BRIEFING

European Parliament

Banking Union Working Group: selected issues (September 2017)

Banco Popular

- On 6 June, the ECB declared Banco Popular to be "**failing** or likely to fail", pointing to "*the significant deterioration of the* ***liquidity situation*** *of the bank in recent days…*".
- On 7 June, the SRB adopted a resolution decision, transferring all shares and capital instruments of Banco Popular to Banco Santander **for one euro**.
- On 7 June, the Commission approved the resolution scheme of Banco Popular under the "EU's bank recovery and resolution rules", noting that the scheme involved **no State aid** nor aid from the Single Resolution Fund.
- An investor presentation by Banco Santander (p. 34) mentions that Banco Popular has a **provisioning deficit** for non-performing assets in the amount of EUR 7.9 billion.
- On 13 July Santander announced it would offer a **compensation to retail customers** affected by the resolution of Banco Popular -as holders of equity or subordinated debt-, setting aside nearly EUR 1 billion for that purpose.
- According to the financial press, investors **filed a lawsuit** against the Single Resolution Board, claiming inter alia that its decision relied on "incomplete information".
- According to the Spanish press, the **ECB struggled** to deal with the **numerous requests for information** from Popular shareholders and was not able to deal with all of them in due time.
- EGOV covered the resolution of Banco Popular in the briefing for the SSM hearing.

Veneto Banca and Banca Popolare di Vicenza

- On 23 June, the ECB declared the two Veneto banks "**failing** or likely to fail".
- On 23 June, the SRB stated that the BRRD **conditions for resolution were not met** as there was no public interest justifying resolution action. As "*neither of these banks provide critical functions, and their failure is not expected to have significant adverse impact on financial stability*", normal **insolvency proceedings at national level** became applicable.
- On 25 June, the performing part of the business was transferred to Intesa San Paolo, subject to an injection of cash and a provision of guarantees by the Italian government. The non-performing part was transferred to SGA, the vehicle previously used for the liquidation of Banco di Napoli. Equity and subordinated shareholders were bailed in.
- On 25 June, the Commission approved **liquidation aid** in form of a cash injection of EUR 4.8bn from the Italian State to maintain the buyer's capital ratios and dividend policy and to cover restructuring costs, and State guarantees of up to EUR 12bn to finance the liquidation mass.
- EGOV circulated a background briefing on the resolution of Veneto Banca and Banca Popolare di Vicenza.

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On-site inspections

On 27 June, the ECB launched a **consultation** on the Guide to on-site inspections.

The **purpose** of on-site inspections is to check the accurateness and **reliability of information** used to conduct bank supervision.

As regards the **composition of the inspection team**, the Guide stipulates that (p. 8) "*[T]he inspection team can be composed of ECB inspectors, supervisors employed by the NCA of the inspected legal entity's participating Member State, and supervisors from other NCAs, as well as JST members or other persons authorised by the ECB. The inspection team may also include external consultants. Regardless of their origin, all team members work under the responsibility of the HoM.*"

The Head of Mission, mandated to lead the inspection, "*...is appointed by the ECB from among ECB or NCA staff...*" (p. 7).

MREL (market confidence charge)

On 17 February 2017 the SRB published its guidelines on the MREL, explaining the approach taken in 2016 and the way forward for 2017. In 2016, the SRB only set *informative targets*, which are non-binding, non-enforceable and non-challengeable. Those targets were calculated based on a simplified methodology based on the default formula laid down in the EC delegated regulation:

MREL = default Loss Absorption Amount + Recapitalisation Amount + Market Confidence Charge)

= (Pillar 1 + Pillar 2 + Combined Buffer Requirement) + (Pillar 1 + Pillar 2) + (CBR -125bps) [1]

= 2*(Pillar 1 + Pillar 2 + Combined Buffer Requirement) -125 bps

In addition, the SRB applied a 8% benchmark (8% of total own funds and liabilities), considering that the MREL should be set at a sufficient level to access, if necessary, resolution financing arrangements, and did not take into account any upward or downward adjustments prescribed by the delegated regulation. The SRB indicated it would refine its methodology in 2017, to cater for different risk profiles, business models and resolution strategies.

Negative goodwill / Badwill

The accounting term "negative goodwill" – also referred to as "badwill" – refers to a situation in which a company claims that it has bought assets or shares at a price **below their real value** (fair market value).

"Negative goodwill" implies that the assets or shares were acquired at a bargain price, for example in a situation of **forced sales** or fire sales.

The **controversial issue** about negative goodwill is the question whether the purchased assets/shares were actually a genuine bargain, or whether some relevant factors (e.g. contingent liabilities, future payment defaults or other losses), have not been fully priced-in. Accounting rules therefore require a thorough assessment of the situation.

A company recording negative goodwill in its accounts may systematically either book **extraordinary gains/profits** to the income statement, or book reserves representing unrealised profits.

[1] In addition, both the Loss Absorption Amount and the Recapitalisation Amount have to meet the Basel 1 floor.

Targeted review of internal models (TRIM)

TRIM, launched in 2015 and to be finalised in 2019, is the ECB project to assess whether the **internal models** currently used by banks comply with regulatory requirements, and whether they are reliable and comparable. A major objective of TRIM is to **reduce inconsistencies and unwarranted variability** when banks use internal models to calculate their risk-weighted assets.

Each on-site mission requires at least six people to work over a period of at least ten weeks. More than 100 missions are scheduled for 2017. For each on-site mission, **up to half of the workforce is made up of external consultants**, allowing the ECB to maintain its other ongoing supervisory activities.

Fines for misconduct

According to a press release of 28 August 2017, the ECB's supervisory arm has **for the first time fined a bank** under direct supervision, that is Ireland's Permanent TSB bank, for breaching regulatory requirements, in this case liquidity requirements. Permanent TSB was fined a total of EUR 2.5 million for breaching its liquidity coverage ratio between October 2015 and April 2016.

The ECB published its decision on its website in the new section "supervisory sanctions".

In March 2017, three scrutiny papers on the topic "Fines for misconduct in the banking sector – what is the situation in the EU?" were published, drafted by the banking panel experts E. Carletti, A. Resti, as well as M. Götz and T. Tröger, and summarized in an internal briefing.

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