Box 2.4

RECENT CORPORATE TRANSACTIONS IN THE SPANISH BANKING SECTOR

The Spanish banking system is currently undergoing a new consolidation process, whose aim is to strengthen its business model in the light of the COVID-19 pandemic-induced economic crisis and pre pandemic profitability challenges (e.g. operational efficiency or net interest income generation). Against this background, four of the 12 significant Spanish banks have approved the consolidation of their business activities through the appropriate corporate transactions. Based on the merger plans, the CaixaBank-Bankia and the Unicaja-Liberbank mergers would enable the resulting banks to improve their profitability and solvency levels, with lower overheads and larger economies of scale which will enhance their digitalisation and access to financial markets.

Both mergers will be legally implemented through the merger by absorption of the smaller banks in each case (Bankia and Liberbank), whose shareholders will receive new shares of the absorbing bank. The Board of Directors of the merged banks will have a greater relative weight of directors in the largest banks in each case (CaixaBank and Unicaja). The FROB —the main shareholder of Bankia— will hold a stake of almost 16% in CaixaBank, following application of the exchange ratio to the share capital of each bank.

The merger of CaixaBank and Bankia (second and fourth largest banks in Spain by asset size) would benefit, in terms of culture adaptation and speed of integration, from having a similar business, targeting the retail segment and with a significant SME portfolio. The resulting bank will have a total loan portfolio of €368 billion, thus becoming the largest bank in terms of Spanish operations, with a total market share of almost 25%. As a systemically important institution, the new CaixaBank's macroprudential buffer will foreseeably be revised upwards. The resulting bank would have a non-performing loans ratio of 3.8% and a non-performing loan coverage ratio of 64%.

The merger plans envisage potential cost synergies arising from the streamlining of the cost structure of up to €770 million per year, and potential additional revenues resulting from a broader customer base of up to €215 million per year. Restructuring costs, estimated at €2.2 billion,[1] and the fair value adjustment to Bankia's assets and liabilities will be absorbed in the regulatory capital base of the two banks prior to the merger, with no risk of breaching capital requirements. A fully-loaded CET1 target of 11.5% is established for the resulting bank. For 2022, the bank resulting from the merger of CaixaBank and Bankia will also target a return on tangible equity (RoTE) of 8%.

The merger of Unicaja and Liberbank will give rise to the fifth largest Spanish bank, with a loan portfolio amounting to approximately €55 billion and a total market share of almost 4.5%. Both banks have a similar business model, targeting the retail segment and lending to SMEs, which could smooth their integration. As regards asset quality, the resulting bank will have a non-performing loans ratio of around 3.6% and a non performing loan coverage ratio of 62%. The two bank's deep historical roots in their home regions (Andalusia, Asturias, Cantabria, Extremadura, Castilla-La Mancha and Castilla y León) and their geographical complementarity would enable the resulting bank to maintain its leadership position in most of them and to extend its reach to 80% of Spain.

Based on the banks' interim estimates, the elimination of overlaps will entail integration costs of approximately €540 million and future synergies, which will be obtained gradually to stand at €159 million per year in 2023. These synergies will enable the resulting bank to improve its profitability, with an expected RoTE of around 6% for 2023. Table 1 summarises the key figures for the two merger transactions.

The announcement of the CaixaBank-Bankia merger negotiations on 4 September 2020[2] was welcomed by the stock market with rises in all bank stocks, since it was considered a potential trigger for other mergers in the banking sector. In fact, the returns seen in the market on that date were significantly higher for all banks than those which would have been observed on a day with no relevant news or events[3] (see Chart 1). The positive effects persisted until the merger agreement between CaixaBank and Bankia was confirmed (18 September

1 In April 2020, the absorbing entity Caixabank has announced plans to lay off approximately 20 % of the combined staff of the two entities and the closure of 25 % of the branches of the network resulting from the fusion.

2 The commencement of the negotiations between these banks was announced on 4 September 2020.

3 This conclusion was reached using the "event analysis methodology", under which the response of stock prices to specific events is analysed and compared with the expected performance had such an event not been known, permitting abnormal returns to be measured. This expected return is calculated using a regression that takes into account the performance of the Madrid Stock Exchange General Index, changes in the slope of the OIS curve and developments in sovereign risk.

Box 2.4

RECENT CORPORATE TRANSACTIONS IN THE SPANISH BANKING SECTOR (cont'd)

Table 1
FINANCIAL INFORMATION OF THE BANKS RESULTING FROM THE MERGERS
DECEMBER 2020 (a)

	CaixaBank-Bankia	Unicaja-Liberbank
Total assets (€billion)	661	113
Loans and advances to customers (€billion)	368	55
Customer funds (€billion)	562	85
Market share	25%	4.5%
NPL ratio	3.8%	3.6%
NPL coverage ratio	64%	62%
Fully-loaded CET1 ratio	13.9%	15.1%
Estimated RoTE	8% (2022)	6% (2023)
Total clients (million)	20	4.5
Branches	6,300	1,500
Employees	51,400	9,900

SOURCE: Banco de España.

a The figures are either the sum or the average of the consolidated financial statements of the banks party to each transaction, which had not been completed at December 2020. They are therefore the resulting banks' tentative financial position figures for when the mergers are concluded in 2021.

Chart 1
IMPACT OF CAIXABANK-BANKIA MERGER
Initial impact 4 September and accumulated impact from 4 to 18 September (a)

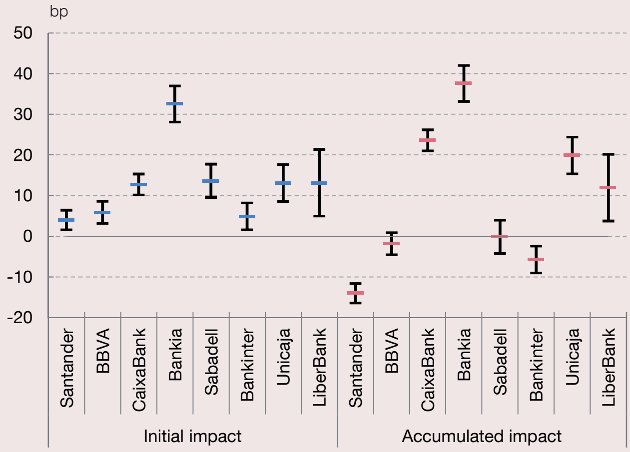
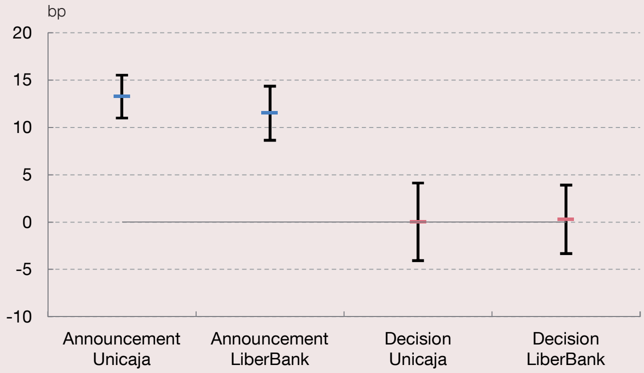


Chart 2
IMPACT OF UNICAJA-LIBERBANK MERGER
Impact announcement on 5 October and impact decision on 29 December (a)



SOURCES: Thomson Reuters, Dealogic and Banco de España.

a The charts show the "abnormal returns" for each bank and the estimation error.

2020), but only for these two banks and for the other two that the market perceived as the likeliest candidates for a merger (Unicaja and Liberbank), whereas the favourable effect faded for the remaining banks[4] (see Chart 1).

The market responded to the confirmation of discussions for the merger of Unicaja and Liberbank with further larger-than-expected stock price increases (5 October 2020). However, the merger confirmation on 29 December

4 Chart 1 shows that, for these four banks, the effects are significant and positive until ten days after confirmation of the merger agreement between CaixaBank and Bankia.

Box 2.4
RECENT CORPORATE TRANSACTIONS IN THE SPANISH BANKING SECTOR (cont'd)

2020 seemed to have already been discounted on that date (see Chart 2). Furthermore, the lack of response at other banks indicates that the market was not expecting any additional mergers.

These consolidation transactions are taking place at a time when the European Central Bank (ECB) has just published its Guide on the supervisory approach to consolidation in the banking sector,[5] which is intended to clarify the prudential supervisory approach the ECB follows when determining whether the arrangements implemented by a credit institution resulting from a consolidation ensure the sound management and coverage of its risks. The document covers several key aspects, such as the objectives and phases of consolidation processes, and their prudential treatment, supervisory expectations regarding the resulting bank, and the application of this framework to less significant institutions.

The supervisory expectations are focused on the sustainability of the business model of the resulting bank, which will be examined by the ECB in order to assess its solvency, profitability and risk profile. It will also place particular focus on the existence of suitable governance arrangements and risk management frameworks.

As regards prudential aspects, the Guide highlights the post-merger capital requirements, the treatment of badwill and the approach to internal models. Specifically, for consolidation transactions where no substantial supervisory concern has been identified, the Guide envisages the following approach:

— Credible integration plans will not be penalised with higher capital requirements (P2R and P2G) than those derived from applying the weighted average of the banks' consolidated pre-combination capital requirements.

— Prudent recognition of badwill, which is expected to materially contribute to the capital of the resulting bank and cannot be distributed as dividends until the sustainability of the business model is established.

— Temporary acceptance of the use of existing internal models, subject to a roll-out plan.

From the resolution perspective, the Single Resolution Board (SRB) has announced that the resolution plans of the absorbed banks and their MREL requirements will cease to apply if the mergers take place as envisaged. It will also review the absorbing banks' plans and MREL decisions after the merger. Furthermore, the SRB has expressed interest in avoiding that these requirements hinder this type of transactions, provided that the resolvability of the resulting bank under the regulatory terms is ensured.

5 See SSM Guide to the Supervisory Approach to Consolidation in the banking sector, published on 12 January 2021.