EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Danièle NOUY

Chair of the Supervisory Board

COURTESY TRANSLATION

Mr Marco Zanni
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 20 July 2017

Re: Your letter (QZ050)

Honourable Member of the European Parliament, dear Mr Zanni,

Thank you for your letter regarding Banco Popular Español, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 9 June 2017.

As laid down in the Interinstitutional Agreement between the European Parliament and the European Central Bank (ECB), any reporting obligations vis-à-vis the European Parliament are subject to the relevant professional secrecy requirements as outlined in the Capital Requirements Directive IV[1]. These rules also apply to information about banks which the ECB determined to be failing or likely to fail. While I cannot disclose confidential information, let me nevertheless provide you with some relevant considerations in response to your question.

The recent liquidity crisis experienced by Banco Popular Español S.A. was idiosyncratic and was triggered by a series of events over the recent months, including:

- In February 2017 the institution disclosed the need for extraordinary provisions amounting to €5,700 million, leading to losses of €3,485 million in 2016, and appointed a new chairman;
- On 10 February 2017 DBRS downgraded the rating of the institution;
- On 14 February 2017 Fitch downgraded the rating of the institution;
- On 3 April 2017 the institution released an ad-hoc public statement on the outcome of several internal audits with a potentially significant impact on its financial statements and confirmed that it would replace its chief executive officer after less than one year in office;
- On 7 April 2017 Standard & Poor's downgraded the rating of the institution;

[1] Directive 2013/36/EU of the European Parliament and of the Council

- On 10 April 2017 the institution announced that it would not pay dividends and that a capital increase or a corporate transaction could be required owing to the group's tight capital position and the level of its non-performing assets;
- On 21 April 2017 Moody's downgraded the rating of the institution;
- On 3 May 2017 the group disclosed its quarterly results for the first quarter of 2017, which underperformed market expectations;
- On 31 May it was disclosed in the media that the bank could face a wind-down process if the ongoing sale process was not finalised in the very short term;
- On 6 June 2017 DBRS and Moody's downgraded the rating of the institution.

The ECB has continuously monitored the situation, increasing the frequency of that monitoring when the situation became more critical, i.e. daily since the beginning of April. In particular, the monitoring of the liquidity coverage ratio was one of the supervisory tools used to assess liquidity risk.

On 6 June 2017 the significant deterioration of the liquidity situation of Banco Popular Español S.A. led to the determination that the entity would have, in the near future, been unable to pay its debts or other liabilities as they fell due. This situation made it impossible to delay the failing-or-likely-to-fail decision until the weekend, as there were no alternative supervisory or early intervention measures available which could have prevented the failure. Consequently, the ECB determined that the bank was failing or likely to fail in accordance with Article 18(1) of the Single Resolution Mechanism Regulation (SRMR)[2] and duly informed the Single Resolution Board, which adopted a resolution scheme entailing the sale of business. The resolution by sale of business was implemented by the resolution authorities having regard to the results of the valuation of the institution which was carried out specifically for that purpose in accordance with Article 20 of the SRMR. This type of valuation, which is consistent with the goals of the resolution, is transaction-specific and, thus, should not be considered as an assessment of the capital position of Banco Popular Español S.A. on a stand-alone basis.

The aforementioned ECB decision that the bank was failing or likely to fail was taken on the basis of insufficient liquidity. At this time, the objective elements[3] were not sufficient for the ECB to determine that the institution was failing or likely to fail on the basis of its capital position. Of course, the ECB had been closely monitoring not only the liquidity but also the capital position of the bank. Its structural problems (high level of non-performing assets, low coverage, poor profitability) were reflected in commensurate capital requirements established by the ECB. This capital demand reflected, inter alia, the results of the 2016 EBA stress test, which revealed that Banco Popular Español S.A would suffer a significant impact under a stress scenario. It had performed the worst in Spain and the third worst in the whole sample in terms of its CET1 ratio under the adverse scenario. However, it would not be correct to single out the EBA stress test results as the ultimate supervisory indicator of the health of an institution. In particular, the stress test was not a pass or fail exercise; rather it was conceived as input to the Supervisory Review and Evaluation Process

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[2] Regulation (EU) No 806/2014 of the European Parliament and of the Council

[3] EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU: https://www.eba.europa.eu/documents/10180/1085517/EBA-GL-2015-07+GL+on+failing+or+likely+to+fail.pdf

(SREP) decision and was reflected in the 2016 SREP decision in the form of Pillar 2 guidance. Therefore, the stress test exercise needs to be interpreted together with the other tools available to supervisors, such as asset quality reviews, on-site and internal model investigations, as well as other ongoing supervisory monitoring activities. Its ultimate goal can neither be to assess the economic value of the bank as a whole from a gone concern perspective, nor to anticipate the impact of an idiosyncratic run on a bank. Instead, it is a tool designed to cast light on the resilience of institutions to certain adverse macroeconomic scenarios which may or may not materialise.

Yours sincerely,
[signed]

Danièle Nouy