

1 STRUCTURE AND EVOLUTION OF CREDIT INSTITUTIONS
UNDER BANCO DE ESPAÑA SUPERVISION

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1.1 Types of credit institution

The credit institutions (CIs) registered at the Banco de España (BE) at end-2010 numbered 339, 14 fewer than in 2009 since significant changes had taken place in nearly all categories. These changes were considerable in the savings bank group (see Table 1.1 and Box 1.1).

There was a net increase of seven banks: six Spanish banks and one subsidiary of a foreign bank. The changes in Spanish banks related in full to the savings banks restructuring process which began in the year. Specifically, they included the creation of five banks which head the related institutional protection schemes (IPs) of savings banks and the registration of BBK Bank, the recipient of CajaSur's banking business.

A non-EU subsidiary, Banco Pichincha España, was registered in the foreign banks group, while there was no net change in branches due to the three additions and three deregistrations,² all of which were EU banks.

At end-2010 the registered savings banks amounted to 36, having decreased by ten in the year as a result of seven merger processes and the transfer of Caja Castilla-La Mancha's banking activity to Banco Castilla-La Mancha. A total of 16 institutions participated in the seven above-mentioned mergers: two processes were takeovers (Caixa Girona was taken over by la Caixa and Caja Guadalajara was taken over by Cajasol) and the remainder (Nova Caixa Galicia; Catalunya Caixa; Unnim; Caja España de Inversiones, Salamanca y Soria; and Unicaja-Caja Jaén) were mergers of the 12 savings banks involved.

22 savings banks joined together to form the five banks that head the IPs: Banco Financiero y de Ahorros (seven institutions), BMN (four institutions), Banca Cívica (four institutions, one of which is Cajasol following the takeover of Caja Guadalajara), Banco Grupo Cajatres (three institutions) and Banco Base (four institutions). CajaSur was transferred to BBK.

Consequently, at the end of 2010 as a result of all the above-mentioned processes, the savings banks were encompassed in 19 financial groups,³ 27 fewer than a year earlier.

The number of registered credit cooperatives decreased by one due to the deregistration of Caixa dels Advocats, which was taken over by Caja Aragonesa y de los Pirineos. At year-end, Caixa R. de Balears was taken over by Cajamar, although this decrease was not registered in the BE register until the beginning of 2011 and, consequently, it was not reflected in Table 1.1.

In the cooperatives group more institutions became part of IPs. Three institutions joined the IPS, already in existence in 2009, led by Cajamar Caja Rural and a new IPS was cre-

¹ This chapter should be read in conjunction with Annex 2 "Activity, results and solvency of credit institutions" at the end of this Report and with Annex 3 "Financial and statistical information on credit institutions", which are only included in the online edition.

² The new institutions were: AKF Bank, Orey Financial and Industrial Commercial Bank China Luxembourg; and the deregistrations were: ING Bank N.V. and Newedge Group, due to closure and Banco Privado Português, due to the withdrawal of authorisation.

³ This figure includes, in addition to CECA, the Cajasur group which was assigned to BBK. This group's banking activity was transferred to and merged into the BBK group at the beginning of 2011.

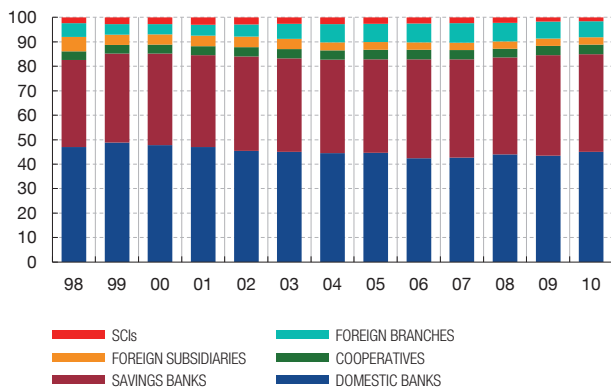
REGISTERED CREDIT INSTITUTIONS, CONSOLIDATED GROUPS AND MIXED GROUPS
TABLE 1.1
Year-end data

Number	2007	2008	2009	2010
CREDIT INSTITUTIONS REGISTERED IN SPAIN (a)	358	361	353	339
Deposit institutions	282	285	283	279
Banks	151	156	154	161
Domestic	53	49	47	53
Of which: heads of IPSs of savings banks	—	—	—	5
Foreign	98	107	107	108
Branches	80	89	89	89
Subsidiaries	18	18	18	19
Savings banks	46	46	46	36
Of which: savings banks participating in IPSs	—	—	—	22
Credit cooperatives	85	83	83	82
Of which: heads of IPSs of cooperatives	—	—	1	2
Of which: cooperatives participating in IPSs	—	—	2	18
Specialised credit institutions	76	75	69	59
Electronic money institutions	—	1	1	1
MEMORANDUM ITEMS:				
Mergers and acquisitions (b)	7 (14)	4 (10)	8 (15)	12 (23)
Between banks	3 (6)	2 (7)	4 (8)	—
Between saving banks	1 (2)	—	—	7 (16)
Between cooperatives	1 (2)	—	—	1 (2)
Between SCIs	—	1 (2)	—	1 (2)
SCIs acquired by/merged with deposit institutions	2 (4)	1 (1)	4 (7)	3 (3)
CONSOLIDATED GROUPS EXISTING AT YEAR-END (c)	102	100	99	71
Parent credit institution	89	88	88	62
Spanish banks and ICO	15	17	17	21
Of which: heads of IPSs of savings banks	—	—	—	5
Savings banks	46	46	46	14
Credit cooperatives	18	15	14	15
Of which: heads of IPSs of cooperatives	—	—	1	2
Specialised credit institutions	1	1	1	1
Foreign CIs	9	9	10	11
Other consolidated groups	13	12	11	9
Spanish parent	6	6	5	4
Foreign parent	7	6	6	5
MIXED GROUPS AND FINANICAL CONGLOMERATES	42	42	44	30
Supervised by Banco de España	41	41	43	29
Supervised by DGS including CIs	1	1	1	1
MEMORANDUM ITEM:				
Bank offices abroad	9,493	10,661	11,159	11,589

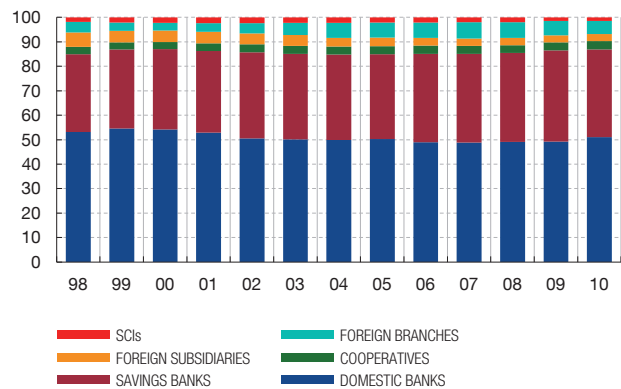
SOURCE: Banco de España. Data available at 4 April 2011.

- a** The number of registered CIs includes ICO in the domestic banks category. However, in the rest of the tables of this Report, both ICO and the only electronic money institution are excluded, unless stated otherwise.
- b** The figures in brackets are the number of institutions which have merged or been acquired.
- c** For the sole purpose of this table, a consolidated group (CG) is defined as a group which includes, in addition to the parent (or failing this the reporting institution), one or more fully or proportionally consolidated financial institutions; accordingly, individual CIs not forming part of consolidated groups are excluded. Unless indicated otherwise, in the rest of the tables of this Report CGs include individual credit institutions not belonging to any consolidated group. The CG classification is based on the nature and nationality of the parent (ultimate holder). The data still include the ISP of Banco Base and do not take into account its break-up at the close of 2011 Q1.

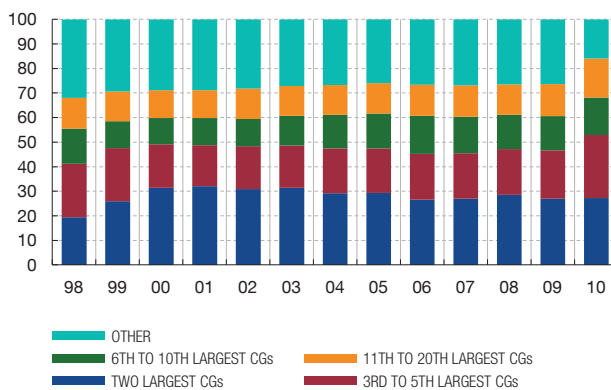
A. TOTAL BALANCE SHEET. BUSINESS IN SPAIN (CIs)



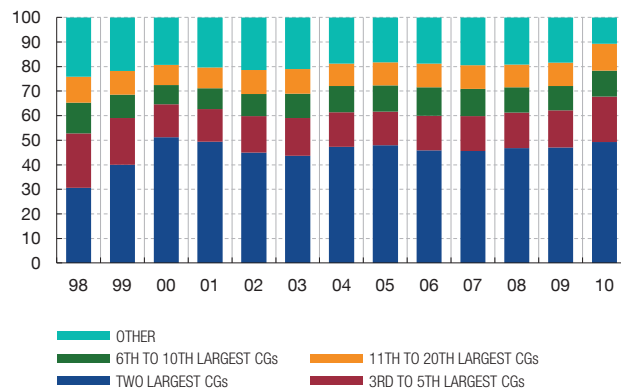
B. TOTAL BALANCE SHEET + MANAGED ASSETS. TOTAL BUSINESS (CIs) (b)



C. TOTAL BALANCE SHEET. BUSINESS IN SPAIN (CGs)



D. TOTAL BALANCE SHEET + MANAGED ASSETS. TOTAL BUSINESS (CGs) (b)



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

- a Year-end data relating to registered credit institutions and consolidated groups existing at each date. The criteria used to segment CGs by size are: balance sheet total for business in Spain and balance sheet total for total business plus managed assets at each year-end (it should be recalled that the data referring to CGs include individual CIs not belonging to any consolidated group).
- b Assets managed both by institutions themselves and by third parties.

ated, Grupo Cajas Rurales del Mediterráneo, which brings together 14 institutions and is headed by Caja Rural del Mediterráneo.⁴

At the close of 2010 there were 59 registered specialised credit institutions (SCIs), their numbers having experienced a net decrease of ten in the year, caused by six deregistrations and four takeovers. Of the latter, three SCIs were merged into their parent banks (Banco Santander took over Bansalease and Hipotebansa, and BMW Bank absorbed BMW Financial Services) and Unión Financiera Asturiana (an SCI) took over Financiera Oviedo (another SCI).

The changes in the market shares of the different types of credit institutions in the total balance sheet of business in Spain (see Chart 1.1.A) in 2010 were as follows: Spanish banks gained 1.5 percentage points (pp) and cooperatives 0.1 pp at the expense of the

4 See the breakdown of institutions in Annex 6 “Spanish consolidated groups of credit institutions” which is included in the online edition of the Report.

market share of savings banks and branches of foreign banks which slipped 1.1 pp and 0.5 pp, respectively, since the share of subsidiaries of foreign banks and SCIs remained virtually unchanged.

Turning to total business, the most significant changes in market share measured in terms of the total balance sheet plus assets managed by CIs (see Chart 1.1.B), were recorded in the Spanish banks group, which increased its share by almost 2 pp, and in savings banks and foreign branches, whose shares dropped 1.5 pp and 0.5 pp, respectively. At-end 2010, the share of Spanish banks exceeded 51 %, its highest level in recent years.

The market share of consolidated groups (CGs) by size (see Charts 1.1.C and 1.1.D) varied significantly, and market concentration increased in terms of business in Spain and of managed assets plus total business to the detriment of “other institutions” or smaller CGs, whose weight fell back by 10.5 pp and 7.8 pp, respectively, in 2010. The five largest CGs recorded the highest increase in market share of approximately 6 pp in both cases.

1.2 Operating resources

The number of active CIs⁵ in 2010 stood at 332, posting a decrease of 13 in the year. At the same time, the number of operational offices fell by 2.8 % to 43,303 at year-end.

Throughout 2010 1,230 branches in the active CIs operational network were closed which meant that the density of offices per inhabitant decreased for the second consecutive year to 11.2 per 10,000 inhabitants over 16 years of age.

The change in size of office network for Spanish banks followed a different pattern to that of the other groups. For instance, while the other groups followed the downward trend that began mid-2008, Spanish banks increased their operational offices by 380, which represents 2.8 % growth of their network and is accounted for by the transfer of the branch network of Caja Castilla-La Mancha to the bank that has inherited its activity. Net of this effect, it is estimated that the operational network of Spanish banks decreased by 175 branches, down 1.3 % (a lower pace of decline than in 2009), and that of savings banks fell back by 3.9 %.

In the foreign banks group, while the size of the subsidiaries’ network did not change, that of foreign branches shrank by 2.6 % with the closure of five offices.

At end-2010 the savings banks’ network included 22,750 branches, down 6.2 % on the previous year. Although, if the above-mentioned effect of the transfer of offices to Banco Castilla-La Mancha is excluded, it is estimated that the savings banks’ operational network decreased by 3.9 %, with 947 fewer offices than a year earlier.

The network of SCIs shrank more quickly in 2010, by 21.2 %. This was the highest reduction in relative terms across all CIs, with the closure of 76 offices. The smallest decrease in operational network was in the cooperatives group with the elimination of 24 branches (0.5 %).

As for consolidated groups’ bank offices abroad, in contrast to developments in the network in Spain, the number of branches rose by 3.9 % to 11,589.

The above-mentioned shrinkage of the operational networks of Spanish CIs was accompanied by a reduction in the number of serving employees to 263,392 at year-end, down

⁵ Of the total institutions registered, only those effectively carrying on operations at the end of 2010 are considered here; that is to say, those institutions which are registered but inactive are excluded.

2.1 % on the previous year. The decline in serving employees was slightly sharper among those assigned to the office network (2.8 %), who account for 72.8 % of total employees. The total number of hours worked posted a decrease of 5 %, which was considerably steeper than the reduction in headcount.

If the effect of CCLM becoming Banco CCLM is disregarded, banks shed a total of 1,075 jobs (1 %) and in 2010 savings banks stepped up the staff reductions which began in 2009, resulting in a total of 4,228 fewer employees (-3.2 %).

In percentage terms, the steepest staff cuts affected employees assigned to the office network of SCIs which dropped by 17.9 %. Lastly, serving employees of credit cooperatives fell by 1 %.

As a result of the changes in the size of the office network and of the staff assigned to it, the ratio of employees per operational office remained unchanged for total CIs (4.4), savings banks (4.4) and credit cooperatives (3.2), while it rose by two-tenths in SICs (5.5), decreased by one-tenth in banks (4.9) and posted declines both for Spanish banks and for foreign subsidiaries and branches.

The number of CIs' agents increased in 2010 by 2.4 % to 5,289. The most significant increases were in foreign subsidiaries, foreign branches and credit cooperatives, whose growth rates exceeded 8 %. The largest reduction was in savings banks (28 %); this decrease slackens to 5.6 % net of the effect of transferring the activity of Caja Castilla-La Mancha to a bank.

For the second consecutive year, the stock of automated teller machines (ATMs) shrank by 696 or 1.2 %. The deposit institutions which increased, albeit only slightly, the number of ATMs were credit cooperatives (0.6 %) and Spanish banks (0.1 %), net of the transfer of CCLM. Consequently, the ratio of ATMs per 10,000 inhabitants over 16 years of age decreased to 15.4, with an annual decrease of 0.2.

By contrast, point-of-sale (POS) terminals for total CIs expanded further to 1.48 million, at a similar pace to the previous year. The overall increase was 2.6 %.

The total number of credit and debit cards in circulation decreased by 2.6 million (2.7 %) to 93.8 million. The decrease was significant for credit cooperatives and SCIs, which posted declines of 4.9 % and 7.2 %, respectively. Those issued by savings banks fell by 4.4 % and increased by 1.8 % for banks (excluding the effect of the transfer of CCLM these rates would be -3.1 % and 0.6 %, respectively). The number of cards per inhabitant over 16 years of age decreased by one-tenth to 2.4 cards.

1.3 Consolidated groups

As at the end of 2010, there were 71 consolidated groups,⁶ 28 fewer than a year earlier. Among the changes recorded during the year, which are detailed below, the most significant related to the savings bank restructuring process.

In the case of parent banks, five banks set up during the year to head savings bank IPSs were registered (Banco Grupo Cajatres, Banco Mare Nostrum, Banco Financiero y de Ahorros, Banca Cívica and Banco Base), while Banco Guipuzcoano was deregistered, due

⁶ In accordance with Table 1.1, consolidated groups are defined as groups that include, in addition to the parent (or reporting institution), one or more other fully or proportionally consolidated financial institutions.

to its integration into the Sabadell group. There were 14 groups with a savings bank parent at end-2010, 32 fewer than at end-2009, owing to the creation of the five aforementioned IPSs, seven mergers, which affected 16 institutions, and the business transfer from Caja Castilla-La Mancha to the bank with the same name.

Among the credit cooperatives, one consolidated group was registered, that of Caja Rural del Mediterráneo, which joined an IPS as the head of 13 participating cooperatives.

There was no change in the groups that have SCIs as their parents, while Banco Pichincha España was added to groups with foreign CI parents.

Lastly, among groups whose parents are not credit institutions, Arafin EFC was deregistered from those with a Spanish parent, owing to the change in its corporate purpose, while Gmac España EFC was deregistered from those with a foreign parent.

In 2010, mixed groups (MGs) and financial conglomerates (FCs) numbered 30, one of which was supervised by the Directorate General of Insurance (Bilbao Hipotecaria EFC). At end-2010 there were three financial conglomerates (Santander, BBVA and la Caixa), there having been no changes during the year.

Over the last two years, the Spanish banking system has been undergoing intense restructuring, basically focused on the savings bank sector.

The reasons behind the need for this reform can be summarised as follows:

- From a structural point of view, the absence of a share capital created weaknesses for savings banks, limiting their ability to raise capital and hampering the possibility of introducing ownership and governance systems fully adapted to international best practices. There were no external investors on their governing bodies, which particularly constrained the possibility of market discipline being exercised properly.

These weaknesses, which had not involved significant practical difficulties while the savings banks followed their traditional business model, became important when, in some cases, their credit policies took a more ambitious turn and they resorted for funding to the much less stable wholesale markets. With the onset of the international financial crisis, it became evident that markets were beginning to demand higher and better quality capital and more conservative financial structures from financial agents.

- As has been pointed out in numerous publications, the business model of certain savings banks from 2000 to 2007 focused on high credit growth, with rising exposure to the real estate development and construction sector, which is characterised by a strong cyclical component. In order to meet the operational and competitive requirements of this strategy, which was pursued at a large number of institutions, overhead expenses rose substantially and branch networks increased notably. In certain cases, the expansion involved relaxing credit standards and neglecting sector concentration risks.

Furthermore, the traditional sources of funding were not sufficient to finance this strong business growth, resulting from higher demand for credit, and, consequently, wholesale funding (for example, the securitisation of mortgage loans) began to be used more often.

The coming together of these factors –strong business growth, heavy reliance on wholesale funding, laxer risk standards and legal status limitations– was the reason for the need to reform the savings bank sector, which became increasingly pressing with the onset of the economic recession from end-2008.

This process has taken place under the impact of three crises which coincided with the different manifestations of the economic downturn: the international financial crisis, the Spanish economic crisis and the sovereign debt crisis.

The first crisis is the *international financial market crisis* which began during summer 2007. It originated in the US subprime mort-

gage market and involved a sharp drop in liquidity especially on the wholesale markets most closely related to toxic products (securitisation and credit derivatives markets). This illiquidity harmed Spanish institutions, which saw how their sources of funding gradually dried up. This situation became especially acute following the bankruptcy of Lehman Brothers.

Initially, Spanish institutions were relatively safe –but not immune– from the crisis: they had no exposure to products related to these US real estate assets, although the deterioration of liquidity conditions had a significant effect on the business strategy pursued in recent years. Faced with this situation, the Spanish authorities adopted several remedial measures:

- On one hand, they tried to improve the financing of the banking system through the Fund for the Acquisition of Financial Assets and the programmes providing guarantees for bank issues of bonds and notes. Similarly, the new policy of supplying unlimited liquidity, implemented by the European Central Bank from autumn 2008, helped to achieve this objective.

However, the temporary nature of this funding support subsequently prompted the banking system to launch new strategies, offering high yields to attract deposits, which ultimately squeezed margins in the income statement through higher financial costs. The positive side is that an improvement has been seen in recent quarters in the financing of lending through deposits which, to a certain degree, lessens reliance on wholesale markets.

- On the other, several plans to merge institutions began to be promoted and the possible new instruments to encourage the restructuring of the savings bank sector began to be analysed.

At the end of 2008 the Spanish economy, which had already begun a process of adjustment of the imbalances built up during the upswing, went into recession with six consecutive quarters of declines in GDP. Thus, at the beginning of 2009 *the Spanish economic crisis intensified*. This crisis unfolded in parallel with the international crisis and was characterised by a fall in production and, especially, employment (unemployment was slightly above 20%) as well as by a severe adjustment in the real estate sector. It is also important to recall that the imbalances which had built up included the high levels of indebtedness in the private sector.

The impact of this crisis was an exponential rise in doubtful assets and loan-loss provisions at credit institutions, with the corresponding effect on income statements due to the increase in provisions and the effect on margins of the decrease in profitable assets. Additionally, it clearly underlined the above-mentioned problems of over-expansion and of the build-up of real estate risks in part of the credit system.

At that time, the need to restructure the banking system, focused essentially on savings banks, became more evident.

In order to undertake such a process, the Government approved the creation of the Fund for the Orderly Restructuring of the Banking Sector (FROB), which was ratified by Parliament in July 2009. The FROB can act in two ways:

- Strengthening the mechanisms for supervisory intervention of troubled institutions with future viability problems, by making such mechanisms swifter and easier to enforce.
- Downsizing the sector through the merger and concentration of viable institutions, permitting a reduction in capacity (either through the number of branches and central services or operating expenses) and an increase in the average size of the resulting institutions. This might reasonably be expected to improve their ability to tap new sources of financing, their operating efficiency and their risk management and monitoring.

In order to achieve both objectives, the FROB was given ample financial resources (€9 billion of capital and a borrowing limit of €90 billion, guaranteed by the Treasury) enabling it to provide sufficient financial aid to institutions or groups of institutions and to send a clear message to markets about the public authorities' determination to resolutely tackle the necessary restructuring of the system.

In practice, almost all of the FROB's actions in this phase involved support for merger and concentration processes led by savings banks and stronger management teams. These actions took the form of €11.6 billion of aid granted or committed to nine different merger plans. Finally, one of these processes, instrumented through Banco Base, did not prosper and the aid envisaged was not disbursed. This process split into a new merger plan for three savings banks, on the one hand, and one independent savings bank, on the other. Aid was requested for these two plans through the new framework approved in 2011, as shown below. Consequently, the definitive disbursements amounted to €10.1 billion.

Only in one case did the FROB¹ provide aid for the restructuring of an institution with viability problems (CajaSur). The final amount of this aid was €392 million.

In short, the merger and concentration processes have reduced the number of institutions in the savings bank sector from 45 to 18, which has increased the average size of institutions by approximately one and a half times. Another highly important issue is that these processes have given rise to a current of opinion among most of these institutions' main interest groups that the reforms need to be implemented and networks and costs adjusted. It should be underlined that the accounting methods governing the business combinations resulting from the above-mentioned processes made it possible to write down a further €22 billion of loans and foreclosed assets of institutions participating in the processes against reserves. If we add to this figure the €58 billion of write-

downs made by the banking system in the three-year period from 2008 to 2010, which were charged to the income statement, and the €16 billion drawn down from the general provisions, the Spanish banking system's total balance-sheet write-downs in the above-mentioned three-year period were equivalent to 9% of GDP.

Strains on financial markets heightened from the beginning of 2010, initially centred on the sovereign debt of certain euro area countries, although distrust later spread to a large part of this market. This marked the onset of the *so-called sovereign debt crisis*, which commenced with the Greek crisis in spring 2010 and continued with the episodes of Ireland (end-2010) and Portugal (in 2011). It should be noted, however, that this latest episode has affected Spain to a much lesser degree, since it has decoupled from the three countries involved.

In the case of the *Greek crisis*, investors' doubts focused on the sustainability and reliability of public finances in Europe, which triggered a significant rise in risk premia and bigger financing difficulties for the European banking system, especially for banks in those countries in which investors perceived greater signs of vulnerability. Faced with this loss of confidence, which also affected institutions in Spain, the Spanish authorities decided to boost the restructuring of the sector and stressed, in particular, that the merger process should be concluded in the shortest period possible, as permitted by corporate and mercantile legislation.

Furthermore, the Banco de España decided to change its regulations on loan-loss provisions. The central planks of the reform were:

- The shortening of the periods for recognising losses on doubtful assets to a maximum of 12 months, unifying the various time frames in existence.
- The inclusion of an objective criterion for the write-down of foreclosed assets which includes the recognition of a minimum impairment based on the time elapsed from the acquisition of the asset, in addition to that which might be disclosed by virtue of compulsory, regulated, up-to-date appraisals.
- The incorporation of real estate collateral into the calculation of the loan-loss provision, with discrimination on the basis of the quality of the collateral and the application of regulated reductions to the appraisal value and certain additional caveats.
- The introduction of new qualitative risk management criteria which must be incorporated by institutions into their lending policies.

Another important initiative was the active participation of the Spanish banking system in "stress tests" coordinated at European level by the Committee of European Banking Supervisors and published at the end of July 2010. Spain's participation was highly

¹ In the case of Caja Castilla-La Mancha the restructuring was in the form of aid granted by the Savings Banks Deposit Guarantee Fund.

notable, since it was the country with the highest number of institutions analysed (which represented more than 90 % of the system compared with the 50 % envisaged), and a much greater level of detail was provided than in other European countries. This set of initiatives was completed with the major legislative reform of July 2010, included in Royal Decree-Law 11/2010 on the reform of the savings banks. The most salient aspects of this Royal Decree-Law are as follows:

- It opened up alternatives, from the standpoint of legal status, for savings banks to operate as commercial banks, since they can agree to transfer their financial business to a newly created bank, retaining their status as a credit institution or becoming special foundations.
- It clarified the requirements which must be complied with by institutional protection schemes (IPSs) for the purposes of solvency regulations.
- It required greater professionalisation in the management of savings banks.

Although the implementation of these measures partially eased the strains experienced by the Spanish banking system on the markets, the banking crisis in Ireland diluted their beneficial effect from October. In 2010 Q4, the Irish banking system recognised the existence of significant losses which compromised the solvency of its major banks and, secondarily, its public debt due to the specific guarantee given by the Irish government to bank liabilities. The recognition of these losses also sparked notable scepticism about the results of the stress tests in July, triggering greater market uncertainty.

The Spanish authorities' reaction centred on consolidating and accelerating the restructuring which had already been agreed. The Banco de España encouraged savings banks belonging to an IPS to transfer their financial business to the core credit institution and to make deeper adjustments to overhead expenses.

Also, the Banco de España, in November 2010, decided to increase institutions' transparency, by requiring them to detail their exposures to the real estate development and construction sector, and the situation and projections of their financial structure, in order to give investors access to more information on which to base their assessment of the situation of each institution.

Lastly, in early March 2011, Parliament approved Royal Decree-Law 2/2011, whose purpose was to increase solvency in the Spanish banking system through higher capital requirements.

This new Royal Decree-Law firstly establishes a new "core capital" ratio, further to solvency obligations already in force, with the following characteristics:

- The ratio is satisfied with "core capital", a concept based on the "common equity Tier 1" of Basel III (under the definition which will apply when it begins to be implemented in 2013),

which includes only higher quality capital instruments. The concept of core capital does not include hybrid instruments, but it does include preference shares subscribed by the FROB and, transitionally, the debt that must be converted into shares before 2014, which has a series of characteristics ensuring its stability and high loss-absorbing capacity.

- A core capital ratio of 8 % of risk-weighted assets, which stands at 10 % for institutions, irrespective of legal status, with higher prudential risk in the following form:
 - Their reliance on wholesale funding exceeds 20 %.
 - Less than 20 % of their capital is held by third-party investors.

Furthermore, on the basis of the stress tests which may be performed, the Banco de España may increase the ratio required from specific institutions.

- The regulation also envisages that those institutions not meeting this ratio initially will have to submit a strategy and an implementation timetable, which must be approved by the Banco de España. These will be followed by recapitalisation plans in those cases in which use of FROB funds is envisaged.

Royal Decree-Law 2/2011 also included a reform of the regulations governing the FROB. The amendments introduced were aimed at improving the Fund's ability to act through various channels:

- The types of financial instruments that the Fund can subscribe to, to support the recapitalisation of viable institutions, are limited to ordinary shares or capital contributions to credit cooperatives (the possibility of financial support comprising preference shares to encourage merger processes remains, but only in the case of credit cooperatives).
- The institution applying for the aid must submit a recapitalisation plan, to be approved by the Banco de España, comprising a business plan and a set of specific commitments which must be verified subsequently.
- The institution's economic value and, consequently, the subscription price of the aid given by the FROB will be determined by a report of independent experts, although the definitive or reference value, as the case may be, will be taken to be that set in recent market transactions, if any.
- The FROB's contributions will be temporary, and for a maximum of five years. Directors must be appointed to the board of the bank created by the transformation of the savings bank, with a number of votes equivalent to the equity holding. Furthermore, a prerequisite for aid to savings banks is the transfer of the banking business to a bank within three months.

At the cut-off date for this Report on Banking Supervision (30 April 2011), the following objectives of Royal Decree-Law 2/2011 had been achieved:

- On 11 March 2011 the Banco de España published the results of its calculation of the core capital ratios of all Spanish credit institutions. In short, it identified 12 institutions (four banks and eight savings banks) with a core capital shortfall amounting to €15.2 billion (finally, following the break-up of the initial Banco Base IPS, the number of institutions with a shortfall rose to 13 and the two institutions or groups resulting from this break-up have submitted their strategy separately, which is based on estimated capital requirements of €2.8 billion for CAM and a total of €519 million for the three other institutions)².
- On 14 April 2011 the Banco de España approved the strategies and timetables submitted by the 13 institutions or groups. To sum up:
 - Two subsidiary banks of foreign institutions have been recapitalised by their parent.
 - Another two banks have issued instruments which qualify as core capital.
 - Four groups of savings banks have proposed as their priority option an IPO or raising capital from investors and, should it not be possible to implement the plan as envisaged, resorting to the FROB, in accordance with the legal provisions.
 - One savings bank has shown its preference to merge with another more capitalised institution and, as an alternative, resorting to the FROB.
 - Lastly, the other four savings banks have expressed their preference for the FROB to take a stake in their capital, in order to reach the required capitalisation level, without ruling out the possibility of raising part of the capital needed from private investors.
- Those institutions which considered resorting to the FROB as their primary source of funds submitted their specific

² Following the break-up of the Banco Base IPS, commitments to pay up €1.5 billion of convertible preference shares lapsed.

plans for recapitalisation to the Banco de España prior to the deadline of 28 April 2011.

Meanwhile, the FROB has formally undertaken, to all the institutions whose priority or subsidiary strategy involves resorting to its aid, to contribute the funds required so that all institutions in the Spanish banking system meet the new core capital ratio.

Consequently, all the steps are being taken to complete the process of reinforcing the solvency of the financial system in the terms and within the deadlines envisaged by Royal Decree-Law 2/2011. As a further step within the envisaged timetable, the recapitalisation plans submitted by the institutions are currently being analysed. This process must be concluded before 30 September 2011 with the implementation of all the measures included in the compliance strategies. The deadline may be extended by three months by the Banco de España, where so required for sufficiently justified operational reasons, or by up to six months in the case of IPOs.

The strategy implemented to restructure the savings bank sector has involved the following: the restructuring of institutions' balance sheets; the merger of savings banks to create bigger and more efficient participants; the changing of legal status to facilitate access to capital markets and to improve governance; and, lastly, the recapitalisation of the sector. All of these steps are being taken, furthermore, with heightened transparency so that depositors, investors and analysts know on an informed basis about each institution's situation.

Savings banks represent 37 % of the Spanish banking system's assets. As a result of the restructuring process described above, the breakdown of this 37 % is as follows: nine savings banks, representing 13 % of the whole system's assets, satisfactorily meet the new capital requirements, although in certain cases they are voluntarily becoming commercial banks to engage in their financial activity or are exploring new integration possibilities. Four savings banks or groups in the form of IPSs, representing 15 % of total assets, are planning to indirectly pursue their business through commercial banks and aspire to meet the capital requirements by raising capital from third parties, without the need to use public funds. The remaining five savings banks representing 9 % of all the banking system's assets will foreseeably have to resort to aid from the FROB, which means that they will have to change their legal form in order to perform financial activity through commercial banks and the FROB will take stakes in their capital.