Credit Suisse Caught Up in Espírito Santo Mess

Securities That Swiss Bank Helped Put Together Played Role in Toppling Banco Espírito Santo

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Credit Suisse Group AG CSGN.VX +1.00% helped sell billions of dollars of securities that ultimately played a role in toppling Portugal's second-largest bank.

The Swiss bank was responsible for putting together securities that were issued by offshore investment vehicles and then sold to retail customers of Portugal's Banco Espírito Santo SA.

Many customers didn't realize that these vehicles were loaded with debt issued by various Espírito Santo companies and apparently served as a mechanism to finance the family-controlled empire, according to corporate filings and people familiar with Portugal's investigation into the Espírito Santo affair. It is unclear what, if any, direct role Credit Suisse had in selling the securities to bank customers.

Now those investment products are at the center of an unfolding scandal. Banco Espírito Santo was bailed out and broken up this month. Other parts of the Espírito Santo group have filed for bankruptcy amid alleged fraud and accounting problems. In addition to sinking the Portuguese stock market, the episode has undermined confidence in the European banking sector, analysts say.

Representatives of Credit Suisse and Espírito Santo declined to comment.

Portuguese regulators investigating the Espírito Santo mess have identified at least four offshore investment vehicles whose securities, mostly preferred shares, were sold with the help of Credit Suisse to Banco Espírito Santo customers, according to the people familiar with the investigation. Portuguese regulators, who received complaints about the products from customers who didn't understand what they were buying, are now making the bank buy back the securities. That caused crippling losses for the bank.

The offshore vehicles used at least some of the proceeds from selling the securities to buy more Espírito Santo debt, according to corporate filings. Regulators suspect the...
sales were part of an effort to prop up the bank and other Espírito Santo companies, the people say.

Three of the vehicles—named Top Renda, EuroAforro Investments and Poupanca Plus Investments—are based in Jersey, an island tax haven off France's northern coast. Credit Suisse served as "arranger and dealer" for those three vehicles, a role that included not just underwriting securities but also handling administrative and financial needs, according to corporate records filed with the Jersey Financial Services Commission.

A fourth vehicle, EG Premium, is in the British Virgin Islands, also a tax haven.

Portuguese regulators suspect sales of securities Credit Suisse put together were part of an effort to prop up Banco Espírito Santo. The securities were issued by offshore vehicles loaded with Espírito debt. Zuma Press

The people familiar with the investigation say all four entities are controlled, at least in part, by Swiss financial company Eurofin Holding SA, which was part-owned by Espírito Santo until 2009 and has had close business ties to the collapsed conglomerate. Portuguese regulators suspect Eurofin played a central role in Espírito Santo's financing and ultimate collapse, according to a person familiar with the investigation.

Eurofin said in a statement last week that it didn't sell or promote any investment products to Espírito Santo clients and that it has never designed products for retail customers. Eurofin also has denied playing a central role in the Espírito Santo situation.

It isn't clear who owns the four investment vehicles. Representatives of the trust company listed as custodian of the three Jersey entities didn't respond to requests for comment.
The vehicles invested primarily in debt issued by Espírito Santo companies, including the Portuguese bank, its Luxembourg-based parent and an Angolan mining- and infrastructure-investment company called Escom, according to corporate filings and internal Eurofin documents reviewed by The Wall Street Journal.

Poupanca, for example, reported a total of €426 million (about $570 million) in assets last year, about €1.3 million of which was in cash and money it was owed. The remaining €425 million was investments in long-term bonds issued by Espírito Santo companies, according to Poupanca's financial statements. Top Renda and EuroAforro's balance sheets consist of similar proportions of Espírito Santo debt. EG Premium was also a big buyer of Espírito Santo bonds, according to internal fund documents.

The annual reports of the three Jersey vehicles, which have been operating for more than a decade, say their "sole purpose" is issuing preferred shares, which are a cross between unsecured debt and equity.

The vehicles regularly issued new series of preferred shares in relatively small batches, sometimes just €30 million, according to filings. Each series of securities was marketed to small groups of Banco Espírito Santo clients via the bank's branches, according to one of the people familiar with the investigation. The small number of clients meant that, under Portuguese rules, there didn't need to be a fund prospectus detailing the composition of the securities, the person said.

Portuguese regulators believe the vehicles were designed to appeal to retail customers. "Aforro" and "poupanca" mean "savings" in Portuguese. "Top Renda" means "Top Income." Bank branch managers told retail customers that the products were as safe as deposits but with better returns, the person said.

The sale of preference shares allowed the vehicles to keep buying Espírito Santo debt. In February, for example, EuroAforro sold €182 million of preference shares, according to a corporate filing. It used the proceeds, as well as cash and money received from selling other unspecified assets, to buy €476 million of Banco Espírito Santo debt and about €82 million of EG Premium preference shares, the filing shows.

Credit Suisse had agreements dating back to the mid-2000s with EuroAforro and Top Renda to handle the issuance of up to $2.5 billion of each of their preference shares, according to corporate filings. Those programs were still active as recently as last year, filings indicate. Credit Suisse also has been responsible for Poupanca's preferred-share sales, according to filings.

Credit Suisse also was responsible for paying the three vehicles' operating expenses, including legal and audit fees and administrative costs, according to filings. Those expenses totaled tens of thousands of dollars a year.

Portugal's markets regulator late last year started examining the offshore vehicles' products after hearing from Banco Espírito Santo customers who were confused about what they had invested in, according to the person familiar with the investigation.

By early summer of this year, regulators had determined that about €2 billion of the vehicles' products were currently held by Banco Espírito Santo customers, the person said. Much of that had been sold to customers earlier this year, months after Portugal's
central bank ordered Banco Espírito Santo to curtail its ties to other Espírito Santo entities.

Bank of Portugal Governor Carlos Costa said late last month that Banco Espírito Santo would have to buy back some of those products from clients, causing €1.25 billion in losses for the bank. Those losses helped topple the bank, which was bailed out early this month.

Mr. Costa said Eurofin was involved in the placement of securities to clients that caused the €1.25 billion loss. He also said the central bank is investigating why Banco Espírito Santo apparently didn’t comply with orders to reduce exposure to other Espírito Santo entities.

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