Banco Santander SA

Why Santander rescue of Banco Popular is a European test case

Unprecedented step under new rules for saving failing banks

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Martin Arnold in London and **Tobias Buck** and **Rachel Sanderson** in Madrid JUNE 7 2017

Spain's Banco Santander said it would acquire its struggling rival Banco Popular for a symbolic €1 on Wednesday in a deal engineered by Europe's new bank resolution authority that imposes heavy losses on shareholders and bondholders.

How important is this for Europe's new rules for saving failing banks?

Very. The Single Resolution Board was created at the start of 2015 as a pan-European authority for dealing with failing banks. Since then however, the institution has remained almost entirely untested. Now with Banco Popular it has shown its teeth at last. The SRB, chaired by Elke Koenig, acted swiftly after it was informed by the European Central Bank that Popular was "failing or likely to fail" on Tuesday. It imposed heavy losses on shareholders and junior bondholders before transferring Popular's remaining equity to Santander for only €1. The move is an unprecedented step as it imposes losses for the first time on holders of alternative tier one (AT1) securities — the riskiest bonds in a bank's capital structure that are designed to absorb losses in a crisis.

Are there other struggling lenders in Europe that may require the new authority's attention?

Yes. There are problem banks in Italy and Portugal that could provide further tests for Europe's new failing bank regime. Two banks in Italy's industrial north east face the prospect of resolution or a tough bail-in of creditors by the end of this month if EU authorities fail to agree a precautionary recapitalisation, say people informed of the talks. Popolare di Vicenza and Veneto Banca require nearly €5bn in additional capital to remain afloat. Portugal's central bank has agreed a deal to sell control of Novo Banco — the lender rescued from the ashes of Banco Espirito Sancto — to US private equity investor Lone Star. But the deal requires bondholders to suffer more losses and they trying to block the deal, which could leave Novo Banco facing a resolution process by European regulators.

How did the situation get so bad at Popular?

The Madrid-based bank managed to avoid needing a state bailout along with many of Spain's savings banks after the financial crisis. But since then it has been struggling to recover from heavy losses on real estate loans that went bad after Spain's property bubble burst. Emilio Saracho, a former JPMorgan Chase banker, has been searching for ways to improve the fortunes of a bank that lost €3.5bn last year since he took over from Angel Ron, its long-serving chairman, in February. Mr Saracho put the bank up for sale a few weeks ago, but investors took fright as bidders dropped out of the process. The bank's share price lost more than half its market value in the past week amid fears the lender was running out of time to plug a capital shortfall, which analysts estimated at €4bn-€5bn. It also risked running short of liquidity as a growing number of clients withdrew deposits. On Tuesday, the rating agency Moody's downgraded Popular's unsecured debt and deposit rating.

What does the deal mean for Santander?

Since Ana Botín took over from her late father as executive chairman of Spain's biggest bank in 2014 she has faced under pressure to improve the bank's relatively low capital levels while also fielding regular questions on whether she would continue her father's acquisitive strategy. By taking over her struggling rival Popular for only €1, Ms Botín shows that she has inherited her father's flair for daring dealmaking. But in launching a €7bn share issue, she is raising more than analysts think is needed purely to cover the capital shortfall at Popular and taking the opportunity to also bolster the bank's overall capital levels. The Santander boss has been attracted by the opportunity to acquire Popular's strong market position among small and medium sized businesses in Spain, and to expand in its home market at a time when the economy is recovering.

Ana Botin © AFP

What does the Popular sale mean for Spain's broader banking system?

Spain suffered a severe banking crisis in 2012 that forced Madrid to ask its European partners for a €100bn bailout package. Though intensely controversial at the time, Spain's efforts to restructure its banking system are today widely seen as a story of success — especially when set against Italy's perennial banking troubles.

Madrid nationalised and recapitalised a string of failing regional savings banks, and set up a bad bank to warehouse the sector's toxic real estate loans. Confidence in the system was restored, and credit started flowing to households and companies once again — helping fuel Spain's broader economic recovery. Against this benign backdrop, Popular stood out: unlike its peers, the bank never managed to rid itself of non-performing real estate loans and assets amassed during the boom. The sale of Popular to Santander draws what regulators hope is a final line under the country's banking troubles. Luis de Guindos, the country's economy minister, described the deal in a statement as a "good exit" for the Madrid-based bank, noting that it did not involve the use of public money and would provide "maximum protection for depositors". He added: "The current situation is very different from 2012, given the good health of the financial sector as a whole and of the Spanish economy in general."

Podcast: Santander-Popular deal, troubled bank 'resolution' and the FX scandal