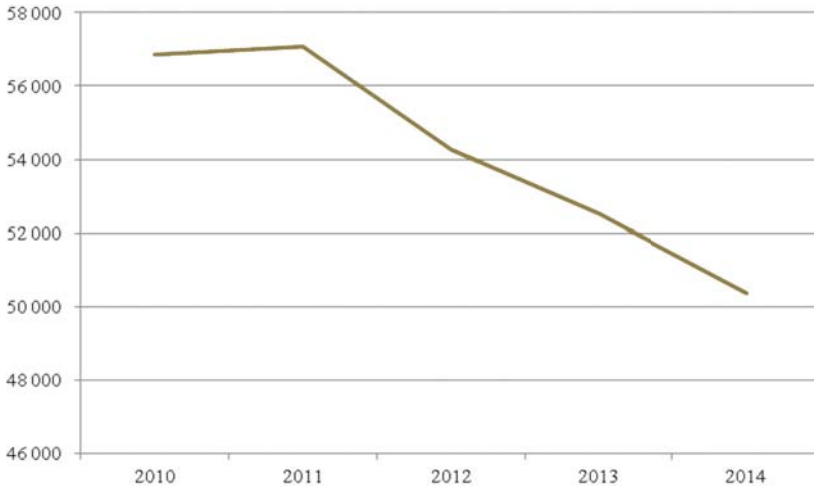


SOURCE: PORTUGUESE BANKING ASSOCIATION.

Analysing the changes in staffing levels, they have also registered a significant decrease since 2011 (Figure 9). This is the result of a number of different factors, particularly

the bankruptcy of certain banks (e.g. BPN) but also the downsizing strategies implemented by other banks (e.g. BCP, BPI and Banif).

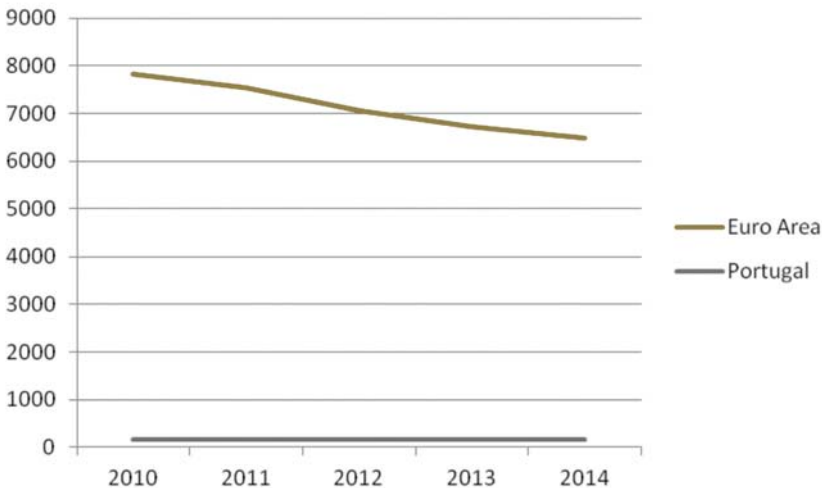
Figure 9. Trend in the number of employees of Portuguese banks



SOURCE: PORTUGUESE BANKING ASSOCIATION.

Finally, analysing the respective trends in the number of MFIs in the Euro Area and in Portugal reveals a clear difference (Figure 10). The Euro Area shows a marked decrease in the number of MFIs after 2010 (7828) when compared to 2014 (6472). Portugal, however, only registered a slight reduction in the number of MFIs (164 in 2010 and 158 in 2014).

Figure 10. Trend in the number of MFIs (Euro Area and Portugal)



SOURCE: BDP.

■ 3. Corporate governance of Portuguese banks

The governance of Portuguese companies is regulated by Article No 278 of Commercial Societies Code which considers three types of Corporate Governance Models (Decree-law No 76-A/2006 of 29th March):

Two one-tier models

- Latin Model or Monist which consists of a Board of Directors and Fiscal Council;
- Anglo-Saxon Model which requires a Board of Directors, an Audit Committee and a Certified Public Accountant (CPA).

One two-tier model

- Dualist or Germanic which comprises a Board of Directors, a Supervision and General Board and a Certified Public Accountant (CPA).

In the case of state-owned banks, they need to adhere to certain specific rules, particularly those set out by Law No 71/2007 (Public Manager Regulations). For example, all board members of Caixa Geral de Depósitos (CGD) need to have at least graduated from university (according to their corporate governance report).

The corporate governance model of Portuguese listed banks conform to regulations from the Portuguese Securities Market Commission - “CMVM”, with particular reference to the document “CMVM Recommendations on Corporate Governance”.

All banks in the Portuguese system need to comply with several rules imposed by the supervisor (in this case the Bank of Portugal). The reference for this supervision is the Legal Framework of Credit Institutions and Financial Companies, approved by Decree-law No 298/92 of 31st December. Moreover, there are several guidelines set out by the European Banking Authority (EBA) regarding the qualifications and professional experience of banks’ board members (EBA guidelines - EBA/GL/2012/06). This more recent document stems from the creation of the EBA on 1st January 2011 as part of the European System of Financial Supervision (ESFS).

Decree-law No 126/2008 of 21st July introduced a number of criteria and procedures to evaluate the suitability of proposed board members as well as their professional qualifications, specifically in terms of academic qualifications and professional experience.

Moreover, the previous directive 2006/48/CE was modified with the incorporation of new directives from the European Parliament (directive 2013/36/EU and regulation EU No 575-2013), from which stemmed Decree-law No 157/2014.

Article No 435 of regulation EU No 575-2013 describes credit institutions' requirement to publicize their board member recruitment policy and also board members' capacities in terms of experience and competencies.

According to the Bank of Portugal's instruction n° 30/2010, prospective board members of banks must provide the following:

- Information about their professional experience, academic qualifications, suitability and independence;
- A detailed curriculum vitae;
- A copy of their national identity card; and for first applications only an updated criminal registration certification which is valid for five years and needs to be renewed.

The recent adoption of Decree-law No 157/2014 in association with Letter No 2/2015/DSP obliges banks to comply with the following requirements (Instruction No 30/2010 and Instruction No 73/96 were canceled accordingly):

- Internal regulation for the selection and evaluation of board members;
- The results of any evaluation or re-evaluation need to be part of a report, which will be used in the General Assembly and will be used in the process of authorization defined by the Bank of Portugal;
- The previous procedures should also be applied to other vital functions of the bank.

The mandatory elements required for board member registration are now more detailed and rigorous (Instruction No 12/2015). As an example, it defines what information must be included in their curriculum vitae. There is some evidence that EBA, ECB and the Bank of Portugal are now more aware of the importance of a careful selection of bank board members. BdP (2015) considered that in order to boost confidence in the financial system, supervisors should possess instruments to globally evaluate the corporate governance of banks.

The Portuguese banking system is composed of approximately 30 banks; the majority are privately-owned banks and the only two banks that are state-owned belong to the same financial group (CGD and Caixa Investment Bank). In terms of listed Portuguese banks, there were only three in 2011 (BCP, BES and BPI), all of which rank among the top five banks with greatest market share.

In terms of corporate governance model, there is a predominance of the Latin model comprising a board of directors and a fiscal council. In 25 institutions analysed, 19

adopted this type of governance model, whose implementation is normally dictated by the cultural influence by the country. The other two models of corporate governance, the Anglo-Saxon model and the German model, were used in three banks each and, interestingly, not a single listed bank used the Latin model (Table 1).

● **Table 1. Portuguese banks' characteristics¹**

Bank	Ownership	Governance model	Publictraded
Banco BPI SA	1	1	1
Banco Comercial Portugues SA	1	2	1
Banco Espirito Santo SA	1	1	1
Banco Santander Totta SA	1	0	0
Caixa Economica Montepio Geral	1	2	0
Banco Internacional do Funchal SA	1	0	0
Caixa Geral de Depósitos SA	0	1	0
Crédito Agrícola Financial Group	1	2	0
Banco Popular Portugal	1	0	0
Banco Bilbao Vizcaya Argentaria (Portugal) SA	1	0	0
Banco Itau BBA International	1	0	0
Banco Finantia	1	0	0
Caixa - Banco de Investimento SA	0	0	0
Banco BAI Europa	1	0	0
Banco Credibom	1	0	0
Banco BNP Paribas	1	0	0
Banif - Banco de Investimento	1	0	0
Banco BIC	1	0	0
Banco BIG	1	0	0
Banco Primus	1	0	0
Banco Privado Atlântico Europa	1	0	0
Finibanco - Holding, SGPS S.A.	1	0	0
Banco Carregosa	1	0	0
Credito Agricola, SGPS, SA	1	0	0
Banco Português de Gestão	1	0	0

One characteristic that is evident in the boards of Portuguese banks is the absence of women: in 11 banks there were no women at all on the board of directors. Moreover, only four banks had more than two women on their board.

In terms of the age of board members, it can be seen that listed banks show higher values: about 60 years old compared to approximately 52 years old for non-listed banks.

¹ See Appendix: methodology.

Regarding the percentage of foreigners on the boards of directors, it can be seen in Table 2 that a substantial number of the institutions have no foreign board members. As expected, the presence of foreigners is more evident in the financial institutions that also have a substantial presence of foreign shareholders.

The board size data also yielded surprising values, specifically in the case of listed banks. Even taking into consideration the comparatively larger size of these banks, an average of 23 board members is without any doubt too many when compared to standard values.

● **Table 2. Portuguese banks' board characteristics**

Bank	Gender	Member age	Foreign	Boardsize	Executives11	Execompl1
Banco BPI SA	0.04	59.17	0.33	24	7	5.30
Banco Comercial Portugues SA	0.05	60.25	0.08	20	7	3.80
Banco Espirito Santo SA	0.08	60.92	0.16	25	9	7.20
Banco Santander Totta SA	0.00	52.50	0.20	12	9	4.30
Caixa Economica Montepio Geral	0.00	66.80	0.00	5	5	2.03
Banco Internacional do Funchal SA	0.14	45.75	0.00	9	5	3.00
Caixa Geral de Depósitos SA	0.00	53.14	0.00	11	7	0.70
Crédito Agrícola Financial Group	0.07	62.50	0.00	14	5	
Banco Popular Portugal	0.00	53.00	0.75	4	4	0.80
Banco Bilbao Vizcaya Argentaria (Portugal) SA	0.11	72.00	0.33	9		
Banco Itau BBA International	0.00	69.50	0.00	11	4	0.30
Banco Finantia	0.14	61.33	0.00	7		
Caixa - Banco de Investimento SA	0.00	48.57	0.00	7	3	0.10
Banco BAI Europa	0.17	61.00	0.00	6	3	0.37
Banco Credibom	0.00	44.40	0.60	5	2	0.51
Banco BNP Paribas	0.25	48.50	0.67	8	3	1.05
Banif - Banco de Investimento	0.11	50.75	0.00	11	7	1.49
Banco BIC	0.14	60.00	0.00	7	4	0.70
Banco BIG	0.00	41.00	0.17	6	6	2.27
Banco Primus	0.00		1.00	5	2	0.31
Banco Privado Atlântico Europa	0.25	50.00	0.00	7	5	0.68
Finibanco - Holding, SGPS S.A.	0.00	66.80	0.00	5	5	0.04
Banco Carregosa	0.13	70.00	0.00	8	4	0.38
Credito Agrícola, SGPS, SA	0.00	66.00	0.00	3	3	
Banco Português de Gestão	0.00		0.00	7	5	0.77
Total average	0.07	57.56	0.17	9.44	4.96	1.72
Average private banks	0.07	53.14	0.19	9.48	4.52	1.53
Average state-owned banks	0.00	50.86	0.00	9.00	5.00	0.40
Average listed banks	0.05	60.11	0.19	23.00	7.67	5.43
Average non-listed banks	0.07	51.98	0.17	7.59	4.14	0.90

Furthermore, huge differences can be seen in terms of executive compensation in listed banks in comparison with CGD (the biggest Portuguese bank in terms of assets). Contrary to expectations, CGD has a far lower level of executive compensation than BES: €0.7 million compared to €7.2 million (Table 2).

Three indexes used to evaluate the board members' qualifications will be analysed below. In Table 3, it can be seen that Eduindex is greater in the case of state-owned banks with 1.68 and, contrary to expectations, listed banks show the lowest value with 1.02. This result reveals that, on average, the board members of state-owned banks have superior qualifications in terms of business/economics when compared to the other banks.

● **Table 3. Board member qualifications of Portuguese banks**

Bank	Eduindex	EduindexDP	EduindexFP
Banco BPI SA	1.21	0.46	0.71
Banco Comercial Portugues SA	0.84	0.52	0.28
Banco Espirito Santo SA	1.00	0.44	0.36
Banco Santander Totta SA	1.67	1.67	0.83
Caixa Economica Montepio Geral	1.00	0.80	0.20
Banco Internacional do Funchal SA	1.11	0.67	0.00
Caixa Geral de Depósitos SA	1.50	0.79	0.50
Crédito Agrícola Financial Group	0.33	0.33	0.00
Banco Popular Portugal	0.75		
Banco Bilbao Vizcaya Argentaria (Portugal) SA	1.00	0.33	0.33
Banco Itau BBA International	1.80	0.67	1.33
Banco Finantia	1.33	0.50	0.50
Caixa - Banco de Investimento SA	1.86	1.33	0.50
Banco BAI Europa	1.00	0.25	0.00
Banco Credibom	1.00	0.20	0.80
Banco BNP Paribas	1.67	2.00	1.00
Banif - Banco de Investimento	1.60	1.00	0.00
Banco BIC	0.75	0.33	0.33
Banco BIG	1.33	0.83	0.17
Banco Primus	1.00	0.00	0.50
Banco Privado Atlântico Europa	1.43	0.43	0.57
Finibanco - Holding, SGPS S.A.	1.00	0.80	0.20
Banco Carregosa	0.00	0.00	0.00
Credito Agricola, SGPS, SA	1.00	1.00	0.00
Banco Português de Gestão	2.00	0.50	0.00
Total average	1.17	0.66	0.38
Average private banks	1.12	0.60	0.35
Average state-owned banks	1.68	1.06	0.50
Average listed banks	1.02	0.47	0.45
Average non-listed banks	1.19	0.66	0.35

In the case of EduindexDP, which takes into consideration the quality of qualifications obtained in prestigious domestic universities, state-owned banks once again show higher values than the other banks. Interestingly, of all the groups of banks analysed, listed banks have the lowest value with only 0.47.

Finally, with respect to EduindexFP, listed banks have a value of 0.45, which is closer to the value for state-owned banks of 0.5. This means that even in the case of qualifications obtained in prestigious foreign universities, state-owned banks show a higher value, representing on average a better level of qualifications of their board members.

■ 4. Concluding remarks

In this study, data from Portuguese MFIs were analysed, in some cases in comparison with Euro Area MFIs. This offers an understanding of the main trends that have affected the Portuguese banking system in recent years. Of particular note is the fact that after the bail-out of Portugal in 2011, the Portuguese banking system started a process of downsizing, evidenced not only by the reduction in the number of branches but also by cuts to human resources. Another particularly negative aspect is the fact that some Portuguese banks have been registering negative net incomes and a significant reduction in the volume of loans.

In terms of board characteristics, it is evident that the majority of Portuguese banks use the Latin model of corporate governance (though none of the listed banks use it). There is a small number of banks that are listed (only three) and very few women on the board of directors.

Furthermore, the presence of foreign board members is not particularly relevant and in the case of state-owned banks there was not a single foreigner on the board of directors. State-owned banks also showed a lower level of executive compensation than similarly-sized private banks (e.g. CGD compared with BES).

Finally, contrary to what might be expected, the board members of state-owned banks present a higher level of qualifications than those of the other groups of banks, both in terms of total qualifications in business/economics as well as with respect to whether the qualifications were obtained in domestic or foreign prestigious business schools.

It is hoped that the present study may contribute to a better understanding of the trends and the organization of the Portuguese Banking System. In addition, it may be of use to researchers, analysts and policy makers who are interested in the topic of Portuguese banks in order to systematize the Portuguese Banking System. More-

over, this study revealed some interesting data about corporate governance in all Portuguese banks, which previously constituted a gap in the literature.

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Appendix: methodology

Variables	Measures
Panel A: Board members' qualifications	
Eduindex	Index that aggregates the qualifications of board members in the areas of economics/business.
EduindexDP	Index that aggregates the qualifications of board members obtained in prestigious domestic universities, according to Eduniversal Rankings (areas of economics/business).
EduindexFP	Index that aggregates the qualifications of board members obtained in prestigious foreign universities, according to Eduniversal Rankings (areas of economics/business).
Panel B: Governance variables	
Ownership	Dummy variable equal to 1 if a bank is privately-owned.
Governance model	0 - Latin Model; 1 - Anglo-Saxon Model; 2 - Dualist or Germanic (in 2011).
Publictraded	Dummy variable equal to 1 if a bank is listed.
Gender	Total number of women on the board of directors divided by the total number of board members (0 - Male; 1 - Female), All members were included, even those that joined the bank in 2012.
Member age	Average age of the members of the board of directors.
Foreign	Percentage of board members born in a country with a different official language.
Boardsize	Number of directors on the board.
Executives11	Number of members of the board of directors that are executives in 2011.
Excomp11	Total annual compensation of the board of directors in 2011.

