



Inside story – Espirito Santo Financial Group, Rio Forte and Espirito Santo International under creditors’ protection in Luxembourg

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Background

Espirito Santo Financial Group SA (ESFG) is a Luxembourg-based company, incorporated in 1984, and the holding company of the banking and financial activities of the Espirito Santo Group. The main shareholder of ESFG is a limited liability company headquartered in Luxembourg, Espirito Santo International S.A. (ESI). The activities of the Group cover commercial banking, investment banking, insurance, asset management, private banking, among others in Portugal and internationally. The banking activities are mainly conducted through Banco Espirito Santo (BES), which is the largest lender and the second-largest bank in Portugal in terms of market value.

The holding structure of the Group is rather complex. Concisely, BES is partly owned by ESFG whose main shareholder is Espirito Santo Irmaos SGPS SA. Espirito Santo Irmaos SGPS is wholly owned by Rio Forte Investments SA which is owned by ESI.

In May 2014, ESFG posted a first quarter net loss of €37 million (up from €13.1 million compared to the previous year) and on 8 July 2014 ESI announced that it missed payments to some investors holding its short-term commercial paper.

This information sparked fire amongst investors and analysts as ESI indirectly controls BES and its creditors could have been tempted to go after BES’s assets to seek payment.

Apparently, the Group as a whole and particularly Rio Forte had borrowed a large amount of money not only from BES but also from its clients and depositors. It has been reported that the total exposure of BES to other entities of the Group amounted

to €1.18 billion. BES itself admitted in a statement dated 10 July 2014 that its retail clients hold €255 million of commercial paper issued by ESI, €342 million of commercial paper issued by Rio Forte, €44 million of commercial paper issued by subsidiaries of Rio Forte and €212 million of commercial paper and bonds issued by ESFG and its subsidiaries. BES's institutional clients hold €511 million of debt securities issued by ESI and €1.5 billion of debt securities issued by Rio Forte and its subsidiaries. In addition, the same statement mentioned that ESFG had issued a €700 million guarantee to cover debt instruments issued by the Group entities and distributed by BES to retail clients.

There were some speculations that irregularities had occurred at the level of ESI and the media further stated that criminal investigations had been initiated against former top executives of the Group. Shares were removed or suspended from stock markets in Lisbon and Luxembourg.

In view of the risks and amounts at stake, some actions had to be taken, both at the level of BES and of the Luxembourg entities to stop the outbreak of panic that had been caused by the posted figures and the information regarding a potential default.

The case

On 18 July 2014, ESI filed a petition to be placed under controlled management according to Luxembourg law. The court, in a judgment issued on 22 July 2014, declared the petition admissible and appointed one of its judges, Ms Vice-President of the District Court, Ms Karin Guillaume.

Rio Forte and ESFG also filed petitions to be placed under controlled management. Such petitions were declared admissible by judgments issued on 29 July 2014 and Ms Vice-President of the District Court, Ms Anick Wolf was appointed as delegate judge for both entities.

In addition, another entity of the Group, namely Espirito Santo Financière S.A. (ESFIL) has also filed a petition which was declared admissible on 5 August 2014.

Controlled management is governed under Luxembourg law by the Grand-Ducal Decree dated 24 May 1935 (*Arrêté grand-ducal du 24 mai 1935 complétant la législation relative aux sursis de paiement, au concordat préventif de la faillite et à la faillite par institution du régime de la gestion contrôlée*). Such proceeding, rarely used and relatively unknown, is available to companies having either lost their creditworthiness or having difficulties to meet all their commitments. The aim of the proceeding is to allow the debtor to obtain a restructuring of its business or a better realization of its assets.

The proceeding consists of a three-step process

First step: the debtor files a petition (which must be grounded and justified and must include some documentation). The court shall decide whether the petition is admissible or inadmissible. If it is admissible, the court shall appoint a judge to prepare a report on debtor's financial situation. In case it is inadmissible (for instance,

if the debtor has already ceased its payments and lost creditworthiness) the court may declare the debtor bankrupt.

Second step: the judge files the report (experts may be appointed to assist the judge with the report) and the court hears the debtor. The court then decides either to place the debtor under controlled management or to reject the petition (and possibly to declare the debtor bankrupt if the conditions for bankruptcy are met). If controlled management is granted, appointed commissioners shall propose a reorganization plan or a realization plan to be executed within a time limit determined by the court.

Third step: the plan shall be approved by creditors at a majority of more than half of the creditors representing at least more than half of the total amount of the accepted claims. Further to the creditors' approval, the court shall decide to approve or disapprove the proposed plan.

The current situation and the next step

Currently, the controlled management petitions filed by the four Luxembourg entities of the Group, namely ESI, Rio Forte International, ESFIL and ESFG have been admitted by the Luxembourg Court and delegate judges have been appointed for each entity. Consequently, the four entities can no longer alienate assets, receive new capital or grant securities without prior approval of the delegate judges and all enforcement measures on their assets are suspended.

The delegate judges together with the appointed experts (Mr Paul Laplume and Mr Alain Rukavina) are now undertaking the process of drawing up the reports, which shall be deemed strictly confidential. Thus, in the near future, the second step to be carried out by the court shall be to grant or not to grant controlled management and whether to allow or not to allow the preparation of a realization or reorganization plan. At this stage, the risk of having the entities declared bankrupt cannot completely be ruled out. Hearings are reported to be scheduled on 8 October 2014 for ESI and on 6 October 2014 for ESFG and Rio Forte.

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