



"The likely map of the Spanish Banking System after the ongoing war"

Francisco Pérez

Javier Quesada

Universitat de Valencia & Ivie

Siena

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Causes, problems and implied consequences for the Spanish Savings Banks (SB)

Three overlapping causes:

- **Spanish crisis:** Continuous loss of international competitiveness, foreign current account deficit, housing bubble burst (1999→2010)
- **International crisis:** Financial and otherwise (after 2007..)
- **Sovereign crisis:** Public budget deficit (2010...)

SB problems

- Problems of liquidity, solvency and profitability
- Some SB had to be rescued (use of public funds through a new fund “FROB” conditioned on structural reform: ongoing process of mergers&acquisitions: until now from 45 → 17 or less)

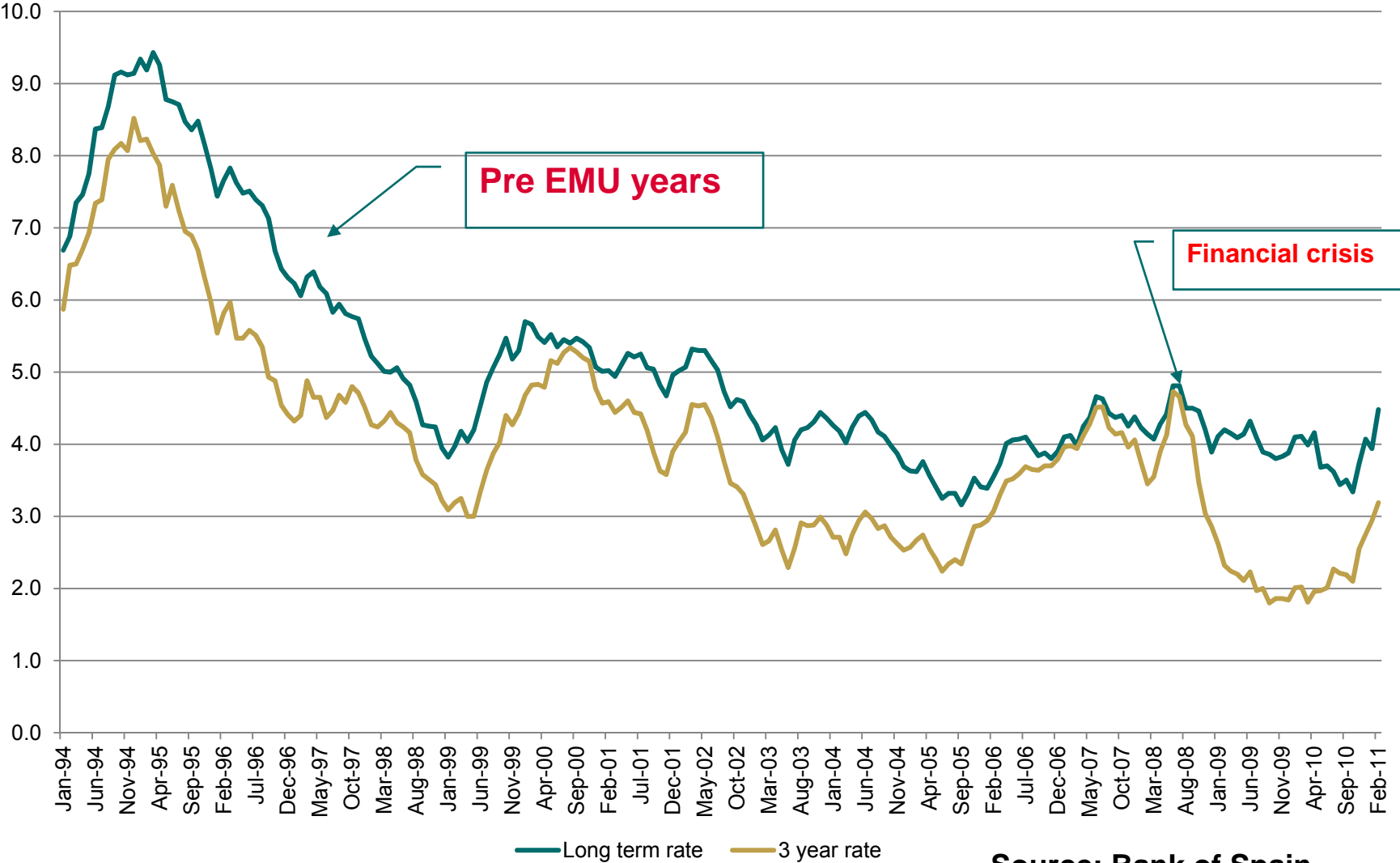
Consequences:

- After the on going war a new Peace Treaty will be reached:
 - SB's will either be transformed into private commercial private banks with new shareholders (other commercial banks, investment funds, foreign sovereign funds) or will stay as SB's with public presence (5 years)



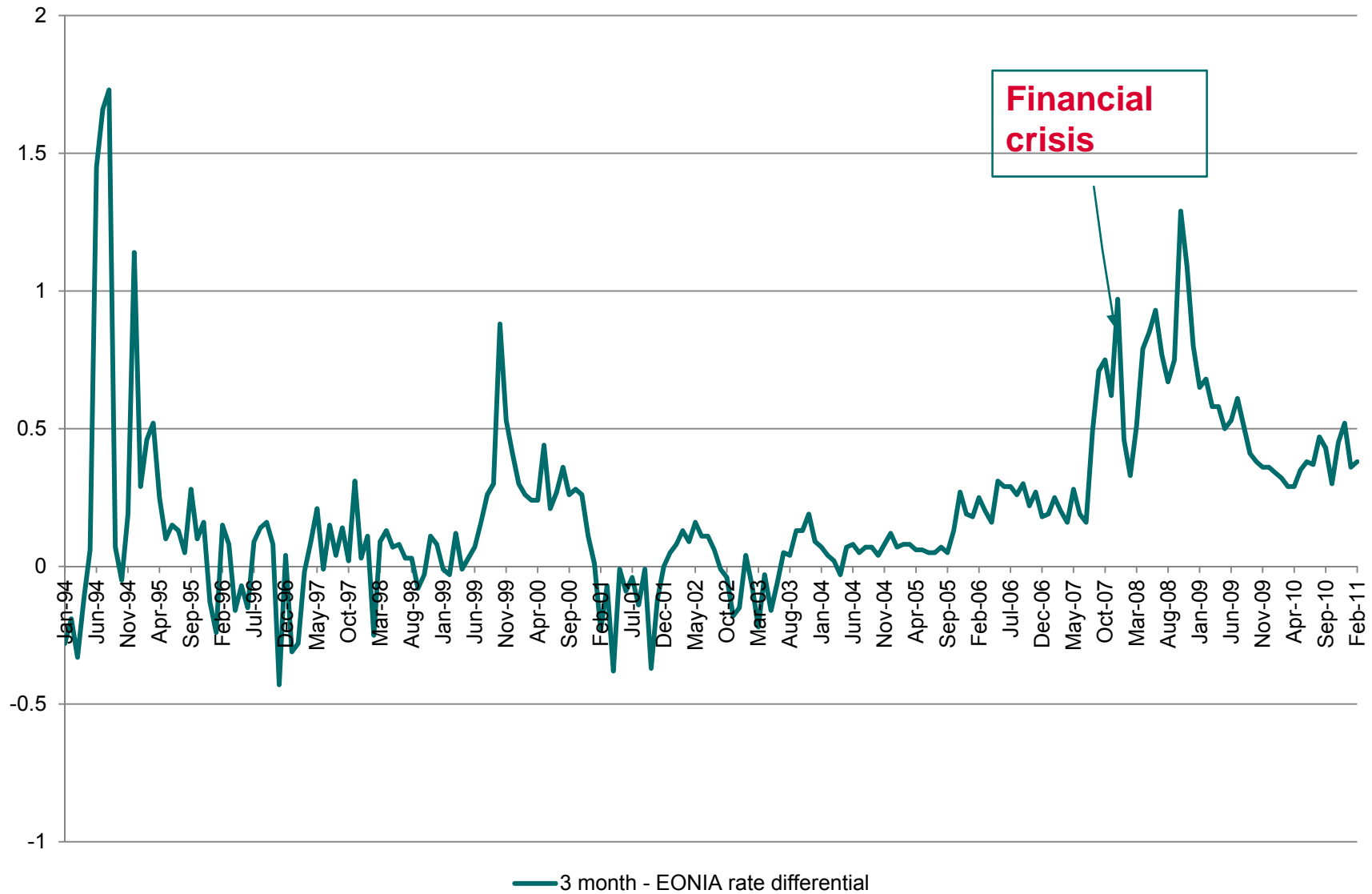
A period of falling interest rates in Spain


Interest rates



Source: Bank of Spain

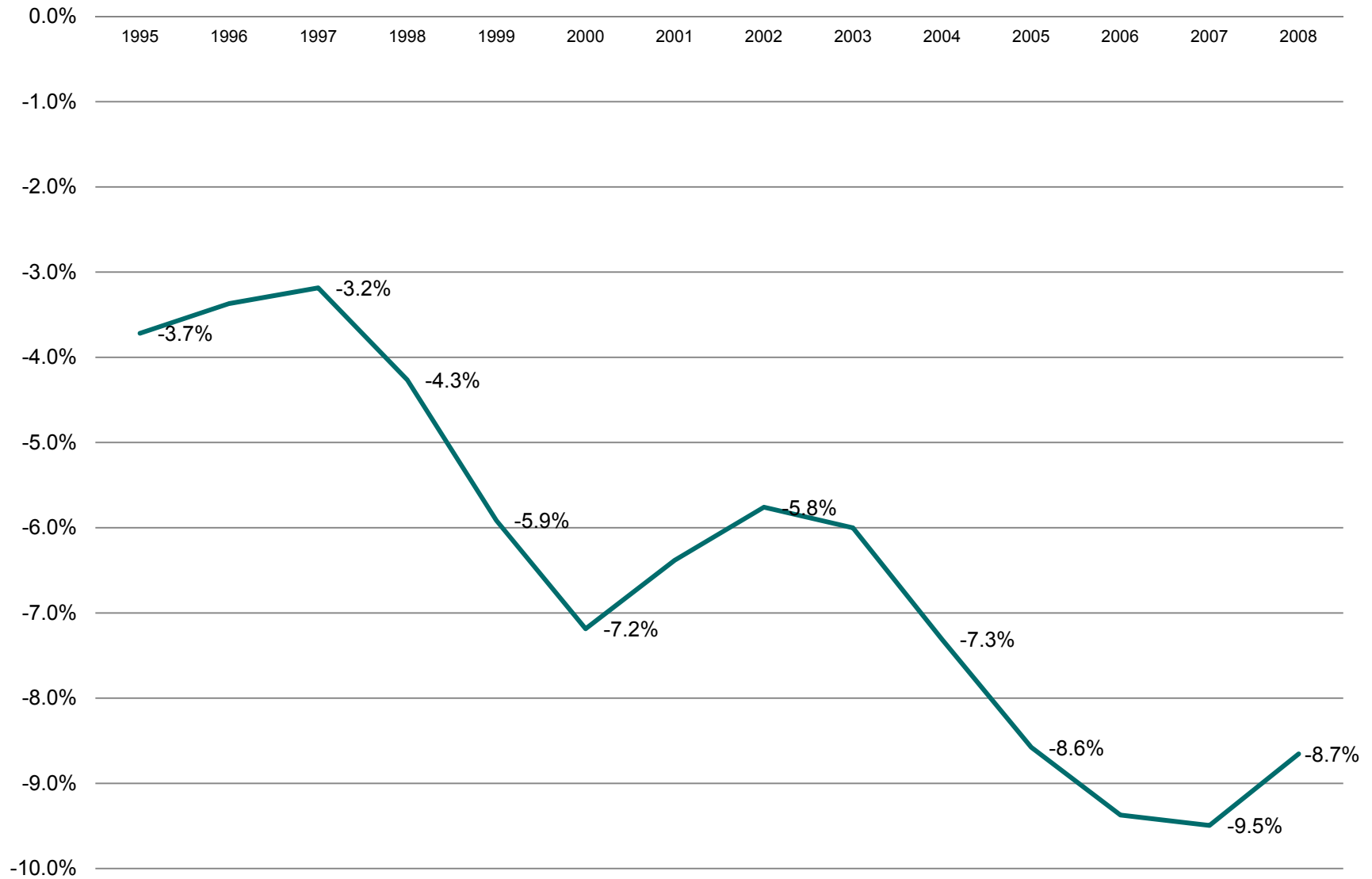
Disruption periods in the interbank market





Many years with very significant trade deficits may be an indication of a continuous loss of international competitiveness

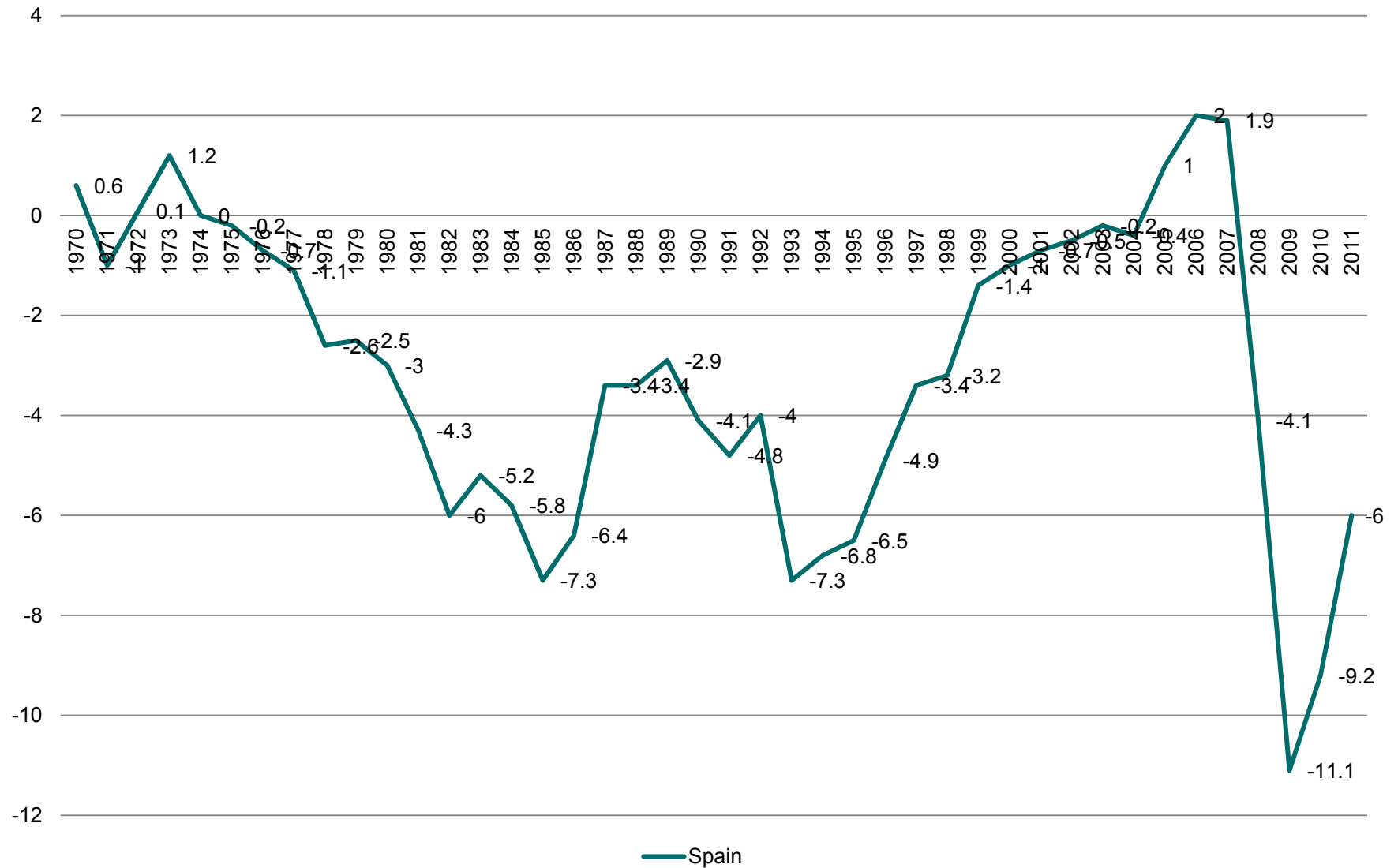
Trade deficit as % of GDP: Spain 1995-2008





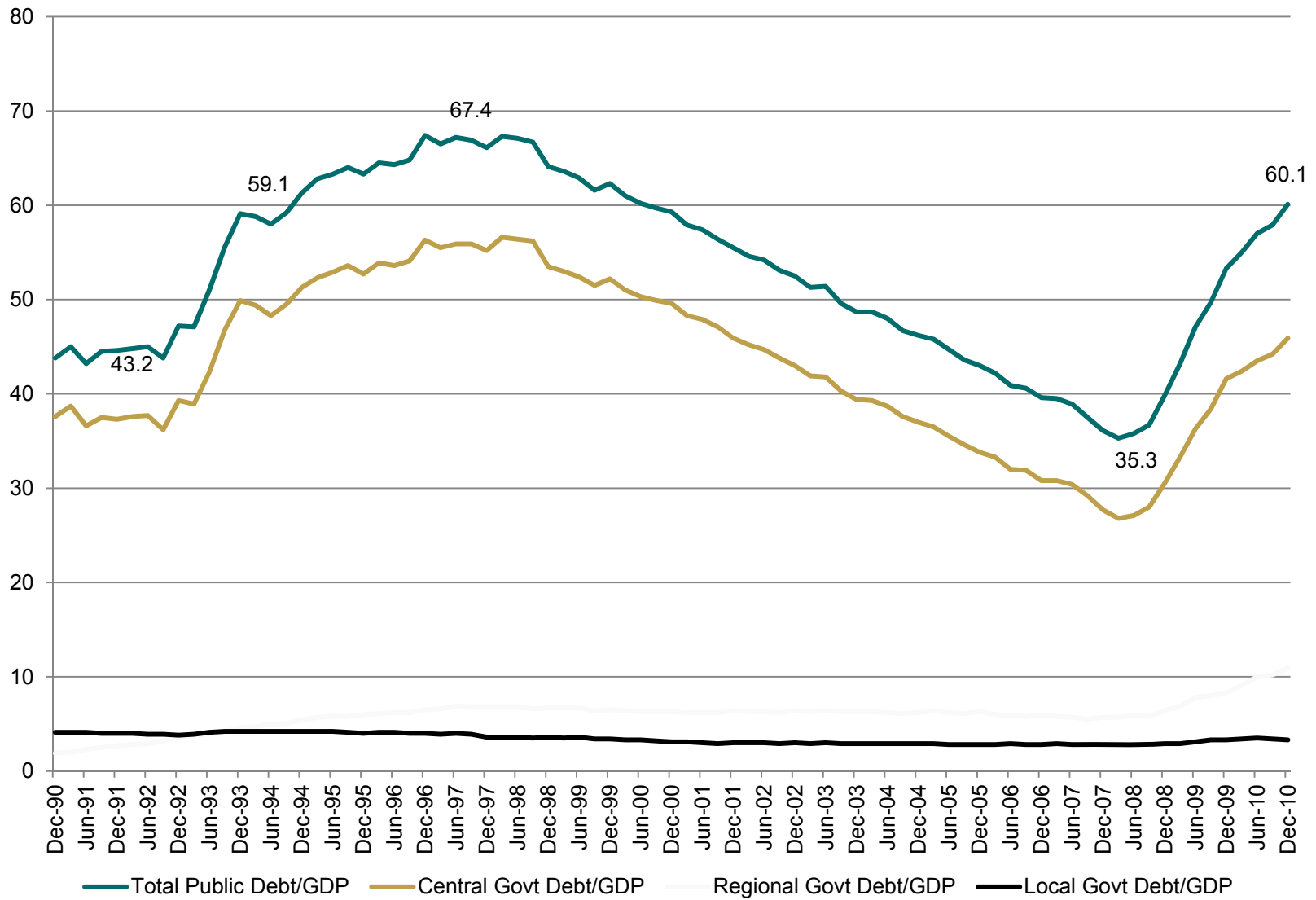
With the crisis the budget surplus turns into a very high deficit (originated in a revenue fall)

Budget surplus as % of GDP: Spain



Source: Bank of Spain

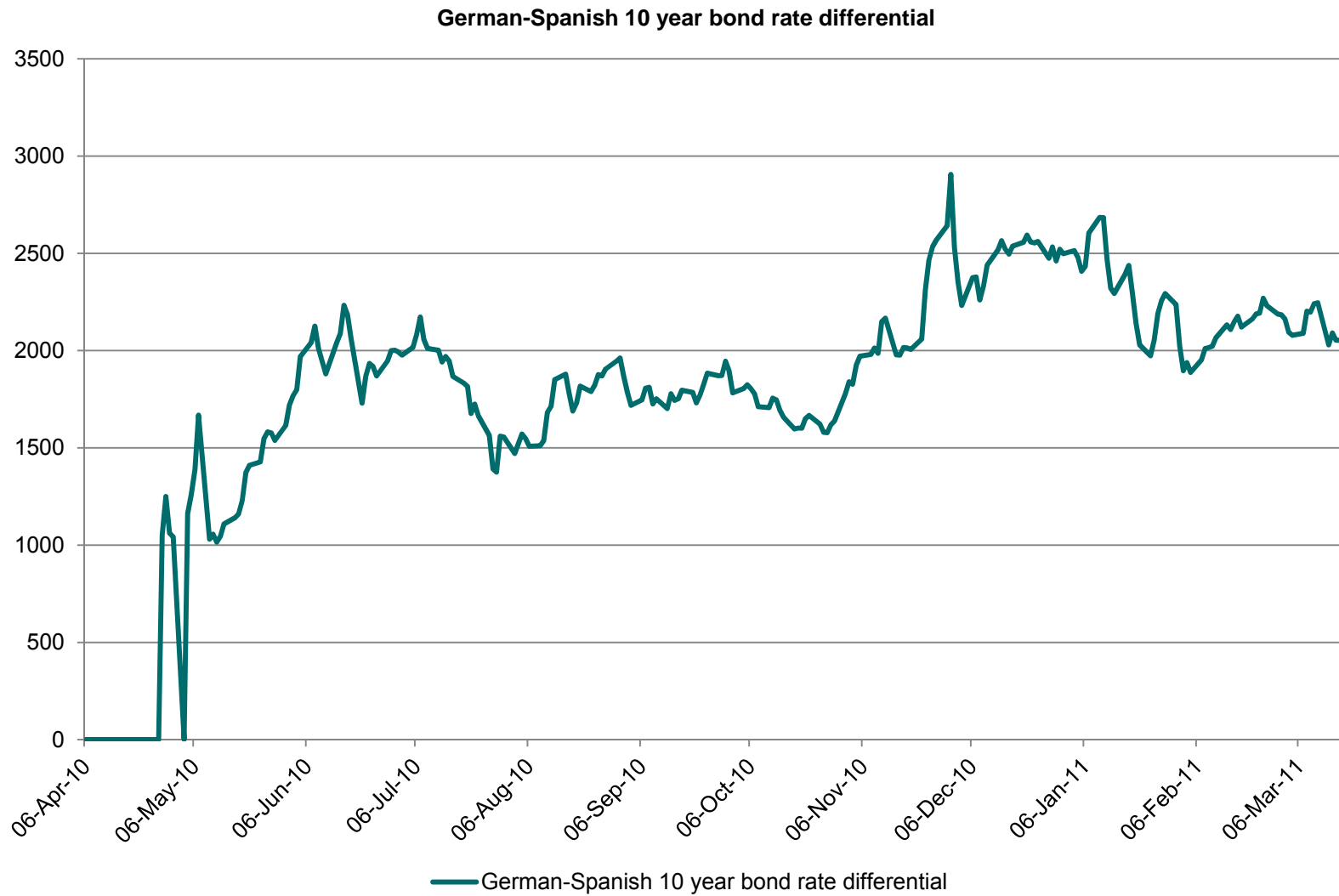
Increasing Debt/GDP ratio



Source: Bank of Spain



Country risk premium



Source: Bank of Spain

Responses to the crisis

- **Structural reforms:**
 - **Deficit reduction:**
 - Tax increases (VAT, capital gains, tobacco..), reduction of subsidies, freezing of pensions,
 - Public wage reduction, public investment cuts, Health (drug prescriptions) cost cuts
 - Privatization of State Loteries and Airport Management Systems (49%)
 - **Labour reform**
 - Reducing duality at the labour market (soft outcome)
 - Collective bargaining (in progress ??)
 - **Pension reform**
 - Gradual extension of retirement until 67, more required years to draw benefits...
- **Financial reforms**
 - Stress tests
 - Loss provisions and write-offs
 - SB's restructuring and normative reform
 - FROB (Fund for the Orderly Restructuring of Banks) June 2009
- **Measures at the European level (May 2010):**
 - European Financial Stability Facility (EFSF)
 - ECB's Securities Markets Program

Some SB's weaknesses:

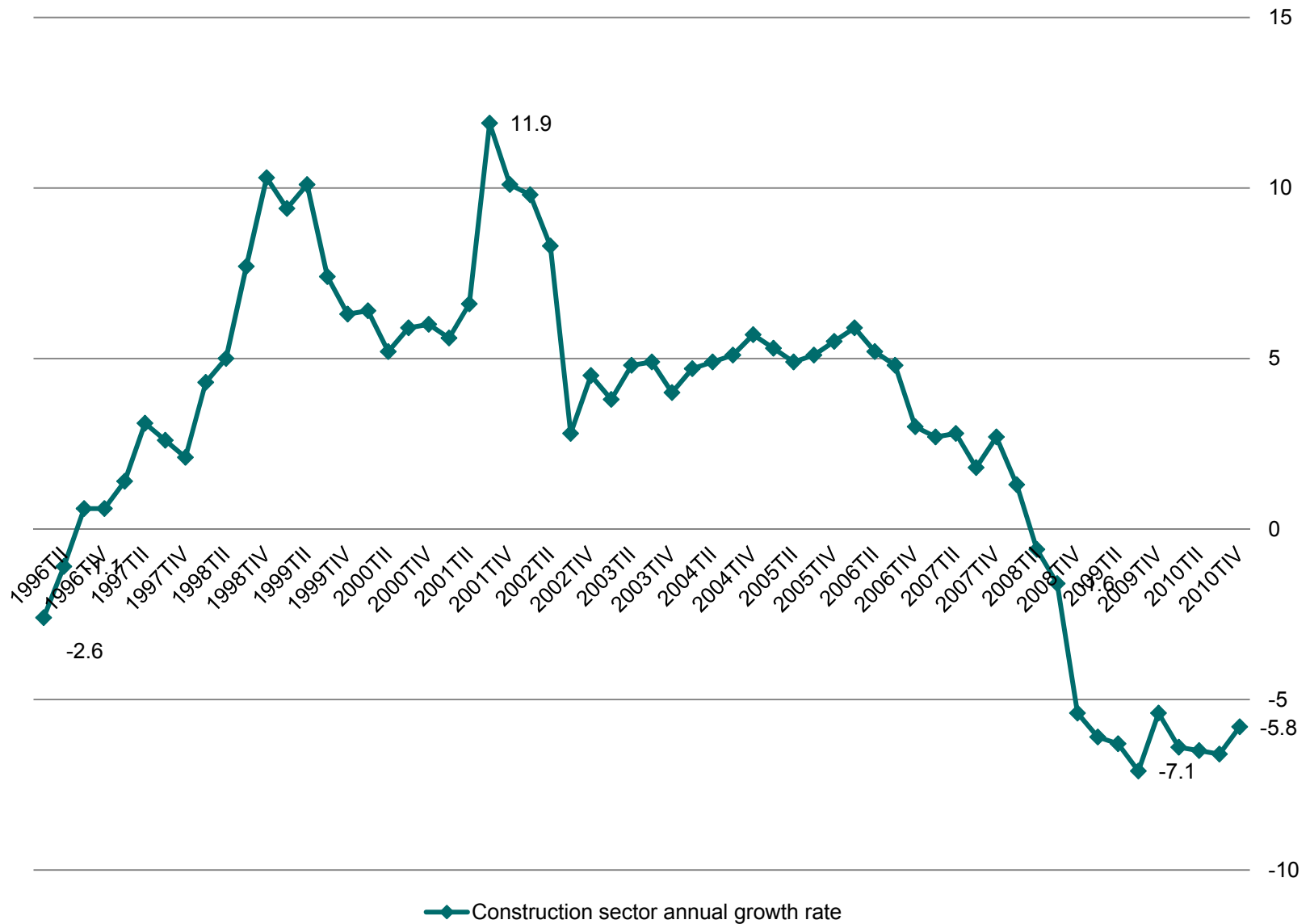
- High risk concentration in the construction sector: urban land development and housing
- Excess capacity after a territorial expansion led by the construction sector → Lower profitability
- High liquidity and interest risk: short run liabilities (with foreign investors) and long run assets
- Solvency issues:
 - Non-performing loans → Loss provisions
 - Difficult access to capital

GDP in construction: annual nominal growth rates. Spain

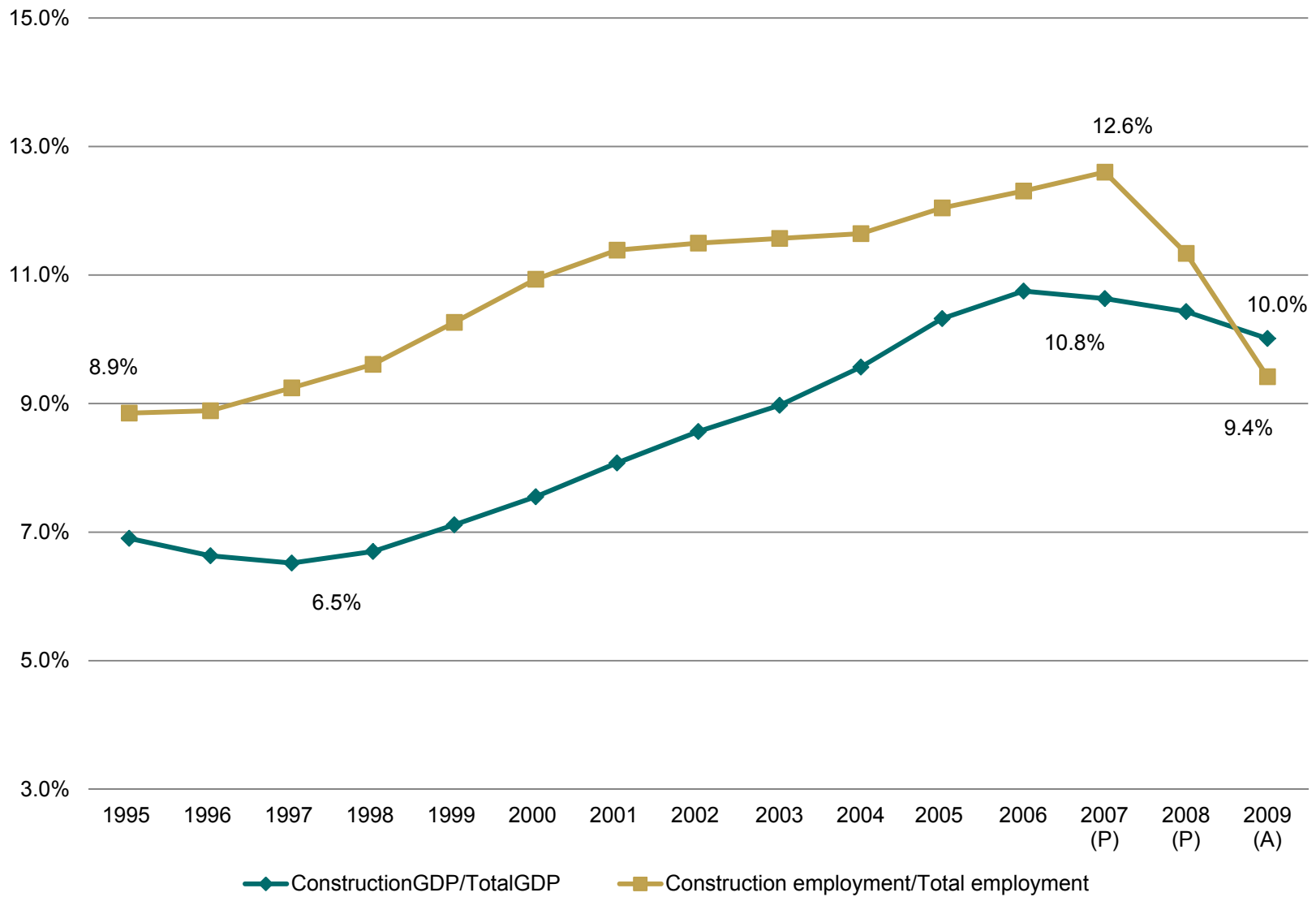


Source: Bank of Spain

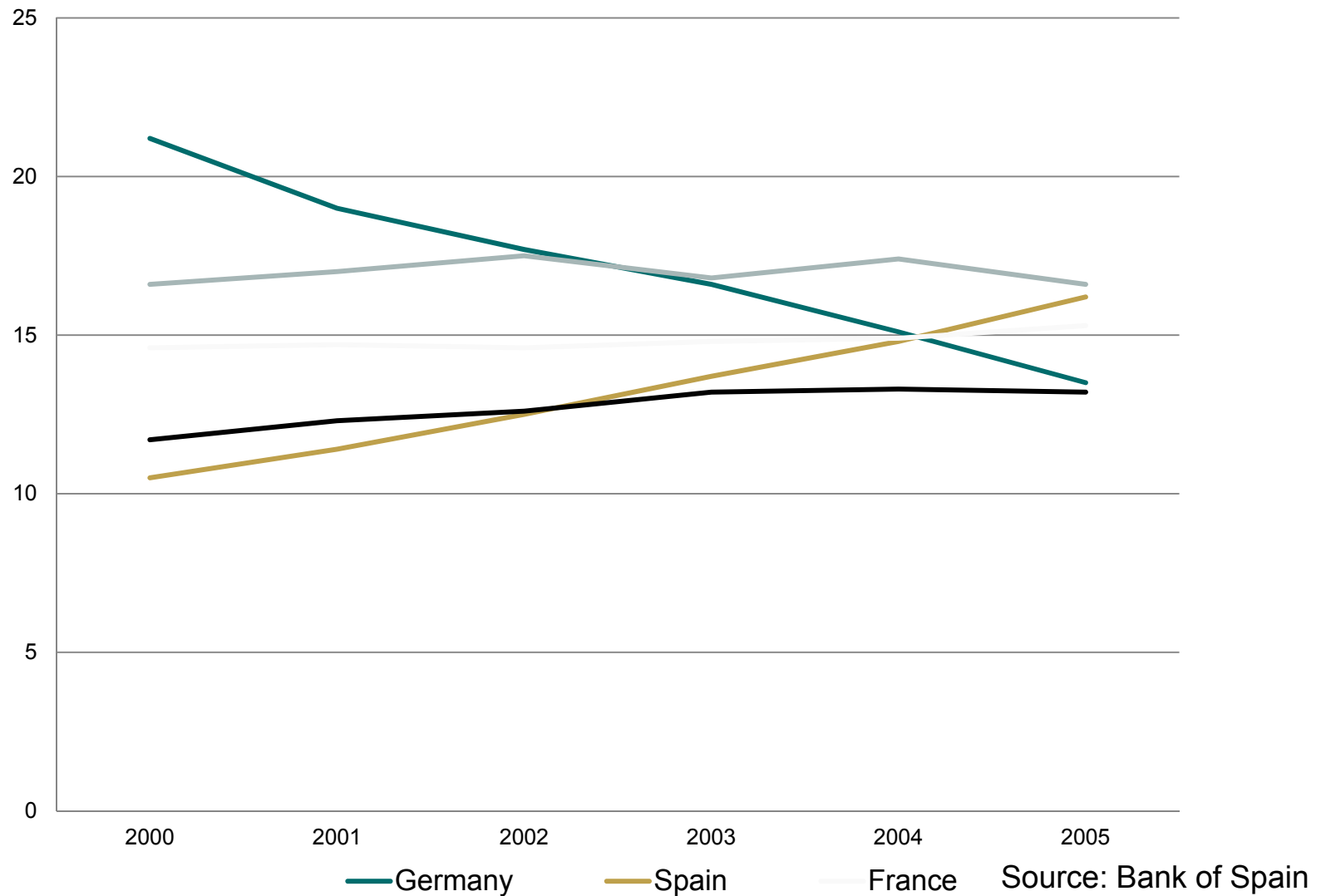
GDP in construction: annual real growth rat. Spain



Construction sector: share in GDP and employment



Construction sector: share in GDP

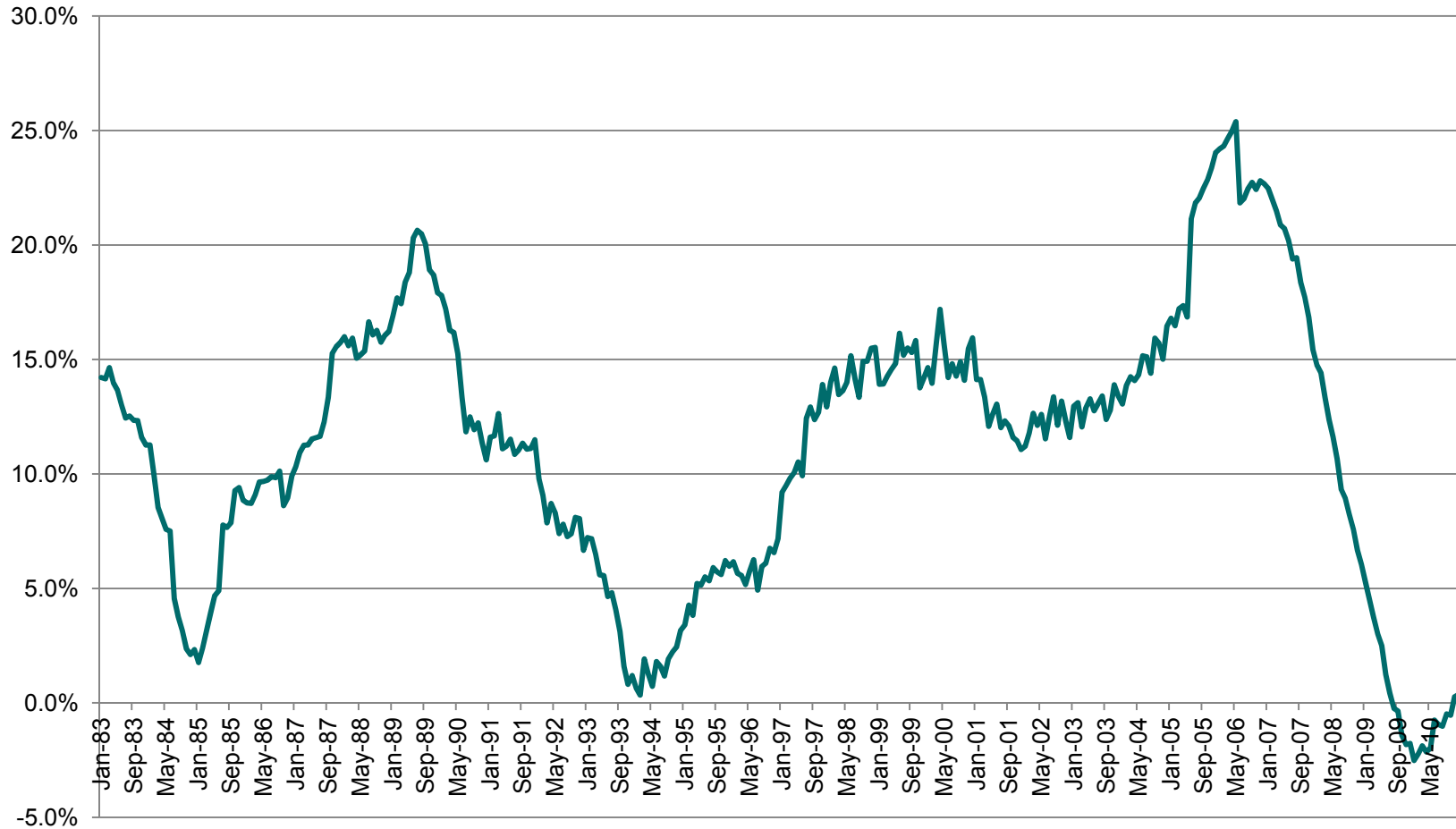




Very rapid credit growth

Bank loans to other resident sectors (non public, non foreign): nominal annual growth rates

Loans to other sectors



Loans to other sectors

Source: Bank of Spain

High exposure of savings banks to the promotion and construction sectors

- **Stress tests:**

- all SB's and all com. banks traded at the stock mkt (90% of all banks' assets) were tested
- High transparency
- Hard assumptions:
 - -2.,6% GDP fall for the forthcoming years. (In 2009 = -3,6%)
 - Significant reductions in guarantee values
 - 28% *for finished housing*
 - 50% *in the process of construction*
 - 62% *land*
 - Operating surplus 37% lower than the average for the last 20 years
- Only a few banks did not pass the test

Stress test: Worst scenario. July 2010

1º Banca March: 19%.	14º. Bankinter: 6,8%.
2º BBK (sin CajaSur): 14,1%.	15º Ibercaja: 6,7%.
3º Kutxa: 10,6.	16º Ontinyent: 6,6%.
4º. Santander: 10%.	17º Caja Madrid, Bancaja, Insular de Canarias, Laietana, Ávila y Rioja: 6,3%.
5º. BBVA: 9,3%.	18º Caixa Pollensa: 6,2%.
6º Unicaja: 9%.	19º Banco Guipuzcoano: 6,1%.
7º CAM, Cajastur, Cantabria y Extremadura: 7,8%.	20º CAI, Círculo de Burgos y Caja Badajoz: 6,1%.
8º La Caixa y Caixa Girona: 7,7%.	21º Banco Pastor: 6%.
9º Banco Sabadell (sin Banco Guipuzcoano): 7,2%.	22º CajaSol y Caja Guadalajara: 6%.
10º Caixa Galicia y Caixanova: 7,2%.	23º Caja Duero y Caja España: 5,6%
11º Banco Popular: 7%.	24º Banca Cívica: 4,7%.
12º Caja Vital Kutxa: 7%.	25º Caixa Sabadell, Terrasa y Manlleu: 4,5%.
13º Caja Murcia, Caixa Penedés, Sa Nostra y Granada: 7%.	26º CajaSur: 4,3%.
	27º Caixa Catalunya, Tarragona y Manresa: 3,9%.

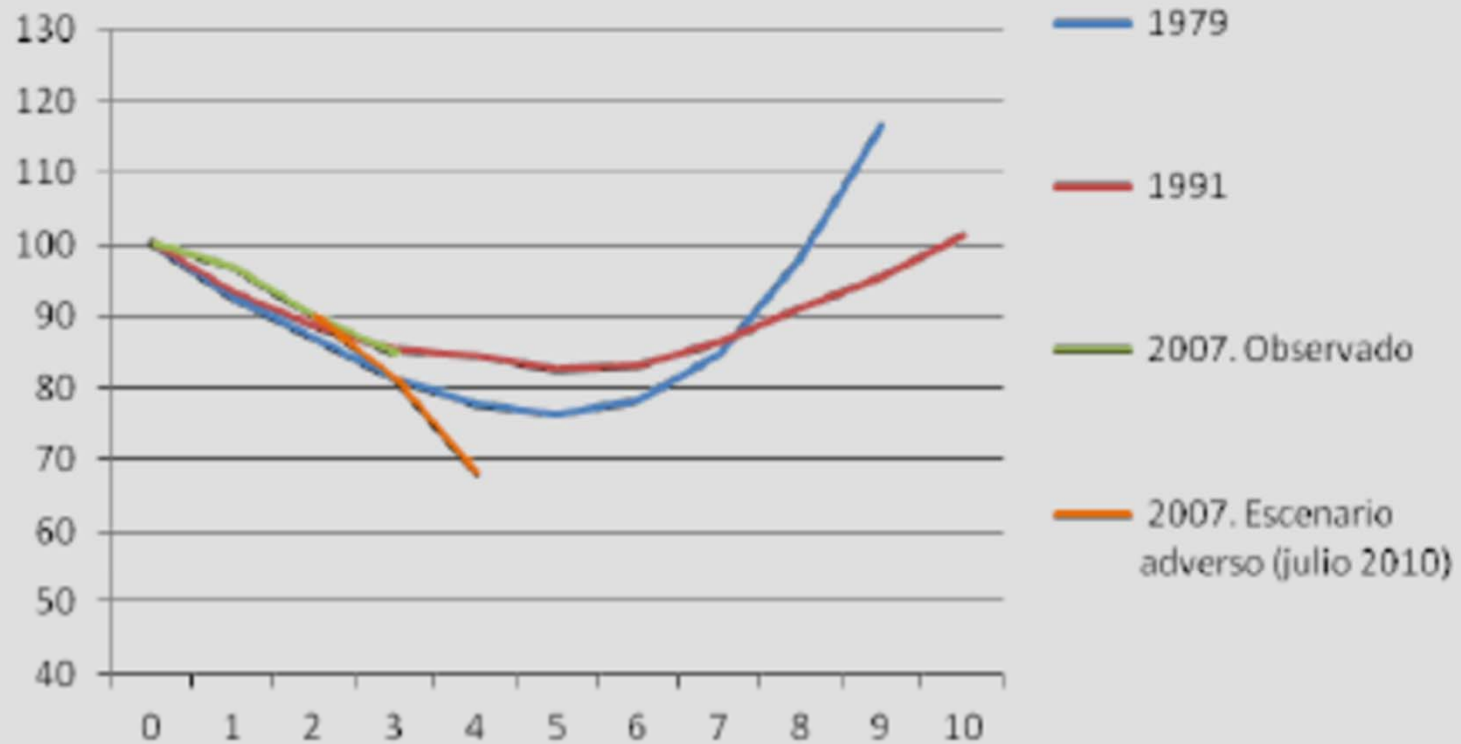
Source: Bank of Spain

- High exposure of savings banks to the promotion and construction sectors →
 - Stress tests
 - **Stricter Loss provisions and write-offs**

Stricter norms for loss provisions (after the Summer of 2010)

- Provisions
 - If asset prices fall and the value of the guarantee falls below the loan it has to be provisioned back to 100% in **no more than one year**.
- Applicable partial write-offs of the minimum of loan & value. Recommended down adjustments:
 - 20%: Owner occupied housing
 - 30%: Non residential construction investments
 - 40%: Residential housing
 - 50%: Land property for urban zoning
- Incentives for write-offs
 - Immediate 10% write-off of real property acquired from «dation in payment» (assignment in payment originating in a non performing mortgage)
 - 20% write-off after 1 year holding of the property in the balance sheet & 30% after year 2
 - Today, banks are the largest real estate agents in the country

Real Housing prices: a comparison with other housing crises




Years after the peak

Source: Bank of Spain

Bank of Spain's estimates of SB's real estate exposure

- Savings banks' real estate exposure (217 mm €). Bank of Spain considers potentially problematic 46% (approx. 100 mm €) made by:
 - Loans under special scrutiny: 28.000 mill €
 - Dubious loans: 28.000 mill €
 - Real estate property given in dation 44.000 mill €
- Specific loan loss reserves amount to 31% of potential risk (with generic provisions adding up to 38%)

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- High exposure of savings banks to the promotion and construction sectors →
 - Stress tests:
 - Stricter Loss provisions and write-offs
 - **SB's restructuring and normative reform**

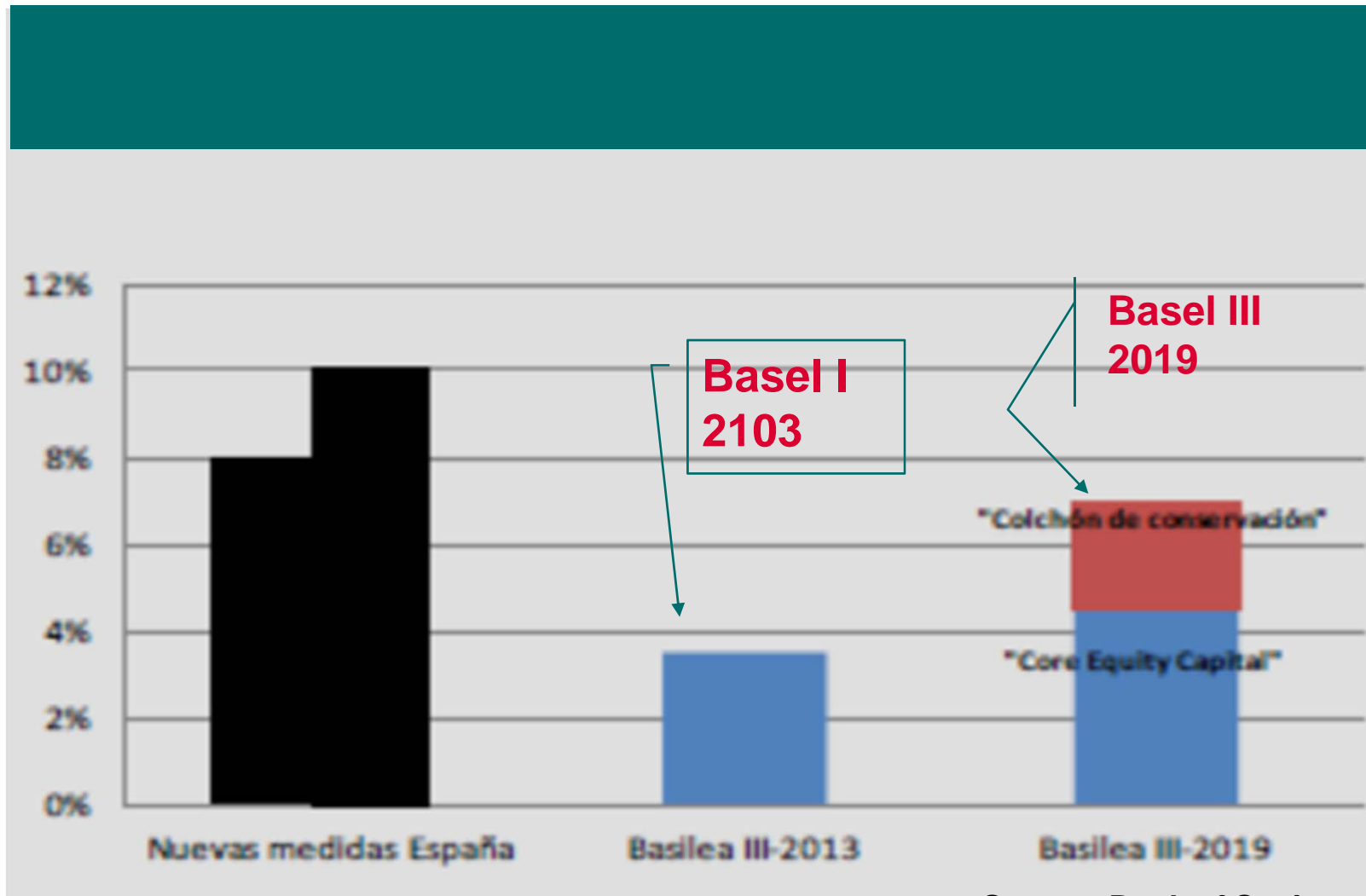
New regulation

- The Law on SB's was modified in the summer of 2010
 - It would allow SB's to raise high quality capital at the capital market
 - Voting rights could be assigned to participative quotas
 - 3 options for SB's
 1. Integrate into a SIP with a coordinating bank as the central organisation
 2. Transfer the credit and deposit business to a bank
 3. Transform the SB into a Foundation
 - More professional management
 - Market discipline
- More transparency:
 - Additional information on loan portfolio in construction and land development by SB's (Annual Accounts)
- A new capital reinforcement norm for the entire banking system was introduced in 2011
 - Easier access to capital markets
 - *8% or 10% core capital ratio*

Minimum capital requirements

- **Basel III: 7%**
- **Spain**
 - 8% of assets weighted by risk
 - 10%
 - if you have NOT placed at least 20% of your shares with third party investors
 - if you are exposed more than 20% to the wholesale market
- **Calendar**
 - March 28th
 - SIP's strategic plans are submitted to the B. of Spain
 - April 14th
 - The Bank of Spain approves or asks for modifications
 - April 28th
 - Approval of the plan by the entities
 - September 30 th
 - FROB
 - End of 2011 for private investors
 - March 2012: Stock Mkt

New core capital requirements: Spain vs Basel III



Source: Bank of Spain

- High exposure of savings banks to the promotion and construction sectors →
 - Stress tests
 - Stricter Loss provisions and write-offs
 - SB's restructuring and normative reform
 - **FROB (Fund for the Orderly Restructuring of Banks) From June 2009**

The main steps

1. Several SB's merge into a new commercial bank forming a temporary SIP (System of Integration Protection). The new bank acts as a holding company
2. Banking activities are transferred to the new bank, geographical market redistribution among former savings banks, integration of management decisions, one only overhead office, ICT integration, temporary use of former brand names
3. Launching of the new bank with a new brand name
4. Savings banks might disappear as banks and become foundations who are shareholders of the new bank.
 - There are alternatives to this one

What's a SIP (Integrated System of Protection)?

- 2 or more SB's integrate their organisations into a holding company, a new ordinary commercial bank.
 - They transfer the financial business activity to the bank.
- It is a requirement to obtain public rescue funds (8% annual interest rate).
 - Not a requirement if you are not asking for public funds.
 - Nevertheless most SB's have created a SIP.
- The integration contract determines:
 - Share of each SB in the new Bank
 - Governance issues
 - Complete consolidation of the profit and loss statements
 - Solidarity on solvency and liquidity issues

3 ways of raising capital for SB's

1. \sum SB's \rightarrow SIP \rightarrow FROB Govt as a lender or as a shareholder \rightarrow (5 years) \rightarrow Transfer to a Final Investor
2. Third large investor: \sum SB's \rightarrow SIP \rightarrow Final Investor (a third party)
3. Stock Market: \sum SB's \rightarrow SIP \rightarrow Stock Market Final Investor

Significant consequences of the integration process

- Larger Saving banks' average size (29.000 → 76.000 mill €)
- Lowering excess capacity:
 - 10 - 25% additional reduction in branches
 - 12 – 18% “ “ “ number of employees
 - Additional to the previous reduction of 5% and 4% respectively from previous peak values in 2008.
- Additional write-offs of 22.000€ to the previous 30.000€ already provisioned since 2008,

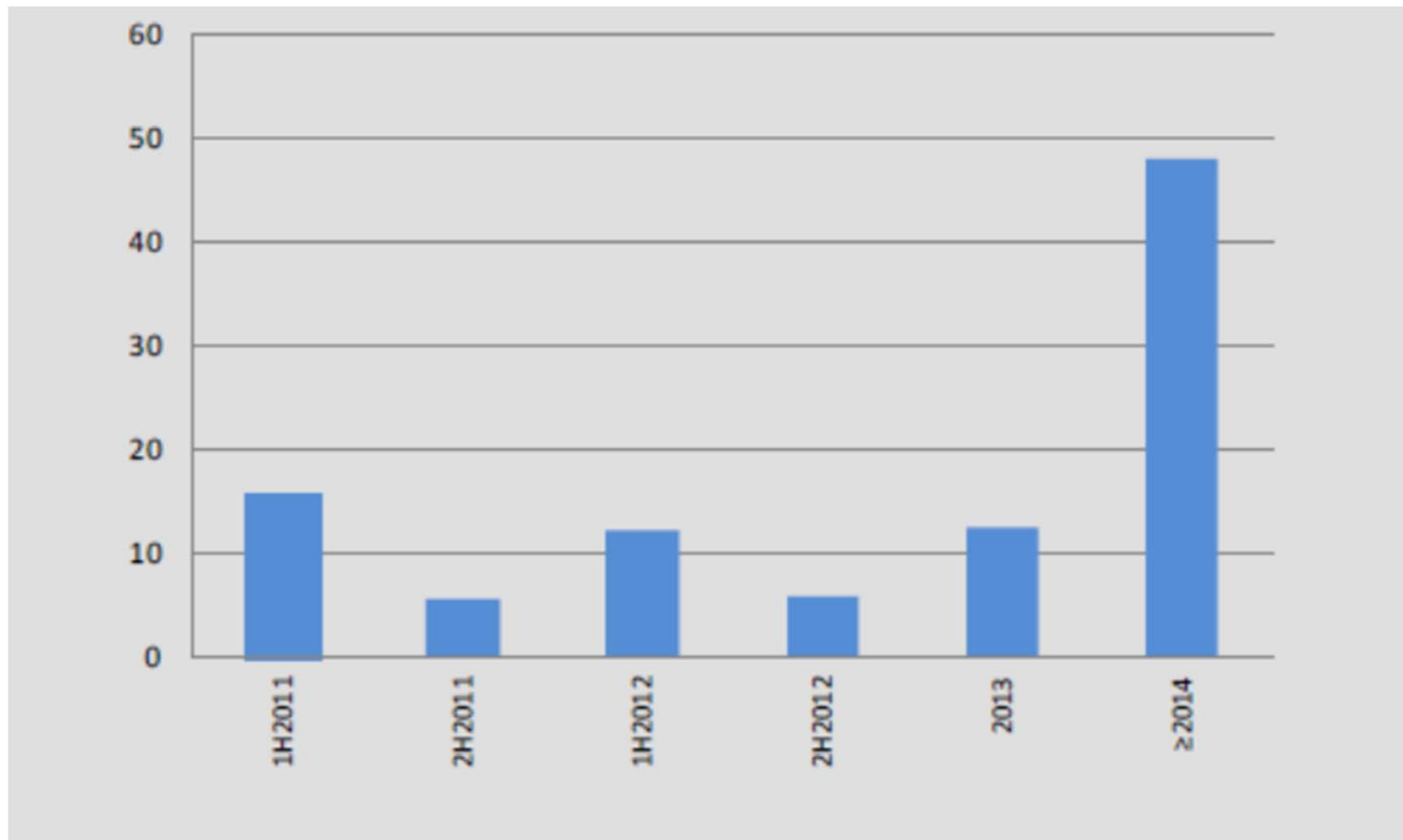
Some problems for the capitalization process

- What's the net worth of a SB?
- Which discount rate on the book value should be initially offered to the new investors?
- If a SB cannot raise capital at an appropriate cost and reach the minimum level as fixed by the new capital requirements, can it apply to the FROB (Public rescue funds)?

New definition of “core capital”

- **Core Capital**
 - **Common stock +**
 - **+ Disclosed Reserves +**
 - **+ Floating primes**
 - **+ Net income from the current year**
 - **+ Convertible debt**
 - **+ FROB participations**
 - **- Own shares**
 - **- Losses from the current year**

Wholesale financing of the Spanish Banking System Market debt maturity as of January 2011 in %

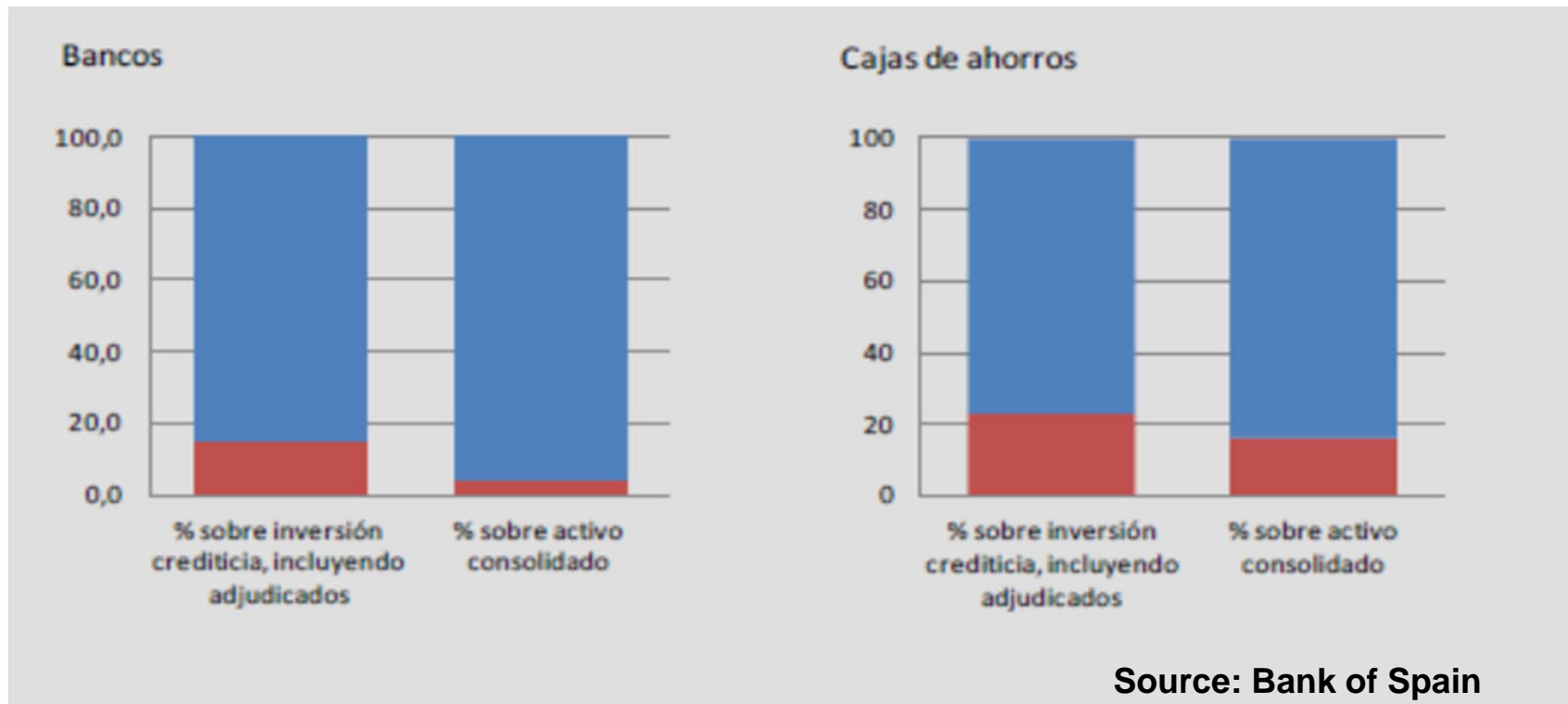


Source: Bank of Spain

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SB's exposure to construction and urban land promotion			
	Exposure	% over total exposure	% over total credit risk
Credit risk (1)	172	80%	18%
	117	54%	12%
Finished promotion	50	23%	5%
On going promotion	26	12%	3%
Land urban developm.	22	10%	2%
Rest	19	9%	2%
<i>Normal under surveillance</i>	28	13%	3%
Finished promotion	7	3%	1%
On going promotion	4	2%	0%
Land & urban development	10	5%	1%
Rest	7	3%	1%
<i>Doubtful</i>	28	13%	3%
Finished promotion	9	4%	1%
On going promotion	5	2%	1%
Land & urban development	7	3%	1%
Rest	7	3%	1%
Real estate dation	44	20%	4%
Finished houses	18	8%	2%
On going construction	3	1%	0%
Land	23	11%	2%
TOTAL EXPOSURE	217	100%	22%

Weight of the construction and land development sectors in total credit investment



Source: Bank of Spain

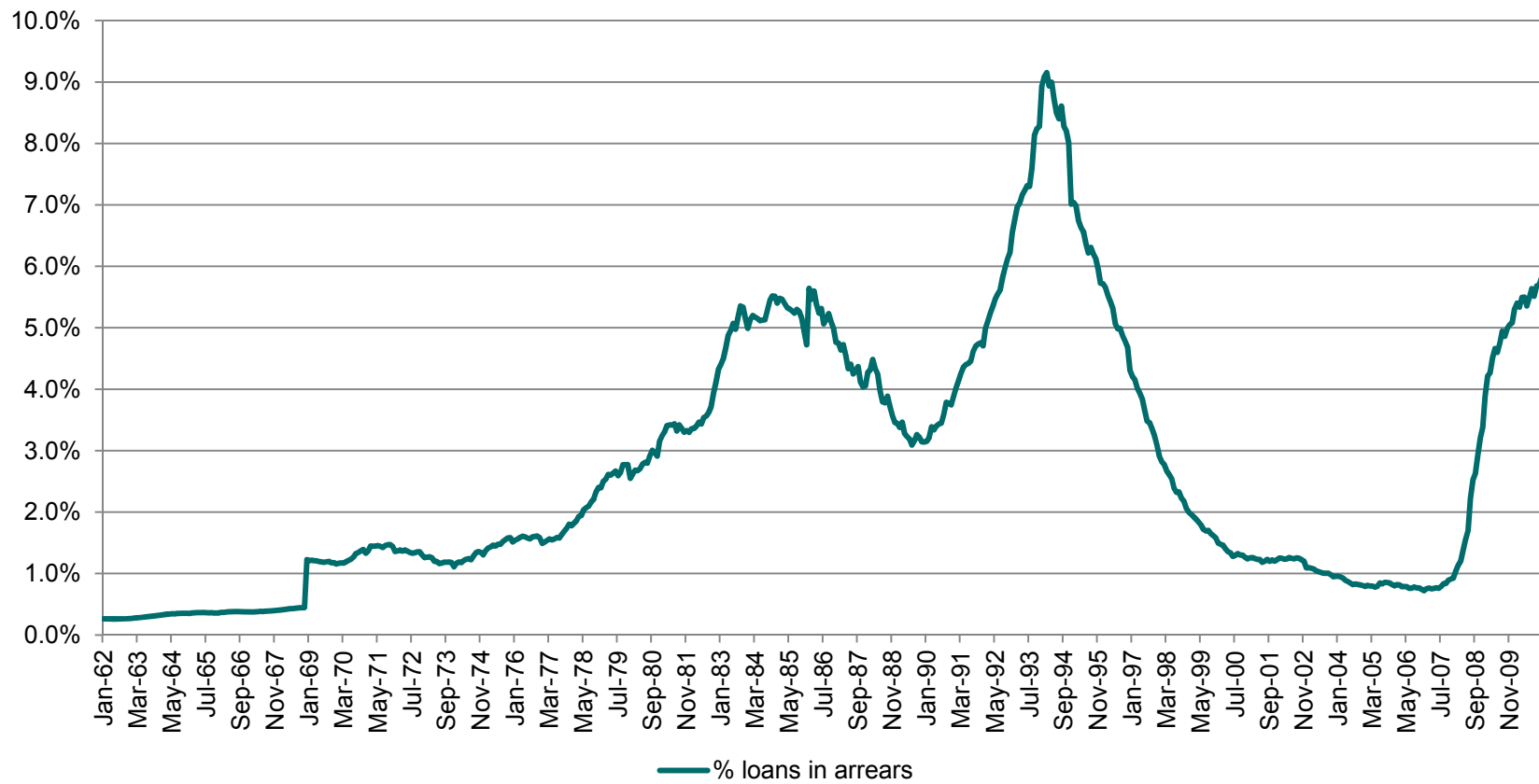


The new map: Saving Banks

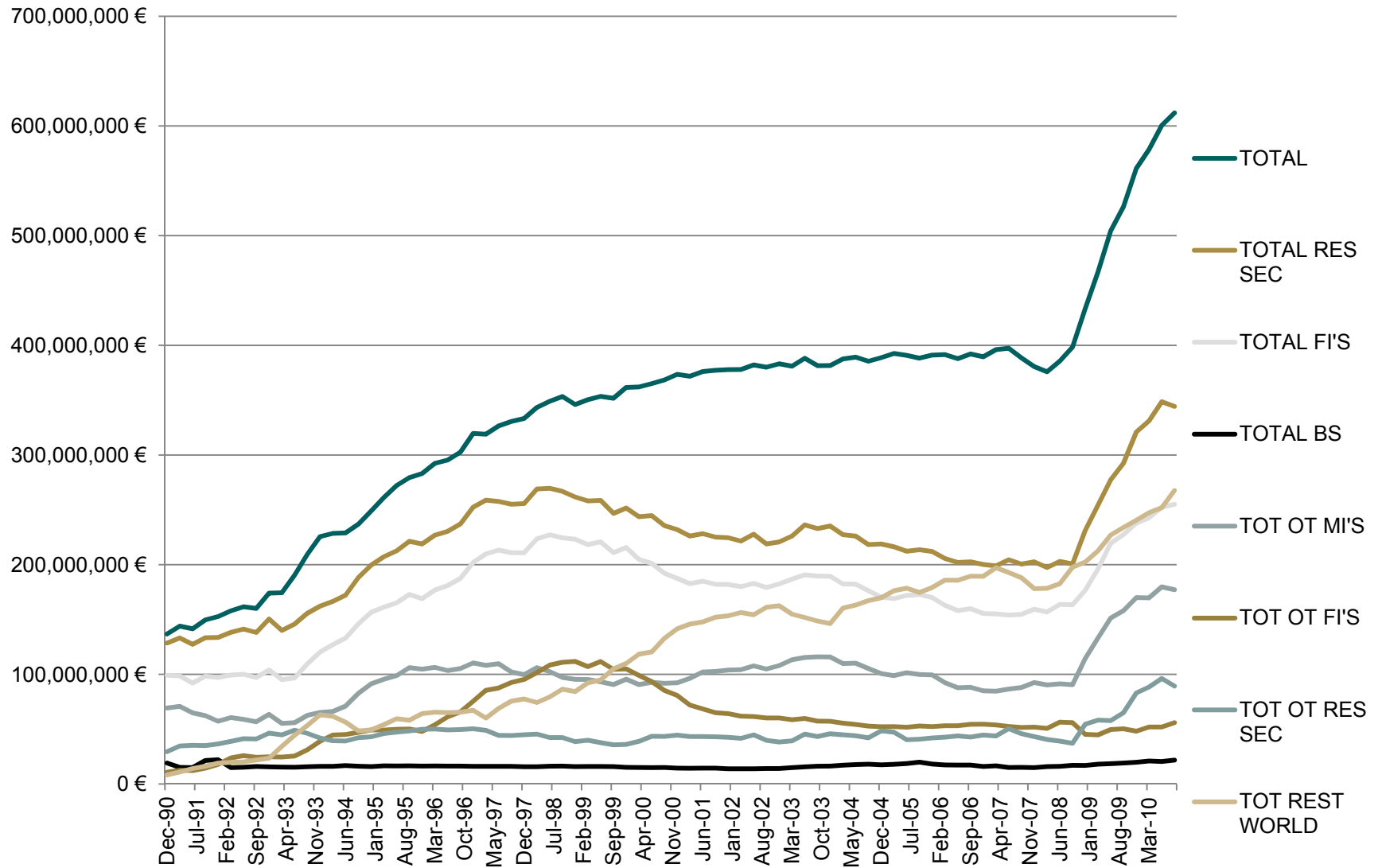
- From 45 → 17 SB`s
- 12 integration processes:
 - 7 mergers or acquisitions, 5 SIP`s
(Sistemas Integrados de Protección)

Loans in arrears

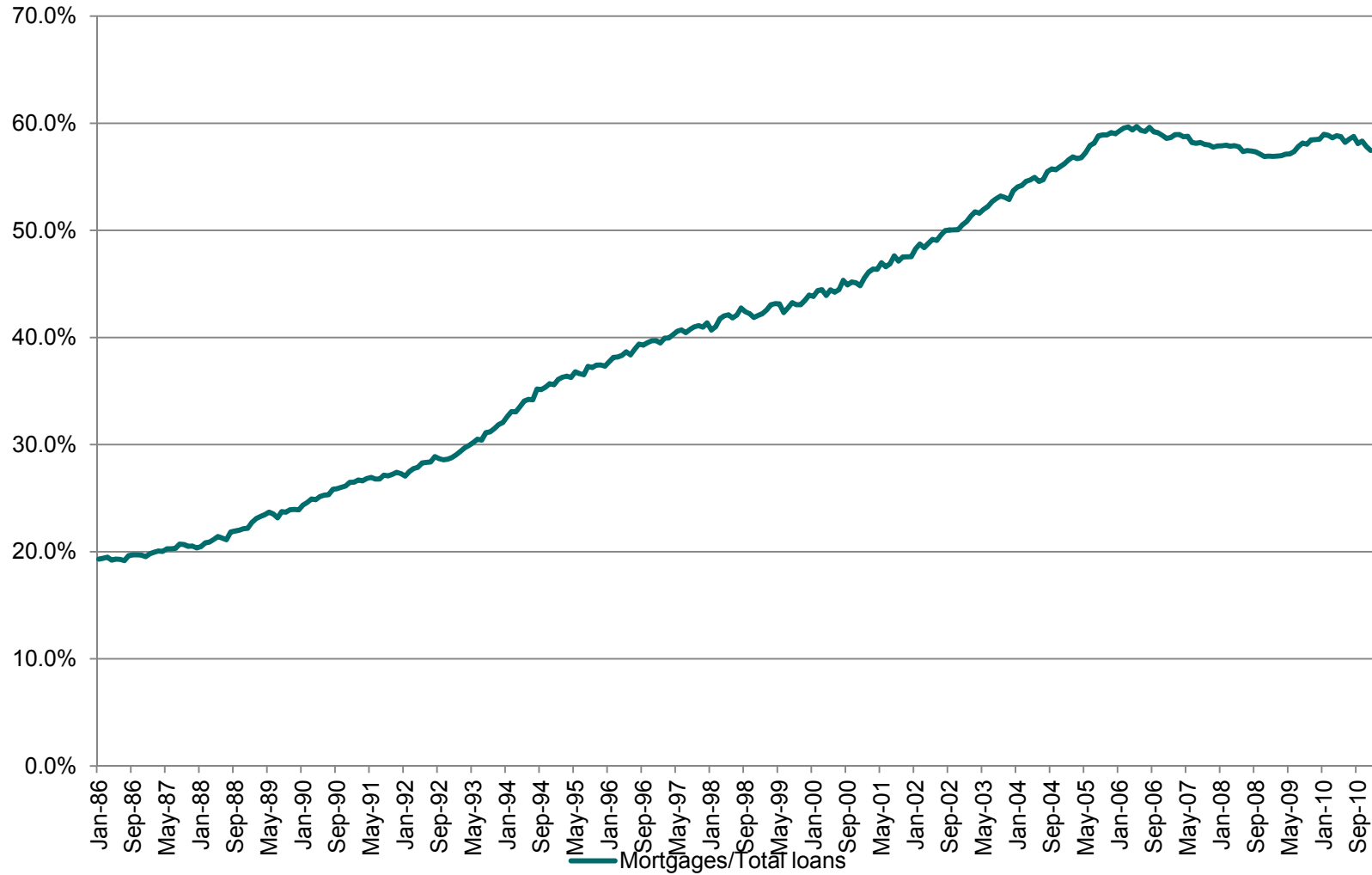
% loans in arrears



Loans in arrears, by types



Mortgages/Total loans



The new map

- 6 large commercial banks of about 200.000 € of liabilities size.
- 10 smaller banks or savings banks, very much oriented towards the territory.

Coefficient of main capital

- 8%: general capital coefficient for individual banks or consolidated groups that may raise reimbursable capital from the public.
 - This rate is 10% for those entities which have not placed to third parties at least 20% of their voting rights and that are exposed to wholesale finance in more than 20% of the total.
- Options for banks:
 - Raise capital at the market
 - Use FROB (public) funds (until now banks have used 11.559 mill €). The public sector gets seats at the governing boards.
 - Sell assets (industrial shares, commercial branches...) (difficult times to make capital gains..)
- Short term

Coefficient of main capital

	Initial position	Main capital coefficient	Compliance		
Individual Banks	Mill €	8 Or 10%	Yes/No	Percentage points difference	Capital needs
Bankinter	2144	8	no	-1,1	1333 mill €
Barclays	1005	8	no	-2,8	552 mill €
Caixa	16083	8	yes		0
Bankia	14125	10	no	-2,9	5775 mill € (1795 if traded at the Stock Exchange)
...
Commercial Banks	104710				1075 mill €
Savings Banks	65564				14077 mill €
Cooperative Banks	9367				
TOTAL	179642mill €				15152 mill €

The new map of Spanish SB's

- http://graficos.lainformacion.com/economia-negocios-y-finanzas/mapa-de-las-fusiones-de-cajas-de-ahorro-espanolas_vnxutGNH17TX86g9faduf2/

Concluding remarks

- The length and intensity of the current economic crisis has forced Spanish authorities to rescue and re-regulate savings banks.
- A large exposure to housing and land risk has aggravated the negative impact on their liquidity, profitability and solvency.
- By now, banks have already
 - recognised losses amounting to 9% of GDP
 - increased their capital ratios (11.800 mill € from FROB)
 - made more capital provisions to face expected losses
 - made themselves more transparent than before.
- Main consequences:
 - They are becoming conventional banks
 - The market will be reduced from
 - 37 commercial banks; 16 Savings banks and 60 Cooperative banks
 - To 6-7 large (international) commercial banks, 6-10 regional banks and 15 cooperative (local) banks.



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