Summary for non-specialists
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Financial Assistance Programme for the Recapitalisation of Financial Institutions in Spain. Update on Spain's compliance with the Programme - Winter 2013

The European Commission published an update on Spain's compliance with the conditionality of the Financial Assistance Programme for the Recapitalisation of Financial Institutions Programme since the submission of the First Review report in mid-November 2012. This report is necessary for the release of the funds needed for the recapitalisation of Group 2 banks prior to the next formal second review, to be issued only after a joint European Commission/European Central Bank[1] mission that will take place in Madrid in late January 2013.

The intermediary report found that progress with the implementation of both the bank-specific and the horizontal conditionality of the programme continues to be broadly on track. The European Commission adopted the restructuring plans for Group 2 banks (Banco Mare Nostrum, Banco Caja 3, Liberbank and Banco CEISS) on 20 December 2012, the Asset Management Company, Sareb, has become operational in its basic functions with the appointment of its Board of Directors, the approval of the by-laws of the company and the transfer of assets of Group 1 banks, and the bank regulatory and supervisory framework has been further improved. More specifically, possibilities to improve the regulatory and supervisory functions of Banco de España have been identified, legislation strengthening the governance of savings banks and clarifying their role as shareholders of credit institutions has been prepared, and a policy document on amending the provisioning framework and strengthening the credit institutions' funding, provisioning and capitalisation requirements has been submitted.

[1] The mission will also involve expert teams from the European Stability Mechanism and the European Banking Authority. The International Monetary Fund will participate in the meetings as part of its independent monitoring.

On this basis, the European Commission in liaison with European Central Bank recommended to the European Stability Mechanism the release of the second loan tranche of EUR 1.865 billion. The approved restructuring plans for Group 2 banks puts them on track to re-establish their viability over time and limit the amount of funds required from the taxpayer. The capital injection needed to cover the capital shortfall for Group 2 banks estimated at about EUR 6.3 billion in the bottom-up stress test would amount to only EUR 1.865 billion after burden sharing measures and other adjustments.

As regards key challenges for meeting the programme's objectives, preserving financial stability and finalizing the restructuring of the banking sector represents the most important one. Since mid-November, Spain has maintained access to financial markets and investor confidence showed tentative signs of stabilisation, albeit at a low level. Net borrowing from the Eurosystem declined and the outflow of non-resident deposits came down. However, the supply of credit remains constrained by the banks' more prudent credit policies, limited access to market financing and declining profitability due to asset impairments. At the same time, financial-sector deleveraging and the economic recession continue to reinforce each other as the structural adjustment of the real economy advances towards a sustainable resumption of economic growth. Risks to Spain's financial sector remain significant, despite the overall good performance.

In addition, financial sector reforms need to be further advanced. The draft roadmap for the listing of the banks included in the stress test, which have benefitted from State aid as part of their restructuring process, could be further enhanced. The biggest challenge in recent months has been to render Sareb operational in due time, which was achieved, but it still faces additional operational defies going forward. In a similar way, the operationalization of eliminating the savings banks' controlling stakes in commercial banks remains a demanding goal.