New measures for the Spanish Banking System

4 February 2012

Madrid

- The new measures are designed to clean up institutions' problematic exposures to construction and real estate developers in Spain particularly land from their balance sheets...
- ... as well as to consider potential migrations from normal to problematic portfolios
- As a reminder, BdE considers as the following problematic exposures:
 - Doubtful loans: Loans in which some installment has not been paid for a period of more than 90 days, and those exposures in which there are reasonable doubts as to total repayment under the terms agreed
 - Substandard loans: Loans showing some general weakness associated with the fact they are to a specific troubled group or sector or if weaknesses are apparent in certain operations, even if these operations do not qualify individually for classification as doubtful or write-off
 - **Asset foreclosures:** Assets ownership goes to the credit institutions, as a result of the application of these regular tools in a crisis situation such as the present. Supervisors prevent them from becoming potential mechanisms to defer the recognition of losses



- The measures are applied to the stock of legacy assets at 31.12.2011 ...
- and not to new operations
 - It could be expected that new operations are subject to stricter lending standards. In this respect, note that the 2010 reform of the CBE 4/2004 already included different considerations in order to incentivise higher lending standards by institutions to this sector.
 - For instance, it is considered that, as a general practice, financing the acquisition cost of land for its further urban development will not be higher than the 50% of the minimum between the appraisal value and the price registered in the public deed (escritura pública)
 - To avoid a negative impact on new real estate sector activity in future cycles



• The new measures are particularly focused on land because their key objective is to eliminate the major uncertainty affecting the Spanish institutions' balance sheets, that is the uncertainty associated with the value of land

Exposure to construction and property developers, €bn





The measures are based on three complementary tools:



General provisions to take into account potential migration from normal to problematic portfolio



1. Specific provisions € 25bn

2. General provisions

€ 10bn

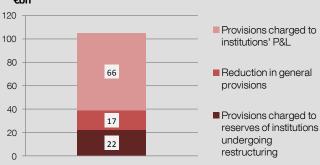
€ 50bn

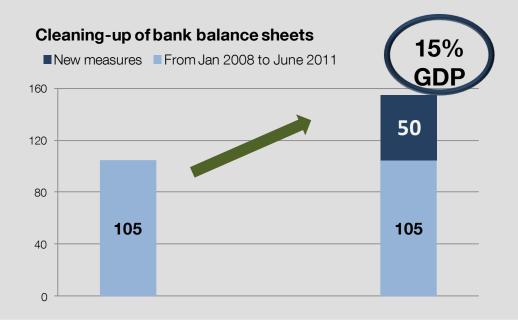
3. Capital add-on

€ 15bn

A figure of €50bn means a 5%
 of Spanish GDP ... on
 top of the cleaning-up
 already conducted by institutions

Cleaning uo of bank balance sheets, Jan 2008 to June 2011 €bn







Additional specific provisions: €25bn

Land related assets: provisions for this type of assets represent a 76% of total additional specific provisions

	LAND CBE 4/2004	LAND New Measures
Foreclosed	10% 1 st year; 20% 2 nd year; 30% 3 rd year	
Doubtful – past due 90 days	Provisions = [loan - 50% haircut appraisal value of the collateral]; to be set in one year from 25% to 100%	60% of the value of the loan
Rest of doubtful	Minimum of 25% of the value of the loan	
Substandard	Minimum of 10% of the value of the loan	
	31% coverage ratio	60% coverage ratio



Additional specific provisions: €25bn

Housing under development: provisions for this type of assets represent a 12% of total additional specific provisions

HOUSING UNDER DEVELOPMENT CBE 4/2004			
Foreclosed	10% 1 st year; 20% 2 nd year; 30% 3 rd year		
Doubtful – past due 90 days	Provisions = [loan - 50% haircut appraisal value of the collateral]; to be set in one year from 25% to 100%		
Rest of doubtful	Minimum of 25% of the value of the loan		
Substandard	Minimum of 10% of the value of the loan		
	27% coverage ratio		

HOUSING UNDER DEVELOPMENT New Measures

50% of the value of the loan

50% of the value of the loan or 24% for on-going developments (*)

46% coverage ratio

(*) The exposure on-going under development classified as substandard is around €2bn



Additional specific provisions: €25bn

Other different from land and housing under development: provisions for this type of assets represent a 12% of total additional specific provisions

Finished housing and other real estate collateral

- **Foreclosed:** the new measures apply the same treatment as CBE 4/2004, but increasing the value of the provisioning coefficients: 10% (1st year); 20% (2nd year) and 30% (3rd year) to 25% (1st year); 30% (2nd year); 40% (3rd year) and 50% (4th year)
- **Doubtful and substandard:** the new measures eliminate the exceptions for minimum provisioning requirements, that are set at 25% for doubtful and 20% for substandard

Foreclosed housing from households (first residence)

■ The new measures apply the same treatment, but expanding one year the provisioning coefficients: 10% (1st year); 20% (2nd year) and 30% (3rd year) to 10% (1st year); 20% (2nd year); 30% (3rd year) and 40% (4th year)

Other with personal guarantee

- For those classified as substandard the minimum provisioning coefficient goes from 10% to 24%
- These changes give greater incentives to sell the assets in the market





New operations:

CBE 4/2004 criteria are maintained, but coverage requirements for foreclosed assets will be 40% for the 4th year

Stock of the legacy assets at 31.12.2011:

One-off measures

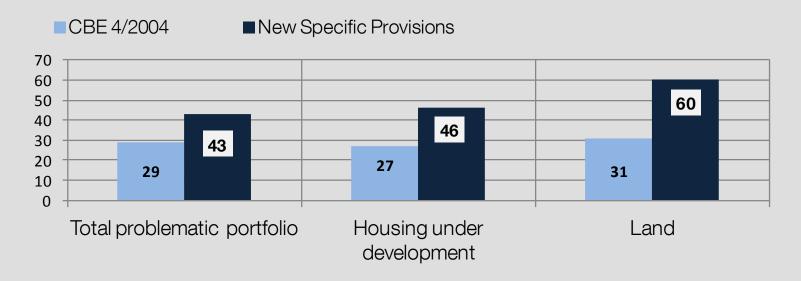
- 1. 60% coverage of the value of the loan for land related assets (see slide #7)
- 2. 50% coverage of the value of the loan for related assets to housing under development. When the collateral is on-going housing under development and the loan is classified as substandard, the coverage is 24% (the volume of these loans is around €2bn) (see slide #8)
- 3. Foreclosed finished housing and other real estate collateral: increase the value of the coefficients and a coefficient of 50% the 4th year. The latter is also applicable to foreclosed housing from households, being the coefficient for the 4th year 40% (see slide #9)
- 4. For doubtful and substandard loans with finished housing and other real estate as collateral, minimum provisioning coefficients are required without exceptions (see slide #9)



Additional specific provisions: €25bn

The increase in specific provisions means a direct increase in coverage ratios

Loan Coverage Ratio, %





General provisions: €10bn

€10bn represents a **7**% **of the construction and real estate developers normal portfolio**

- This provision is established to take into account that there may still be the **possibility that migration to the problematic portfolio** of construction and real estate developers exposures which are currently classified as **normal**
- Collective assessment for impairment
 - This is for specific portfolios
 - It is not a reform of the present Spanish dynamic provision
 - This one-off provision does not enter into the definition of regulatory capital



General provisions: €10bn

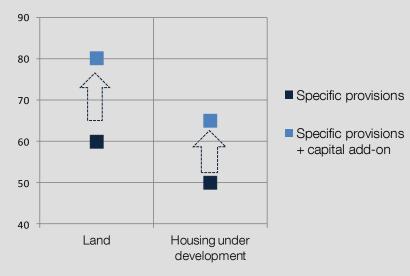
• When a loan classified as normal is re-classified to the problematic portfolio, the amount accumulated in this fund of provisions can be used as much as necessary depending on the provisioning requirements resulting from the re-classification

These potential re-classifications will not have an impact on the P&L until the provision fund constituted as a result of the application of the new measures is completely depleted



- Capital add-on: €15bn
 - •The capital add-on is computed for land and housing under development classified in the problematic portfolio (*) over the "capital principal" minimum requirements of 8% / 10%
 - It takes into account valuation uncertainty regarding this type of assets increasing their coverage: +20pp for land related assets and +15pp for housing under development in the problematic portfolio (*)





(*) Except on-going housing under development classified as substandard that represents an exposure around €2bn



Summing-up

•The total estimated amount of the new measures is €50bn of additional cleaningup

Specific provisions: +€25bn; Capital add-on: +€15bn; General provisions: +€10bn



Coverage Ratio, %



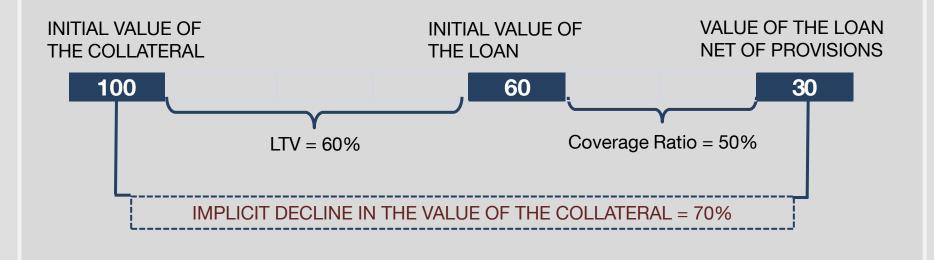


The measures also consider potential migration from the 'normal' portfolio to the 'problematic' portfolio

 To compute a decline in the prices of the collateral compatible with a given level of coverage, it is necessary to consider the loan to value ratio (LTV)

EXAMPLE:

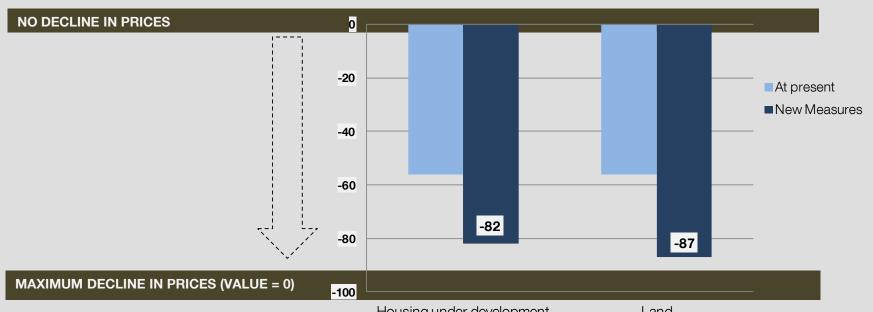
- A loan of €60 where the value of the collateral is €100 has a LTV of 60%: that means that the value of the loan is protected against an initial decline in the value of the collateral of 40%
- A loan of €60 with a LTV of 60% and a coverage ratio of 50% means that the implicit decline in the value of the collateral is 70%





- Considering the coverage of land related assets (80%) and the average LTV of the portfolio, the implicit decline in land prices is, on average, 87%
- For housing under development the decline in the implicit value of the collateral is, on average, 82%

Decline in the value of land and housing under development compatible with new coverage ratios, considering the average LTV of the portfolios %



Housing under development

Land



- The impact of the measures is a one-off: the objective is to eliminate uncertainty regarding banks' balance sheets, and particularly the value of land related assets value
- €50bn is the initial impact: in order to assess this figure it is necessary to take into account
 - Possible merger and acquisitions may change provisioning figures. Under IFRS
 - Need to identify the acquirer and the acquiree
 - The acquiree must put its balance sheet at fair value
 - Under this context, (part of) the adjustment will go directly against own funds
 - •No final data for year-end 2011, and in fact all calculations are based on June 2011 figures
 - •This is particularly relevant because many institutions have announced a strong increase in provisioning in 4Q-11
 - The position of each particular institution needs to be considered
 - BE transparency requirements have obliged institutions to disclose risks and coverage to the construction and real estate sector
 - For the global assessment of the impact the asset protection schemes given to CCM, Cajasur and CAM need to be factored in





- √ 3rd of February of 2012: approval of RD-L
- √ 31st of March of 2012: presentation of a plan to comply with the measures
 - BdE approval within 15 working days
- √ Year-end 2012: compliance with the measures
- ✓ In order to facilitate these processes **the FROB can buy shares** of the institutions. These shares must be sold through competitive procedures in, at a maximum, 3 years





- √ 3rd of February of 2012: approval of RD-L
- √ 31st of May of 2012:

 presentation of an integration plan
 - Approval by the Ministry of Economy in one month
- ✓ 12 months after the approval of the integration plan: compliance with the measures. The integration must be operative since 1.1.2013 at the latest

Conditions for the integration:

- As a general rule, the resulting entity must have a balance sheet which is 20% higher than the largest institutions participating in the process
- Improvements in corporate governance
- Objectives on lending to households and SMEs
- Objectives on reducing exposure to construction and real estate developers
- IPS type agreements not contemplated

FROB can provide funds to facilitate the processes:

- The new RD-L opens the possibility for the FROB to instrument the funds through Cocos
- Convertible in shares in 5 years
- FROB capital from €9bn to €15bn, reducing its leverage



- Other relevant measures included in the RDL are those related to the rules for loans and credits other than mortgages to be considered as collateral in Central Bank operations
- This set of measures respond to accommodate the measures in order to increase collateral availability recognition announced by the ECB on 8 December 2011
- The ECB measures, and particularly the 3 years LTRO has improved the liquidity situation of the banking sector reducing funding tensions
- Looking ahead, at some point the huge amount of liquidity in the hands of banks will come back to the markets, but in any case the re-opening of wholesale markets requires:
 - Regaining confidence for Europe
 - National authorities and institutions solving potential weaknesses
 - Opening of interbank markets



Conclusions

There were basically 4 uncertainties regarding the Spanish banking sector:

✓ Uncertainties regarding the corporate model of savings banks have been resolved: from 45 savings banks to 15 commercial banks

- ✓ Uncertainties regarding balance sheet cleaning-up have been resolved: €50bn of additional cleaning-up, meaning a coverage ratio for land related assets of 80%, that is, 87% decline in land prices
- ✓ Uncertainties regarding funding have been alleviated and funding tensions reduced after the ECB 3 year LTRO
- Uncertainties regarding the impact of the negative macro outlook in asset quality are present but contained, as a moderate increase in NPL could be expected

Background material

GDP projections and NPL evolution

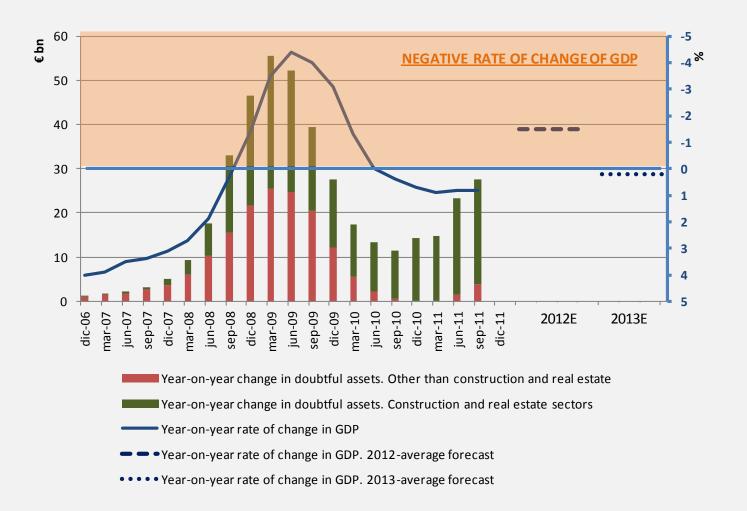
Housing prices

Government net borrowing and Nation net borrowing

Exports

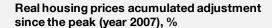
Foreign claims of the Spanish banking sector

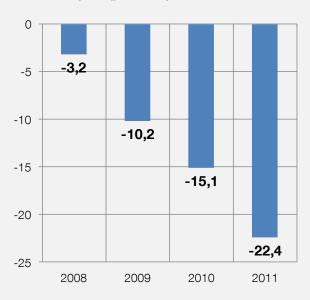




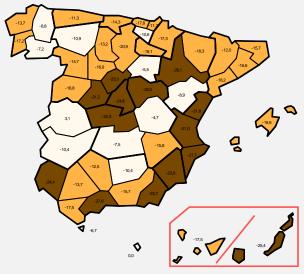


Background material Housing prices (1/3)





PROVINCIAL BREAKDOWN OF HOUSE PRICES ADJUSTMENT



CHANGE IN NOMINAL TERMS FROM 2008 PEAK TO Q4-2011 (%). NATIONAL AVERAGE = -19%

MAXIMUM FALL - PERCENTILE 25
PERCENTILE 25
PERCENTILE 75 - MINIMUM FALL

Source: Ministerio de Fomento and Banco de España.

DEMAND. Before a notary (in last twelve months)

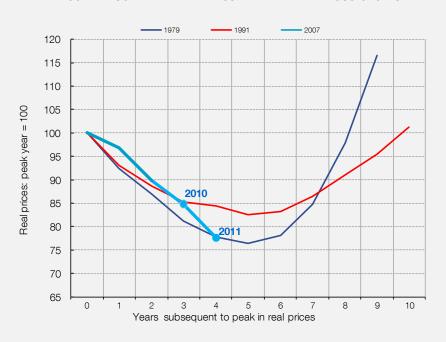


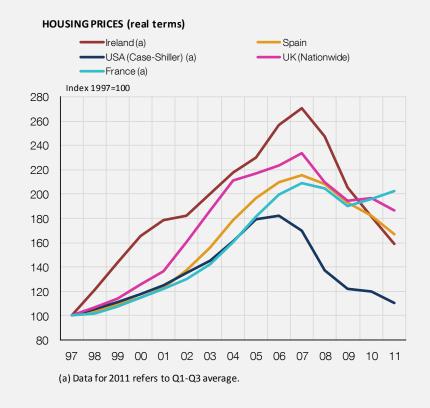


Background material Housing prices (2/3)

SPAIN. THE ADJUSTMENT OF HOUSING PRICES (In real terms)

COMPARISON BETWEEN THE CURRENT AND PREVIOUS CYCLES

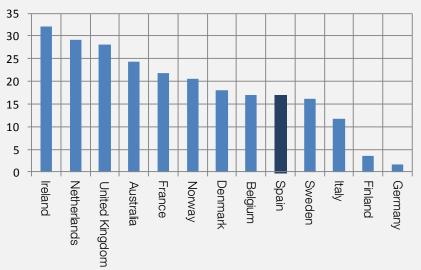






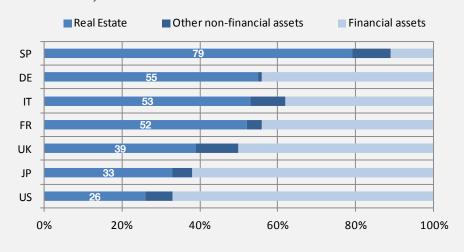
Background material Housing prices (3/3)

Percentage increase in house proces not attributable to fundamentals, IMF April 2008



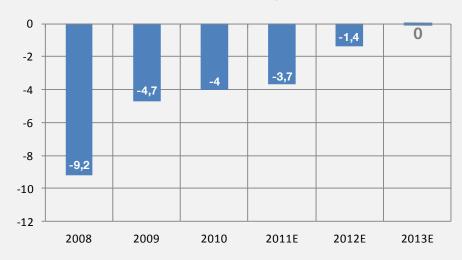
Households asset split (% of total assets)

Source: Oliver Wyman

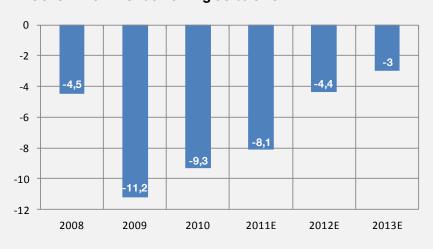




National economy's net borrowing as % of GDP

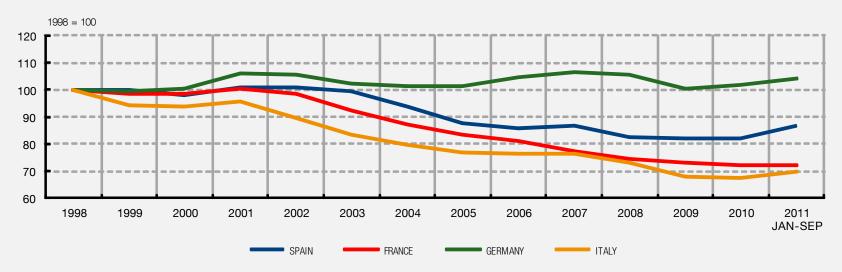


Government net borrowing as % of GDP





EXPORT MARKET SHARES OF GOODS (REAL TERMS)



SOURCES: Eurostat and IMF.



Consolidated Foerign Claims of Spanish banks as % of consolidated total assets of the Spanish deposit institutions. September 2011

