BANCO DE ESPAÑA
Eurosistema

20.06.2014

Closing address of the seminar "Europe in the aftermath of the crisis"

APIE-UIMP

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Introduction

Thank you very much, Miguel Ángel, for your introduction. And thanks again for inviting me to close the course organised by APIE at the UIMP. As in previous years, it is a real pleasure to be among you.

I will take the opportunity to offer some thoughts on the situation of the Spanish banking system and the challenges it has ahead, two years after the approval of the financial assistance programme for Spain, and five months after the conclusion of this programme once its objectives were met.

In particular, after discussing the macroeconomic environment and reviewing the transformation of the banking sector over the past two years, I shall focus on the public cost the process has entailed and highlight the main challenges facing both the financial industry and the financial authorities.

1. Progressive recovery in the Spanish economy

Allow me to begin with a brief overview of the current situation of the Spanish economy, which is far different from that two years ago, when the extreme tensions on the capital markets derived from the institutional crisis of the euro area, the vulnerability of public finances and of part of the banking system, and the recession under way drove the Spanish government to apply for financial assistance.

At present, the economy, after beginning to show moderately positive growth rates in the second half of 2013, is set on a path of recovery. The information available indicates that year-on-year growth rates might draw close to 2% late next year.

Positive figures can likewise be seen in the labour market. Following a process of job destruction that ran for over five years, the incipient recovery in the market observed in the closing months of 2013 has gained in momentum in the first half of 2014, providing for a slight reduction in the unemployment rate which, however, remains at unacceptably high levels.

The firming of the improvement in the labour market is crucial for driving the expansion of domestic demand and, thereby, making the incipient path of recovery sustainable. Contributing factors here must also include the adjustments made by the economy, which have seen an appreciable moderation of the main imbalances in public finances, the external balance, private-sector debt and the real estate market. The measures recently announced by the European Central Bank (ECB), aimed at containing the risk of the euro area running an excessively low inflation rate over a prolonged period, likewise contribute to bolstering the growth outlook for our economy and assisting the adjustment under way.

But let us not forget that the crisis – complete with double-dip recession – in the Spanish economy has had a most severe impact on employment and income levels, and has caused a most pronounced setback in terms of real convergence with Europe. Merely restoring pre-crisis levels of well-being will take several years. Evidently, here, maintaining the reform drive is crucial for speeding the process of recovery of the levels of economic prosperity lost due to the crisis.

2. Banking sector: situation following the reform

The Spanish banking sector has concluded a far-reaching transformation, entailing the clean-up, restructuring and recapitalisation of the most vulnerable banks, all resulting from the transformation of the former savings banks. The consequences of this reform have been reviewed on various occasions, so I need not detail them here. Allow me merely to summarise the three key elements of the process.

i) Firstly, the reform has driven an intense restructuring and re-sizing of the banking industry, enabling its excess capacity to be corrected.

Of note has been the integration of savings banks into existing or newly created banking groups, which has enabled the number of credit institutions to be reduced by over 30. Banks have in the past two years also stepped up the process of re-sizing initiated at the onset of the crisis. Overall, in the last six years, the sector has reduced numbers of offices and employees by around 25%. This has appreciably strengthened the average operational efficiency of the sector.

ii) Secondly, bank balance sheets have been subject to an intense clean-up. This has enabled one of the main sources of vulnerability of the Spanish banking sector, namely its excessive exposure to the real estate sector, to be defused. In particular, claims on the real estate sector, including loans and foreclosures net of provisions, declined by close to 60% from December 2011 to December 2013.

This has been possible mainly thanks to three fundamental factors: i) the increase in provisioning requirements established in 2012 by royal decree-law, ii) the revision of the classification and level of provisioning of restructured and refinanced loans in light of the related guidelines issued by the Banco de España in 2013 and iii) the transfer of real estate assets to Sareb by the banks that received public aid under the financial assistance programme.

iii) Lastly, bank solvency ratios have been notably strengthened thanks to the recapitalisation of vulnerable institutions under the financial assistance programme. The remaining banks have also made appreciable improvements to their levels of own funds through various means such as the issuance of capital instruments, asset disposals or retained earnings, in line with the recommendations on dividend pay-outs made by the Banco de España over the past two years.

3. Cost of the reform of the banking sector

At this stage we might ask what the necessary total cost has been to ensure the stability of the banking system and how it has been distributed among the various parties involved. And, specifically, we can ask what the taxpayer has contributed in this process.

An accurate reply to these questions is no easy task, as two factors combine to complicate the estimations required. First, not all aid has already been disbursed; rather, it consists of guarantees covering against future losses that only have a certain likelihood of occurring. Second, not all aid disbursed will entail a loss for the public coffers, insofar as it may be partly or fully recouped through its return by the recipient banks themselves or from the proceeds of the sale of State stakes in these banks.

That said, a good starting point to disentangle the matter is the note published last week by the Banco de España[1], which included an update of the different types of public financial assistance provided to the banking sector in the period 2009-2013.

Essentially, three different types of public financial assistance have been made available. The first and most significant type have been the contributions of funds in the form of subscription of capital instruments, whether ordinary shares or contingently convertible bonds. These amounted to a total of €61,495 million, of which €1,760 million have already been recouped, and encompassed actions both by the FROB and the Deposit Guarantee Fund (DGF) which, despite being financed by contributions from the banking industry, is included for National Accounts purposes under the public sector.

We might also add here the acquisition by the DGF of shares valued at €1,803 million of Nova Caixa Galicia Banco Catalunya Banc held by minority investors in these banks following the burden-sharing exercises undertaken, and the subscription by the FROB of capital and subordinated debt instruments of Sareb for a total of €2,192 million.

The second type of public financial aid refers to the so-called Asset Protection Schemes (APSs) or other guarantees offered by the DGF or the FROB under resolution or restructuring processes.

APSs consist of the assumption by the guarantor of a majority portion of the risk associated with specific portfolios of the beneficiary bank. These APSs, therefore, involve a cost that depends on the actual losses incurred whose real amount will only be known at the end of the period over which the guarantee is in force. In any event, the expected value of this cost shall be regularly evaluated by independent experts so that the guarantor agency (the FROB or the DGF) may make the related provision in its financial statements.

Finally, the third type of public aid comprises State-backed guarantees of debt issues by certain banks and the extraordinary credit facilities offered to provide liquidity to the sector.

As regards these guarantees, no loss from these contingencies is expected to arise for the State, which will in turn receive revenue in the form of fees and commissions. Currently[2], 69% of the guarantees granted have been returned and the termination process is expected to continue in accordance with the redemption of the issues. Likewise, all amounts drawn down on the credit facilities were duly repaid and the other available

[1] See "Background note on public financial assistance in the restructuring of the Spanish banking system (2009-2013)" published on 12 June 2014 and available at www.bde.es

[2] As at 30 April 2014.

facilities have been settled following the recapitalisation or, where appropriate, disposal of the recipient banks.

As of today, therefore, the public assistance granted is essentially in the form of the capital contributions made and the guarantees offered. That said, not all of the public assistance granted that I have described involves a direct cost to the taxpayer, since the banking industry has also contributed via the DGF.

Hence, to estimate the direct cost to the taxpayer of the aid provided to banks, we should first consider the amounts paid out by the FROB to these banks, add this to the expected cost of the APSs extended by the FROB (at Banco de Valencia and Caja Sur) and of other guarantees and coverage offered by it in connection with resolution processes, and subtract the amounts recouped or expected to be recouped.

That is to say, we should firstly calculate the funds paid out by the FROB to purchase shares or contingently convertible bonds, which amount to €53,553 million, adding these to the estimated cost of the APSs and other guarantees granted in resolution processes which, on the latest valuations available, account for €2,087 million.

From this amount it would be necessary to subtract the recovery of the amounts disbursed through the redemption of convertible bonds subscribed by the FROB or the disposal of the FROB's shareholdings in the banks receiving aid. Here, the €1,760 million from the sale of NCG and the return of the aid granted to Banca Cívica by Caixabank[3] should be recorded. Further, the convertible bonds subscribed by the FROB in Caja3 (absorbed by Ibercaja), CEISS (absorbed by Unicaja) and Liberbank, are highly likely to be redeemed before 2017, entailing the return of €1,135 million.

The most uncertain element of the recoverable amounts is the estimation of the outcome of the sale of Catalunya Banc, currently under way, and of the divestment of BFA/Bankia and BMN. However, it is likely that these disposals will entail an appreciable lessening of the cost that the restructuring of the financial system has involved for taxpayers.

In any event, the figures are sizeable. However, in terms of GDP they are not higher than those recorded in other European countries during the financial crisis despite the fact that, in most of them, banks have not had to face a real shock with an impact on the scale of that of the collapse of the real estate sector in Spain.

As discussed earlier, the banking industry – via the Deposit Guarantee Fund – has also contributed notably to stabilising the financial sector. This contribution has been possible thanks to the maintenance at all times, despite the severity of the economic and financial crisis, of appreciable financial soundness at most institutions, representing more than 80% of the sector as a whole.

[3] Note that this figure does not include the sale of shares of Bankia by BFA (100%-held by the FROB) in February – accounting for 7.5% of capital, at the price of €1.51 per share – insofar as the liquidity obtained remains in the selling institution and is not therefore a refund of assistance until BFA's capital is amortised.

The DGF's support was in the specific form of direct injections into CAM, UNNIM and CCM (for a value of €7,942 million), the APSs granted to these institutions (whose estimated cost as at 31.12.2013 was €6,898 million at present value) and the potential losses caused by the acquisition of shares in NCG and CX, provisionally evaluated at €754 million.

4. The new challenges for the sector and the authorities

Having reviewed the transformation of the Spanish banking sector and its consequences in terms of costs for the public coffers, I have some thoughts I would like to add on the outlook for the sector. In particular, moreover, I wish to analyse the consequences, both for banks and public authorities, of the regulatory reforms agreed in response to the financial crisis.

As I said earlier, the banking industry has been strengthened considerably in terms of asset quality, efficiency and solvency. This has been the result of the restructuring undertaken, the independent measures of the banks themselves, the regulatory changes made and the proper application of the demanding accounting rules laid down by the Banco de España. I trust this will all come to light in the assessment exercise which, as you know, is being conducted at the European level as part of the groundwork for the start-up of the Single Supervisory Mechanism (SSM) in November this year.

However, the challenges ahead are significant. The current environment, marked by still-weak macroeconomic conditions and very low interest rate levels, continues to exert pressure on banks' turnover and margins. While the recovery under way is being felt and there are discernible signs of credit stabilising and non-performing loans declining, it is likely that banks' recurring income – in line with developments in the rest of Europe – will remain at still-low levels for some time.

In addition, the new regulatory changes, both prudential and resolution policy-related, require not only the availability of ample capital levels but also, moreover, of other liabilities-side instruments able to be converted into capital if needed. Taking advantage of the foreseeable improvement in economic conditions to raise the return on equity, while responding to new regulatory requirements, is a notable challenge for the financial system.

The path pursued by the sector as a whole – to contain financial and operating expenses while combining diversification with the harnessing of competitive advantages and moderating dividend pay-outs and remuneration – is an appropriate one for adjusting to the new competitive, regulatory and supervisory environment within the framework of the SSM.

Turning to what are essentially institutional matters, several challenges remain. I would like to indicate three of these.

First, to conclude the reform of the Spanish banking sector, it is necessary to complete the adaptation of savings banks to the new arrangements stipulated in Law 26/2013 of 27 December 2013 on savings banks and bank foundations. This Law is a fundamental step for ensuring that all credit institutions are managed independently and professionally so that the governance problems which contributed to destabilising part of our financial system are diffused once and for all.

In practical terms, this year should see the completion of the transformation of virtually all of the savings banks – those still existing as such – into ordinary foundations or bank foundations. For this purpose, and as it is legally conferred to do, the Banco de España is drafting a Circular. This Circular will regulate the core aspects of the functioning of bank foundations in order to safeguard the healthy and prudent exercise of the dividend and voting rights corresponding to them as the shareholders of credit institutions, thereby ensuring the professional management of such credit institutions. The Circular will specify aspects such as: (i) the content of the protocol governing bank foundations' management of their ownership interest in the credit institution; (ii) the financial plan, which will envisage how they must meet the possible capital needs of the institution in which they have an ownership interest; and (iii) the requirements which the reserve fund must fulfil as regards its funding, target volume and possible uses; all the foregoing in cases where, given the percentage of ownership they hold in the credit institutions, these requirements must be met. Similarly, the Circular will determine the circumstances in which bank foundations will be compelled to diversify their investments and, if appropriate, to relinquish control of the credit institutions which they own through the corresponding divestment. I trust that the period for public consultation of the Circular will open shortly.

Second, the new European framework of resolution is already prompting, in most national jurisdictions, reflection on the institutional architecture of bank resolution.

In the past, resolution agreements have required close collaboration between the various authorities involved in the process; namely, the supervisor, the resolution authority, if any, and the governments concerned insofar as the resolution has habitually required the use of substantial public funds.

The experience in our country has been no exception. The current distribution of functions between the Banco de España and the FROB – whose Governing Committee includes representatives of the Ministry of Economic Affairs and Competitiveness, the Ministry of Financial Affairs and Public Administration, and the Banco de España – has required that the two institutions were intensely involved in the resolution processes. Thus, while the supervisor is responsible for initiating the resolution process of an institution and approving the resolution plans, the FROB must prepare these plans, put them into practice and, in sum, manage the State's ownership interest in those institutions that received financial aid, including any future divestment. Consequently, the coordination between the Banco de España and the FROB has been pivotal in ensuring effective management of the crisis.

The Single Resolution Mechanism, whose regulation will be published shortly, includes the delegation of the resolution powers in relation to significant institutions to a new European agency (the Single Resolution Board). At the same time, as a result of the new Recovery and Resolution Directive, the combination of significant requirements governing the "bail-in" of bank creditors to cover the potential capital shortfalls of non-viable institutions and the availability of a common resolution fund wholly funded by the industry will considerably reduce the need to resort to using public funds in bank resolution processes. Consequently, the changes introduced by the new European resolution framework could require some adjustments to national arrangements which affect the nature of the resolution authority, its relationship with the supervisor and the degree of direct involvement of government authorities.

Finally, I think the time is right to reflect on possible regulatory changes that may help to maintain the strength of other areas of the financial sector, such as credit cooperatives, in the new regulatory and competitive setting.

The cooperative sector in Spain, unlike other countries, barely represents 6% of credit activity in Spain, but it plays an important role in specific fields such as rural areas. The sector, in most cases, is well-capitalised with comfortable liquidity positions as a result of pursuing prudent, retail customer-focused management and of scant exposure to the real estate development business. This has enabled it to avoid the problems experienced by other types of institutions.

That said, regulatory changes and competitive pressure also pose an important challenge for these institutions which will require them to maintain sufficient levels of operational effectiveness, effective control of risk concentration and, especially, sound foundations for ensuring that regulatory capital is preserved and, if necessary, increased.

Consequently, in line with the recent announcement made by the Minister of Economic Affairs and Competitiveness, possible regulatory adjustments need to be studied which, while conserving the essential core of the current business model of credit cooperatives and without calling their identity into question, ensure the soundness of the sector in a more demanding environment. I think that the organisation of credit cooperatives in other advanced economies, where they represent a larger share of the banking business than in Spain, are a useful reference for the reflection I referred to earlier.

Thank you very much.