



Exma. Senhora
Dra. Rita Laranjinha
Chefe do Gabinete de S. Exa.
o Ministro dos Negócios Estrangeiros

Cumpre-me enviar a V. Exa. uma carta conjunta endereçada por S. Exa.
o Primeiro Ministro, muito agradecendo o seu encaminhamento por mala
diplomática aos seus Altos Destinatários:

- Presidente da Comissão Europeia;
- Presidente do Banco Central Europeu.

Com os melhores cumprimentos

pl' A Chefe do Gabinete e P.S.O.

Rita Faden

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António Costa
Prime Minister
Lisbon, December 14, 2015

European Commission
President
Jean-Claude Juncker

European Central Bank
President
Mario Draghi

Dear Sirs,

I am writing to share with you my concerns with the Portuguese financial system and to request your expert assessment of the financial health of the Portuguese banking system. Your cooperation is of the utmost importance in order to promote the financial stability needed to foster the recovery of the Portuguese economy and safeguarding at the same time the interests of the State and tax-payers.

Since taking office two weeks ago, my Government has faced pressing issues arising from the financial system in particular from the *Novo Banco*, but also from *Banif*, which are the third and eighth largest banks, respectively. Due to the interlinked nature of the banking system any event with these two banks may trigger effects on the other banks. It is necessary that the market acknowledges that there is a well-defined strategy to the banking sector, which in the current institutional framework of the banking union needs the support and commitment from the European institutions.

Let me recall that *Novo Banco* failed the latest ECB tests, requiring additional capital in the amount of 1,600 million euros. In August 2014, in the process of resolving such a large bank as *BES*, the Portuguese Resolution Fund did not have the necessary resources and it is now highly indebted. Unfortunately, since *Banif* has entered a pre-resolution process, the Portuguese Resolution Fund may need additional funds that does not possess. I believe that this is also a test for the European resolution model. A failure will deliver a wrong message to the markets, in particular because the Single Resolution Fund will only be fully capitalized in eight years' time.

Assessing the full extension of non-performing loans and the exposure to the real estate sector in the balance sheets of Portuguese banks is of paramount importance; this impairs not only the profitability of banks, but also their ability to finance new and viable projects in the economy. Similarly to what occurred in other economies, e.g. Spain or Ireland, a solution to be adopted may have to address directly these non-performing assets.

We have clear ideas on what has to be done in our banking system and our plan has two intertwined components.

On the one hand, in the course of addressing the underlying problems, we believe that the sector needs to take this opportunity to consolidate into two strong pillars: a solid public-owned bank and fewer stronger private banks. We know that *Caixa* needs to accomplish



the targets established in its restructuring Plan, improving its investment banking operation.

On the other hand, it is fundamental that financial and time limits conditions are created to address any remaining problems detected following your detailed review of the banking sector balance sheets. Previous experiences were based on endless recapitalizations and State-aid that proved inefficient to bring the bank's operations into profit zone and to restore banking lending capacity to the private sector. The precise definition of this package should be considered in close cooperation by the European and Portuguese authorities and should take into account changes in the regulatory framework that will occur in the next couple of years.

The approach implemented so far has been a drag on the banks capacity to restructure and, at the same time, to promote the economic recovery. Without a sound financial sector, neither the quantitative easing nor the huge European Commission investment push will reach the real economy in Portugal.

In May 2014, the Portuguese Authorities claimed that they had made savings out of the 2011 financial package aimed to act as a back stop facility of the financial sector. In the aftermath, the third and the eighths largest banks are in the process of being resolved. This is not the future we envisage for the Portuguese economy, neither I am sure you envisage for Europe.

Following your assessment we are ready to discuss the adequate course of action that it is deemed necessary to solve once and for all the problems facing the Portuguese banking sector. The Portuguese Government is fully committed to be part of the solution and you may count on my personal engagement to reach this goal.

To this end, I request a meeting as soon as possible, ideally during the course of this week, to define a strategy of a global intervention on the financial system, the calendars of capitalization and selling processes of Novo Banco and Banif and the financial situation of the Resolution Fund.

Looking forward to hearing from you.

Yours faithfully,

António Costa

Prime Minister



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Prime Minister
Lisbon, December 14, 2015

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