

ANNEX 2 ACTIVITY, RESULTS AND SOLVENCY OF CREDIT INSTITUTIONS

ACTIVITY, RESULTS AND SOLVENCY OF CREDIT INSTITUTIONS

The regulatory changes introduced to tighten the accounting rules for estimating and recognising the impairment of doubtful assets, the commencement of restructuring of the savings bank sector and the persistence of the scenario of recession and of funding difficulties in the international financial markets affected the performance of Spanish credit institutions' balance sheets at both consolidated and individual level. The notable restructuring effort, particularly in the savings bank sector, brought a reduction in balance sheet size at individual and consolidated level in banking business in Spain, while, in contrast, the activity abroad of the consolidated groups grew notably. Thus activity showed a fall in customer loans, except in activity abroad where they grew significantly. On the liabilities side uneven behaviour was also apparent in deposits, which grew in consolidated groups but decreased at individual level, recourse to traditional interbank markets was replaced by funding through money market operations via counterparties and net worth fell as a result of the extraordinary write-downs in the period.

Against this background of transition, in 2010 CIs and CGs¹ as a whole showed an across-the-board worsening of all their income statement margins and profitability indicators. Compared with the previous year, the decline in operating profit (accelerated by high write-downs) spread to the gross and net interest margins as a result of the stagnation of activity and of the higher cost of funding. Additionally, the insufficient containment of expenses by institutions also contributed to the adverse performance of the efficiency ratio. At disaggregated level, the larger CGs (which are those with a greater presence abroad) and, to a lesser extent, the institutional group of commercial banks (at individual level) stood out as the most profitable segments.

With regard to the solvency of CGs subject to compliance with the solvency ratio in Spain, although total own funds decreased, their highest-quality component, tier 1 capital (original own funds), continued to rise, basically due to capital stock and minority interests, to lower deductions for valuation differences, and to contributions by the FROB to the own funds of some institutions. However, it grew more slowly than in prior years, strongly influenced by the behaviour of reserves, which decreased in a context of sharp asset write-downs. To this must be added the negative contributions of lower amount from other components, including deductions and the so-called instruments subject to limits. Meanwhile, capital requirements decreased as a result of lower requirements for credit and counterparty credit risks. In these, excluding securitisation and equity positions, changes in the relative weight of the various asset categories in terms of exposure values contributed to falls in the applicable average risk weight and thus led to lower capital requirements despite the moderately higher exposure values. Noteworthy in counteracting the fall in capital requirements for credit and counterparty credit risks were the capital requirements for position, foreign exchange and commodity risks, which increased significantly as a result of the activity of the major international groups, whose long positions in foreign currency increased.

¹ Although the data in the Banco de España's Report on Banking Supervision (RBS) are consistent with those contained in the Financial Stability Report (FSR), which is also produced by the Banco de España, there may not be an exact match. There are various reasons for this, including the different scope of analysis stemming from the groupings of institutions considered: credit institutions in the RBS and deposit institutions in the FSR. The available information has been summarised in the tables in Annex 3 of the internet version of this Report.

2.1 Activity of credit institutions and their consolidated groups

In a scenario of continuing recession, of persistence of the difficulties in international financial markets since in 2007, of regulatory changes to tighten the accounting rules for estimating and recognising the impairment of doubtful assets, especially mortgage credit (CBE 3/2010), and of inception of the restructuring of the savings bank sector approved by Royal Decree-Law 11/2010, credit institutions saw a slight decline in their balance sheets at individual level in 2010. Their total balance sheet decreased by 0.6 % in annual terms which, adjusted for the effect of the extraordinary write-downs with a charge to reserves (see Table A.2.1), would leave a minimal decrease of 0.1 %, i.e. the balance sheet remained practically steady in the year, following the trend of 2009. Unlike in previous years, the volume of the balance sheet changed adversely in comparison with the behaviour of nominal GDP, which increased by 0.8 % (see Panel A of Chart A.2.1).

This decrease was influenced by the considerable rise in impairment allowances and by the derecognition of written-off assets, which depressed both own funds and the volume of loans and advances to other debtors. All this came about as a result of, first, the write-downs charged to reserves, basically in savings banks, associated with merger and IPS (institutional protection scheme) processes, and, second, the continuing high impairment allowances recorded with a charge to income already seen in previous years.²

In the other major balance sheet items, liabilities decreased slightly (0.3 %) and, consequently, equity declined year-on-year by 6.6 % (see Table A.3.2), although it would have grown by 2.1 % if the extraordinary write-downs charged to reserves had not been made.

The slight decrease in assets is, however, the result of offsetting movements in various items, derived from the economic setting in which institutions have been operating. Thus there were falls in the amounts relating to cash and central banks and to loans and advances to credit institutions, with decreases of 19.4 % and 8.5 %, respectively, but the residual item "Other assets" increased significantly because it includes the loans entered into through reverse repos via counterparties, which grew by 288 %, offsetting the fall in the first two items. These counterparties are a variation on the classical interbank market in which they provide government debt as collateral and the platform guarantees that the transactions will be successfully carried out. Other offsetting movements are the decrease of 4.3 % in debt securities and the increase of 19.6 % in trading derivatives, which practically offset each other in absolute value. More significant is the change in loans and advances to other debtors, an item which accounts for 61.2 % of assets and which decreased by 1.2 %. Within it, credit to resident general government grew by 21.7 % while credit to the resident private sector fell by 1.8 %. However, if the change in the latter is adjusted for the effect of the extraordinary write-downs with a charge to reserves made by savings banks, the high impairment allowances recognised on the income statement and the derecognition of written-off assets with the release of previously provisioned amounts³ (see Table A.2.1), and considering that the bulk of these adjustments were made to credit to the resident private sector, this latter item seems to have grown slightly by 0.2 %.

Doubtful assets continued to rise at high rates, although more slowly than in the previous two years. This growth, along with the slight fall-off in lending, caused the doubtful assets ratio to rise by more than 0.5 pp to 4.10 % in December 2010. The doubtful assets ratio of mortgage loans to households for house purchase and refurbishing stood at 2.42 %, down somewhat more than 0.3 pp compared with the previous year, evidencing the sound pay-

² The accounting rules require assets to be reflected in the balance sheet net of the related impairment allowances.

³ The accounting rules require assets to be reflected in the balance sheet net of the related impairment allowances.

Yearly data

€ m

	Total credit institutions		2010		
	2009	2010	Comercial banks	Saving banks	Other
DETAIL OF OWN FUNDS (a)					
PRIOR YEAR BALANCE	177,808	186,023	107,421	64,716	13,886
Total revenue and expenses recognised	13,547	10,951	8,929	1,824	198
Increase (decrease) in capital / endowment fund	5,195	8,265	7,941	—	324
Distribution of dividends	-7,457	-7,194	-6,845	-7	-342
Other increases (decreases) in equity	-3,069	-19,197	-682	-18,288	-228
Of which: due to mergers, acquisitions and creation of IPSs	—	-16,896	—	-16,896	—
FINAL BALANCE	186,023	178,848	116,765	48,245	13,838
IMPAIRMENT ALLOWANCES. LOANS (b)					
PRIOR YEAR BALANCE	45,097	53,131	23,106	24,469	5,556
Movements reflected in income statement	20,250	17,683	10,788	5,244	1,651
Other movements	-2,790	18,331	1,600	16,388	344
Balances used	-9,427	-17,476	-7,202	-8,873	-1,400
FINAL BALANCE	53,131	71,670	28,292	37,227	6,151
MOVEMENT IN THE WRITTEN-OFF ASSETS ACCOUNT (c)					
PRIOR YEAR BALANCE	24,051	31,859	17,952	11,281	2,626
Additions charged to impairment allowances	9,510	17,653	7,319	8,930	1,404
Additions charged directly to income	1,525	1,709	667	937	106
Past-due income	1,150	1,868	885	851	131
Other	571	945	610	297	38
Total additions	12,756	22,175	9,481	11,015	1,679
Total reductions	-4,943	-5,804	-1,818	-3,572	-414
Net change due to exchange differences	-6	20	13	7	—
FINAL BALANCE	31,859	48,250	25,628	18,731	3,891

SOURCE: Banco de España. Data available at 4 April 2011.

a Data from the statement of changes in equity. Confidential Return A1.

b Data from breakdown of movements in impairment allowances. Confidential Return T14.

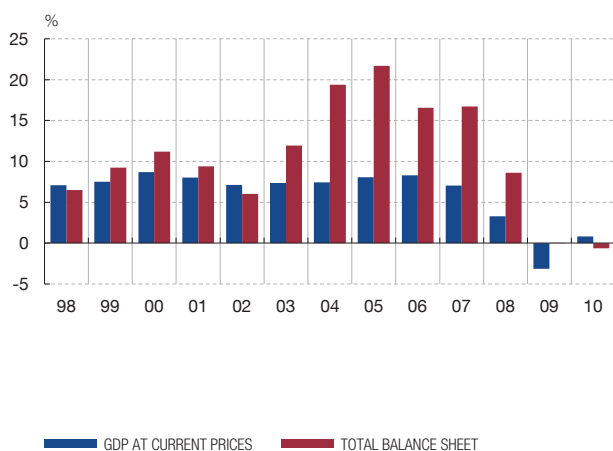
c Data from movement of the written-off assets account during the current year. Confidential Return T10.7.

ment behaviour of households. As a result of the increase in doubtful assets, but also in impairment allowances with a charge to profit and loss and to equity, the doubtful assets coverage ratio increased by 0.3 pp to 47.95 %.

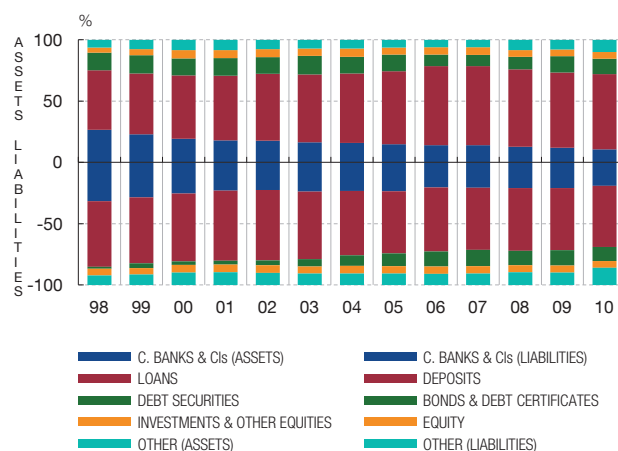
The liabilities side, which saw a slight decline of 0.3 %, showed symmetrical behaviour to that on the assets side. The most notable development was a significant replacement of central bank funding, down by 33.7 %, and of interbank deposits, down by 4.8 %, by funding through money market operations via counterparties, which is recorded in the line item "Other liabilities". In the course of 2010, the main European counterparty clearing houses (LCH Clearent and Eurex Repo) began to accept Spanish sovereign bonds as collateral in repo transactions, giving Spanish institutions an alternative means of funding to the traditional interbank market. Meanwhile, the slight fall-off in deposits from the private sector eased with respect to the previous year (-0.6 %), with contrasting behaviour between those executed via repos, which were down by 30.7 %, and term deposits, the liabilities item with most weight in ATA, which were up by 1.2 %. Also noteworthy is the behaviour of

Total business. Year-end data

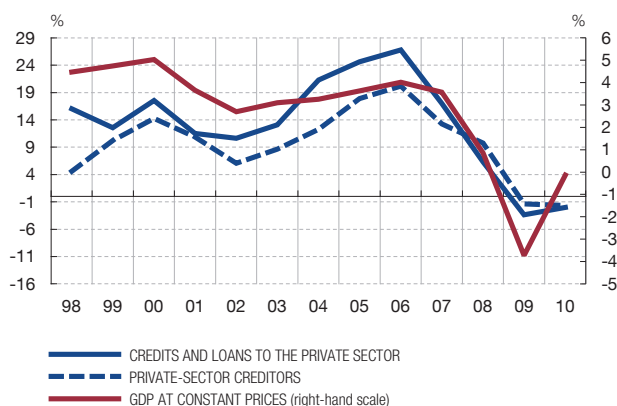
A. YEAR-ON-YEAR CHANGE IN GDP AND IN BALANCE SHEET



B. INDIVIDUAL BALANCE SHEET



C. CHANGE IN BUSINESS ACTIVITY WITH THE PRIVATE SECTOR



SOURCE: Banco de España. Data available at 4 April 2011.

a The data in this chart refer to the institutions active at each year-end.

debt certificates including bonds, down by 9.6% due to the slump in those relating to commercial paper and bills (-48%), which was not offset by the rise in mortgage covered bond issues (7.5%) (see Panel B of Chart A.2.1).

The weight of own funds, the basic component of equity, decreased to 5.7%, reversing the trend of the previous year, after a fall of 3.9% during the course of year. As mentioned above, this development was influenced by the significance of the write-downs with a charge to reserves, and by the smaller contribution from profit or loss, which was, moreover, heavily impacted by the substantial provisioning. This outcome resulted, inter alia, from an increase of €8,265 million in own funds, basically bank capital stock and reserves, and from decreases of €19,197 million in own funds, of which €16,896 million relate to extraordinary write-downs at savings banks (see Table A.2.1).

In 2010, the distribution by institutional group (see Table A.3.3) of the total balance sheet reflects, unlike in the previous year, a loss of weight by savings banks and foreign banks

to Spanish banks, which gained 1.6 percentage points to reach 45.4 % of the total. In the item “Loans and advances to other debtors” the situation was similar, except that in this case the share of foreign banks did not change, so the 1.6 pp redistributed passed in full from savings banks to Spanish banks, as a result of the aforementioned extraordinary write-downs at savings banks. The share accounted for by investments in debt securities decreased significantly in foreign banks and, to a lesser extent, in Spanish banks, with declines of 1.9 pp and 0.7 pp, respectively, as a result of the fall in the balance of commercial paper and bills. Finally, the share of savings banks in tax assets rose by 14.1 pp as a result of the restructuring process under way.

On the liabilities side, the share of banks in the “Central banks” item decreased considerably by 19.5 to 43.3 % at year-end, this decrease being offset by an equivalent rise in the share of savings banks to represent 54.8 % of this item. As noted above, this development is related to the funding obtained through counterparty clearing houses and recorded in the residual item “Other liabilities”, in which banks increased by 9.1 pp and savings banks decreased by 6.4 pp to stand at 40.6 %. In the item “Deposits from other creditors”, which is the one with the greatest weight on the liabilities side, the shares of foreign banks and savings banks fell by 0.5 pp and 2.6 pp, respectively, these portions passing to Spanish banks, which grew by 3.2 pp.

In own funds, the aforementioned adjustment in the savings bank sector led these institutions to lose 7.8 pp to stand at 27.0 % of the total while Spanish banks gained 6.6 pp to stand at 61.6 %, the other types of credit institutions remaining practically unchanged.

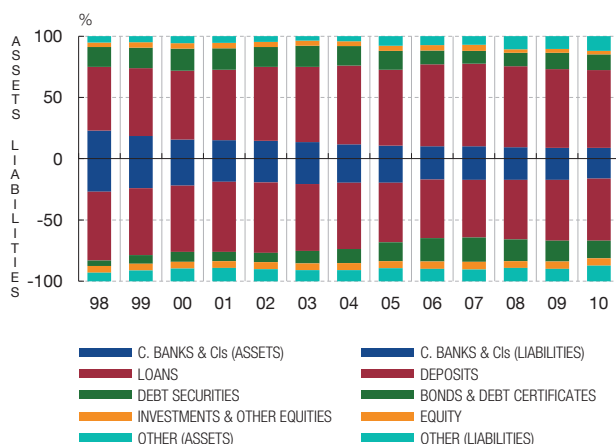
As regards securitisations, the stagnation of the assets and liabilities securitised by Spanish CIs continued in 2010, due to the freezing of the markets for instruments of this type. 2010 saw another sharp fall-off in new issues of asset-backed securities (–43.6 %, see Table A.3.7), continuing the declining path of previous years. The decline in CIs’ liability securitisations was even more marked, since they fell to less than half (–53.8 %), with a total absence of new securitisations of liabilities other than mortgage covered bonds, which fell off by 38 %. In any event, given market conditions, new issues of asset-backed securities continued to be massively retained by the originating institutions for use as collateral in their liquidity management. Only 2.3 % of new securitisations involved a significant transfer of risk and were thus recognised as such in the solvency ratio, and only a minimal percentage of 4.7 % entailed derecognition of the securitised assets. Notably, in the past year the securitisation of residential mortgage-backed bonds has regained weight and, as mentioned above, new securitisations of liabilities other than covered bonds have disappeared.

The outstanding balances of asset securitisations backed by residential mortgages and mortgage covered bond securitisations continued to constitute the vast majority of CIs’ securitisations (39 % and 38 %, respectively, see Table A.3.8). The originators and issuers continue to be concentrated in savings banks (which represent 61.1 %), followed by banking groups (which represent 32.3 %).

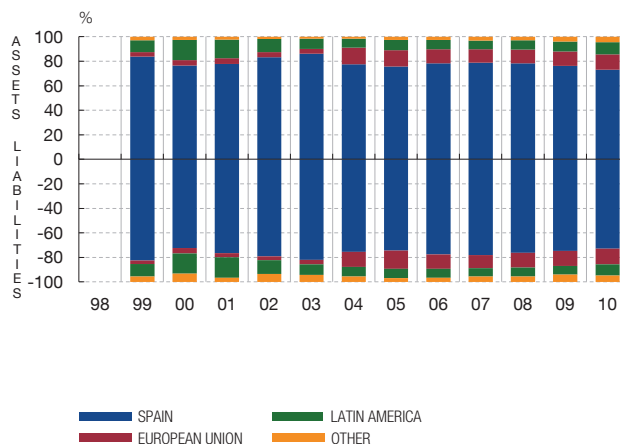
The growth rate of CGs’ activity continued to decline yet another year. The total amount of their balance sheets exceeded €3.8 trillion at end-2010, showing a moderate year-on-year advance of 2.0 % (2.8 % in 2009, 8.8 % in 2008 and 14.8 % in 2007). This is because activity in Spain contracted by 1.9 %, its share of total activity edging down by 3 pp to stand at 73.7 %, in contrast to activity abroad, which grew by 15.1 %, driven partly by acquisitions by the major Spanish banking groups of foreign branch networks and institutions in the year (see Tables A.3.5 and A.3.6).

Total business. Year-end data

A. CONSOLIDATED BALANCE SHEET



B. GEOGRAPHICAL DISTRIBUTION OF BUSINESS



SOURCE: Banco de España. Data available at 4 April 2011.

a The data in this chart refer to the CGs active at each year-end note that they include individual CIs not belonging to any consolidated group).

The various assets-side items of the balance sheet generally followed the patterns mentioned above at individual level, except that the “Cash and central banks” items grew by 39.9 % at consolidated level while it decreased by 19.5 % in business in Spain, this decline being in line with developments at individual level. There is a slight increase in loans and advances to other debtors, which were limited by the adverse performance at domestic level. By contrast, the behaviour on the liabilities side diverged from that noted at individual level in deposits from other creditors, which increased by 4.1 %, and by 3.1 % in business in Spain. Equity declined by 2.4 % and own funds fell by 1.9 %, in both cases by less than in the individual balance sheets, as already noted above (see Panel A of Chart A.2.2).

As regards the geographical distribution of consolidated group assets, the loss of weight of activity in Spain was more than offset by the growth of activity abroad, most significantly in Latin America and, to a lesser extent, in the EU. Financial assets and liabilities in Latin America grew by 25.8 % and 26.1 % respectively, and the net asset value of managed funds grew by 37.2 % (see Panel B of Chart A.2.2 and Table A.3.6).

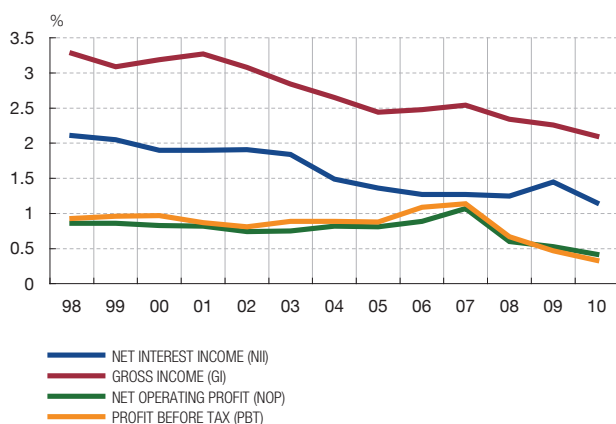
2.2 Results of credit institutions and their consolidated groups

At end-2010, the individual income statements of CIs showed an aggregate profit of €10,219 million, which represents a significant decrease (–23.1 %) with respect to the previous year. The return on average total assets (ROA) fell to 0.32 % (0.42 % in 2009), while the efficiency ratio was not impervious to the general deterioration of the income statement and rose to 46.08 % (see Table A.3.9).

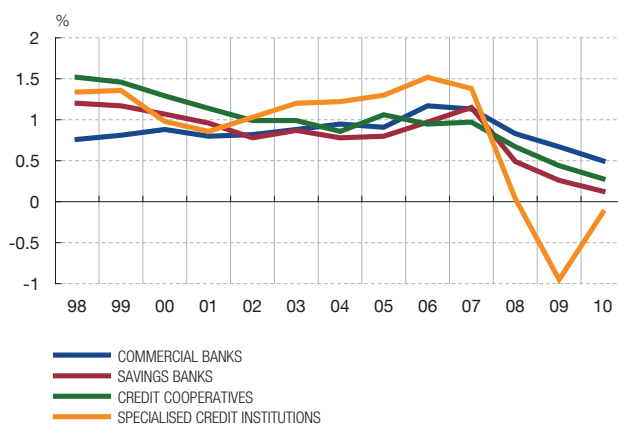
Unlike in previous years, 2010 ended with a contraction in all margins and in the bottom line of the income statement of CIs. Net interest income (NII), which in 2009 had performed positively, succumbed to the pressure derived from an increasingly adverse economic and financial environment. The other main items –gross income (GI), net operating profit (NOP), profit before tax and profit for the period– continued to worsen (see Chart A.2.3.A).

Percentage of ATA. Yearly data

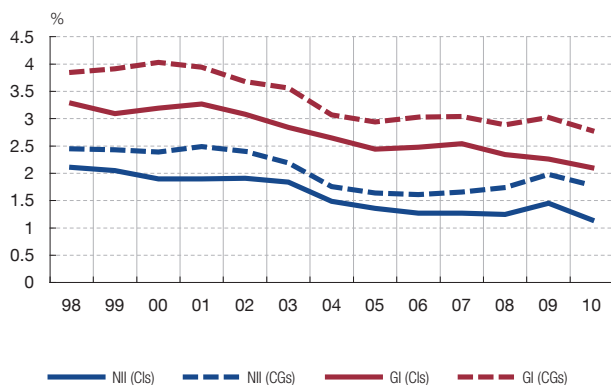
A. INCOME AND PROFIT (CIs)



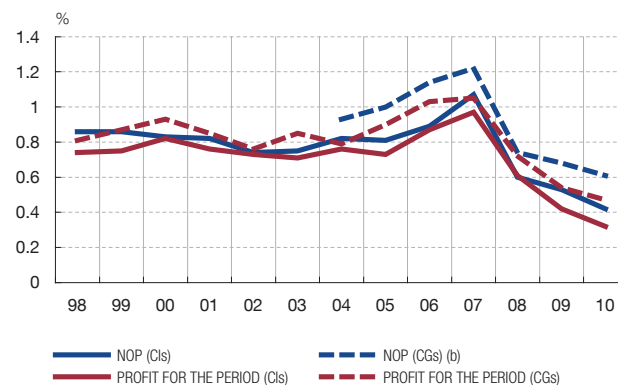
B. PROFIT BEFORE TAX (CIs)



C. NET INTEREST INCOME (NII) AND GROSS INCOME (GI)



D. NET OPERATING PROFIT (NOP) AND PROFIT FOR THE PERIOD



SOURCE: Banco de España. Data available at 4 April 2011.

- a The data in this chart refer to the institutions active at some time during each year. The label "CIs" denotes individual data. In the case of data referring to CGs, note that they include individual CIs not belonging to any CG.
- b Uniform information is not available for the NOP of CGs for years prior to 2004 due to the conceptual changes introduced jointly by Banco de España Circular 4/2004 and Circular 6/2008.

In particular, NII slipped by 30 bp as a percentage of ATA with respect to 2009, declining to 1.15 % as a result of the falls in financial income (-25.1 %) and financial costs (-29.0 %). The commercial strategies for attracting deposits pursued by some institutions in 2010 contributed to the erosion of this margin.

Another factor which decisively shaped the performance of GI was the complex macroeconomic conjuncture in 2010, marked by the sovereign debt crises in the euro area (and the rescues of Greece in May and Ireland in November) which affected the normal functioning of the interbank and wholesale markets in general, giving rise to restrictions and considerably higher funding costs. Against this background, Spanish institutions found themselves obliged to resort increasingly to the funding granted by the Eurosystem. In this situation, the ECB's monetary policy was characterised by the maintenance of the interest rates applicable to refinancing operations (stabilised at a level of 1 % since May 2009) and of the spreads on standing credit facilities (0.75 %) and standing deposit facilities (-0.75 %).

The contribution from the return on equity instruments (which notably grew by 53.9%) could not prevent GI from falling moderately (-6.5%) to stand at 2.10% of ATA (16 bp lower than in 2009). As regards other ordinary revenue, the available data reveal that, despite the lower activity, net fee and commission income remained relatively steady (falling by only 2.3%). Unlike in the preceding two years, the financial assets and liabilities in the trading portfolio generated positive net income, which explains the strong performance of this segment of the income statement.

The NOP of CIs diminished in absolute terms (-21.1%) and in relative terms (-11 bp) to stand at 0.42% of ATA. In this case, the unfavourable changes in this margin can, without loss of generality, be attributed to the continuing high level of write-downs. The containment of administrative and amortisation expenses (unchanged overall) did not prevent the worsening of the efficiency ratio which, due to a decrease in the denominator (GI), returned to the levels (46.08%) of 2006-2007 (see Chart A.2.4.C). Looking ahead to coming years, it seems reasonable to expect that the optimisation of operating costs by institutions (as a result of the process of restructuring and concentration under way) may result in improvements in efficiency, especially among the institutions which until now have formed part of the institution group of savings banks.

Finally, the profit before tax of CIs decreased by 28.9% dragged down by the fall in the "Other income (net)" item (-58.0%), although the impairment losses improved with respect to 2009. Also, the profit for the period fell by 23.1% due to the significant decline in the amounts relating to income tax. As a result of all these developments, the return on equity (ROE), an indicator of bank profitability, decreased, and this decline affected the consolidated ROE mentioned below.

Analysis by institutional group⁴ (see Table A.3.10) reveals the diverging paths taken by income margins in the three types of deposit institutions (commercial banks, savings banks and credit cooperatives). Broadly, only banks performed systematically better than the average, even recording GI which timidly nudged above that of 2009 (up by 1.0%). By contrast, the relative position of savings banks worsened. Meriting separate mention are the specialised credit institutions (SCIs), whose small size and specific business focus make them very sensitive to the current situation of rising bad debts. In 2010, although SCIs incurred lower losses than in 2009, their aggregate NOP, profit before tax and profit for the period continued to be negative.

With regard to consolidated groups, aggregate profit for the period decreased by 10.0% with respect to 2009 to stand at €18,115 million (see Table A.3.11). ROE declined to 7.46% and the efficiency ratio rose to 47.22%. However, as noted in previous years, the figures in the income statements of CGs are, in absolute and relative (% of ATA) terms, significantly more positive than for individual CIs as a whole, at least as regards margins and profitability, although in 2010 this was not so in the case of the efficiency ratio, which was higher (less favourable) for CGs.

Against this background, the ATA of CGs increased by 3.1% (in contrast to 0.7% for CIs) in 2010, buoyed by the strong performance of the five major CGs (see Table A.3.12), which

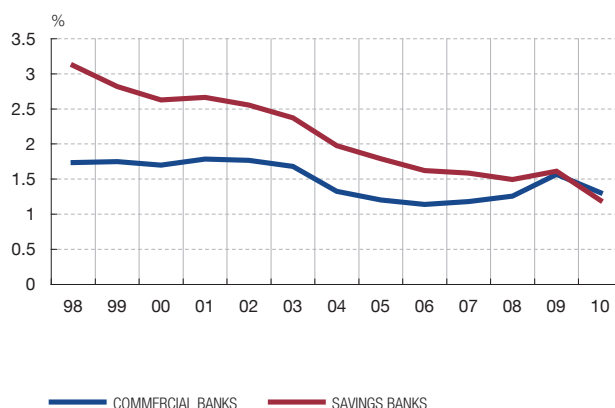
⁴ Unlike in previous editions of the *Report on Banking Supervision in Spain*, the analysis by institutional group is limited to individual credit institutions. The transformation in 2010 in the composition of the main consolidated groups of commercial banks and savings banks resulted in a structural change in the data for that year (compared with the data available for previous years). For this reason, Table A.3.12 was redesigned to show a classification by size (as measured by ATA) of CGs.

Percentage of ATA. Yearly data

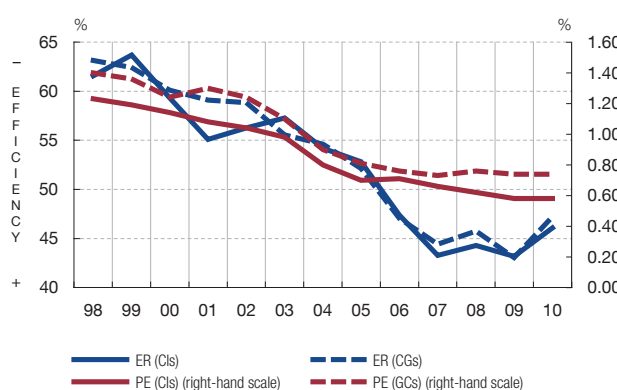
A. RETURN ON EFAs AND AVERAGE COST OF IBFLs (CIs)



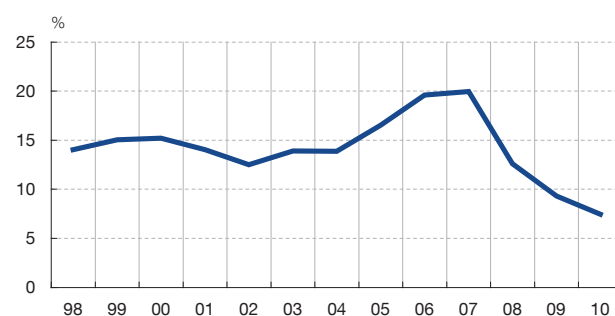
B. TOTAL SPREAD (CIs) (b)



C. EFFICIENCY RATIO (ER) AND PERSONNEL (c)



D. RETURN ON EQUITY (CGs)



SOURCE: Banco de España. Data available at 4 April 2011.

- a The data in this chart refer to the institutions active at some time during each year. The label "CIs" denotes individual data. In the case of data referring to CGs, note that they include individual CIs not belonging to any CG.
- b Total spread is defined as the average return on earning financial assets (EFAs) minus the average cost of interest-bearing financial liabilities (IBFLs).
- c The efficiency ratio is defined as administrative expenses and amortisation divided by gross income. Personnel expenses are expressed as a percentage of ATA (absolute values).

expanded their volume of assets by a significant 4.6 % and, at the same time, managed to improve their results (profit before tax increased by 10.4 % in 2010).

As pointed out in previous editions of the Report on Banking Supervision in Spain, the growing geographical diversification of the business abroad of the large banking groups (mainly in Latin America and the European Union, and incipiently in Asia) continues to be one of the pillars sustaining the ever-wider gap in results in favour of CGs.

2.3 Solvency of consolidated groups of credit institutions subject to compliance with the solvency ratio in Spain⁵

The solvency ratio of CGs subject to compliance with the solvency ratio in Spain (hereafter in this section, CGs) in 2010 stood at 11.9 %, down 0.3 pp from the previous year (see Table A.3.13 and Panel A of Chart A.2.5). This decline took place due to a fall in total own

⁵ In this section, the abbreviation CGs is used to refer to consolidated groups of credit institutions and to individual institutions not belonging to any consolidated group of credit institutions subject to compliance with the solvency ratio in Spain. The entry into force in 2008 of Banco de España Circular 3/2008 of 22 May 2008 to

funds (of 3.7 %) higher than the decrease in capital requirements (of 0.9 %), and, as a result, the surplus of own funds fell to €80 billion (see Panel B of Chart A.2.5).

Although total own funds as a whole decreased, their highest-quality component, which has the largest weight in the total (85.4 % in 2010, see Panel C of Chart A.2.5), namely tier 1 capital (original own funds), continued to grow in anticipation of a regulatory context in which, in order to build up the resilience of the financial system to adverse scenarios, the measures adopted at international and Spanish level⁶ will require the quality and level of credit institutions' capital to be increased in the coming years, in some cases progressively and in others more immediately.

The growth of tier 1 capital in 2010 (3.7 %), however, was significantly more moderate than in previous years, mainly because of the effect exerted by reserves, a component which represented 59.5 % of tier 1 capital in 2009. Reserves, in a context of substantial write-downs by CGs, decreased significantly in 2010 (–6.3 %) to account for 53.8 % of tier 1 capital. Also contributing negatively to the growth of tier 1 capital in 2010 were the rise in deductions therefrom, particularly those for intangible assets, and, to a lesser extent, the fall in instruments subject to limit (especially preference shares and non-voting shares not carrying early redemption incentives). On the other hand, contributing significantly to the growth of 3.7 % in tier 1 capital in 2010 were the increases in eligible capital stock and in other country-specific original own funds, in particular, within the latter, convertible preference shares recorded in the caption “Other” in Table A.3.13, which includes the contributions from the FROB to the own funds of some credit institutions.⁷ Positive contributions, albeit to a lesser extent, were also made by the increase in minority interests and the lower deductions for value adjustments eligible as tier 1 capital. It should be mentioned that these lower deductions were favoured by the entry into force in 2010 of an amendment to Rule 8.1.d) of CBE 3/2008, whereby credit institutions may, when calculating own funds, opt to disregard fair value gains and losses on available-for-sale debt securities.

As regards the other components of own funds, tier 2 capital (additional own funds) decreased by 17.2 %, basically as a result of the fall in core additional own funds, to which practically all their main components contributed –lower securities of indeterminate duration, lower additions to core additional own funds from adjustments made to valuation differences in tier 1 capital, and lower provisions– in line with an economic setting in which significant write-downs have been made. The second of the factors mentioned relates to the regulatory change mentioned above concerning the inclusion of certain gains in own funds. Supplementary additional own funds (and, in particular, their main component, subordinated loan capital), also contributed to the decrease in tier 2 capital with a fall of 10.1 %.

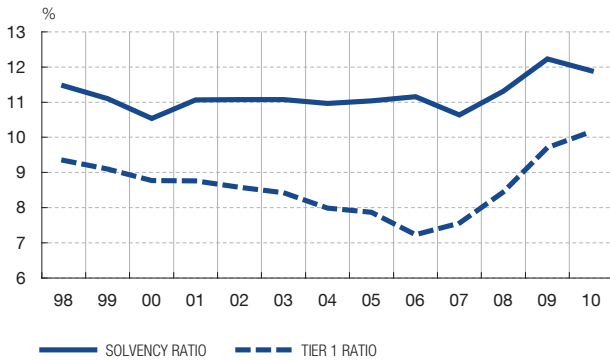
credit institutions on determination and control of minimum own funds (hereafter “CBE 3/2008”) gave rise to a certain break in the time series of the data analysed in this section, since those relating to 2008 onwards were reported by CGs in accordance with CBE 3/2008, while the data relating to prior years were reported under CBE 5/1993. This break affects both the main solvency items analysed and the breakdowns resulting from the entry into force of CBE 3/2008. Accordingly, the figures prior to 2008 constitute what has been considered a best approximation in terms of both amount and item description.

6 These measures include, at Spanish level, Royal Decree-Law 2/2011 of 18 February 2011 for strengthening the financial system, under which the general core capital requirement for credit institutions is 8 % of risk-weighted assets; this requirement rises to 10 % for those groups or institutions that have not placed at least 20 % of their capital stock with third-party investors and whose wholesale funding exceeds 20 %. The notice published by the Banco de España on 10 March 2011 stated that at that date the core capital of the system amounted to €179,642 million and had to be raised by €15,152 million in a set of institutions to meet the requirements of Royal Decree-Law 2/2011.

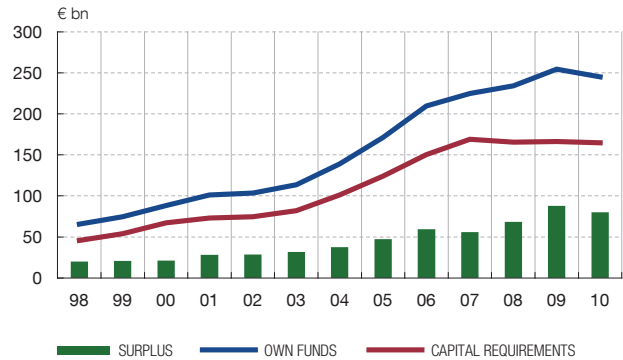
7 Royal Decree-Law 9/2009 of 26 June 2009 on bank restructuring and strengthening of the own funds of credit institutions (BOE of 27 June 2009).

Year-end data

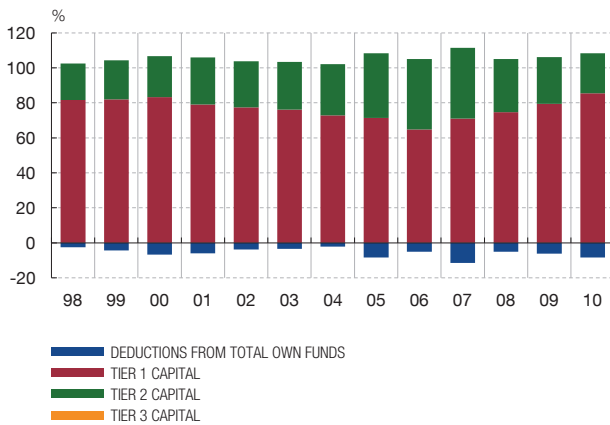
A. SOLVENCY RATIOS



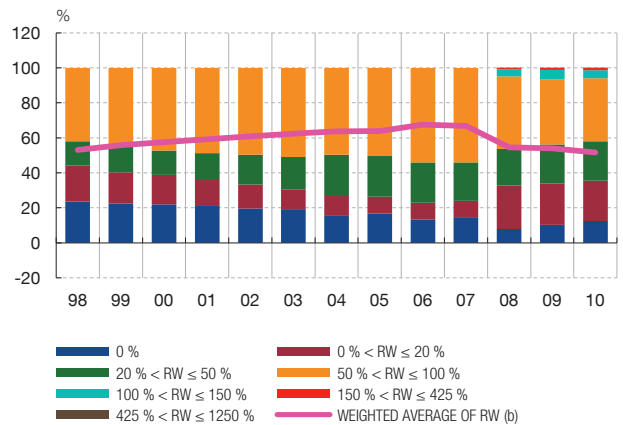
B. OWN FUNDS AND CAPITAL REQUIREMENTS



C. COMPOSITION OF OWN FUNDS



D. BREAKDOWN BY RISK WEIGHT OF CREDIT AND COUNTERPARTY EXPOSURES



SOURCE: Banco de España. Data available at 4 April 2011.

- a The data in this chart refer to the CGs existing at each year-end (note that the data include individual CIs not belonging to any CG).
- b Using exposure values as weights.

Lastly, the increase in deductions from original and additional own funds stemmed from the larger excesses over 10% of capital at unconsolidated investee financial institutions; from the larger excesses over 20% of capital at insurance and similar investees; from larger negative amounts resulting from comparison of provisions and expected losses under the IRB approach; and from larger deductions relating to the amount of exposures in securitisations which receive a risk weight of 1250%.

The decrease of 0.9% in capital requirements was the result of a fall in capital requirements for credit and counterparty credit risk, the component with the largest weight (87.3% in 2010), which was not offset by the increase in requirements for position, foreign exchange and commodity risks, in requirements for operational risk and in transitional, settlement and other requirements (see Table A.3.14).

Closer analysis of the requirements for credit and counterparty credit risk shows that these requirements decreased by 2.3% due to the fact that, despite the increase in exposure

values⁸ (3.3 %), the overall average risk weight applicable to those values decreased by 2.4 pp to approximately 51.5 % (see Panel D of Chart A.2.5). This decrease basically reflected a larger proportion of exposures weighted at 0 % and a smaller proportion of exposures in the intervals (0 %-20 %), (50 %-100 %) and (100 %-150 %), which counteracted slight increases in the proportion of exposures in the intervals (20 %-50 %) and (150 %-425 %).

Examination of the components of credit and counterparty credit risk requirements shows that the requirements calculated under the standardised approach (excluding securitisation positions), those calculated under the IRB approach (excluding securitisation positions) and those for securitisation positions decreased (1.8 %, 2.5 % and 13.2 %, respectively), the first two contributing to a greater extent to the decrease in total requirements for credit and counterparty credit risks, in line with their predominance (62.7 % and 35.6 %, respectively).

The lower requirements under the standardised approach (excluding securitisation positions) reflected a fall of approximately 3.1 pp in the applicable average risk weight to 55.8 %, which amply counteracted the increase in the overall exposure values.⁹ Contributing to this fall in the average risk weight was a redistribution of the weights, measured in terms of exposure values, of the various asset categories: there were losses in the relative weights of exposures to Corporate (3.1 pp) and Institutions (2.6 pp) and gains in exposures to Central governments or central banks (4.3 pp) and, to a lesser extent, in Exposures secured by real estate (1 pp) and Past-due items (0.5 pp). By asset category, the decrease in total requirements was basically due to the decrease in requirements in the Corporate category. The items contributing to counteract this decrease notably include Exposures secured by real estate and Past-due items. Generally, the behaviour of exposure values (rather than average risk weights) was mainly responsible for the changes in requirements in each category.

The decrease in requirements under the IRB approach (excluding securitisation positions) resulted from lower requirements in the minor components of Equity and, to a lesser extent, of Other assets other than financial assets.¹⁰ These movements were, in the first case, basically a decrease in the requirements calculated using internal models, with respect to which the value of the original exposures decreased significantly, and in the second case, a complete reallocation of the exposures to the standardised approach. Disregarding these items, the requirements for credit and counterparty credit risk under the IRB approach would have remained relatively steady (with a growth rate of 0.4 %) because, although the exposure values grew (3.1 %), the average risk weight applicable to this subset of exposures decreased by 1.1 pp to approximately 42.2 %. By component, the very slight growth in total requirements was due to increases in requirements in the Retail and

8 Broadly, “exposure values” are the values which result once various effects have been taken into account which may give rise to a decrease in the original exposure value or to reallocations of the exposures to other categories with a different treatment for capital requirements purposes (effects such as those derived from value adjustments and provisions, from the application of credit risk mitigation techniques or from the application of conversion factors to exposures in off-balance-sheet items). Multiplying the exposure values by the related risk weight gives the so-called “risk-weighted assets”. The capital requirements are calculated as 8 % of these “risk-weighted assets”.

9 Exposure values grew at a rate of 3.6 %, which was lower than that of the original exposures due to a larger increase in value adjustments and provisions (46 %) and to the impact on exposure values of the application of credit risk mitigation techniques (88 %).

10 The category Other assets other than financial assets makes up the whole of the amount of the caption Other in Table A.3.14.

the Institutions categories, which were practically offset by the decrease in requirements in the Corporate category. In this latter category, the fall in requirements was concentrated in the portion treated under the basic IRB approach, since under the advanced IRB approach the requirements for this category grew. As under the standardised approach, the changes in requirements in these categories were caused by the behaviour of exposure values. In that behaviour, care must be taken not to overlook the effect that would be expected from the progressive reallocation of the exposures of certain portfolios from the standardised approach to the IRB approach and from the basic IRB approach to the advanced IRB approach.

With regard to the requirements for securitisation positions, which correspond nearly entirely to traditional securitisations, the decrease was concentrated in those calculated under the standardised approach, which in 2010 represented 84.8 % of the total. The securitisations treated under the standardised approach barely showed any increase in their exposure values, but their average risk weight increased significantly by 8.8 pp to 64.7 %, in line with the downward path of the credit ratings. This higher risk weight would have entailed an increase of 15.8 % in the requirements for these securitisation positions before application of limits. However, since the originators limited the resulting requirements to those that would have applied to the securitised exposures if these had not been securitised, the final requirements were lower than in 2009. The same features were observed in the securitisation positions under the IRB approach.

Despite the lower relative weight of position, foreign exchange and commodity risks, it should be mentioned that the requirements for them rose considerably (31.8 %) and were what most contributed to counteracting the fall in the requirements for credit and counterparty credit risk. Noteworthy was the increase in requirements for foreign exchange risk derived from the taking of larger long positions in foreign currencies.

Lastly, the capital requirements for operational risk grew slightly by 1.7 %. This resulted from a rise in the requirements calculated under the standardised and alternative standardised approaches (6.8 %), a decrease in those calculated under the basic indicator approach (-7.4 %) and stagnation of those calculated under advanced approaches (0.1 %). The behaviour of requirements under the standardised and basic indicator approaches is influenced by the changes that may take place in the so-called gross income¹¹ of the last three years, since these requirements are calculated by applying to this income weights that are 15 % for the basic indicator approach and between 12 % and 18 % for the standardised approach depending on the line of business in which the income arose.

¹¹ Broadly, the so-called gross income is the result of grouping together certain items in the income statement of CGs.