



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

## Notice

The ECB has decided to publish non-confidential versions of its 'Failing or Likely to Fail' assessments for transparency and accountability purposes in view of their general interest while removing confidential information to comply with the professional secrecy rules governing supervisory work. The 'Failing or Likely to Fail' assessments were first announced in press releases and referenced in the subsequent decisions by the Single Resolution Board. The publication of non-confidential 'Failing or Likely to Fail' assessments is an exception to the general communications policy of the ECB, which, in line with the law, does not foresee publication of individual supervisory decisions that are protected by professional secrecy rules.

## Note

In the following pages, at point 7.d, the reference made to the 'disclosure of worse-than expected quarterly results (3 May)' at Banco Popular Español contains a typographical error. The disclosure took place on 5 May, not 3 May.

Press Release:

<https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170607.en.html>

*This is a non-confidential version of the ECB Failing or Likely to Fail assessment adopted by the ECB on 6 June.*

*Information protected by professional secrecy and confidentiality rules inherent to banking supervision has been blanked out. Considering confidentiality limitations, the information published in this non-confidential version may not give a comprehensive view of the supervisory history or the actions undertaken.*

## **‘Failing or Likely to Fail’ Assessment of Banco Popular Español**

### **Introduction**

1. Pursuant to Article 18(4) of Regulation (EU) 806/2014 (the SRM Regulation – SRMR) an institution shall be deemed to be ‘Failing or Likely to Fail’ (FOLTF) in one or more of the following circumstances:
  - a) the entity infringes, or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the ECB, including but not limited to the fact that the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;
  - b) the assets of the entity are, or there are objective elements to support a determination that the assets of the entity will, in the near future, be less than its liabilities;
  - c) the entity is, or there are objective elements to support a determination that the entity will, in the near future, be unable to pay its debts or other liabilities as they fall due;
  - d) extraordinary public financial support is required (state aid) with certain exceptions.
2. The assessment of FOLTF shall be made by the ECB, after consulting the SRB, in accordance with Article 18(1) subparagraph 2 of the SRMR.

### **Status and assessment of the Supervised Entity’s liquidity position**

3. Over the past months, the Supervised Entity has experienced a substantial deterioration of its liquidity position, primarily driven by a significant depletion of its deposit base. The Supervised Entity has been confronted with material cash outflows across all customer segments [...].
4. [...] **[Assessment of liquidity outflows]** The events which led to the acute liquidity problems currently faced by the Supervised Entity are listed in more detail below.

5. The Supervised Entity has attracted particular [...]attention due to low profitability, bad quality of assets and low coverage compared to peers, ([...] coverage of 45% as of 31-March-2017) [...], and since January has been subject to negative media coverage on an on-going basis, including but not limited to:
- a. speculation concerning the resignation of the bank's directors and senior managers;
  - b. significant negative profit for 2016 and losses still recorded in Q1 2017;
  - c. the solvency position of the Supervised Entity based on a fully loaded basis and the lack of profitability;
  - d. announcement by the bank on the need for a capital increase or a corporate transaction;
  - e. announcement by the bank of restatement of 2016 financial accounts due to accounting inaccuracies;
  - f. uncertainty regarding both the high level of NPAs, which the bank has not been able to reduce over the last years and their coverage [...].
6. In February, when presenting 2016 annual accounts, the Supervised Entity disclosed the need for extraordinary provisions in an amount of €5,700 million leading to losses of €3,485 million for 2016, and replaced long-standing chairman Angel Ron by Emilio Saracho (formerly Vice President of JP Morgan) who initiated a revision of the institution's strategy set by the former management. The announcement of additional provisions and year-end losses induced a rating downgrade by DBRS (10 February)<sup>1</sup> and caused significant concerns on the side of the Supervised Entity's customer base which were reflected by material unexpected deposit withdrawals and a high frequency of customer visits to the Supervised Entity's branches.
7. [...] the release of an ad-hoc disclosure on 3 April informing about the outcome of several internal audits with potentially significant impact on the bank's financial statements and the confirmation that the bank's Chief Executive Officer (CEO) would be replaced after less than one year in office, has triggered another wave of deposit outflows that has not come to a halt so far and which has been further fuelled by:
- a. a rating downgrade by S&P (7 April)<sup>2</sup>;

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<sup>1</sup>Rating excerpt: "The downgrade of the Senior Unsecured Long-Term Debt & Deposit ratings reflects DBRS's concerns over Popular's weakened capital position following a higher than anticipated net loss of EUR 3.5 billion in 2016, which was announced on February 3, 2017. As a result, the Bank's fully loaded Common Equity Tier 1 (CET1) ratio deteriorated to 8.17% at end-2016 from 10.9% at end-2015, in spite of the EUR 2.5 billion capital increase completed in April 2016. The current level of capital is well below DBRS's expectations and compares unfavourably with similarly rated European and domestic peers. The downgrade also reflects the continued challenges that the Bank is facing that were evident in the Bank's results, particularly the Bank's struggle to materially reduce its still elevated stock of non-performing assets (NPA) as indicated by the slow pace of NPA reduction in 2016. At end-2016, the Bank had NPAs of around EUR 35 billion, representing around 29% of total gross loans and foreclosed assets". Source: DBRS Downgrades Popular's Senior Ratings to BBB, Negative Trend.

<sup>2</sup> Rating excerpt: "S&P ratings on Popular reflect its higher credit risk and worse asset quality than the Spanish banking sector average. Popular's stock of nonperforming assets (NPAs) peaked at 36.7% of gross loans at end-2016, compared to our 15% estimate for the system. While we expect some improvement, we believe that Popular's NPA ratio will remain significantly higher than that of the system in 2017. In addition, its 46% coverage of NPAs is below that of peers. S&P ratings also reflect Popular's weak capitalization to absorb unexpected losses, and our view of its limited ability to generate capital organically and financial flexibility. The €2.5 billion rights issue completed in June 2016 was more than offset by the €3.5 billion losses reported in 2016. It has also recently announced additional provisions and regulatory capital adjustments that will lower its total capital ratio to 11.70%-11.85% for first-quarter 2017, compared to its 11.375% supervisory review and evaluation process (SREP) requirement. Given its weaker financial situation, we believe that Popular is ultimately more vulnerable to adverse developments in the funding markets. The bank also relies to a greater extent than peers on short-

- b. an announcement that the bank would not pay dividends and that a capital increase or corporate transaction could be required due to the Supervised Entity's tight capital position and the necessary alignment of the NPA's coverage<sup>3</sup> to its peers (10 April);
  - c. a rating downgrade by Moody's (21 April)<sup>4</sup>;
  - d. the disclosure of worse-than expected quarterly results (3 May);
  - e. Continuous negative press coverage, as for example articles on 11 May<sup>5</sup> and 15 May<sup>6</sup> that suggested that the Supervised Entity has mandated an urgent sale of the bank due to the imminent risk of bankruptcy/illiquidity, and that the bank was confronted with significant additional need for provisioning resulting from an on-going on-site inspection by the supervisor.
8. [...]The deposits lost since 31 May are particularly relevant, once it was disclosed in the media that the bank might face wind-down if the on-going sale process is not fruitful in the very short term [...].
9. [...].
10. [...].
11. [...].
12. [...].**[Paragraphs 9 to 12 relate to the assessment of counter balancing and funding capacity as well as of the liquidity situation]**
13. [...]. While the Supervised Entity has developed various additional liquidity generating measures over the past weeks [...]and started to implement them, the magnitude of the realised and still expected inflows are insufficient to remediate the on-going depletion of the institution's liquidity position.
14. On 5th of June the GovC, based on a request from Bank of Spain (BdE), did not object to grant ELA [...]. [...], Even with the recourse to ELA, the current liquidity situation does thus not suffice to ensure the Supervised Entity's ability to meet its liabilities due within the course of 7th of June. [...]  
**[Description of additional expected liquidity outflows].**
15. The Supervised Entity has a subsidiary in Portugal, Banco Popular Portugal, which is supervised by the ECB. [...] **[Description of the funding situation of Banco Popular Portugal]** .

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term funding (equivalent to 39% of total wholesale funds at end-2016) and pays somewhat above-average rates on new retail deposits. Finally, since the announcement of the rights issue, Popular has shown some disagreements between its major shareholders. This led to the departure of the chairman, with a replacement having just taken office. In addition, the bank has just announced that its CEO will be stepping down, only a few months after his appointment. Our ratings are supported by Popular's solid franchise in the Spanish SME segment, with an 18% market share. This is around 10% higher than its natural market share." Source: [S&P Full Analysis \(11/04/2017\)](#).

<sup>3</sup> BPE's NPA ratio (including NPL and Foreclosed assets) stands at [...](-€37bln gross NPAs) as of March 2017 with a 45% coverage ratio, showing a substantial coverage gap to peers (the implicit gap goes from €2.5bln to €5bln compared to average and best in class, respectively; already disclosed by the bank).

<sup>4</sup> Rating excerpt: "The rating action follows the announcement on 3 April 2017 of needed adjustments to 2016 financials and reflects Moody's heightened concerns regarding Banco Popular's creditworthiness, namely its weakened solvency levels, which are rapidly deteriorating against the background of still very significant asset quality challenges. The rating agency notes that Banco Popular's capitalisation buffers have been further eroded since year-end 2016 and that the bank's total capital ratio (TCR) has come closer to its regulatory capital threshold. The rating agency's increasing concerns regarding Banco Popular's ability to comply with regulatory capital requirements on an ongoing basis have led to downgrade the bank's long-term ratings by two notches. Moody's believes that the bank is under increasing pressure to urgently improve its risk-absorption capacity and accelerate the execution of its de-risking strategy." Source: Moody's - Moody's downgrades Banco Popular's senior unsecured debt ratings to B1 and deposit ratings to Ba3, outlook negative.

<sup>5</sup> [Saracho encarga la venta urgente del Popular a JP Morgan y Lazard](#)

<sup>6</sup> [El BCE inspecciona a Banco Popular durante dos meses en pleno proceso de venta](#)

16. [...] **[Assessment of the impact on the Supervised Entity's liquidity of the funding and operating structure of the group].**

*Proportionality and limited scope for alternative liquidity measures*

17. As described above, the Supervised Entity currently has very limited options to obtain funding via regular market transactions or central bank operations and is not capable of mobilising sufficient additional liquidity via the measures foreseen in its contingency funding and recovery plans. The Supervised Entity has already put in place several measures to correct the liquidity position [...]. Nevertheless, these measures have finally not been sufficient to reverse the deterioration of the liquidity position of the Supervised Entity.

18. As an alternative measure to ensure the capacity to meet all liabilities as they fall due, the Supervised Entity is currently trying to implement a corporate transaction, i.e. its sale to a stronger competitor. However, considering the most recent and so far on-going deterioration of its liquidity position, taking into account that there is no evidence of the capacity of the Supervised Entity to turn around its liquidity situation in the near future, together with the fact that negotiations have so far not yet lead to a positive outcome, a confirmation of such a private transaction is not foreseeable in a timeframe that allows the Supervised Entity to be able to pay its debts or other liabilities as they fall due.

19. At the same time, there are no available supervisory or early intervention measures that could restore the liquidity position of the Supervised Entity in an immediate way and allow it to ensure sufficient time in order to implement a corporate transaction or other solution. The available measures to the ECB as competent authority under the national transposition of Article 104 of Directive 2013/36/EU (CRD IV) and Article 27-29 of Directive 2014/59/EU (BRRD) or under Article 16 of Regulation (EU) No 1024/2013 (the SSM Regulation) cannot ensure that the institution will be in a position to meet its liabilities and other debt as they fall due, given the extent and pace of the liquidity deterioration observed.

*Given the above, particularly the excessive deposit outflows, the speed at which liquidity is being lost from the bank and the inability of the bank to generate further liquidity, there are objective elements indicating that the Supervised Entity is likely in the near future to be unable to pay its debts or other liabilities as they fall due. Therefore, the Supervised Entity is deemed to be failing, or in any case likely to fail in the near future, in accordance with Article 18(1)(a) and 18(4)(c) of the SRMR. According to Article 18(1) of the SRMR, it is necessary for the ECB to consult the SRB prior to finalising its FOLTF assessment.*

Moreover, on 6 June 2017, [...]the Supervised Entity communicated to the ECB that the Board of Directors reached the conclusion that the bank is likely to fail [...] **[Content of the communication of the Supervised Entity to the Supervisor].**

## Annex 1A: Background information on the status of the Supervised Entity's capital position

Based on Q1 2017 financial statements [...] Common Equity Tier 1, Tier 1 and Total Capital Ratios of the Supervised Entity are 10.02%, 10.87% and 11.91% respectively as of 31 March 2017 on a consolidated basis. [...] **[Description and assessment of Q1 2017 capital situation]**

Capital requirements	CET1	T1	Total Capital
Minimum regulatory requirements (Art. 92 CRR)	4.50%	6.00%	8.00%
Pillar 2 Requirement (P2R)	2.00%	2.00%	2.00%
<b>Minimum requirements</b>	<b>6.50%</b>	<b>8.00%</b>	<b>10.00%</b>
Capital Conservation Buffer (CCB)	1.25%	1.25%	1.25%
S-SIB buffer	0.125%	0.125%	0.125%
<b>MDA</b>	<b>7.875%</b>	<b>9.375%</b>	<b>11.375%</b>
Pillar 2 Guidance	[...]	[...]	[...]
<b>P2G</b>	[...]	[...]	[...]
Capital Supply at 31.03.2017 on a consolidated basis	10.02%	10.87%	11.91%
Capital Supply at 31.03.2017 on a solo basis	[...]	[...]	[...]

The Supervised Entity has failed – so far - to address the issues generated by the high NPA portfolio, amounting to €37 billion [...] with a coverage ratio of 45%, despite the extraordinary provisions booked in 2016 (€ 5,7 billion). Despite a stock of impairments amounting to € 17 billion in Q1 2017, no significant NPA reduction has been achieved.

[...] **[Forward looking assessment of capital situation]**

The bank has announced to the market that they will address the capital need through either a capital increase combined with the sale of non-strategic assets or a corporate transaction before year-end.

Moreover, on 6 June 2017, [...] the Supervised Entity communicated to the ECB that the Board of Directors reached the conclusion that the bank is likely to fail [...] **[Content of the communication of the Supervised Entity to the Supervisor]**.

