European Securities and Markets Authority

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ESMA70-146-10

OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY

of 12 June 2017

on a proposed emergency measure by CNMV under Section 1 of Chapter V of Regulation (EU) No 236/2012

In accordance with Article 44(1) of Regulation (EU) No 1095/2010, the **Board of Supervisors** has adopted the following opinion:

I. Legal basis

1. According to Article 27(2) of Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps1, the European Securities and Markets Authority (ESMA) shall within 24 hours of the notification made by a competent authority under Article 26 of that Regulation, issue an opinion on whether it considers the measure or proposed measure is necessary to address the exceptional circumstances.

2. ESMA's competence to deliver an opinion is based on Article 29(1) (a) of Regulation (EC) No 1095/2010 (ESMA Regulation). In accordance with Article 44(1) of the ESMA Regulation the Board of Supervisors has adopted this opinion.

II. Background

3. In accordance with Article 26 of Regulation (EU) N0 236/2012, the Comisión Nacional del Mercado de Valores (CNMV) notified ESMA on 11 June 2017 of its intention to make use of its powers of intervention in exceptional circumstances and to introduce an emergency measure[s] under Article 20(2)(a) and (b)of that Regulation.

4. The concerned emergency measure consists of a ban on net short positions on shares issued by Liberbank, S.A. (ISIN ES0168675090, hereinafter "Liberbank"), either directly or through related instruments relevant for the calculation of the net short position determined in Annex I, part 1, articles 5 and 6 of Commission Delegated Regulation EU Nº 918/2012

[1] OJ L 86, 24.3.2012, p. 1–24.

and irrespectively of the trading venue or market in which the transactions leading to those positions are conducted.

5. The proposed measure will not apply to trading in index-related instruments or baskets of financial instruments. Furthermore, the CNMV is exempting from the measure the following activities:

    a. market making activities, in accordance with Regulation No 236/2012 on short selling;

    b. the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component; and

    c. the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights.

6. The proposed measure is expected to enter into force on 12 June 2017 at 08:15 am CET, (before trading session begins) and to be applicable until 23:59 of 12 July 2017.

7. The CNMV justifies the proposed measure by the existence of specific adverse situations or circumstances that constitute a serious threat to market confidence in the Spanish banking sector. The proposed measure aims at preventing this threat from materializing as it could have further implications in terms of financial stability in Spain.

8. Liberbank has experienced severe share price falls in the last weeks. In the last three weeks (between 22 May and 9 June 2017), it has lost 45% of its market capitalisation. In the last three trading sessions, i.e. 7, 8 and 9 of June 2017, it fell respectively 7,68%, 18,02% and 17,57%, with noticeable increases in the traded volumes. The CNMV notes that there is no underlying inside information from Liberbank that could justify this downward trend.

9. Liberbank, which is under the supervision of the European Central Bank, had as of 31 December 2016 a balance sheet of 38.3 billion Euros, an equity of 2,4 billion Euros, 896 branches, 4,854 employees, more than 1.8 million clients. This domestic bank operates basically in four Spanish regions, in which it has a very significant market share. On 9 June 2017, its market capitalization was 631.3 million Euros.

10. The price movements mentioned above need to be considered in the context of the recent events that affected Banco Popular (the sixth largest Spanish bank, more than 150 billion in assets as of 31 December 2016). In the last months, Banco Popular faced severe problems which resulted in the Single Resolution Board resolving Banco Popular and selling it to Banco Santander on 7 June 2017. The application of bail-in measures meant

that all shareholders and subordinate bond holders of Banco Popular lost their whole investment overnight.

11. This event has greatly increased the sensitivity of the Spanish market and of international investors and there is a risk that possible similar cases could arise in the future. The CNMV also reports that market confidence has deteriorated in relation to a part of the local banking sector.

12. The CNMV considers that the severe price declines recently affecting Liberbank seem highly correlated to the recent Banco Popular demise and the effects of its resolution on shareholders and bondholders. The CNMV also notes that the issuer informed it that all relevant information is already published and that such published information does not seem to justify this price movement. Liberbank even published on 8 June 2017 a price sensitive information about an improvement of its figures related to its non-performing assets and a statement about the lack of any underlying difficulty or negative circumstance that could be behind the plunge of its share price. Furthermore, the CNMV highlights that there is a significant degree of coverage of the market situation of Liberbank in economic and general Spanish press and also several references to the possible build-up of short positions.

13. In this context, the CNMV considers it necessary and appropriate to introduce the proposed measure. Without such a measure being taken at this point in time for a temporary period of one month, the substantial selling pressure and unusual volatility in the price of shares issued by Liberbank could continue to occur, as the investors take positions following a downward trend that attracts new short positions to take profit should the price fall with increased intensity in the coming days. Although the CNMV acknowledges that as of 8 June 2017, the level of short positions was still limited in Liberbank, around 1,4% of its capital (to be noted that the data on the short positions as of Friday 9 June will be known only on Monday 12 June and on the last trading day the volumes increased significantly and experienced significant intraday movements), the building-up of significant short positions that might exacerbate price falls would cause significant downward spirals and result in the financial institution becoming increasingly vulnerable. Without the proposed measure, the threat to market confidence would remain and would be difficult to tackle.

14. The CNMV considers that aggravated price movements in Liberbank might trigger contagion in other similar entities given the apparently weakened market confidence on part of the Spanish banking sector. Furthermore, due to the interconnections and perceived similarities with other entities, the situation could have a domino effect of a size that could become systemic.

15. Therefore, the CNMV believes that the proposed measure needs to be introduced precisely at this stage of the process (when significant short positions have not yet been built but the prices are falling so sharply) to be the most effective. It should minimise the risk of a loss of market confidence in Liberbank, in similar medium-sized Spanish banks and ultimately

in the Spanish banking system, and reduce the risk of a contagion effect to other shares of the Spanish banking sector.

III. Opinion

16. ESMA is adopting the following opinion on the notified measure, on the basis of Article 27(2) of the Regulation:

On the adverse events or developments

17. ESMA considers that the circumstances described above are adverse events or developments which constitute a serious threat to market confidence and potential risk to financial stability in Spain, as described in Art. 20, par1 (b) of Regulation (EU) No 236/ 2012 as further specified in Art 24 of Commission Delegated Regulation No 918/ 2012.

18. In the week starting 5 June 2017, the European Single Resolution Board (SRB) adopted, for the first time, a resolution decision for a Spanish bank, Banco Popular. During the night between the 6 and 7 June 2017, the ECB determined that Banco Popular was "*failing or likely to fail*", in accordance with Article 18(1) of the Single Resolution Mechanism Regulation, and it informed the SRB which adopted a resolution scheme entailing the sale of Banco Popular to Banco Santander. The purchase price paid by Santander for the shares and capital instruments of Banco Popular was 1 Euro.

19. The resolution scheme has been implemented due to the recent stressed liquid situation of Banco Popular, as a bank run was taking place. The resolution decision avoids adverse effects on financial stability and the real economy thanks to the protection of depositors and critical functions of Banco Popular.

20. Although the drop in value of Liberbank shares has started during the last days of May, the negative trend has significantly accelerated in the last days, exactly at the same time during which the events related to Banco Popular were unfolding and were reported by the largest financial media outlets worldwide. Simultaneously with the spread of the news of the resolution of Banco Popoular, as well as in the following days, the shares of Liberbank have experienced substantial selling pressure, unusual volatility and increased volumes traded.

21. The wider context of the Spanish banking sector is of utmost importance in the assessment of the emergency measure under Article 20 of the SSR especially in light of the fact that Liberbank confirmed to the CNMV that there is no (inside) information that would justify the latest price downward trend. On the contrary, the most recent price sensitive information published by Liberbank on 8 June 2017 was about an improvement of its figures related with its non-performing assets and a statement on the lack of any underlying difficulty or negative circumstances.

22. This seems to confirm, as stated by the CNMV, that there was an impact of the resolution of Banco Popular on the sensitivity of the Spanish markets and on international investors, which might give rise to potential similar cases in the future.

23. Market confidence and financial stability are intrinsically related to the concept of contagion in the financial system. As explained by the ECB in its Financial Stability Review, published twice a year, financial stability is a state whereby the build-up of systemic risk is prevented. In turn, systemic risk can derive from three sources, one of them being contagion effects across markets, intermediaries or infrastructures. The justification provided by CNMV highlights the fact that contagion among Spanish banking institutions could arise - even if the credit institution in question, at the moment of contagion, presents, according to the notifying authority, no underlying solvency or liquidity problem - because of the apparently weakened market confidence in part of the Spanish banking sector.

24. Also, the importance of Liberbank vis-à-vis Spanish financial stability is evidenced not only by the data provided by the CNMV in its notification, but also by the fact that Liberbank is a "significant supervised entity" directly supervised by the SSM/ECB (as of today, only 14 Spanish banks are directly supervised by SSM/ECB). This indicates that Liberbank is relevant not only at national level but Europe-wide.

25. In consideration of the significant selling pressure of Liberbank shares and all of the elements above, ESMA is of the view that the described situation represents an adverse scenario for the Spanish financial system.

On the appropriateness, necessity and proportionality of the measure

26. ESMA considers that the emergency measure under Article 20(2)(a) and (b) of Regulation (EU) N0 236/2012 in relation to Liberbank shares is appropriate, necessary and proportionate to address the threat in the Spanish financial markets, as described in Art 20, par 1 (b) of Regulation (EU) No 236/2012.

27. Liberbank has effectively experienced severe share price falls in the last weeks, with the price falling by 7,68%, 18,02% and 17,57% in the last three trading sessions. Given the reasons highlighted by the CNMV and as explained in the background section, substantial selling pressure and unusual volatility in the price of shares issued by Liberbank could continue to occur, as the market situation may push market participants to take new short positions in order to profit from further price falls, which may in turn exacerbate the falls experienced in past weeks.

28. While the last available data showed a limited level of short positions in the issued share capital of Liberbank, ESMA agrees that it is at this stage of the process that the measure

may be most effective, as it will ban net short positions where they are not yet significantly entered into[2] and where the conditions would make them most profitable for speculators.

29. The measure is adequate to address the expected substantial selling pressures and the unusual volatility causing significant downward spirals in Liberbank shares, given that it limits the ability to enter into new short positions, thus limiting the risk of vulnerability of Liberbank and a further weakening of wider market confidence in parts of the Spanish banking sector.

30. Furthermore, the CNMV highlighted that, in the absence of significant information explaining such a negative trend, the falls in the price of Liberbank shares are probably linked with the recent Banco Popular demise and the effects of its resolution on shareholders and bondholders. As that may have an impact also on other Spanish banks and financial institutions, the fact that the measure restricts the ability to adopt short positions may also indirectly reduce the risk of a contagion effect to other shares of the Spanish banking sector. The measure is therefore deemed necessary to prevent this risk.

31. The measure is deemed to be appropriate because it is the least stringent of all the measures that would sufficiently address the threat. A temporary restriction on short selling according to Article 23 of the Regulation (EU) No 236/2012 would not address the timing of the threat as it will remain applicable for a few days only (i.e. a maximum of three trading sessions where renewed). Moreover, a mere prohibition on short sales would not cover activities through derivatives that result in building of a net short position.

32. Lastly, the measure proposed by the CNMV does not extend the prohibition to index-related instruments or baskets of financial instruments, to market making activity and to short positions entered into to hedge positions on convertible bond or subscription rights. This clearly shows the intention of the CNMV to minimise possible detrimental effects of the measure.

IV. On the duration of the measure

33. ESMA considers that the duration of the measure of one month, instead of the maximum period of three months allowed by the Regulation, is justified, as the CNMV intends to keep the measure for as short a time period as possible and only while the risks to market confidence and potentially to financial stability would still be significant.

34. For those reasons, ESMA agrees with the CNMV's intention to lift the ban once the situation returns to normal parameters, but at the same time recognises that the CNMV cannot, at present, exclude a renewal of the measure if the threat were still to be present at the expiry of it. Therefore, ESMA recommends CNMV to monitor closely the situation.

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[2] As mentioned above the data on the last trading session is not available, so the considerations above are based on short positions as of Thursday.

This opinion will be published on ESMA's website.

Done at Paris, 12 June 2017

For the Board of Supervisors

Steven Maijoor

Chair