STATISTICAL EFFECTS ON SPANISH CREDIT INSTITUTIONS' BALANCE SHEETS OF THE RECENT RESTRUCTURING AND RECAPITALISATION OPERATIONS

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Introduction

The restructuring and recapitalisation of the Spanish banking system under way in recent years accelerated notably from June 2012, when the Spanish authorities requested external financial assistance under a sectoral programme. In this connection, the Spanish and European authorities signed a Memorandum of Understanding (MoU) last July. The MoU set out the specific measures needed for such restructuring and included, among other aspects, the segregation of problem assets, stress tests to estimate the capital needs credit institutions might have under adverse conditions and improved risk-identification and crisis-management mechanisms. The milestones laid down in the MoU have since been progressively reached, meaning that Spain has been able to access European financing from the European Stability Mechanism (ESM) to recapitalise institutions with a capital shortfall. This set of measures has affected many items on credit institutions' balance sheets; however, as this article will show, their effects on financing flows to the private sector have not been significant.

One of the key aspects of this restructuring process has been the creation of the Asset Management Company for Assets Arising from Bank Restructuring (SAREB), to which insufficiently capitalised banks have been transferring their portfolio of problem assets. In December, the so-called "group 1"[1] banks transferred various assets to SAREB for a nominal value of €71 billion. In exchange, these credit institutions received securities issued by SAREB amounting to €36.6 billion[2] (see Figure 1). In the coming days there will be a similar operation, albeit for a smaller amount, with the "group 2" banks, which are those that require public aid to cover their capital shortfall, although they are not majority-owned by the Fund for the Orderly Restructuring of the Banking Sector (FROB).

Likewise in December, the group 1 banks received fresh capital from the FROB, which channelled the financial assistance provided by the ESM, for an amount of €37 billion. Shortly, the group 2 banks will receive fresh capital under a similar arangement.

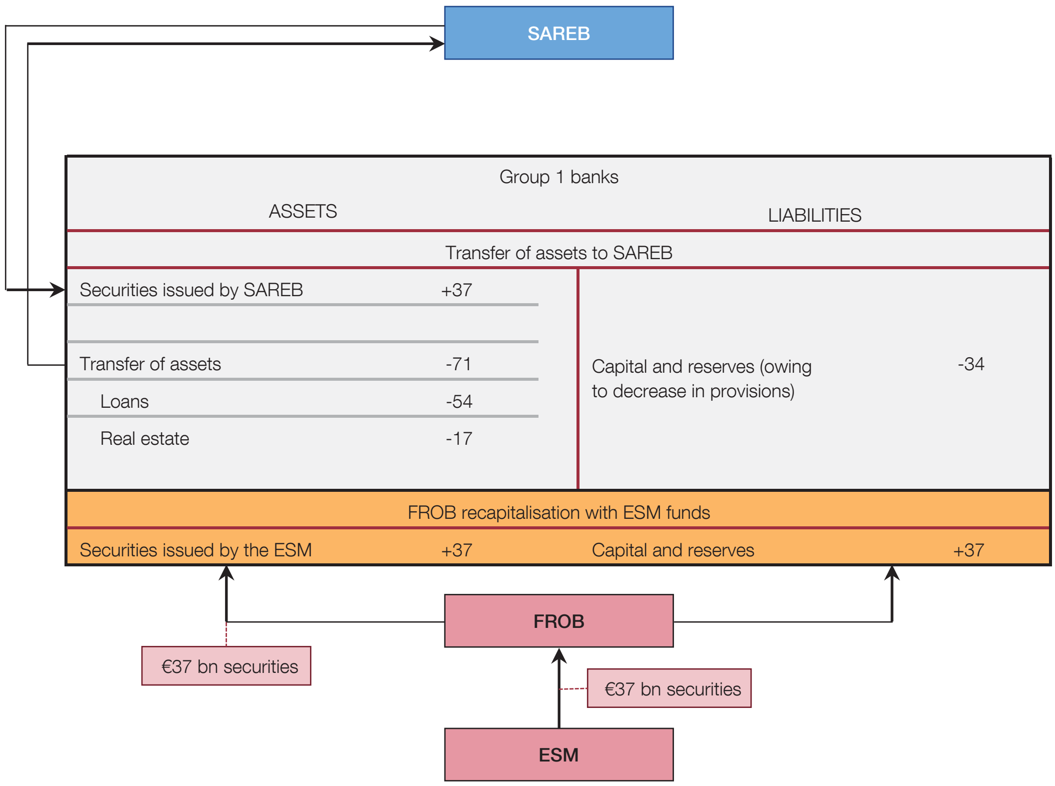
This article briefly reviews the impact of these operations on the main variables of bank balance sheets, especially on the credit granted to the private sector.[3] The following section looks at the effects of the transfer of assets to SAREB on institutions' accounts. Next, an analysis is made of the recapitalisation carried out by the FROB with ESM funds, and, finally, the foreseeable prospects for this process in the short term are summarised.

The transfer of assets to SAREB

To overcome the uncertainty associated with the presence of impaired assets on the balance sheets of certain Spanish banks, the MoU proposed segregating the impaired assets of banks experiencing problems. To this end, the company SAREB was set up in November 2012. Its aim is to acquire those impaired assets and sell them as profitably as possible, within a maximum timeframe of 15 years.[4] The assets subject to transfer basically comprise loans to real estate developers and fixed assets (real estate or land).

1 Included in this group are BFA-Bankia, NCG Banco, Catalunya Banc and Banco de Valencia, which were, at the outset, the banks in which the FROB had a majority stake.
2 The difference is due to the discount on the transfer price of these assets to SAREB.
3 Annex 1 at the end of this article lists the statistics disseminated by the Banco de España that draw on credit institutions' accounting information.
4 The FROB's share in SAREB's capital is currently 45%, meaning that private investors (banks and insurance companies, above all) hold the majority stake.

EFFECTS ON GROUP 1 BANK BALANCE SHEETS OF THE TRANSFER OF ASSETS TO SAREB AND OF RECAPITALISATION WITH ESM FUNDS **FIGURE 1**



SOURCE: Banco de España.

The transfer price of these assets to SAREB has been determined taking as a reference their estimated economic value and, subsequently, additional downward adjustments have been made, bearing in mind factors such as management and administration costs. In exchange for these assets, SAREB delivers State-backed securities issued by it to the banks.

The first – and no doubt most relevant – step of this asset segregation process took place last December when the group 1 banks transferred assets to SAREB for a nominal value of €71 billion, of which €54 billion related to loans[5] and €17 billion to fixed assets[6]. Hence, a substantial decline was seen in December in the outstanding balance of credit to the private sector on the balance sheets of these banks, although the operation involving the transfer of loans to SAREB did not affect the flow of financing received by the private sector, since all that had happened was a sectoral reclassification of the credit granted. These credit claims simply moved into the possession of an entity (SAREB) which, for statistical purposes, is classified in an institutional sector other than that of credit institutions. Specifically, SAREB is classified in the sector “Other financial intermediaries”, where institutions such as securitisation special purpose entities or securities dealer companies are to be found.

5 The bulk of this was loans to non-financial corporations.

6 Actually, the decline in the figure for real estate in December compared with the previous month was smaller, which masks the fact that in the closing months of the year banks recovered fixed assets held by their special purpose entities to transfer them to SAREB, but both the recovery and subsequent transfer occurred in December. Consequently, these amounts (recovered and transferred in the same month) do not feature in the December data as a reduction from the real estate on banks’ balance sheets.

LOANS GRANTED TO OTHER RESIDENT SECTORS BY CREDIT INSTITUTIONS
Changes in December 2012 on a month earlier. Nominal amounts (€bn)

TABLE 1

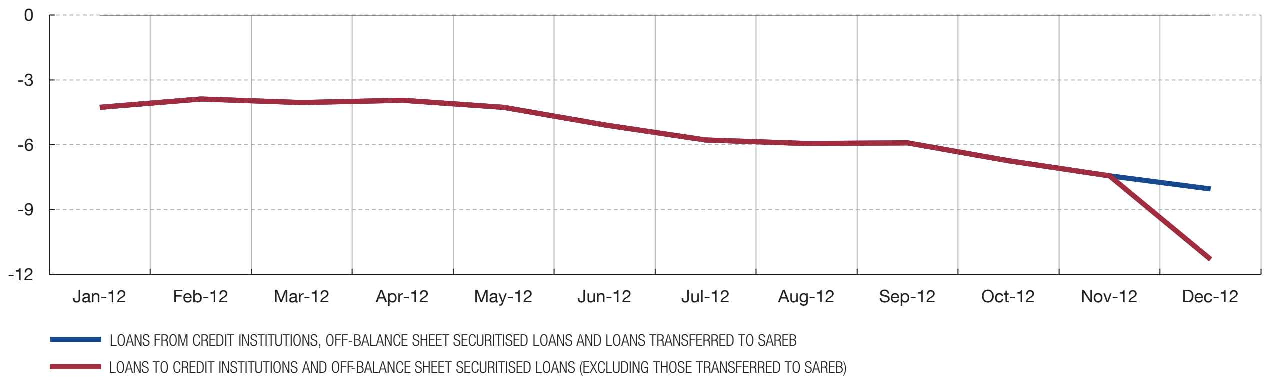
Total change	**-80**
Of which:	
Transfer of loans to SAREB	*-54*
Cancellation of loans previously granted to special purpose entities owing to recovery of real estate (a)	*-6*
Other credit	*-20*

SOURCE: Banco de España.

a Preliminary estimate.

CREDIT TO NON-FINANCIAL CORPORATIONS RESIDENT IN SPAIN
Year-on-year growth rate

CHART 1



SOURCE: Banco de España.

As can be seen in Table 1, the outstanding balance of credit to other resident sectors fell in December by almost €80 billion on the previous month, but almost 70% of this decline was the outcome of the transfer of loans to SAREB, which does not entail any real change in the supply of financing. Further, an additional portion of the decline in credit in December is also indirectly linked to the transfer of assets to SAREB, since in that month loans previously extended by banks to special purpose entities for the management of real estate assets were removed from balance sheets, which reveals that banks recovered a portion of these real estate assets to transfer them to SAREB.[7]

Accordingly, once the assets now held by SAREB are added to the funds lent by credit institutions, the aggregate of financing received by the private sector in December can be seen to be moving on a declining course, similar to that of the previous months (see Chart 1).

The above-mentioned figures refer to the nominal value of the assets transferred. But, as was also earlier indicated, the transfer price was lower than this nominal value. In the case of both loans and fixed assets, the effective value was approximately 50% of the nominal value. The difference between them was reflected in the provisions previously set aside by the group 1 banks and in the recognition of additional losses that occurred when these impaired assets were removed from the balance sheet in December. The effective value of

7 On the preliminary information available, it is estimated that these loans removed from the books account, at least, for €6 billion.

the assets transferred by the group 1 banks to SAREB totalled €36.6 bn, which was the amount of the securities issued in exchange by SAREB for payment of the transfer. As a result, credit institutions' securities portfolio vis-à-vis other financial intermediaries showed an increase for this same amount in December.

The transfer of problem loans to SAREB also entails a decline in doubtful assets on credit institutions' balance sheets. Thus, the doubtful assets ratio of credit institutions, which stood at 11.4% of total credit to other resident sectors last November, fell by almost 1 pp in December to 10.4%, as a result of the problem loans removed from the balance sheets of the group 1 banks. This improvement in the proportion of doubtful loans reflects, in any event, the clean-up drive made on these institutions' balance sheets. This has affected their profit and loss account in recent years and has required strong recapitalisation, which is examined in the following section.

The recapitalisation of group 1 banks with ESM funds

Along with the possibility of transferring impaired assets to SAREB, the Memorandum of Understanding set in train a process for determining Spanish credit institutions' capital needs, through an exhaustive and independent valuation of their loan portfolios and of their capacity to withstand adverse macroeconomic scenarios.

These exercises enabled the banks to be classified into different groups, according to their capital needs and their capacity to address them by their own means.[8] The group 1 banks, in which the FROB had a majority stake, were estimated to have negative net worth as at end-2012, meaning that their recapitalisation was a pressing concern. In this connection, the ESM made a loan in December of €39.5 billion to the FROB, €37 billion of which were earmarked for the recapitalisation of the group 1 banks[9] which, with these funds, would not only cover losses and their negative net worth, but would also meet the 9% top-quality capital requirement and the capital needs identified in the stress test. The recapitalisation was instrumented through ESM securities. Accordingly, in the banks' assets an entry has been recorded for an increase in the portfolio of securities other than shares, issued by "other resident sectors" of other euro area countries, since this is how the ESM has been sectorised.

As a result of this recapitalisation operation, along with the reversal of the provisions for the assets transferred to SAREB, the credit institutions' capital and reserves increased by €3 bn in December.

Outlook

The recent steps in the ongoing recapitalisation and restructuring of Spanish credit institutions have had a significant impact on bank balance sheets, as a large amount of loans and fixed assets have been transferred to SAREB, and as the institutions have received through the FROB new funds from the ESM, thereby increasing their capital. In the case of the transfer of loans to SAREB, it should be stressed that this operation, of itself, does not have an impact on financing flows to the private sector, since it only changes the ownership of the credit claim, which from being that of a bank is now that of SAREB.

8 Prior to the application of any type of measure, Spanish banks were classified into four groups on the basis of their financial position. Group 0 comprised the healthiest banks not requiring the application of exceptional measures. Group 1 was made up of banks in which the Fund for the Orderly Restructuring of the Banking Sector (FROB) had a majority stake and which, therefore, are publicly owned institutions. Group 2 included the banks with a capital shortfall and which need public aid to address this shortfall. Finally, Group 3 comprised the banks with a capital shortfall but which can tackle recapitalisation plans by financing themselves exclusively on the markets, without State aid.

9 The rest was for financing the FROB's share in SAREB.

In the coming days, bank balance sheets will be affected by further operations similar to those described, once the group 2 banks[10] transfer their impaired assets to SAREB and receive new capital from the ESM through the FROB. The capital needs of this group of banks are far lower than those of group 1. In this respect, on 5 February the FROB received the €1,865 million requested of the ESM to proceed with the recapitalisation of these banks.

The absorption by SAREB of a high stock of loans to the private sector means SAREB should be considered, for the purposes of the analysis of the economy's financing flows, in the same way as other credit flow-intermediating institutions (such as securitisation special purpose entities). In any event, SAREB's investment policy is to gradually liquidate its assets (real estate and loans alike), meaning that in the future it will progressively cease to play any type of leading role in credit developments.

13.2.2013.

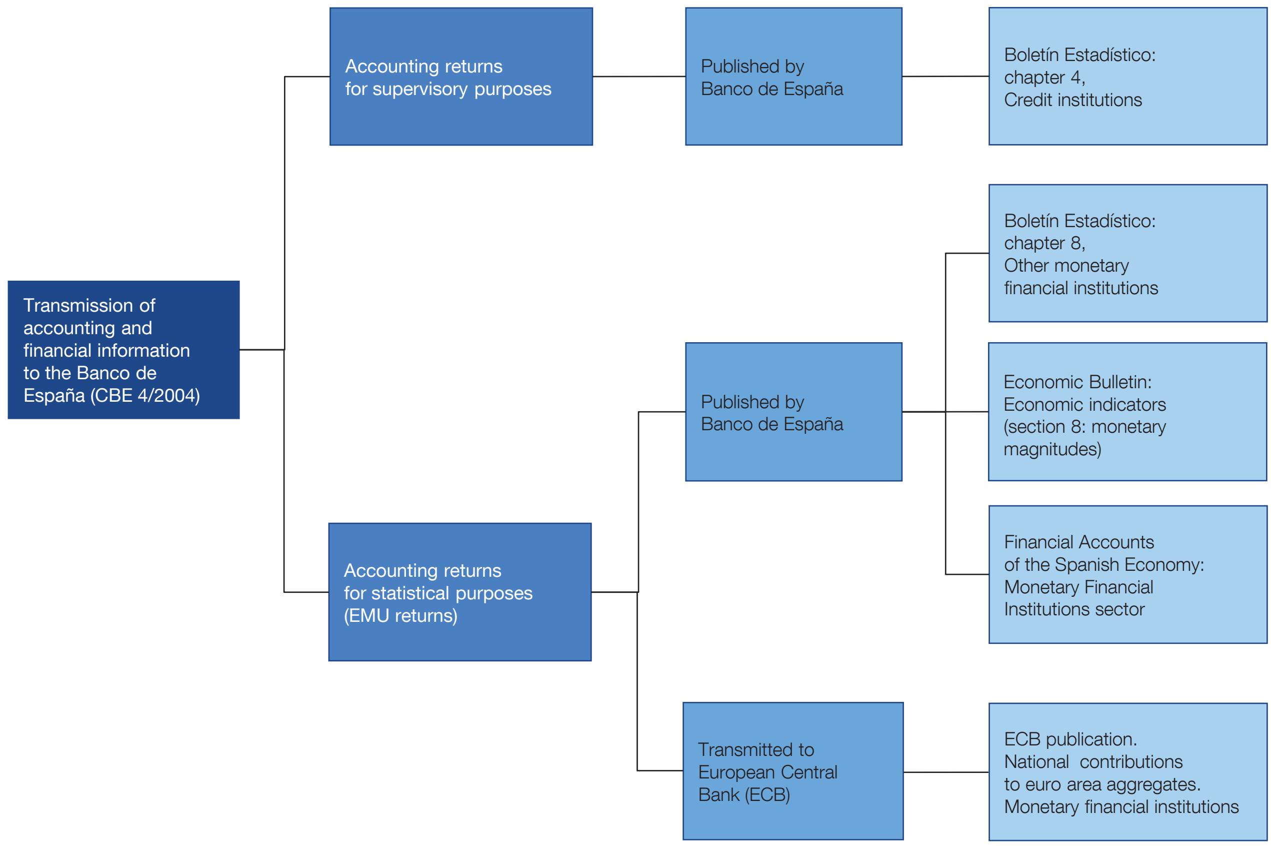
10 This group is made up by Caja3, BMN, Banco CEISS and Liberbank.

ANNEX 1
Statistics disseminated on the basis of credit institutions' accounting information

The Banco de España and the ECB disseminate various statistics on Spanish credit institutions on their respective web sites. In the case of the Banco de España, the bulk of this information is disseminated in the *Boletín Estadístico*[11], although financing flows received by households and non-financial corporations feature in the *Economic Indicators*[12].

The *Boletín Estadístico* disseminates information on bank balance sheets in two areas. First, chapter 4 contains information obtained from credit institutions for supervisory purposes, while chapter 8 offers information on what, under ECB requirements, is called "Other monetary financial institutions", a grouping comprising both credit institutions and money market funds. Both sets of information draw on the returns submitted to the Banco de España by these institutions under the rules and criteria set out in the Banco de España Accounting Circular 4/2004. While there are differences in sectorisation and in the valuation of certain instruments, the information is presented in both chapters in a way in which it may be treated as complementary information. This is because, in light of the end-use made of the information, in the former case the breakdown by instrument is more detailed, whereas in the latter, that by counterparty is.

STATISTICS DISSEMINATED BY THE BANCO DE ESPAÑA AND THE EUROPEAN CENTRAL BANK BASED ON CREDIT INSTITUTIONS' ACCOUNTING INFORMATION FIGURE A.1



SOURCE: Banco de España.

11 See http://www.bde.es/webbde/es/estadis/infoest/bolest.html
12 See http://www.bde.es/webbde/es/estadis/infoest/indeco.html