FINANCIAL TIMES

September 11, 2014 6:58 pm

Banco Espírito Santo: Family fortunes

By Miles Johnson and Peter Wise

Bank chief Ricardo Espírito Santo Salgado faces allegations that his group engaged in a fraud

Writing on the wall: a poster in Lisbon depicting the masked face of Ricardo Espírito Santo Salgado with a slogan that reads, 'It's hard to be a banker nowadays'

It took Ricardo Espírito Santo Salgado almost two decades to win back ownership of his family's bank. But one morning in July, in less time than it took him to sip his morning coffee, Portugal's most powerful banker saw his life's work begin to slip out of his control.

Unable to pay mounting debts across his family's sprawling business empire, the ageing financier was forced by his lenders into a painful fire sale of 5 per cent of the bank that bore his name. Less than a month later, Banco Espírito Santo, Portugal's largest listed bank by assets, had collapsed. A dynasty built up over almost 150 years, weathering wars and revolutions, had come crashing down around Mr Salgado's head. The bank's toxic assets were split off into a "bad" bank as authorities tried to rescue the institution.

Today, the 70-year-old patriarch of the Espírito Santo family is banned from leaving Portugal as he awaits the outcome of investigations into alleged fraud. The case has shaken faith in Portugal's regulators, who face tough questions over their failure to prevent what has become one of Europe's largest financial failures, leaving investors with an estimated €10bn of losses.

The collapse of Portugal's best known bank has shaken confidence in the country's economic recovery less than six months after exiting its painful three-year economic rescue programme.

"The fall of the Espírito Santos is effectively the story of Portugal itself," says one official. "They had too much debt, but they continued to consume."

Financial documents and interviews with Portuguese officials and company executives reveal a trail of secret offshore financing vehicles stretching from Panama to Luxembourg which comprised a desperate attempt to prop up the ailing Espírito Santo empire before its collapse.

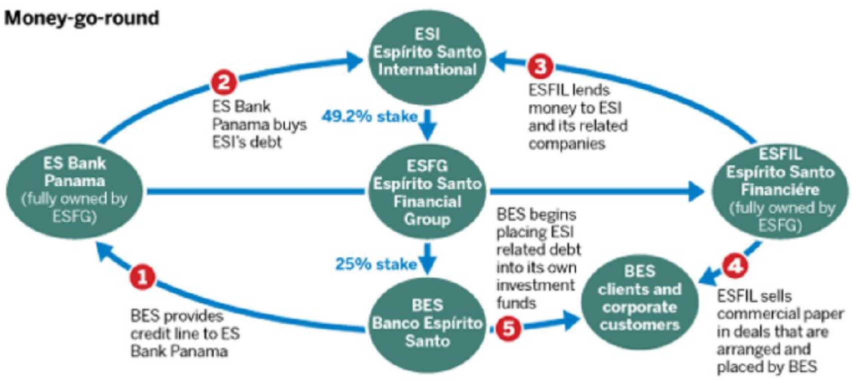
Carlos Costa, governor of the Bank of Portugal, last month accused the ES group of having "developed a fraudulent funding scheme" between its non-financial companies. He added that international experience has shown that frauds can be "difficult to detect before they collapse, in particular when activities are carried out in various jurisdictions".

Mr Salgado, who has said he is innocent of wrongdoing, has pledged to restore his family's honour, quoting Pope Francis: "Don't cry for your suffering, fight for your happiness." Other members of the family could not be reached for comment.

The man known in Portugal as "the owner of everything" had lost it all before. Ricardo Salgado was 31 when he attended the first meeting in exile of the Espírito Santo family in 1975 at a small office in London.

Portugal's radical leftwing government had nationalised the family's bank, seizing their passports and freezing their assets. Five members of the Espírito Santo clan had been imprisoned for months, later fleeing in disguise across the border to Spain. The London meeting was the first gathering of what was to become a secretive family "upper council" dedicated to restoring the dynasty.

Life as an exile was a shock for Mr Salgado, who had grown up in the beachside resort of Estoril and counted the exiled royals King Umberto II of Italy and Juan Carlos of Spain as family friends.



The Espírito Santo clan had not always kept such privileged company. The family traces its fortune back to a Lisbon lottery ticket stand set up in 1869 by 19-year-old José Maria Espírito Santo e Silva. Legend has it that he was the descendant of a child abandoned at a church by a destitute mother, the surname Espírito Santo meaning "Holy Ghost" in Portuguese.

Under the leadership of Mr Salgado, the exiled family began to rebuild its fortune in Brazil and Switzerland before, in 1991, the Portuguese government invited the family to return, allowing it to buy back a stake in the privatisation of BES. Mr Salgado was made executive chairman.

Senior Portuguese business figures say the roots of the family's eventual financial calamity lie in this period. By using only a small amount of the family's capital in the transaction, Mr Salgado achieved his ambition of regaining control of the bank by taking on large levels of debt.

"They put in practically zero capital from the start, it was always leverage," says one Lisbon banker.

Over the next two decades, as BES doubled its market share, the family began to take on more debt to build up interests in real estate, hotels and agriculture, using their stake in the bank as collateral.

Members of the family were placed in positions of power across BES and the Espírito Santo holding companies, with one former insider noting that up until this year there were about 250 family members working at the lender.

In 2009 the family finalised a convoluted corporate structure for its interests whereby its 25 per cent stake in the bank was held in a Luxembourg-listed company called ESFG, which in turn was 49 per cent owned by the family's ultimate holding entity Espírito Santo International (ESI). Intertwined into this was Rioforte, the privately held family industrial group that controlled its interests in agriculture, hotels and property.

By 2011 the crisis that had forced Portugal into an international bailout was weighing down on the family. The value of its stake in BES had fallen sharply after it was forced to cut its dividend and raise new capital. With Portuguese companies now locked out of the capital markets, bankers say it had become increasingly difficult for the family to service its debt.

"They kept growing the asset base – they bought other stuff, they invested a lot and they never got the returns," says a senior Portuguese business figure. "This was 20 years of leverage compounded, from 1993 to 2014. Leverage works very well if you create value. If you don't create value, it goes very badly so you are like Alice in Wonderland, you have to keep running to stay in the same place."

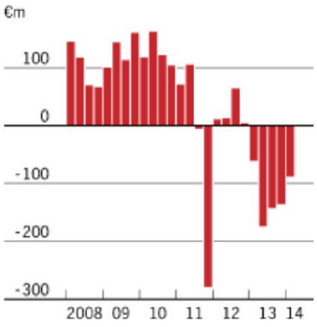
Regulators noticed that Rioforte and other ESI-linked companies had been selling billions of euros' worth of risky short-term debt to BES clients.

"It does seem a little strange that BES was able to raise capital in the market, when other Portuguese banks were not," says an official involved in the investigation. "It is in this phase that the bank began to develop substitutes for the debt and capital that it could no longer raise in the market."

As the European financial crisis deepened, the family was forced to borrow more. By mid-2013 the holding company's vast debt issuance was starting to show in the market.

Net income

A BES-owned fund called Espírito Santo Liquidez marketed to its retail clients had grown to become



Source: Thomson Reuters

the largest fund in Portugal, holding €1.7bn of debt – consisting almost entirely of short-term commercial paper issued by Rioforte and other ESI companies.

"They started moving over to the dark side of the force at some point," says a Portuguese banker familiar with the situation. "All these funds were from 2009 – because of the crisis, they were forced to do other things that were not totally legal as things got worse."

. . .

By November 2013 tensions within the Espírito Santo family were close to breaking point. José Maria Espírito Santo Ricciardi, chief executive of Espírito Santo's investment bank, blamed Mr Salgado – his older cousin – for the mounting problems at ESI.

Mr Ricciardi was one of nine people present at a family council meeting in Lisbon in late 2013. Only the senior representatives of the five branches of the family had a vote, according to people with knowledge of the meeting.

Exasperated, Mr Ricciardi walked out, slamming the door, when he was not allowed to vote against Mr Salgado. His father voted with the other four representatives in unanimous support of the family patriarch.

But having survived the rebellion, Mr Salgado was facing a dire situation at ESI. In its last filing, Rioforte showed it had current debts of €2.9bn, or almost 35 times its declared profits before tax and interest of €84m. Interest charges alone amounted to €89m.

. . .

These towering liabilities were being propped up by questionable assets. The accounting value the company placed on its 49 per cent stake in ESFG was €2.14bn, versus a market value of about €450m at the end of last year.

In August 2013 the Portuguese stock market regulator, alarmed by the growing amount of ESI debt BES had marketed to its clients, passed rules to ban groups from putting more than a fifth of their own securities in a fund.

BES made secret loans to top shareholder

Questions raised over Bank of Portugal's supervision amid revelations undeclared loans were routed through Panama to bank's controlling shareholder, *write Miles Johnson and Peter Wise*

Continue reading

Mr Salgado knew that if he could not find a way to roll over the debt, ESI and Rioforte were going to default. Under immense pressure, he was forced to resign in July this year just before ESI and Rioforte requested protection from creditors. BES, which the Portuguese authorities had repeatedly said was insulated from the family's problems, revealed a loss of €3.6bn, removing the bank from the family's control for a second time.

In transactions regulators are examining as potentially fraudulent, BES had extended hidden credit lines to ESI-linked companies via a subsidiary in Panama. People familiar with the investigation believe as much as €5bn may have travelled through the subsidiary in this way. The Financial Times has seen documents that indicate the arrangement, which was not declared in BES's accounts, had existed since at least 2012.

> As the pressure increased, they allowed the cancer to infect the bank more and more. The cancer was in one place, the brain, but they let it spread across the whole body, and to the bank

These arrangements, hidden from BES investors in off-balance-sheet vehicles and ramped up in the final months before the bank was bailed out, ensured that the troubles of the family's other businesses brought down the bank.

"As the pressure increased, they allowed the cancer [of ESI] to infect the bank more and more," says a Portuguese banker. "The cancer was in one place, the brain, but they let it spread across the whole body, and to the bank."

Mr Salgado said last month that he would not make any public comment until publication of the results of a forensic audit of BES's accounts commissioned by the Bank of Portugal. Daniel Proença de Carvalho, his lawyer, told a Portuguese newspaper that "biased and hasty judgments" were being made about the case, saying that this "breach of the principles of presumption of innocence" was "inappropriate for a civilised democracy".

But as the inquest into the collapse of BES continues, Mr Salgado has retreated from public view, taking two rooms at the five-star Palácio Hotel in Estoril to use as an office a short drive from his home on the coast at Boca do Inferno.

It was at Estoril where the Espírito Santos once entertained royals, business magnates and celebrities. But the family name that had risen from a lottery stand to become one of the grandest in Europe now appears a spent force.

"Everything was built around the Espírito Santo name. It created confidence in people," says one banker. "All that is gone. It's now just a source of bad will."

Angola: Collapse highlights links with former colony

The move to make Banco Espírito Santo's Angolan subsidiary part of the "bad bank" has drawn renewed attention to the links between the Portuguese family empire and the Futungo, Angola's ruling clique, *writes Tom Burgis*.

When BES set up its Angolan bank, known as Besa, in 2001, the former Portuguese colony was nearing the end of three decades of civil war and poised for an oil boom. Angola has since become a hot destination for risk-seeking investors from Portugal, Brazil and China, as well as oil majors. Besa, 55 per cent owned by BES, is among Angola's largest lenders.

But in a country ruled by one party since independence in 1975 – and by one man, President José Eduardo dos Santos, since 1979 – business and politics have been woven together by the ruling elite, named after the old Futungo de Belas presidential palace.

Due diligence investigators and anti-corruption campaigners contend that the interests of members of the Futungo have included minority stakes in Besa. But details are unclear.

A representative of Isabel dos Santos, the president's daughter and Africa's first woman billionaire, said there was "no connection whatsoever" between her and the bank, contradicting press reports that she controls one of its shareholders.

Three senior serving and former officials who have amassed private business interests – including Manuel Vicente, the vice-president – have been named in press reports as having links to Besa. The men did not respond to requests for comment.

Last June António Paulo Kassoma, a former prime minister, was appointed chairman of Besa. In December Angola extended a €5.7bn sovereign guarantee to Besa as it was becoming evident that parts of its loan book were turning sour.

But when Portugal moved to rescue and break up BES, Angola's central bank announced the guarantee would be rescinded. State-appointed administrators would take over the running of Besa, it added.

Portugal's central bank has since shifted BES's €3.3bn credit line to Besa into the healthy rump of the parent bank in the hope of recovering some of it. As a "measure of caution", the Bank of Portugal made provisions for the entire debt to be written off.

RELATED TOPICS European banks

Printed from: http://www.ft.com/cms/s/0/a63a4a56-32c0-11e4-93c6-00144feabdc0.html

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© THE FINANCIAL TIMES LTD 2014 FT and 'Financial Times' are trademarks of The Financial Times Ltd.