

Granada, 17 December 2010

**Savings bank restructuring and institutional protection schemes  
(IPs)**

Conference organised by Caja Granada

Javier Aríztegui  
Deputy Governor

---



It is a pleasure for me to be able to share with savings banks professionals and Spanish financial system specialists some reflections on what are known as “Institutional Protection Schemes”. And it is all the more satisfying to do so in a city as magnificent as that hosting the event today. My thanks, then, to Caja Granada for kindly inviting me to participate in the closing of this conference.

The year 2010 now drawing to a close has been a difficult one for the Spanish banking system, whose activity has continued to unfold in a sluggish economic setting marked by financial markets that have not yet managed to attain the degree of stability and confidence needed. It has thus been a year replete with management challenges, intellectual debates and legislative initiatives. But if we must choose one specific milestone marking it above all others, 2010 has been the year of merger agreements between savings banks, in possibly the most extensive banking concentration process ever undertaken in our country.

A sizeable portion of these agreements has taken the form of Institutional Protection Schemes or - to make a further addition to the plethora of acronyms and initials characterising today’s financial jargon - IPSs. While as a general rule I am against this invasion of jargon, perhaps in this specific case the initials are preferable to the longer version, because IPSs, the focus of this conference, are not merely “institutional protection schemes”, or legal instruments suitable for securing the benefits of consolidation under capital regulations. They are and should be much more than that.

IPSs have arisen as an innovative structure in the banking system and, like all new products, they are best evaluated by organising their assessment in steps, or successive degrees of scrutiny, so that at the end of the process their structure can be fully appreciated.

The first step in the process of evaluation will be to judge whether they are timely. The second will focus on their design and construction. The third will be a “use test”. And the fourth and final level of assessment will look at how readily they lend themselves to progressive development so as to cover potential future needs.

Allow me to cover these successive steps or facets one by one. Let us start with the first, their timeliness.

IPSs are a response to an **unquestionable substantive need**: the downsizing of the Spanish banking sector, following the excesses of the growth period prior to 2007. These factors left many institutions facing the challenge of a future far removed from the comforts that had characterised the previous period, namely: strong economic growth, abundant liquidity on international markets, extensive business margins and healthy assets. Such comforts were viewed by many as a shield against underlying risks, and in some cases they prompted banks to lower their guard against the problems that were gathering.

Given the new playing field in place as from 2007, the responsibility of savings banks is clear: to act resolutely to change those structures that can be improved, in full awareness that other parts of the new situation are exogenous and therefore elude their management capabilities. Hence the importance of taking decisions aimed at improving efficiency, through merger – or concentration – processes that position savings banks at a new set of size and rationality-based coordinates.

Faced with this need, the structuring of the new IPS instrument (new, at least, in terms of its current contours) responds to the need to pave the way so that concentration agreements may be reached between a type of institution –savings banks – which, given its business form and complex governance arrangements, does not have the same flexibility as banks to conclude merger agreements. To smooth these concentration processes, the Fund for the Orderly Restructuring of the Banking Sector was also created, a Fund to which the initiators of the various projects can resort to strengthen their capital. This assistance adds further discipline in respect of compliance with the plans, since the condition imposed by the use of public funds is that the capacity of the banking system should be reduced and its efficiency increased.

Mergers and IPSs are thus two alternatives available to savings banks to concentrate their business and restructure. The two options differ in terms of their legal form, but they coincide fully in their objectives and should be equivalent in terms of their results.

Let us turn to the second step of the evaluation process. The guiding principle of the **design and legal construction** of IPSs has been the search for a concentration mechanism analogous to mergers in terms of practical results. In this connection, the IPS has been structured on three basic pillars.

The first entails the relinquishing by all participants to the central body of the IPS of the capacity to determine and implement business strategies and internal risk control and management tools, in such a way that this central body becomes the nerve centre of the IPS. The second pillar comprises the mutual liquidity and solvency pacts between the participating savings banks and the pooling of results, to extents that should exceed 40%. And the third pillar is a commitment to stability of the agreements, which must run for a minimum term of 10 years, and which cannot be broken without the Banco de España first analysing the viability of the various institutions resulting from the fragmentation process.

It should be stressed that, in all cases, the agreements so far reached go further than these minimum legal requirements, in the extent of pooling of solvency, liquidity and results. This is because, if so approved by the general meetings convened for next week, the extent of pooling will reach 100%. This solidarity arrangement contributes to providing firm foundations for a common project and giving it substance, since objectives are unified, more efficient management arrangements are set in place and the markets and all intervening agents can more readily perceive the project's cohesiveness and viability.

From the standpoint of banking regulation, by using this design IPSs become consolidatable groups of credit institutions dominated by a central body. Actually, however, they are more than a group; they are de facto mergers ("cold mergers" as they have been called) since, for economic – not legal - purposes, each participant has forgone the individuality proper to a separate legal person.

Full mutual liability between the parties to the agreement has been achieved, going beyond what the law governing corporate groups provides for in Spain. Hence, in practice, the participating savings banks become, from a merely economic and managerial standpoint, what are veritable retail banking "regional heads" of the IPS regarding their operational capacity and the way in which they contribute solvency, liquidity and results to the group; yet, from the legal standpoint, they retain their personality and their sovereignty in the agreed distribution of welfare fund assets.

I also pointed out how, like any new product, IPSs must pass muster in respect of the third and most important step of the evaluation process, namely **the “use test”, i.e. proof of their adaptation to reality.**

IPSs have to obtain the same improvements in organisation, efficiency, economies of scope, diversification and quality and unity of management as traditional mergers. They must do so in the same length of time as a normal merger, and they must strive to ensure that their results are clearly perceived by the markets as lasting.

In this connection, it is vital that the initiators should be particularly diligent in countering the danger that the “raw novelty” of this legal formula – whose features have had to be rapidly devised – may be used as an excuse for rigidities, procrastination or half-measures.

Compared with traditional mergers, where the combining of objectives and efforts to advance in a single direction is more natural, all the participants in IPSs must be on their guard to prevent the essential goal of unity from becoming distorted. They must strive to ensure that the mind-set of directors, managers and staff alike is geared towards a single goal; individual visions are no longer appropriate here, and nor are decisions not aimed at achieving a better future for the single corporate project that has replaced its predecessors.

All the participants in institutional protection schemes are assuming a very specific responsibility here, an institutional responsibility and a personal responsibility. The single economic entity resulting from the IPS – the aggregate – must be profitable and efficient, well-managed and display dynamism befitting the financial sector so as to provide the services demanded by the real economy with quality and at competitive prices.

Evidently, in a setting of clear risk-aversion, the road to attain these goals and to convince savings-bank creditors of them, so that they renew the funding they have provided, is not an easy one. This task requires three basic conditions.

First condition: resolve in adopting the measures needed using exclusively corporate criteria, in full knowledge that some of them may not be agreeable owing to the personal sacrifice entailed. To achieve this, it is essential that all the interest groups behind the governance of the merged savings banks should identify with the goals of the single project.

Second condition: flexibility and speed in adopting these measures. As the saying goes, time is precious. The need to access wholesale funding markets as from the first fortnight in January in 2011 and the greater capital requirements imposed by the regulations in the pipeline and by the widespread increase in the perception of risk should be a spur to all, and they impose a clear-cut reduction in all the timeframes envisaged for the conclusion of the projects. In practice, the timetables for the concentration plans suggested some six months back must be significantly shortened. Implementation of the various steps must be brought forward, with every extra effort and sacrifice needed being made.

Third condition: determination in transmitting to the market the idea of a single and consolidated project, of a concentration arrangement equivalent to a merger, of an entity prepared to harness in practice all the synergies and all the management improvements made possible by an IPS structure. To do this a proactive strategy should be adopted, geared to securing the economies of

scale characteristic of a merger and to reducing overheads, including unit wage costs, which is imperative in the current economic circumstances. Any sign of wavering should be avoided, since this would be seen as an excuse to question the group's cohesiveness, which is an unacceptable risk at present.

I stated in the introduction that any new product has to be prepared to overcome a fourth and final trial and evaluation step: it must prove its **capacity for future development**. This is a particularly pertinent demand for the financial system, since what is involved is a nimble and dynamic sector.

IPSs are a structure that must prove to be of use in providing lasting banking services. But it is also true that legislation, specifically Royal Decree-Law 11/2010 of 9 July 2010, has opened up new means for savings banks to pursue their activity, offering a range of possibilities. In particular, it is provided for that savings banks participating in an IPS can convert in the future, de facto or de jure, into savings banks with "indirect activity", or into foundations, which focus on attending to and developing their welfare fund assets. In this connection they will transfer in full the assets assigned to their banking activity to the central credit institution, in exchange for shares, and they will collaborate efficiently in the management and control of the activity pursued by this bank.

Making use of this possibility is a decision incumbent upon the managers of IPSs, and one which should be considered without delay, if funding markets so demand. Or if this should be so required by the even more demanding capital market, to which access will prove vital. In adopting investment decisions, this will call for a high level of certainty in projects and in business structures.

To access bond markets and cover maturities, it may suffice, along with the full sharing of profits and losses and the cross solvency guarantee, to transfer to the central entity a portion of the group's assets and liabilities (normally that associated with wholesale businesses and branches located in territories in which it does not operate exclusively). We shall find out if this is sufficient from January 2011, when significant volumes of external financing will have to be renewed.

However, probably, when it is necessary to raise capital, by issuing shares of the bank located at the heart of the IPS, a larger contribution of strategic assets and liabilities to this bank will be needed, if it is desired to give expectant new members complete certainty regarding the specific assets and liabilities they are going to share and promote as a shareholder. And I insist that, in the current circumstances, this decision must be taken promptly, if the necessary capital is to be raised for the projects that need to be developed.

Firms in other sectors of the economy, savings bank workers, the public in general and welfare projects will ultimately be the true beneficiaries of concentration processes conducted in accordance with the criteria of rationality I have referred to.

The Banco de España, in its capacity as the supervisory authority, has adapted the organisational structure of its supervisory services to the new savings bank map, in order to monitor meticulously the progress of each project.

Before concluding, I must draw attention to an urgent **outstanding task**. Over the past year, savings banks have performed an excellent job of self-criticism, reform and adaptation which, in my opinion, has only been partly publicised and explained to all parties interested in their welfare: the financial markets – on which they depend for the lifeblood of funds to conduct their activity –

and the public, who are the ultimate beneficiaries of the banking services the savings banks provide.

Businesses, balance sheets and income statements have been integrated, market values, capital gains and capital losses have been recognised, and assets have been written off in the concentration processes, which will be recorded in the accounts at year-end 2010. This overhaul and the key future milestones in the concentration processes (relating to resources, systems, human resources, etc.) have not been sufficiently communicated to all interested parties.

Consequently, a major communication drive is needed to explain the changes agreed, the assets and liabilities of the new financial statements (which are still pro-forma) and the pending concentration programme. This is because suspicions arise in the markets from time to time that these changes, rather than amounting to wholesale reform of the organisations concerned, are merely window-dressing. And this task of educating people must be performed before the wholesale markets re-open in about three weeks' time.

When that happens, the new treasury teams resulting from the concentration and merger of savings banks will have to use that detailed information as the basis for their demands for financial resources from euro area creditors. Without fluid communication, matters will be very complicated indeed.

It is now that the true extent of the value added by good management comes into its own. You must take decisions, at times disagreeable ones, to protect profit margins, to reduce operating costs and overheads, to promote business activity, to control risks and liquidity, and to complete the integration of operations. In short, you will have to convince the euro financial markets to commit money to your projects, in the form of loans and capital, and all this must be done very rapidly and in an adverse environment.

The new decade dawning in a few days will be as the old one, full of challenges but also full of hope that we will be able to pool the best of our abilities to contribute to a future the Spanish banking system merits.

Allow me to wrap up by making a small correction so as to infuse some consistency in all I have said. At the beginning I thanked Caja Granada for the invitation to participate in this conference. I should like to clarify by saying that my thanks should really go to IPS "Mare Nostrum".

Thank you very much and Happy Christmas to you all.