

**Inquiry Committee on the financial crisis in Spain and  
the financial assistance programme – Congress of  
Deputies of Spain**

Elke König, Chair of the Single Resolution Board

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Chair, Honourable Members of Parliament,

Thank you very much for the opportunity to speak to you today. I address all of you as representatives of the sovereignty of Spain and therefore as custodians of the public interest.

Before focusing on the Banco Popular resolution case, I would like to take this opportunity to present you the Single Resolution Mechanism, the work accomplished, as well as the work ahead of us as I did already with several National Parliaments.

A core lesson of the financial crisis was that legislators needed to introduce rules to avoid that taxpayers have to bail out failing banks in lack of any better option. With this in mind, the Single Resolution Mechanism was built as the second pillar within the framework of the Banking Union; the Single Supervisory Mechanism being the first pillar.

The mission of the SRB is to ensure an orderly resolution of failing banks with minimum impact on the real economy, the financial system, and the public finances of the participating Member States and beyond. Together with the National Resolution Authorities ("NRAs") of participating Member States, the SRB forms the Single Resolution Mechanism.

The SRB works closely not only with the NRAs, but also with the European Commission, the European Central Bank, the European Banking Authority and national competent authorities.

The SRM framework and its decision-making process, when addressing resolution topics, requires the involvement of the relevant national resolution authority. In today's discussion, in line with the SRM Regulation, FROB is represented by Mr. Ponce, as Chair of the Spanish resolution authority and in his capacity as a member of the Plenary and – where appropriate – the Executive Sessions of the SRB.

The SRB has 142 banks or banking groups under its direct remit. The SRB aims to build their resolvability by designing resolution plans for these groups and thereby fostering preparedness for the management of a potential future crisis affecting a bank. To this end, the SRB is continuously coordinating with other resolution authorities, both within the EU and globally.

The ultimate task of the SRB is to intervene when a bank is 'Failing or Likely to Fail', and such intervention is necessary for the achievement of the resolution objectives; in particular, to prevent severe negative effects on the stability of the financial system and to protect critical functions.

Resolution is a specific procedure, which was introduced as an alternative to the national insolvency regimes in order to serve the public interest in particular circumstances. When a bank is declared 'Failing or Likely to Fail' and there are no private solutions available to prevent that failure, that bank – like any other enterprise – would enter into normal insolvency proceedings. However, since a liquidation of a bank may have severe consequences for financial stability and the real economy, a dedicated resolution framework was put in place; the BRRD and the SRMR.

It is an illusion to think that resolution can eliminate the cost, which is inherent in the failure of a bank. But the resolution framework for the Banking Union introduces an orderly and fair distribution of the cost of the resolution; ensuring that shareholders will bear losses first and creditors bear losses after shareholders, in the order of their priority.

This framework is based on the principle of acknowledgement of chances and risk in the purchase of shares and debt instruments. Chances and risks have to stay aligned. Shareholders and bondholders are aware of the intrinsic risk that the purchase of said instruments entails.

It goes without saying that a resolution action – as any insolvency proceedings – is by nature 'intrusive'. However, resolution provides the tools to tackle negative external effects of the failure of a bank, if the insolvency proceedings cannot sufficiently safeguard the public interest in the specific circumstances. In particular, the resolution framework is designed to enable the resolution authorities to intervene swiftly, to allocate the cost of failure appropriately and avoid that taxpayers face the cost of a bank failure. Bail-in and not bail-out has to be the norm.

Let me explain the conditions that must be met to put an entity into resolution: The entity is 'Failing or Likely to Fail'. There are no supervisory or private sector measures that could restore the bank to viability within the available timeframe. And: Resolution is necessary in the public interest, which means that the resolution

objectives would not be met to the same extent if the bank were wound up under normal insolvency proceedings.

The BRRD and the SRM Regulation set the following resolution objectives:

- to ensure the continuity of critical functions;
- to avoid significant adverse effects on financial stability;
- to protect public funds by minimising reliance on extraordinary public financial support;
- to protect covered depositors and covered investors and;
- to protect client funds and client assets.

The SRB shall also take into account these resolution objectives when choosing the resolution tools and resolution powers to be applied. Therefore, when taking a resolution decision the SRB has to weigh all arguments to choose the tool(s) that best achieve(s) these objectives.

In addition to the above resolution objectives, the resolution framework contains safeguards in order to ensure that, in any case, creditors cannot be worse off in resolution than in insolvency. In other words, the framework is designed in such a way that it ensures that creditors cannot incur greater losses than they would have incurred under a counterfactual insolvency proceeding.

With this in mind, let me now move to the SRB's first resolution decision, the sale of Banco Popular to Banco Santander.

BPE was failing on the evening of 6 June 2017, as the bank had experienced serious outflows of liquidity in the previous weeks or even months, and had to acknowledge on that evening that it would not be in a position to match its liquidity outflows on the next day. There was simply no liquidity left. On 6 June the ECB concluded that BPE was failing and also BPE itself communicated to the ECB that it considered it was 'Failing or likely to Fail'.

Since there were no alternative measures available that could have prevented BPE's failure within the available timeframe, the SRB, as the resolution authority, in cooperation with FROB and with the European Commission, had to act swiftly. In particular, the SRB had to decide between the two options I talked about earlier: to intervene by taking resolution action or, to let the bank enter into normal insolvency proceedings under Spanish law.

The Board, in close consultation with FROB and also Bank of Portugal, decided that it was in the public interest to take resolution action.

I would like to stress that, if the SRB had not taken resolution action, BPE's banking license would have been withdrawn and BPE would no longer have been able to continue its banking activities:

- BPE would no longer have been able to grant loans,
- nor would it have been able to carry out payment and cash services.

This would have affected not only large enterprises, but also a large number of small and medium-sized companies ("SMEs") that play an important role in Spain's economy, as well as families and individuals. If functions of BPE – which are essential for the real economy in Spain – had been suddenly interrupted due to the start of insolvency proceedings, this would likely have had a material negative effect on BPE's clients and a knock on effect on the real economy of Spain. It could have led to contagion to other banks and to an increased uncertainty and mistrust in the financial system. This could have been the case not only in Spain but also beyond: BPE's subsidiary in Portugal was most likely to be negatively affected in case of a liquidation of BPE.

Every resolution action is unique. After analysing the available resolution tools and combinations of tools, the SRB Board – together with FROB and also Bank of Portugal - considered that in the given situation, the sale of business tool would be the most effective tool to reach the resolution objectives.

The rapid outflow of liquidity required swift action to protect the continuity of the bank's critical functions and to prevent risks to financial stability. We considered it essential to apply a resolution tool that could preserve financial stability in an effective manner by immediately restoring sufficient trust in the bank, and that would ensure that BPE would be able to continue to provide services, which were essential for the real economy.

Due to the good preparation and cooperation between the relevant institutions (first and foremost FROB, but also the ECB, Bank of Portugal and the European Commission) ahead of the decision, we felt confident that we could take the resolution action successfully overnight.

FROB participated fully in the decision making process in line with the SRM Regulation, and was subsequently responsible for the implementation of the resolution decision. The close cooperation between the SRB and FROB was crucial for the successful outcome. Of utmost importance was not only the precise coordination, but also the expertise and excellent preparedness that FROB demonstrated. It was not only key for the efficient decision making process, but also for the swift implementation of the resolution scheme at national level.

By selling BPE to a strong banking group like Banco Santander that was in the position to immediately inject sufficient liquidity, BPE could continue operating

under normal business conditions. The bank opened on the morning of 7 June, and people were able to deposit and draw money from BPE and to receive loans like on any other day. By applying the sale of business tool, the SRB managed to protect the depositors, senior bondholders and clients of the bank and safeguarded financial stability in Spain and beyond, without using any State aid.

In line with the BRRD and the SRM Regulation, the resolution scheme was developed in close cooperation with the relevant national authorities, adopted by the SRB's Board and endorsed by the European Commission.

When preparing for resolution, the SRB is required by the SRM Regulation to contract an independent valuer to perform a valuation with the purpose of facilitating and informing the SRB's resolution actions. If need be, the decision of the resolution authority can be based on a provisional report prepared either by an independent expert or by the SRB itself.

In the case of BPE, the SRB hired Deloitte as an independent expert to provide it with a valuation report. Deloitte is a reputable valuation expert of international standing; it was selected following a clear process under rigorous procurement rules.

When procuring the relevant valuation services, the rules for avoiding conflicts of interest foreseen in the EU law have been strictly followed. With a view to cover the diverse expertise needed at the time of resolution, the SRB launched in October 2015 an open call for tenders for valuation services. Following this procurement procedure, in April 2016, a panel of six firms with valuation expertise was established. Deloitte is one of our panel firms. Since then, each time there is a need to hire one of these firms for a specific assignment, the SRB follows a clear process under the procurement rules. This procedure ensures that the SRB does not act arbitrarily: First, the SRB checks whether the contractors are not in a conflict of interest regarding the relevant bank; the law contains specific requirements pertaining to the independence of the valuer. Thereafter, the SRB sends the request for services to all non-conflicted contractors and asks them to submit an offer with respect to the specific assignment. The submitted offers are evaluated according to pre-established criteria and the contract is awarded to the bidder presenting the best offer.

The independent valuer prepares the valuation report, which is a document that informs the SRB of the economic value of the assets and liabilities of the bank under conservative assumptions. The purpose of the valuation differs depending on the resolution tool. When the sale of business tool is considered, as was the case for BPE, the valuation report informs the SRB's understanding of what would constitute commercial terms for the sale of business tool through an open, fair, and competitive sale process.

To be clear, the valuation must be distinguished from the purchase price. This price is not established by the SRB on the basis of the valuation report, but by the buyer on the basis of a competitive marketing process. The price offered by the buyer is a reflection of the market's perception with regard to the value of transferred instruments; this determines any consideration to be paid to the previous owners of the instruments.

The SRB, in cooperation with FROB, ensured that the marketing process was carried out in an appropriate manner. In particular, the SRB and FROB decided to contact the five potential purchasers who had expressed their initial interest during the private sale process conducted by the bank. The bank's previous attempts to find a buyer were a solid base for the SRB and FROB to build on.

Out of the five potential purchasers, only two continued the process and were granted access to the virtual data room of the bank and in the end only Banco Santander submitted an offer. The offered price of 1 EUR took into account that prior to the transfer, the SRB would exercise its powers:

- to write down the existing shares of BPE, to convert the Additional Tier 1 instruments of BPE into shares, and write them down and
- to convert the Tier 2 instruments to new shares of BPE. These new shares were then transferred for 1 EUR.

The offered price of 1 EUR was considered to be in line with the commercial terms that were appropriate in light of the valuation performed by the independent valuer and the circumstances of the case.

On the day of the acquisition, Santander injected several billions of liquidity. This was necessary to restore the confidence of the market in BPE and to comply with its regulatory liquidity requirements. And subsequently Santander had to inject a substantial amount of capital into BPE in order to comply with its solvency requirements.

Lastly – as mentioned before - it has to be kept in mind that the NCWO principle is intrinsic in the BRRD and the SRM Regulation, i.e. that no creditor incurs greater losses than he would have incurred in case of insolvency. An ex post valuation 3, the so called 'No creditors worse off' valuation, is currently being conducted by the independent expert. It is expected to be available in early 2018.

If the valuation 3 concludes that shareholders and creditors were worse off in resolution than they would have been in case of insolvency, the SRB is required by law to provide for compensation of the difference.

Resolution is intrusive and inevitably leads to legal actions. It is, as we can see now, a feast for lawyers, who challenge not only the legal actions of the EU and national authorities involved in such a decision but also the legality of the EU resolution framework as a whole. It is ultimately for the European Courts to decide on such actions directed against the SRB's resolution scheme.

One of the main issues arising in the post resolution development was the appropriate level of public access to the relevant documents underpinning the above decision. The SRB respected the SRM Regulation when publishing immediately after the decision a short version of it, summing up its main elements. Thereafter we published a redacted version of the resolution decision.

When assessing the issue, the SRB had due regard to the protection of the public interest as regards the stability of the financial system of the Banking Union and the financial or economic policy of the Union and beyond, including the policy relating to the resolution of credit institutions. In this regard, we considered that the resolution decision and the valuation report contain information the disclosure of which could undermine the above public interest. In particular, sections of the resolution decision referring to elements of resolution planning and the choice of the resolution strategy, as well as considerations relating to the assessment of the conditions for resolution, could give rise to adverse market reactions.

It should also be noted that documents such as the resolution decision and the valuation report contain business information of BPE which remain confidential as the entity is still active, now as part of Grupo Santander.

Regarding the disclosure of documents, the independent Appeal Panel of the SRB decided about 10 days ago, that the SRB's prudent stance was justified but that the SRB should nevertheless publish certain non-sensitive parts of the valuation report. We are currently assessing the Appeal Panel's decisions with a view to publish on our website, hopefully before year end, a redacted version of the valuation report and some additional features of our resolution decision.

The treatment of these documents with regard to their confidential nature is also among the issues currently being assessed in judicial proceedings at the European level.

Today we can conclude that the situation of the banking sector is much stronger. As reported in the recent Surveillance report of the European Commission, the resolution scheme for Banco Popular has been successfully implemented. The decision added to the stability of the Spanish financial sector and demonstrated that the new European resolution framework is functioning. The bank was resolved in a proper and timely manner within a very short timeframe, with no losses for depositors or taxpayers and with good coordination among all the national and EU

authorities involved. Most importantly, stability in the Spanish financial sector was not endangered.

Furthermore, safeguarding the existence of the bank now integrated into a larger group such as Santander, in addition to protecting deposits, clients and senior bondholders, has meant maintaining the employment of a large number of people. Additionally, the SMEs and companies that were clients of Banco Popular have been able to continue their daily operations.

Resolution should remain the exception – I think we all agree. The role of the SRB is primarily preventive and proactive, focusing on resolution planning and preparation with a forward-looking mind-set. Banks that are well prepared for critical situations will generally be more resilient in the first place.

Concretely, at the latest by 2020, the SRB will have developed complete resolution plans for all the banking groups under its direct remit, plans with the highest degree of sophistication under our framework. Until then, the SRB envisages intermediate stages for resolution plans which will be gradually refined until they reach the ultimate stage. Let me be clear that we already have plans for the vast majority of our banks – it is now about enhancing and enriching them with more detail –, for example tackling possible impediments to resolvability. Let me also add that a resolution plan is by essence a living document and has to be reviewed yearly to take into account all the changes coming from the bank itself and its environment, including the regulatory evolutions. In that sense, the resolution plans will never be final.

The resolution framework requires banks to comply with the ‘minimum requirements of own funds and eligible liabilities’ the so called MREL, in order to be able to absorb losses and restore capital levels so that the entity can continue to perform its critical functions during and after its crisis. Setting MREL is thus an integral part of the resolution planning task. MREL is key to achieving the resolvability of entities.

The SRB has taken a proportionate, multi-year approach to MREL setting. In 2017 we are setting binding MREL targets for the largest and most complex groups under our remit on a consolidated level, and we will continue to enhance our MREL policy in 2018, in line with the rules set out in the SRM Regulation and the Commission’s Delegated Regulation on MREL. In 2018, for those banks for which binding targets have already been set at consolidated level, the SRB will determine targets at individual level. For other banks, we will set binding MREL targets at consolidated level. The approach being taken ensures that banks are able to manage the transition to meeting MREL requirements without significant impact on financial stability or the real economy.

By the latest in 2020, our resolution plans will comprise binding targets for MREL at consolidated and solo level and – another important aspect – they will reflect our findings about the removal of impediments to resolution.

Let me conclude with this thought:

Since the start of the financial crisis in 2008/9 a lot has happened. But there is clearly still much to do. Although bank resolution is still a rather new concept, we can affirm that today banks are in by far better shape now than they were ten years ago. Banks are sounder, safer and less leveraged today. And we as authorities have the tools at hand to resolve a bank in case of failure. This means that the European financial system is more resilient to economic shocks today.

A lot has been achieved but the Banking Union has not delivered on all of its promises, yet. We cannot yet declare mission accomplished, in part because the framework is young and in part because it is incomplete; we are still awaiting MREL to be built up and the third pillar of the Banking Union – EDIS - to be established, just to mention two aspects. Overall, however, the journey that began only three years ago has progressed fast.

Let me stress this: if failure is unavoidable then it is essential to be well prepared with a forward-looking mind-set to avoid the potential negative impact of a bank failure on the economy and on financial stability.

Thank you very much for the opportunity to speak to you today.

I will try to respond to the questions you may have. If your questions refer to the implementation of the decision, I will leave them to Mr. Ponce for his future hearing.

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