23 March 2011

Note on the process of restructuring and strengthening of savings banks. Situation as of March 2011

The entry into force of Royal Decree-Law 2/2011 for the reinforcement of the Spanish financial system has opened up a new phase in the process of restructuring and strengthening the savings banks, which is now focused on recapitalising those institutions that need more capital, as well as encouraging the savings banks to transfer their financial activity to a bank to facilitate their access to capital markets and wholesale funding. Within the framework of this restructuring, Spanish savings banks have been involved since the middle of last year in 12 integration processes (7 mergers or takeovers and 5 institutional protection schemes (SIPs)), which have reduced the total number of savings banks from 45 to 17.

The progress made in restructuring and strengthening savings banks

All the merger operations have been completed, with post-merger arrangements in operation, and all the SIPs (except Banco Base) have adopted all the resolutions and obtained all the authorisations necessary for the integration process to be irreversible on the terms established by the Banco de España (see the table below). In total, the assemblies of 36 of the 40 institutions involved in integration operations have already approved the whole process.

The creation of an SIP involves the signing of an integration agreement defining the percentage share of each savings bank in the commercial bank that will act as the central body, governance agreements, the mutualisation of 100% of the results and the commitment to make available all their assets and liquidity.[1]

The restructuring of the savings bank sector has had very significant consequences in terms of the average size of the institutions, the reduction in capacity, the strengthening of balance sheets, recapitalisation and the improvement in efficiency and profitability.

- *Size of institutions*. The integration processes are correcting the excessive fragmentation of the sector: the average total assets per institution has risen from €29 billion to €76 billion, boosting their capacity to compete more efficiently.

- *Capacity adjustments*. These enable the problem of excess capacity in the sector, as reflected in oversized branch networks and central services, to be addressed. The planned adjustments are very important, since they represent cuts of 10% to 25% in the number of branch offices and of

[1] In the case of Banco Base, the integration agreement was amended to include a condition precedent that suspended its effectiveness until the assemblies had approved the transfer of the assets and liabilities to the central body.

12% to 18% in staffing levels. These cuts come on top of those that had already been made by the institutions before initiating this process, which involved a 5% cut in branch offices and a 4% cut in staff from their peak 2008 levels.

- *Balance sheet write-downs*. The integration processes have also facilitated considerable balance sheet write-downs for the participating institutions, since through the application of fair value accounting in "business combinations" and "joint ventures", the savings banks have recognised additional balance sheet losses on loans and receivables and foreclosed assets totalling €22 billion. To this total must be added the previous write-downs made by savings banks, by means of provisions charged to the income statement and the use of general provisions, totalling €30 billion. As a result, savings banks have recognised a total amount of €52 billion of impairment losses over the three years since January 2008.

The Royal Decree-Law opens a new phase in the process of savings bank restructuring

The adoption of Royal Decree-Law 2/2011 marks the beginning of a new phase in the process of savings bank restructuring which adds to the efforts made by institutions in the last few years to clean up their balance sheets, reduce capacity and increase average size. The Royal Decree-Law raises the capital requirements of Spanish institutions (8-10%), encourages them to raise private capital, requires those which need government funds to pursue their financial activity through a commercial bank and sets a precise timetable for recapitalising institutions that do not reach the required capital levels.

Incentives to raise private capital

The Royal Decree-Law provides incentives for institutions to raise private capital to boost their solvency. They can do this through direct receipt of funds from third parties, market flotation or a combination of the two. The government funds contributed by the FROB are of an exceptional and temporary nature, since they will have to be replaced by private capital when the time comes.

Transfer of financial activity to a commercial bank

The transfer of financial activity to a commercial bank has become the operation most commonly used by savings banks. Although the Royal Decree-Law only requires the pursuit of financial activity through a commercial bank in the case of those institutions that need government funds, many other savings banks have decided to make this transformation voluntarily.

In most of the mergers that have already been approved, steps have been taken to transfer the financial activity to a commercial bank.

Four SIPs have been set up. In one of them, the general assemblies of the savings banks involved in the project have approved the transfer of their financial business to a new commercial bank, and in another two board meetings are scheduled in the next few days to approve this step, which will have to be ratified by the respective general assemblies of each institution.

Recapitalisation and timetable

The Royal Decree-Law establishes a precise timetable for recapitalising the institutions which do not reach the core capital levels required by the new legislation (8% of risk-weighted assets as a general rule and 10% for those groups or institutions which have failed to place at least 20% of their capital with third-party investors and whose percentage of wholesale funding exceeds 20%).

A total of eight savings banks or savings bank groups have to increase their core capital, by a maximum amount of €14,077 million.[2] To do so, they have to submit to the Banco de España their strategy and timetable for complying with the new requirements.

- 28 March is the deadline for submitting to the Banco de España the strategy and timetable for compliance with the new capitalisation requirements.

- The Banco de España will have until 14 April to approve the plans or else require the pertinent changes to them.

- By 28 April all the institutions that need a recapitalisation plan must have approved it.

- 30 September is the deadline for institutions to have implemented their recapitalisation plans. For those institutions which have opted to raise private funds, the Banco de España may grant a postponement in duly justified cases if it reasonably considers that the measures proposed in the plan will be carried out. The plan may be postponed until the end of 2011 for off-exchange recapitalisations and until March 2012 for share listing processes, provided there is a resolution by the competent governing body and a detailed implementation timetable.

In any event, the Fund for the Orderly Restructuring of the Banking Sector (FROB) is obliged to subscribe such capital amounts as may be needed by those institutions requesting it to do so, whether as a first or a second option, to supplement or replace private capital, in accordance with Royal Decree-Law 2/2011.

[2] So far the FROB has contributed and committed funds to the financial system amounting to €11,559 million.

	BASIC MAGNITUDES	APPROVAL BY AUTHORITIES AND BODIES INVOLVED IN INTEGRATION PROCESS AND OTHER RELEVANT RESOLUTIONS (1)											RECAPITALISATION		
INTEGRATION PROCESS	Total assets (€m)	Board of directors of individual institutions	Banco de España	FROB / Min. Ec. Affairs and Fin.	Regional government	EU	Dir. General of the Treasury	National Competition Commission	Labour agree-ment	General assembly of individual institutions	Creation of commercial bank/ merged institution	Gen. meeting comm. bank/merged institution. Issuance pref. shares to FROB	FROB support (€m)	Level required by RD-L 2/2011. Core capital	Additional capital RD-L 2/2011 (€m)
BANKIA *(Caja Madrid, Bancaja, Layetana, Ávila, Segovia, Rioja, Insular)* Form of integration SIP	344.508	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	4.465	10%	5.775
BASE *(CAM, Asturias, Banco Castilla la Mancha, Cantabria, Extremadura)* Form of integration SIP	124.127	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	YES (2)	1,493 (3)	10%	1.447
MARE NOSTRUM *(Murcia, Penedés, Granada, Sa Nostra)* Form of integration SIP	71.723	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	915	10%	637
BANCA CIVICA *(Municipal Burgos, Navarra, Canarias, Cajasol, Guadalajara)* Form of integration SIP	71.668	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	977	10%	847
CAJA 3 *(Inmaculada, Burgos CCO, Badajoz)* Form of integration SIP	20.856	YES	YES	Nn	YES	Nn	YES	YES	YES	YES	YES	Nn	0	8%	None
LA CAIXA *(Caixa, Gerona)* Form of integration Merger	289.627	YES	YES	Nn	YES	Nn	Nn	YES	YES	YES	YES	Nn	0	8%	None
NOVACAIXAGALICIA *(Galicia, Caixanova)* Form of integration Merger	78.077	YES	YES	YES	YES	YES	Nn	YES	YES	YES	YES	YES	1.162	10%	2.622
CATALUNYACAIXA *(Cataluña, Tarragona, Manresa)* Form of integration Merger	76.649	YES	YES	YES	YES	YES	Nn	YES	YES	YES	YES	YES	1.250	10%	1.718
BBK *(BBK, Cajasur)* Form of integration Takeover	48.739	YES	YES	YES	Nn	YES	YES	YES	YES	YES	YES	Nn	392	10%	None
CAJA ESPAÑA DE INVERYESONES (Caja España, Caja Duero) Form of integration Merger	45.543	YES	YES	YES	YES	YES	Nn	YES	YES	YES	YES	YES	525	10%	463
UNICAJA *(Unicaja, Jaén)* Form of integration Merger	34.838	YES	YES	Nn	YES	Nn	Nn	Nn	YES	YES	YES	Nn	0	10%	None
UNNIM *(Sabadell, Terrassa, Manlleu)* Form of integration Merger	28.550	YES	YES	YES	YES	YES	Nn	YES	YES	YES	YES	YES	380	10%	568

(1) The integration resolutions were approved first by the boards of directors, then all the legal authorisations were obtained and finally they were ratified by the savings banks' assemblies.

(2) The effectiveness of the integration agreement is subject to a condition precedent (indirect pursuit of the activity) that has yet to be met. Pending approval of business segregation by assemblies.

(3) Will only be paid out when the condition precedent in the integration agreement is met.

Nn = Not necessary