

Spanish Banking Sector. September 2011

London 20th September 2011

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- **Spanish economy**
- **Spanish banking sector**
- **Takeaways**

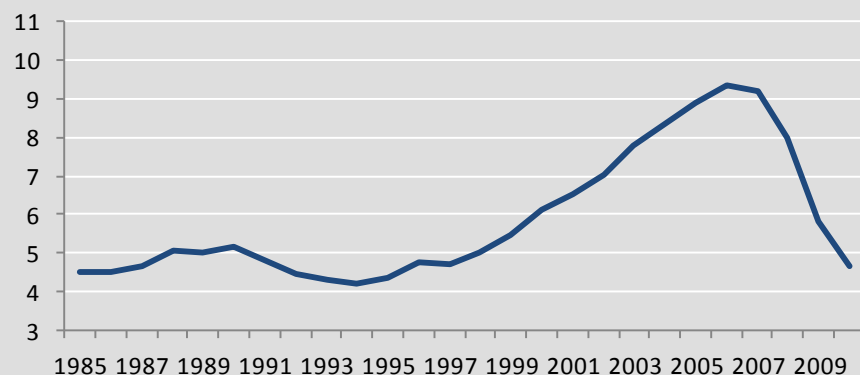


- The Spanish economy experienced a **strong economic expansion between 1994 and 2007**. This expansion has been accompanied by
 - **High levels of investment** (28% of GDP from 2000 to 2007), **only partly residential** (7.9% of GDP)
 - **Budgetary equilibrium**
 - **Low levels of public debt** (36.1% of GDP in 2007)

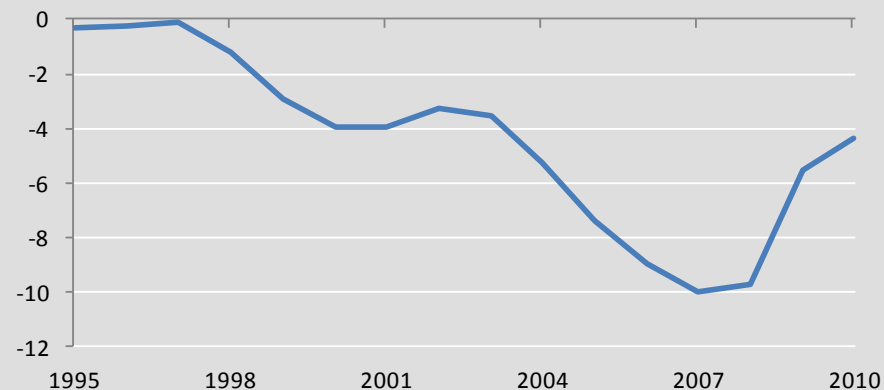


- During this period of economic growth the economy **also accumulated imbalances, which are now in a process of adjustment**
 - **Current account deficit**
 - **Housing sector, including house prices overvaluation**

Investment in housing as a percentage of GDP, %



Current account deficit as a percentage of GDP, %





Good starting position before 2007

- In terms of its **financials** (profitability, efficiency and solvency) and its **business model** (traditional retail banking)

Accumulation of weaknesses, particularly in a group of savings banks

- Fast growing business with **weak corporate governance** and **no market discipline through equity investors** and **poor risk selection and monitoring**

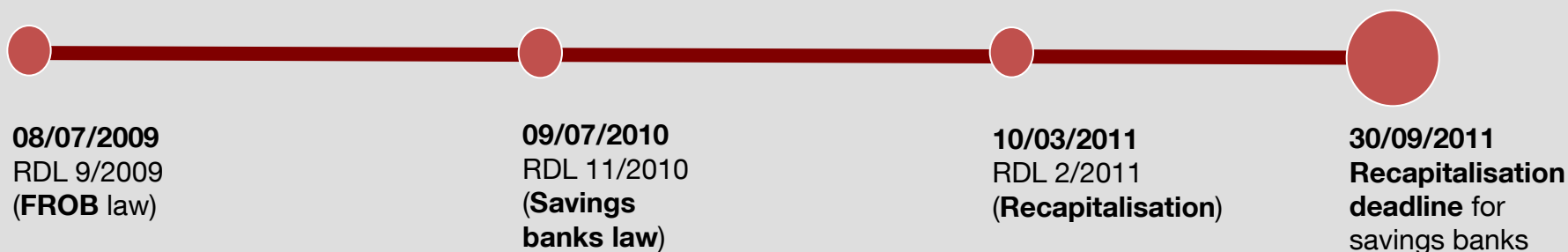
Diagnosis of the situation in year 2009

- **Excessive credit growth**, particularly intense related with real estate developers
- **Overcapacity** in the sector
- **Fragmentation**: excessive number of relatively small institutions (45 savings banks)
- **Lack of clear ownership of savings banks**



- **Strategy:** institution by institution capital injections conditioned to demutualisation of savings banks and restructuring; being transparency a key element of this strategy

- **Key milestones** of this strategy:





- ➔ **Balance sheet write-downs:** from Jan. 2008 to mid-2011 overall write-downs by the Spanish banking sector stands at 10% of GDP
- ➔ **Increase in core capital:** core capital has increased +1.3 pp from Dec. 2008 until Jun. 2011* (+0.3 pp from Dec. 2010 to Jun. 2011)
- ➔ **Consolidation:** from 45 savings banks to 18
- ➔ **New corporate model for savings banks:** transformation into commercial banks
- ➔ **Improved governance for savings banks:** more professional management

* Solvency data for June 2011 are provisional



- **Transparency: communication policy by the BE**
 - **Regular publications** (Statistical Bulletin and Financial Stability Report), including monthly information on doubtful loans, credit, deposits, etc.
 - Numerous and very frequent **meetings with investors (at their request) at the Bank of Spain**
 - **Public presentations** by Bank of Spain top management



■ **Transparency: communication policy by the BE**

■ **Specific information on the web site regarding the restructuring process of the savings banks sector**

- **21.07.2011** Note on the state of the implementation of Royal Decree-law (RD-l) 2/2011 on recapitalisation following the stock market listings of CaixaBank, Bankia and Banca Cívica.
- **13.07.2011** Note on the savings bank restructuring process.
- **28.04.2011** Institutions send their recapitalisation plans to the Banco de España. Press release.
- **14.04.2011** The Banco de España approves institutions' strategies for complying with the capital requirements of Royal Decree-Law 2/2011.
- **30.03.2011** The Banco de España requires the institutions making up Banco Base to submit their new strategies.
- **23.03.2011** Progress report on the restructuring of the Spanish savings banks.
- **11.03.2011** Speech by the Governor at the Council on Foreign Relations.
- **10.03.2011** Capital requirements of credit institutions in compliance with Royal Decree-Law 2 / 2011.
- **22.02.2011** Presentation by the Director General of Banking Regulation in London, Tokyo, Hong Kong and Singapore.
- **21.02.2011** Governor's press conference on the restructuring of the Spanish banking sector and the Royal Decree-Law on the reinforcing of the financial system.
- **01.12.2010** Progress report of the Spanish banking sector.
- **29.06.2010** Progress report on the restructuring of the Spanish savings banks

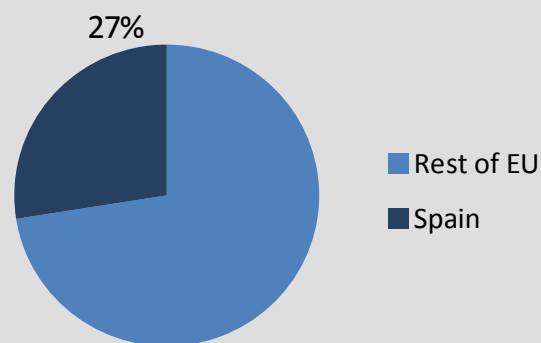


- **Transparency: EU wide stress test exercises reported around 3,200 data points per institution vs. around 100 data per institution the US SCAP**

- *Basically all the Spanish banking sector is subject to the ST, meaning that 25 out of 91 EU institutions considered in the exercise are Spanish.*

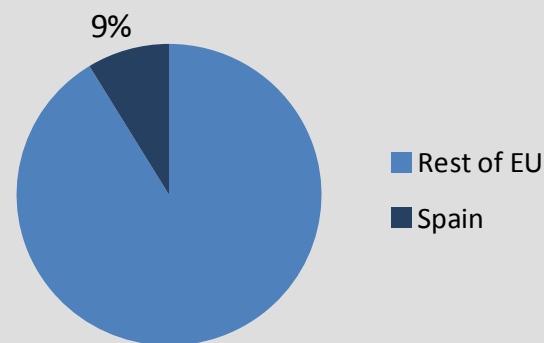
- *More detailed information, particularly regarding exposures and losses by portfolios*

Number of institutions considered in the EBA stress test



Source : EBA Stress Test Results

Total consolidated assets



Source : ECB Statistics on Consolidated Banking Data



- **Transparency: Requiring institutions to regularly disclose to the markets relevant information**

- **Very granular information regarding real state exposures**; also included in the annual accounts and thus subject to the supervision of external auditors

- **Very granular information regarding mortgages in Spain**

- **Special registry** for mortgages (RD 716/2009)

- According to Circular BE 7/2010 institutions must publish very **detailed information for banks that issue covered bonds** (cédulas)

- *Information about the asset side (mortgage volume, average residual maturity of mortgage portfolio, breakdown by eligibility, asset quality, type of collateral, currency, LTV, ...)*

- *Information about the liability side (amount of securitized assets, average residual maturity of securitized bonds,...)*

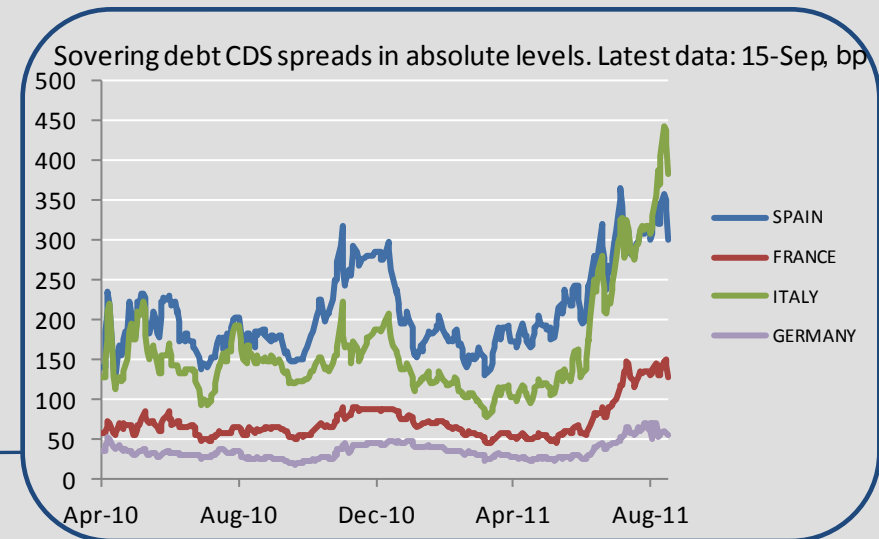
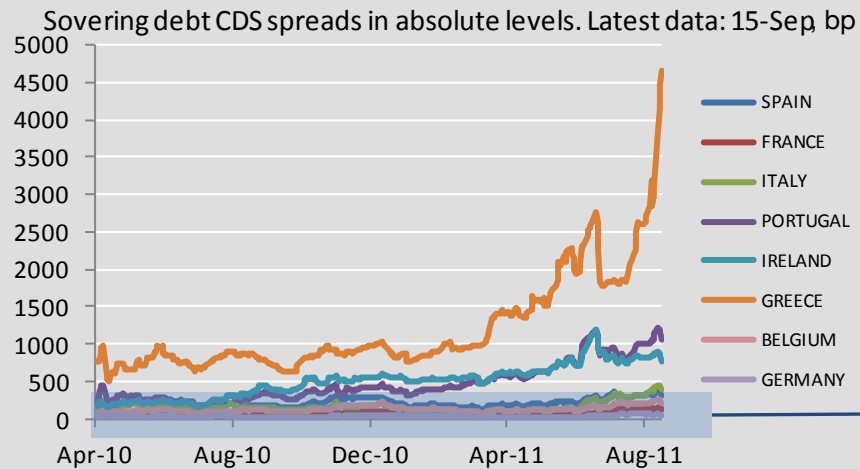
SPANISH BANKING SECTOR

Situation in the euro area: contagion of the sovereign debt crisis



- At present the situation in financial markets in Europe is **characterised by sovereign debt strains**

- Although there are still significant differences in the CDS levels, their recent trend points to the **spread of tensions from the three countries under EU/IMF programmes to larger countries**



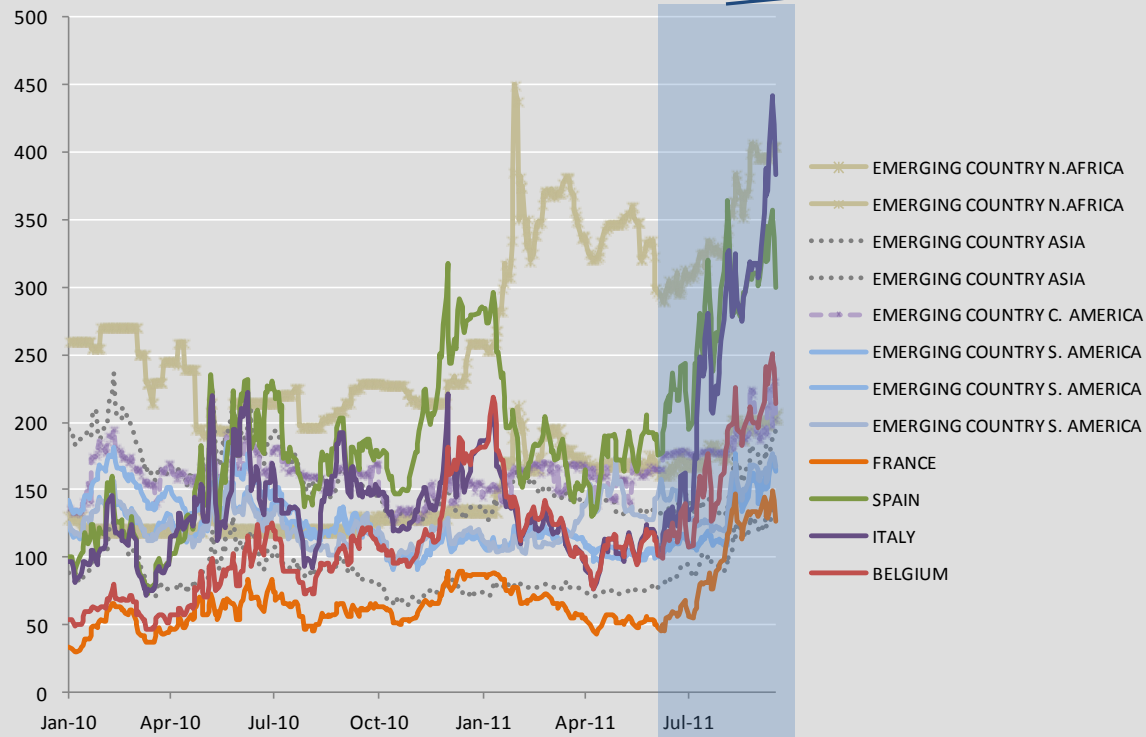
Source: Datastream

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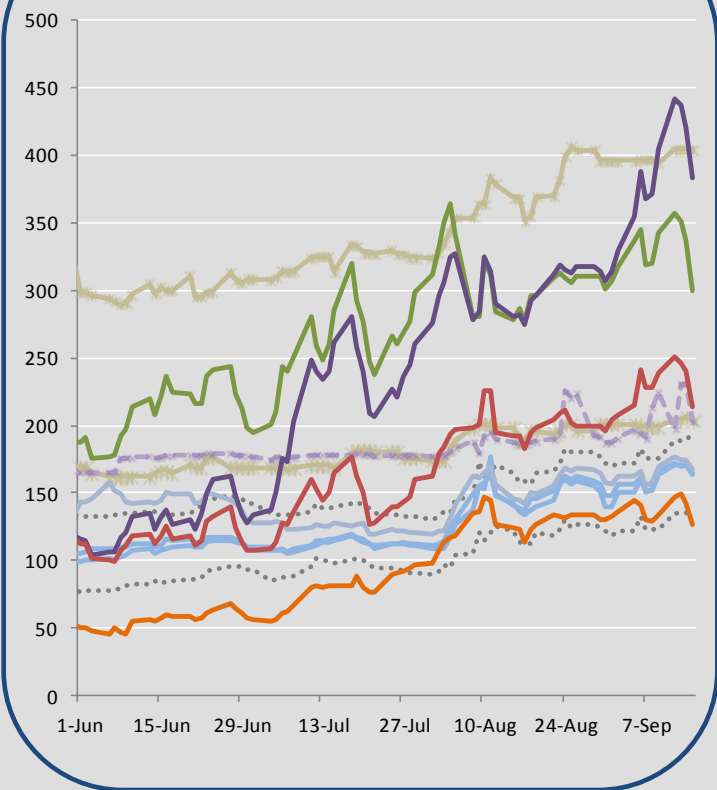
Situation in the euro area: contagion of the sovereign debt crisis



Sovereign debt CDS Spread . Latest data: 15-Sep, bp



Since June-11. Latest data:15-Sep, bp



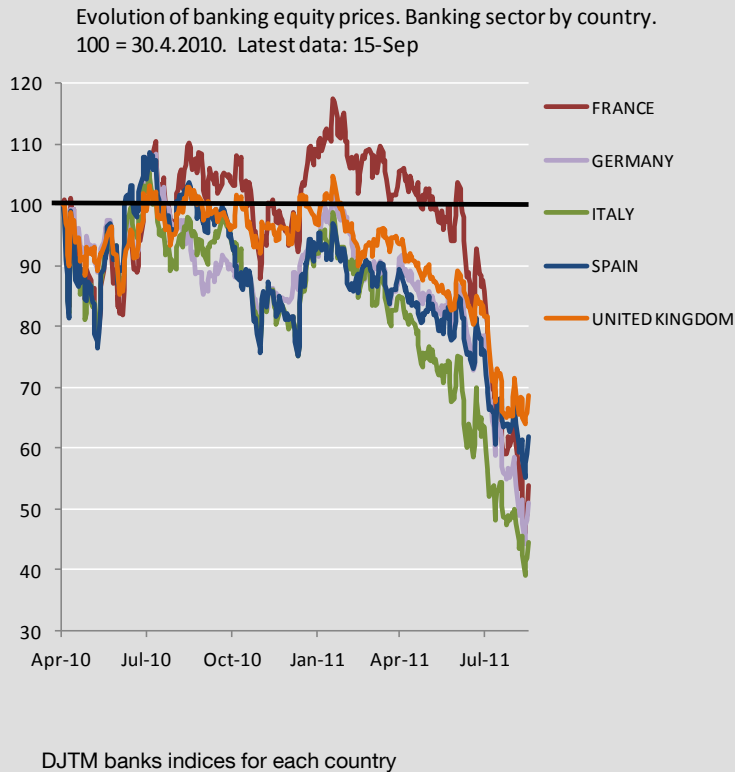
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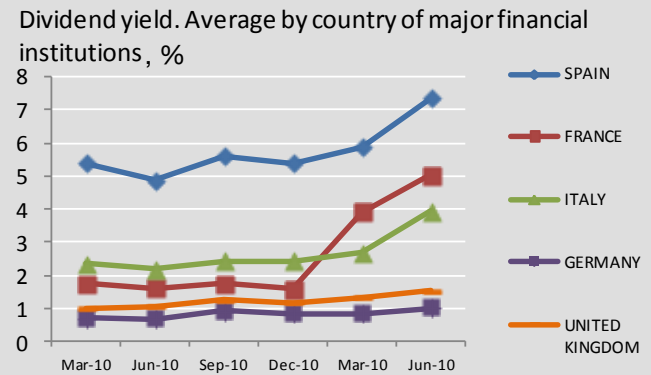
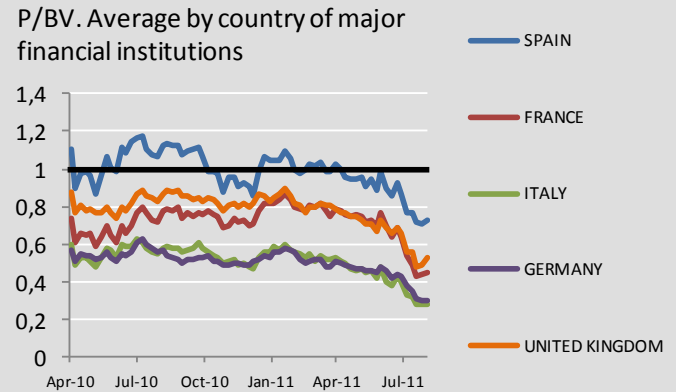
Banking sector market indicators



- Banking sector **stock prices** have been declining with intensity since sovereign crisis started



- Price to book values** show historically low levels, as the opposite is true for **dividend yields**



12-month rolling dividend payment over equity prices

Source: Datastream



- The **exposure of the Spanish banking sector to the sovereign debt is not a major issue** for the Spanish institutions

Spanish Institutions' exposures to foreign sovereign debt

Million €

	Gross Exposures	Of which: Trading Book	Gross Exp. % Total Assets	Trading Book % Total Assets
Greece	448	177	0.01%	0.01%
Ireland	79	0	0.00%	0.00%
Italy	7,408	465	0.22%	0.01%
Portugal	5,492	352	0.16%	0.01%
Spain	231,696	11,546	6.91%	0.34%

Source: EBA Stress Test results

Exposures to sovereigns (central and local governments), as of 31 December 2010

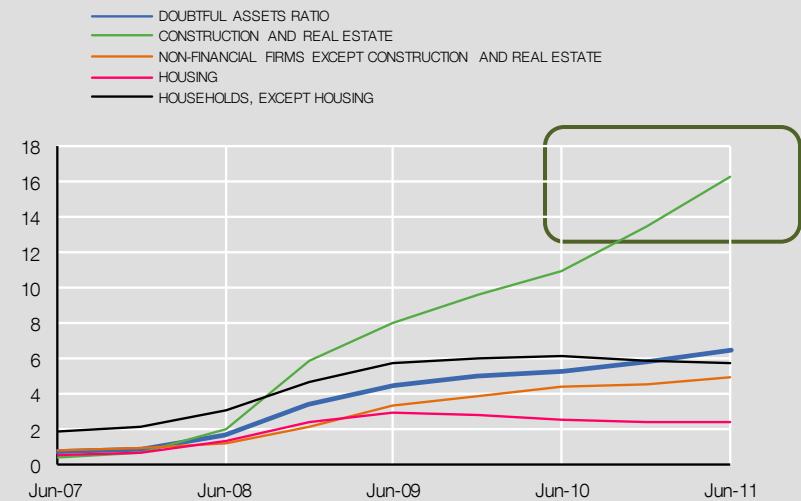
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Exposures to the property developers

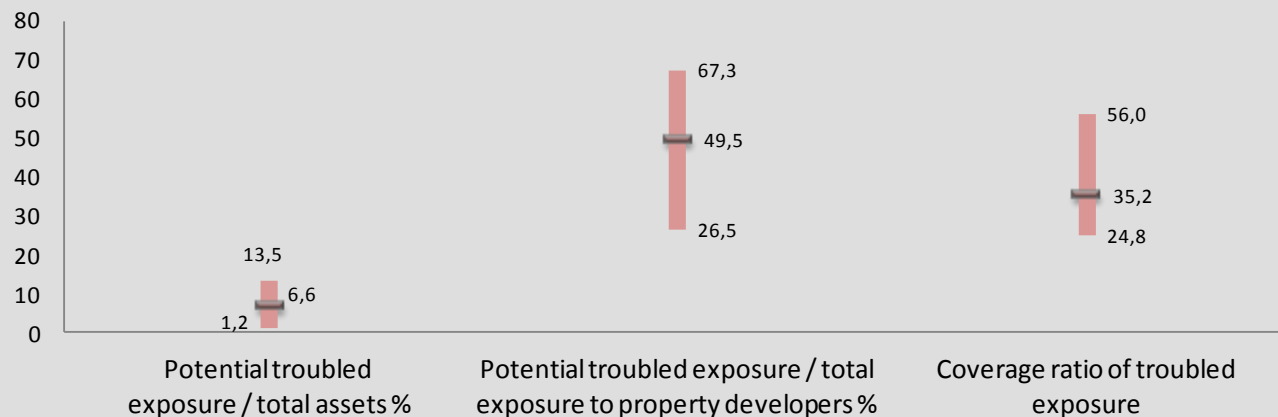


- The **difficulties** for some Spanish banking institutions **remain in their exposures to property developers**
- In any case, **institutions need time to digest these exposures**
- **Transparency is a key element as this process evolves**

Doubtful assets ratios in Spain, by industry. %



Exposure to property developers, Minimum, Median and Maximum. June 2011
Information institution by institution based on their publicly reported data

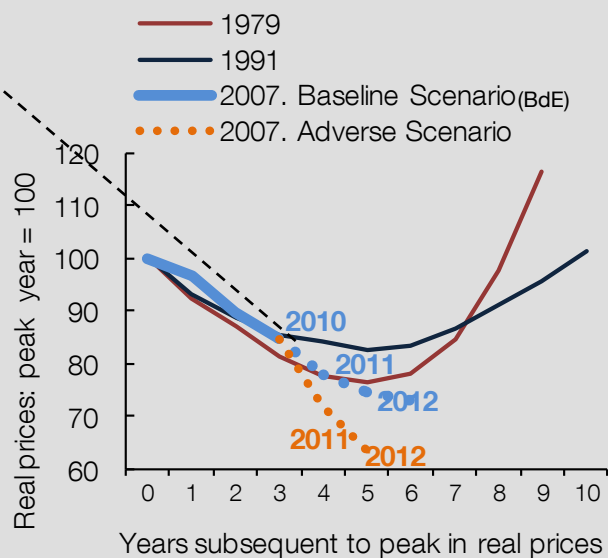




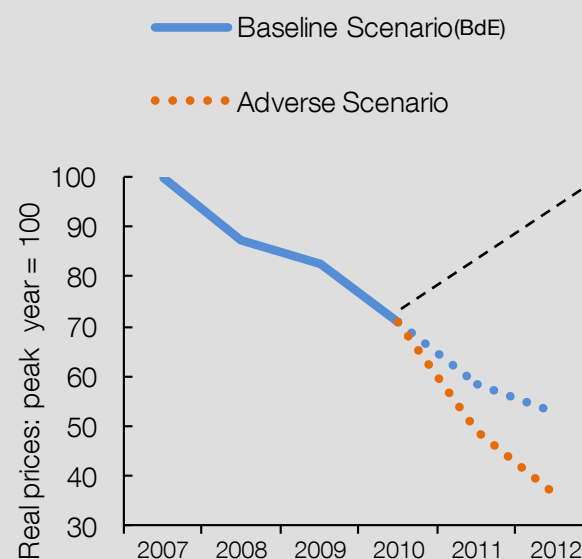
- There has already been a significant correction in house and land prices. In both cases we expect further corrections in the year to come

Last observed data -22% (June 2011) in line with forecasts

THE ADJUSTMENT OF HOUSING PRICES:
COMPARISON BETWEEN THE CURRENT AND PREVIOUS CYCLES (In real terms)



THE ADJUSTMENT OF LAND PRICES:
THE CURRENT CYCLE (In real terms)



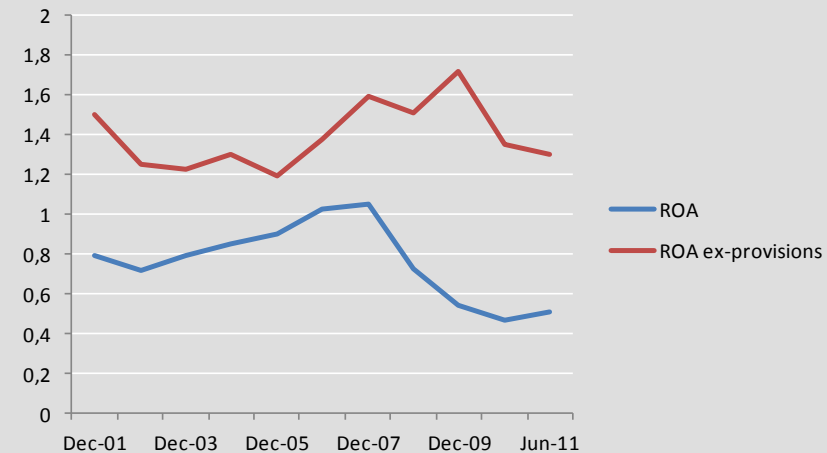
Last observed data -31.5% (June 2011) in line with forecasts



■ P&L accounts are still under pressure:

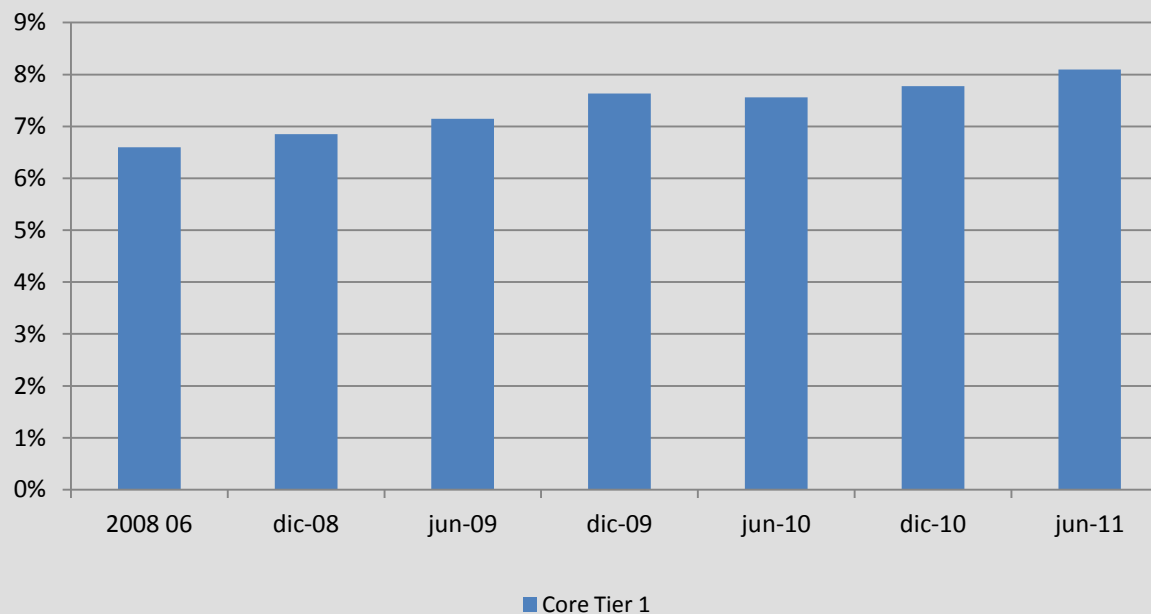
- Low levels of new banking activity
- Pressure on funding costs
- Provisions still high
- However, banking business is viable
- Restructuring and concentration alleviates expenses

Deposit institutions. Last data: June-2011, %





- Spanish deposit institutions have reinforced their core capital



Note. For consistency purposes over time, the Core Tier 1 figure is calculated as the sum of eligible capital and reserves minus intangible assets. This definition does not fully comply with that of EBA used for the 2011 EU-wide stress test exercise, although mostly identical.

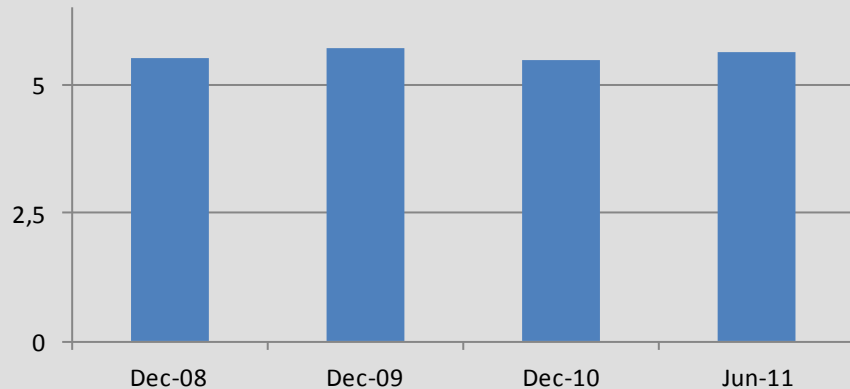
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Spanish institutions have reinforced their capital

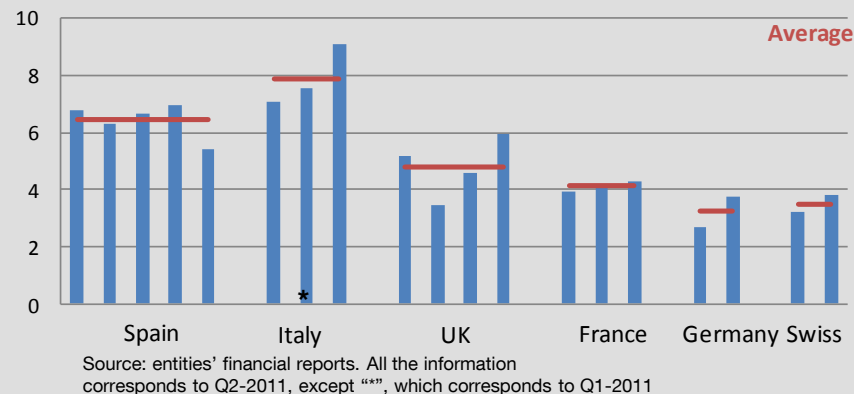


- **In moments of uncertainty**, (core) capital ratio is not the only relevant issue, but also leverage

Equity to total assets. Spanish deposit institutions, %



Equity / Total assets. 2011Q2, %



SPANISH BANKING SECTOR

Funding difficulties require national as well as supranational solutions

▪ Short term funding topics

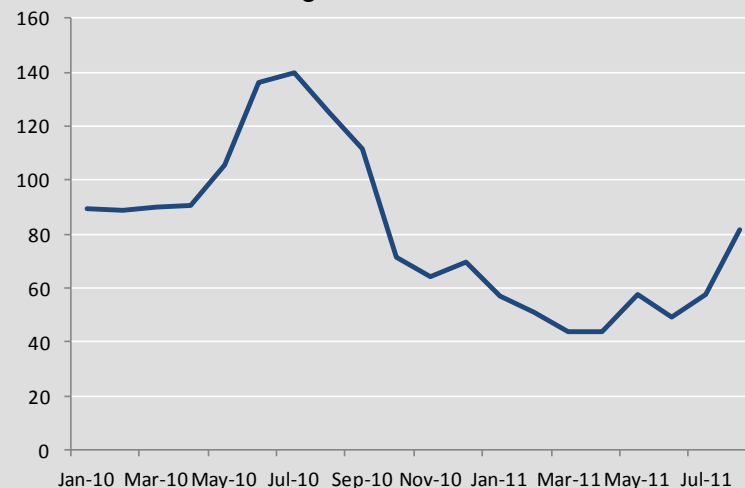
- Wholesale markets are closed
- **ECB full allotment policy reduces the risks arising from short-term liquidity pressures**
- Spanish deposit institutions have **enough collateral to obtain funds from the ECB**

▪ **On the medium term, fixing wholesale markets re-opening requires both**

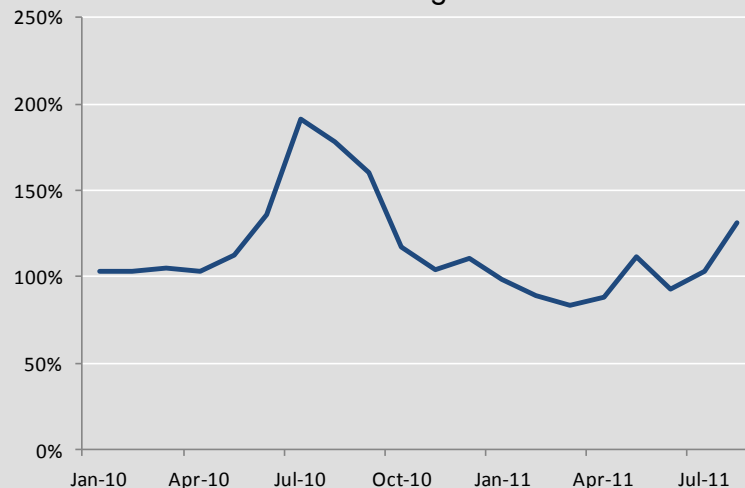
- **Regaining market confidence for Europe**
- **and national authorities and institutions solving potential domestic weaknesses**



Eurosystem gross lending to Spanish banking sector. €thM. Last data: Aug.-11



Eurosystem gross lending to Spanish banking sector. In relative terms. Last data: Aug.-11





- In difficult, uncertain and volatile times such as the current ones **it is key having a strategy. Thus, we stick to our master plan**
- The **Royal Decree-Law 2/2011**, approved by the Parliament on 10 March, required **higher levels (8%-10%) of Principal Core capital for Spanish institutions**
- **On 10 March the BE published the list of the institutions that needed more capital** (as well as the amount of capital) to comply with the new regulation
 - **Two possibilities to obtain the additional capital:** private funds from the markets/private investors; and/or the **FROB** acting as a backstop
 - **An unique timeline: 30/09 is the recapitalisation deadline for all institutions.** The regulation provides for an extension of 3 months (6 in the event of an IPO) only for operational reasons

RESTRUCTURING OF THE SPANISH BANKING SECTOR

Recapitalisation process reaching its deadline



- **Recapitalisation process** is work in progress and **in line with the stipulations of the Royal Decree-law: deadline 30 of September**

Standalone savings banks: 9 inst.

**9 institutions
13% of the
assets of the
sector**

Other savings banks: 9 institutions (*)

**4 institutions
15% of the
assets of the
sector**

**4 institutions
8% of the assets
of the sector**

**2 already
listed in the
stock
exchange**

**1st option:
private capital
IPO and/or
private investors**

1st option: FROB

**The FROB acts as a backstop
mechanism through common
shares and market valuation**

(*) One institution first option is to participate in an integration process with a well capitalized institution



■ Milestones in the CAM process



30.3.2011. The general assemblies of three of the four savings banks making up the Institutional Protection Scheme (IPS) Banco Base did not approved the project. It was the only IPS in which all the resolutions and authorisations to consider the IPS as irreversible were not adopted.

28.4.2011. CAM submitted a recapitalisation plan, including a request for €2.8bn from the FROB

22.7.2011. The BE replaced the institution's directors in order to capitalise the institution and initiate a competitive procedure for its sale to another institution. From 23 July FROB will take over management

Next steps. The FROB will sell the institution through a competitive procedure. Target date for the auction before end-October



- **In a very difficult market environment characterised by increasing uncertainty and risk aversion having a clear strategy is key**

- **We have a strategy in place**
 - Capital injections that are conditioned on the restructuring of the institutions
 - Transparency a key element
 - Enough flexibility to cope with a very rapid changing external environment

- **And so far we stick to the master plan**