

Europe Flash

Madrid, June 25th, 2013
Economic Analysis

Europe Unit
Miguel Jiménez González-Anleo
mjimenezg@bbva.com

Financial Scenarios Unit
Sonsoles Castillo
s.castillo@bbva.com

Regulation and Public
Policies Unit
Tatiana Alonso
tatiana.alonso@bbva.com

Wojciech Golecki
wojciech.golecki@bbva.com

Eurogroup reaches first agreement on direct bank recapitalisation

Last week the Eurogroup reached a first [agreement](#) on details of the direct recapitalisation by the European Stability mechanism (ESM) of ailing banks in stressed countries. A €60bn cap has been imposed over the ESM recapitalization ability. Although this cap can be increased at the discretion of the ESM Board under exceptional circumstances, its relatively low level could limit the effectiveness of the tool in breaking the vicious circle between sovereign and bank risk in the transition to the Single Resolution Mechanism.

- **Eligibility criteria**

To be applied to systemically relevant institutions in stressed countries that are unable to provide the needed financial assistance to restore the viability of the bank.

- **Capital shortfall**

To be identified through a stress test under the guidance of the ESM and after applying appropriate bail-in criteria. Under the current legal framework this would involve shareholders and junior debt only, but the door is left open in the proposal for an early application of the bail-in principles contained in the Recovery and Resolution Directive, still under negotiation. This means that senior bondholders could eventually be required to absorb losses immediately after junior debt-holders do so.

- **Burden sharing**

Two different cases are foreseen.

- **Case 1:** banks with a capital ratio under 4.5% CET1. Member States to cover all capital needed until 4.5% and the ESM to do the rest until reaching the ECB required ratio (equivalent to current EBA 9%).
- **Case 2:** banks with a capital ratio at/above 4.5% CET1 but below the ECB required level. Member State to contribute with a 10-20% share and the ESM to cover the rest. Under exceptional circumstances, the ESM Board can decide to suspend the Member State contribution but unanimity is required.
- **Caveat.** If the amount paid under case 1 (gap until 4.5%) is lower than what the MS would have had to pay under case 2 (i.e., 20% of gap until 9%), the MS would be requested to add the difference (i.e. for a bank with a 4.4% capital ratio, the MS would not just pay 0.1%, but rather 0.9%).

- **€60bn cap and limited retroactivity**

The ESM capacity to directly recapitalize banks has been capped at €60bn although the cap can be revised by the ESM Board. Retroactive implementation will be decided on a case-by-case basis (this seems to be a concession to Ireland; Spain has already expressed its unwillingness to ask for ESM assistance). For risk containment purposes, the ESM will set up (fully owned) subsidiary to conduct direct bank recapitalizations.

- **MoU and conditionality**

The ESM assistance will have to be required by Member States. We understand that the approval of the assistance by the ESM would take place under the same general rules that apply to current ESM sovereign assistance programs (where 85% of votes is required, which grants Germany a de facto veto power). The associated MoU might include conditionality clauses both for the recapitalized banks and also concerning general economic policies of the Member State. To recapitalize banks, the ESM will set up a fully owned subsidiary with no decision making powers.

- **Next steps**

The instrument will be finalized in Autumn (once the negotiations on the Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Fund Directive are finalised with the EU Parliament) and is expected to be put in place in Q2 2014, once national parliamentary scrutiny procedures have been finalised (the main obstacle here is Germany, where changes in existing law could be even required) and the Single Supervisory Mechanism is effective. Notwithstanding this, ESM Chairman Regling said in last week press conference that the ESM should be available to provide a public backstop for the EBA stress test exercise (expected for July of 2014). The framework will be revised two years after its entry into force to account for progress in Banking Union, the evolution of legacy assets and other relevant legal developments.

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.