www.business-systems-review.org

Business Systems Review

ISSN: 2280-3866
Volume 3, Issue 1
January-June 2014

A Need for a Paradigm Shift in the Spanish Banking Sector? The Evolution from Regional to Multinational Banks in Spain

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Submitted: May 30, 2013 / Accepted: February 20, 2014 / Published online: February 22, 2014.
DOI: 10.7350/BSR.D01.2014 – URL: http://dx.medra.org/10.7350/BSR.D01.2014

ABSTRACT

Since the approval of Spain's 2012 National Budget on March 30, 2012, some doubts and controversies have added up to many fears in the private sector regarding the measures and stimuli that the Spanish government was going to undertake. At the same time, this situation was in some measure aggravated by the financial backlog of many small and medium companies, which are and will continue, in the following years to be completely unable to comply with their financial requirements.

In line with Boronat Ombuena's (2009a, 2009b, 2010, 2012) requirements in his new approach to finance and private sector liaisons, the purpose of this paper is to analyze the recent years of the credit sector in Spain as well as its direct and mid-term effects that its mergers and acquisitions (M&A) have contributed up to date, and will still produce in the near future. We will take a closer look at the evolution of the banking sector in Spain from 1995 to 2012 through a historically-based methodology, compiling and synthesizing the existing financial and risk market information and analyzing its evolution.

We shall observe that in a single year, the total number of savings banks in Spain decreased from 45 to only 15 entities and that the risks the financial system took over these last few years were not equally distributed across the entities, resulting in an advanced foreclosure of the regional savings banks and in a market-share growth for the commercial banking entities.

This process has resulted in creating larger entities and, in some cases, a vacuum of regional and local credit entities that in the mid-long term will eventually end up in a representative loss on credit availability. These circumstances call into question the need for a paradigm change and most importantly, new approaches to solve the new challenges that can result in the financial fluidity of the system and the eventual recovery of the economic structure.

Keywords: Spanish banking sector, savings banks, financial crisis, tax adjustments convergence, mergers and acquisitions, M&A, Spain.

1. INTRODUCTION: THE CREDIT SYSTEM EVOLUTION IN SPAIN

The early years of this decade have become a challenge for the already-used economic models and the common uses of the financial markets. We have been able to see old market strategies fail and old banking procedures be completely inadequate for the ever-changing needs of the new paradigm and requirements of the private business sector. However, these challenges are the result of changes that have been taking place from late 1995.

Since the end of the last decade, Spain has slowly been changing its economic model, specifically modifying the banking procedures and credit requirements of core capital in order to restructure its own market, industries and budgetary assignments as a whole.

Whereas in other countries such changes had been undertaken many years in advance, we could still see big financial players in the Spanish banking system which had other legal strategies that seem to be unknown to other countries. We talk about significantly different legal structures and different credit-concerning procedures.

In Spain, since the late eighteenth century, the earlier Italian model of the fifteenth century of the impounding houses of pious character started to grow (although history would take us back to the year 1834, to the Spanish town of *Jerez de la Frontera (Cadiz, Spain)*, with the "Sacred and royal impounding house of the souls of the purgatory of Madrid"). Later on, after more than a century of existence, such structures started to evolve in the mid-nineteenth century to the actual *German Sparkasse-model-like based entities*, that is, a public banking system working as banks with local and regional interests and centred in a non-profit and regional compromised entities with large reinvestment and public service programs.

Nevertheless, such models started to modify their original commitment, which was only *to lend small loans for specific personal purposes*, not competing with larger and more professionalized banks for the business market and commercial loans to the large private sector investment groups. These entities were nominated Savings Banks (*Savings Bank* or *Caja*, in Spanish, or *Caixa*, in Catalan language equivalent) and were specialized in accepting savings deposits and granting loans.

These changes ended up in the opening of their own regional enclosed interests in favour of a nationwide expansion that started mainly after 1992 with three entities ahead of the rest, the Madrid-based *Caja Madrid*, the Barcelona-based *Caixa Catalunya* and the Leon-based *Caja Castilla-León*, among many others that we shall later expose and analyse. The nation-wide assault began with the creation of hundreds of micro-offices in every corner of large and later medium-sized cities. This expansion model wanted to export the regional and proximity-based model of the original entities while giving them a larger impact in the economy as a whole.

On the other side of the spectrum we could find a more-efficient and more professionalized banking system which entities were growing or had been restructuring themselves for more than a decade, creating large banking conglomerates that we know of today, such as the *BBVA (Banco de Bilbao Vizcaya Argentaria)* (the merging result of the historical banks in Spain such as the Bank of Bilbao, Bank of Vizcaya, and also the Argentaria Group, which itself was the nationwide group of the industrial investment state banks such as the Bank of External Commerce -BEX-, Bank of local Credit -BC- and many others, also we found the best known *BSCH (Banco de Santander Central Hispano)*, as well as the natural evolution from the following three private entities: Bank of Santander, Central Bank, and Hispano Bank. This "Central Bank" or "Banco Central" was a private entity with this name, a small commercial bank significantly different from the important concept associated with the Central Bank of a country, and in the case of

Spain it is officially named Banco de España or Central Bank of Spain (BDE). In the new context of the European Union, the role of the central bank of the Spanish economy has changed significantly in the last years (Jaime & Hernández-Carrión, 2012).
The end result of this evolution has been that in almost fifteen years, by the beginning of the twentieth century, the banking map in Spain had been completely overhauled. There was no real difference in products or goals between savings and commercial banks and by then, the credit mass had grown to a spectacular rate, nearly one hundred thousand new employees had been hired in new offices in all Spain (adding also the new foreign banks that opened in the expansion period), resulting in an office or ATM machine in every corner of every city or town.

2. CHRONOLOGICAL EVOLUTION FOR THE 1995-2012 PERIOD

In the early years of the twentieth century, very few mergers had taken place of any strategic importance at the national or regional level. We could only start to see small mergers and small acquisitions by other entities, however, except for the *Cajamar* conglomerate, there was no entity big enough to modify the credit access or fluency in any region by itself. This would later change in regions like the Valencian Community, which, as the foremost example of the national intervention and bank nationalisation, would eventually lose the three larger credit institutions in its soil, the Bank of Valencia, the CAM (Savings bank from Alicante and Murcia, previously known as *Caja de Ahorros de Alicante y Murcia*) and *Bancaja* (former Savings bank from the provinces of Valencia region, or *Caja de Ahorros de Valencia, Castellón y Alicante*).
However, if we continue to analyse this evolution, we can clearly see that after 2009, large conglomerates were created, ending in the actual chain of events.
We shall not endeavour in analysing the internal pros, cons or even wrongdoings in every-single entity, however, in recent studies (Climent Serrano, 2012), there has been a reasonable consensus that there have been many causes that have led to the actual financial crisis.Firstly, those of internal origin:

i. Capacity excess
ii. Non-levered housing investment
iii. Excessive and disproportionate growth
iv. Large levered operations based on non-profitable operations
v. Doubtful credits ending in excessive depreciations and amortizations affecting the banking system cash flow.
vi. Benefit depletion ending in insolvency situations.

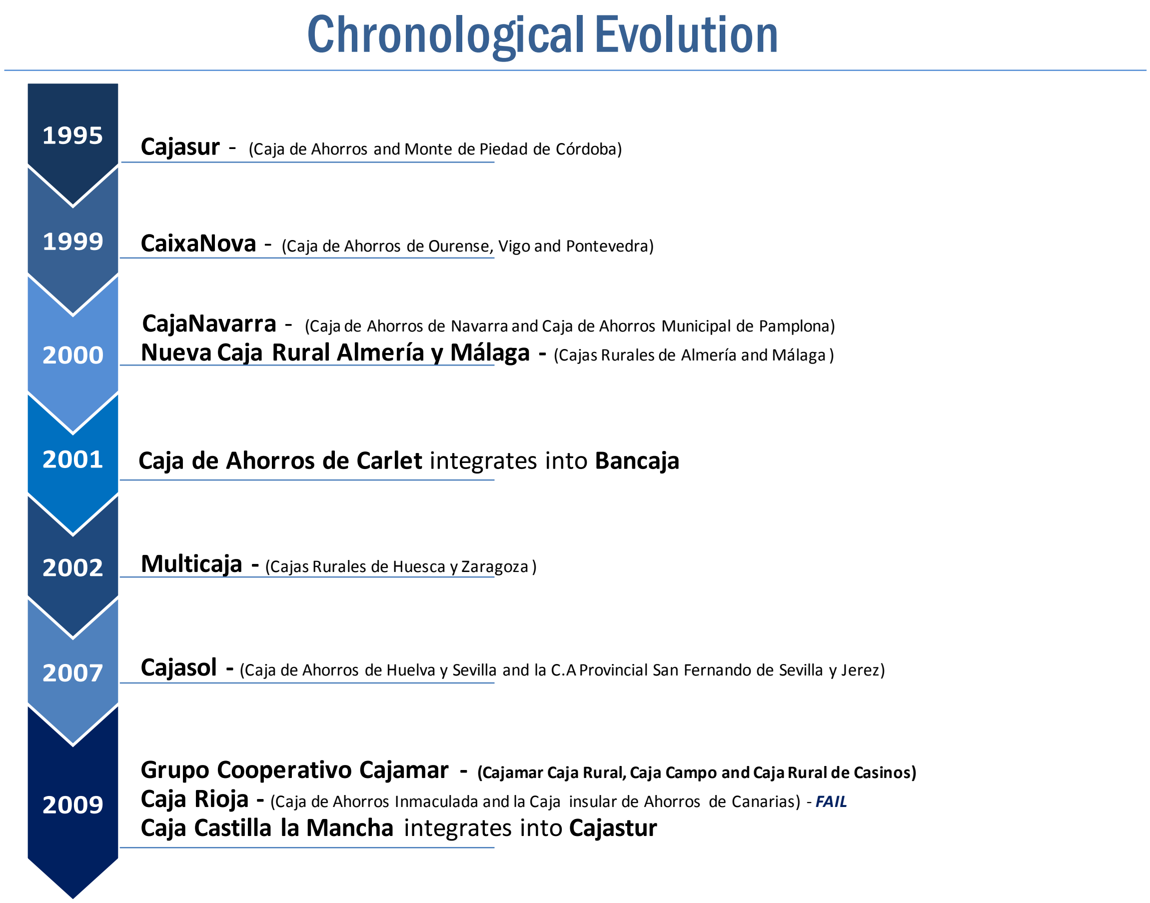
Furthermore, there have also been external causes to all this change and late developments, such as:

i. Negative GDP evolution of the EU countries in general and Spain in particular.
ii. Unemployment rate well above the 20% figure during the process, continuously readjusting the demand to a lower local optimum giving the industrial offer curve little to no time to readjust its means, prices or qualities, ending suddenly in many cases in a structural excess in production.
iii. State value inversion demise

iv. Regulation system modification that subsequently changed most of the financial variables in the model.

Following 2009, several mergers started to really take place and change the regional and national financial landscape, regional savings banks started either to purchase banks due to the legal framework then in place. It was impossible to do it the other way round, since savings banks had no legal core or legal force and therefore were outside the mercantile legislation -due to their particular history- whereas banks were -and still are- specialized companies that function in the financial market.

Figure 1. Chronological Evolution of the M&A operations in the Spanish banking system (First stage from 1995 to 2009)



2.1 Spanish banking and financial system evolution in 2009

03.29.2009 - *CCM (Caja Castilla La Mancha)* is shut down and intervened after the merger with the Andalusian Unicaja savings bank.

05.26.2009 - The then Spanish President, Mr. Rodriguez Zapatero (of the Socialist Party PSOE), starts the Fund for Orderly Bank Restructuring FROB or *Fondo de Reestructuración Ordenada*

Bancaria) which aims to manage the restructuring and resolution of credit institutions and strengthen the resources of these in the integration processes.
These reforms invested 7,550 million Euros through the FROB, although total recapitalization of entities was 13,389 million Euros, compared to 15,152 million Euros initially planned.
This process was done via the legal framework provided by the Royal Decree-law 9/2009 (RD Law 9/2009 or Law Fund for Orderly Bank Restructuring), and Royal Decree Law 11/2010 (Banks Act) and Royal Decree Law 2/2011 (Act Recapitalization).

13.08.2009 - The Bank of Andalusia (Banco de Andalucía) delisted in the Spanish stock market, after successfully culminating the merger of the subsidiary Andalusian by the Banco Popular.

03.11.2009 - The Bank of Spain (Central Bank of the country, officially nominated *Banco de España* belonging to the Governing Council of the European Central Bank or ECB) approved the integration of CCM in Cajastur.

12.11.2009 - The Bank of Spain authorized the establishment of *Cajamar* Cooperative Group (Cajamar, Caja Rural, Caja Campo and Caja Rural de Casinos) as the first merger under the SIP formula made in Spain.

2.2 Spanish banking and financial system evolution in 2010

03.25.2010 - Unnim savings bank receives aid from FROB passing to be in full control.

05.11.2010 - The Andalusian savings banks Unicaja and Caja de Jaen constitute a new entity after the signing of the merger deed.

05.22.2010 - Cajasur is then intervened after the merger with Unicaja is rejected and asks for help for an amount over 500 million Euros to FROB.

07.01.2010 - The two major mergers of Catalan banks, Catalunya Caixa (Caixa Catalunya, Tarragona and Manresa) and Unnim (integrated by the savings banks from Manlleu, Sabadell and Terrassa) started their operational activity.
The governing councils of Caixa Rural Cajamar and Balearic Caixa agree to merge.

07.16.2010 - Cajasur is awarded to the Basque savings bank BBK (Bilbao Bizkaia Kutxa).

09.18.2010 - Shareholders' meetings of *Banco Sabadell* and *Banco Guipuzcoano* agree their integration in the first merger of any kind of Spanish banking for more than a decade. Banco Sabadell acquires Banco Guipuzcoano.

09.21.2010 - CCM savings bank becomes a commercial Bank (participated by 75% by the *Cajastur* Group and by 25% by the CCM Foundation).

01.10.2010 - *Caja España Duero* savings bank, as a result of Caja Duero and Caja España, officially merge.

04.10.2010 - The National Competition Commission approved the merger of *Caja Guadalajara* by *Cajasol,* which supposed the first interregional integration of savings banks in Spain.

12.01.2010 - *Novacaixagalicia*, the resulting savings bank from the merger of *Caixa Galicia* and *Caixanova* started operating after its registration in the commercial register and became a bank by September 14, 2011. *Novacaixagalicia* was operated by 93% by the FROB and is pending auction or tender for adjudication. It has received aid worth of 2,465 million euros.

12.20.2010 - The presidents of *Cajamar* and *Caixa de Balears* formalise Rural notarized the deed of merger of both entities.

12.22.2010 - *Grupo Banco Mare Nostrum* (the resulting integration of Caja Murcia, Caja Granada, Sa Nostra, Caixa Penedès and a SIP) obtains commercial banking operations authorisation.

2.3 Spanish banking and financial system evolution in 2011

01.01.2011 - *La Caixa* savings bank completes the merger of *Caixa Girona*.

01.01.2011 – The year 2011 marks the beginning of operations of the new group of Finance and Savings Bank called *Bankia*. The SIP of Caja Madrid, Bancaja, Caixa Laietana, Caja de Avila, Caja Insular de Canarias, Caja Segovia and Caja Rioja, whose new trademark is Bankia.

01.03.2011 - BBK Bank starts operating and trading.

01.26.2011 - *Banca Civica* (the SIP of Caja Navarra, Caja Canarias, Caja Burgos and Cajasol) starts with operational capacity to handle new customers.

04.06.2011 - *Banco Base* savings bank (cold fusion provided between the Mediterranean-CAM savings bank, Cajastur and other savings banks from Extremadura and Cantabria) settled their project, while acquiring the CAM bank tab, finally intervened on 22 July of the same year.

06.29.2011 - Cajastur, CCM Bank, Caja Extremadura and Caja Cantabria assemblies approve the transfer of financial assets to the new bank (subsequently called Liberbank), created under the SIP formula.

07.22.2011 - Mediterranean Savings Bank (CAM) is intervened after failing integration with Cajastur, Caja Cantabria and Caja Extremadura in the Bank Base. The Alicante-based bank was forced to ask 2,800 million euros to the FROB. The Bank of Spain now has a credit line of EUR 3,000 million for its feasibility and was capitalized with 2,800 million euros, so that the state controls between 80 and 85% of its capital.

09.30.2011 - *CatalunyaCaixa* passes to the FROB which now controls 90% of its capital in the state after injecting 1,719 million Euros.

07.10.2011 - *Banco Popular* communicates to the National Securities Market Value Commission (CNMV) its claim to control all of the *Banco Pastor* through a process of absorption.

20.10.2011 - General meetings of the three Basque savings banks, BBK, Vital Kutxa and approve their integration to create Kutxabank bank, which will begin operating on January 2, 2012.

11.21.2011 *Bank of Spain*intervenes*Banco de Valencia* after the forced resignation of its operators and injects 1.000 million Euros through FROB to ensure its viability and 2.000 million to ensure its liquidity.

11.23.2011 - The *Caja3* savings bank reports to the CNMV the segregation of business of *Caja Inmaculada* (CAI), *Caja Círculo de Burgos* and *Caja Badajoz* for their organization.

12.07.2011 - The Bank of Spain informs that the Mediterranean Savings Bank (CAM) has been bought in an open public auction by *Banco Sabadell*.

2.4 Spanish banking and financial system evolution in 2012

02.03.2012 - The new president in office, Mr. Mariano Rajoy, from the Conservative Party (*Partido Popular* or PP), holds his first reform with the approval of the Royal Decree Law for the reorganization of the financial system, which required financial institutions to increase by 50,000 million Euros its provisions in order to withstand the complete risk of their real estate assets and pushing some of the already existing entities to new mergers and acquisitions.

02.29.2012 - The *Ibercaja* savings bank and *Caja3* boards agree to initiate the process of merging in their banking business.

07.03.2012 - The *Bank of Spain* decrees that Unnim (merger of Caixa Sabadell, Terrassa and Manlleu) is won by open public auction by the BBVA (Banco de Bilbao Vizcaya Argentaria) for one euro and helps Deposit Guarantee Fund in the amount of 953 million euros.

03.30.2012 - The boards of *Unicaja* and *Caja España-Duero* (CEISS) approve the integration and complete absorbing process of the Andalusian entity (Unicaja) by the Castile and Leon region savings bank.

04.18.2012 - The boards of *Caixabank* and *Banca Civica* (Caja Navarra, Caja Canarias, Caja Burgos and Cajasol) approved their proposed merger.

05.09.2012 - The Minister of Economy and Competitiveness, Luis de Guindos (PP), announces the nationalization of 100% of Financial and Savings Bank, the *Bankia* bank matrix, which will be controlled by 45% of the latter company. Bankia, by this time, becomes the biggest former savings bank intervention carried to date.A key figure in this development is the formerPresident of Bankia, Rodrigo Rato. Rato was Minister of the Economy in Spain from 1996 to 2004, Managing Director of the International Monetary Fund (IMF) from 2004 to 2007, who assumed the presidency of the main savings bank in the Bankia merger (Caja Madrid), and resigned on

May 7, 2012. By July 4th, 2012, Rato had been charged with accounting irregularities, along with thirty other former members of the board of directors of Bankia.

05.11.2012 - The then new Spanish government takes another step in this restructuring of banks with a new Royal Decree Law on the reorganization and sale of real estate assets in the financial sector, with the aim of cleaning up and protecting the balance sheets of banks to promote new risk-taking operations.
This new reform also includes the creation of "bad banks" in order to group toxic assets and to require higher provisions for entities to ensure their viability.
It also raises the general provision of the loan portfolio and real estate assets of the banking unproblematic (123,000 million Euros), which will mean around 30,000 million Euros of new banknotes that will have to be made before December 31 of that year.
These write downs join the 54,000 million Euros and made after the approval of Royal Decree Law February financial reform, so that the total sanitation made will be placed near the 84,000 million Euros.

05.29.2012 - The Ibercaja savings bank, Caja3 savings bank and Liberbank boards, approve the protocol integration to create the seventh largest Spanish financial group.

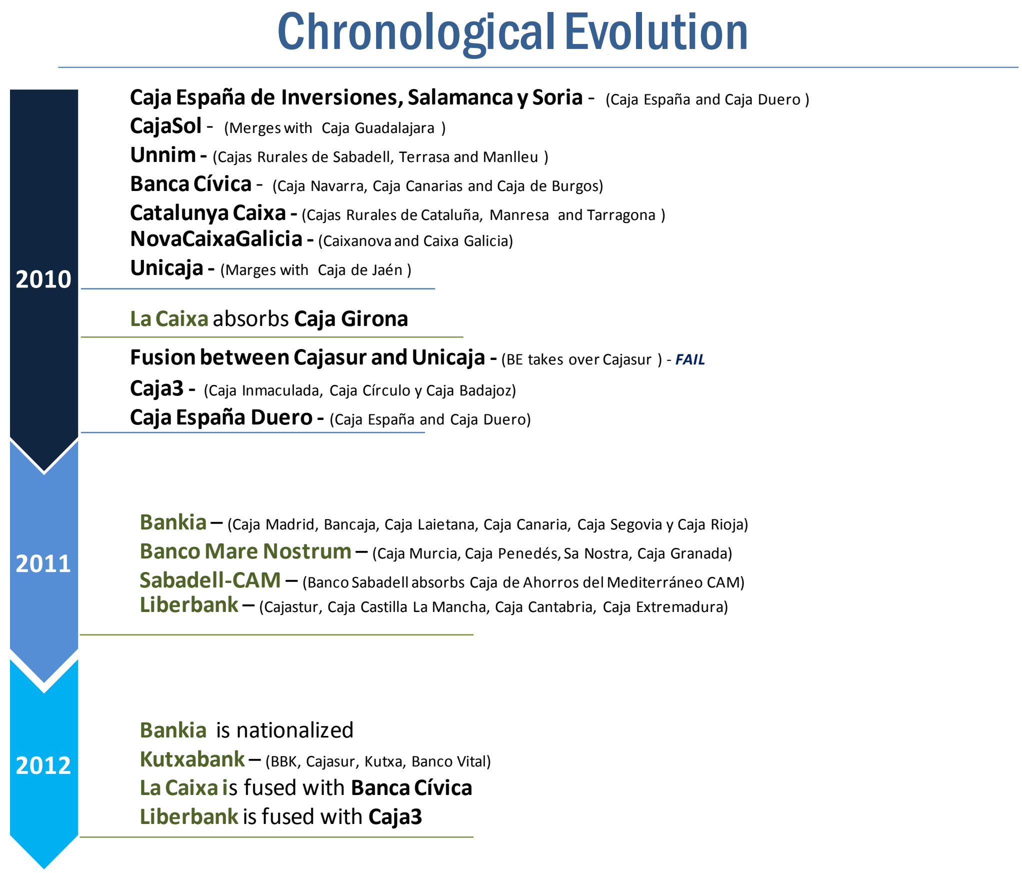
06.08.2012 - The Spanish government announced a third round of write downs pending to be analysed about the sector.

07.10.2012 - The Mediterranean savings Bank-CAM is merged with Sabadell bank and disappears after 137 years of existence. Banco Sabadell acquires Banco CAM.

11.27.2012 - *Caixabank* purchases *Banco de Valencia* from the former *Bankia Group*.

As shown in the timelines, the end result of all these years of changing models could not have been more catastrophic, the fourth largest financial entity nationalized (Bankia, only behind BSCH, BBVA and La Caixa savings bank), the foreclosure of the savings banks social system in favour of a solely commercial banking system. In other words, the model that had taken more than two centuries to build, took less than a decade and a half to ground it.
After the merger, Bankia was initially owned by a holding company named Banco Financiero y de Ahorros (BFA), and the seven banks controlled BFA. The most toxic assets from the banks were transferred to this new bank BFA, which obtained 4.5 billion euros from the Spanish government rescue fund FROB in exchange for preference shares, so the resulting new entity is now *BFA-Bankia*.
A large amount of literature has been published only acknowledging the abovementioned causes (Caja Meri et al., 2008; Pérez 2011; Pons 2011) for example have contributed in several fundamental analyses of the matter at hand),of this financial development, yet, as we will see in our paper, this has not only been the sole reason, but, among many others, show the lack of general knowledge that general public had of the financial market in Spain.

Figure 2. Chronological Evolution of the M&A operations in the Spanish banking system (Second stage from 2010 to 2012).

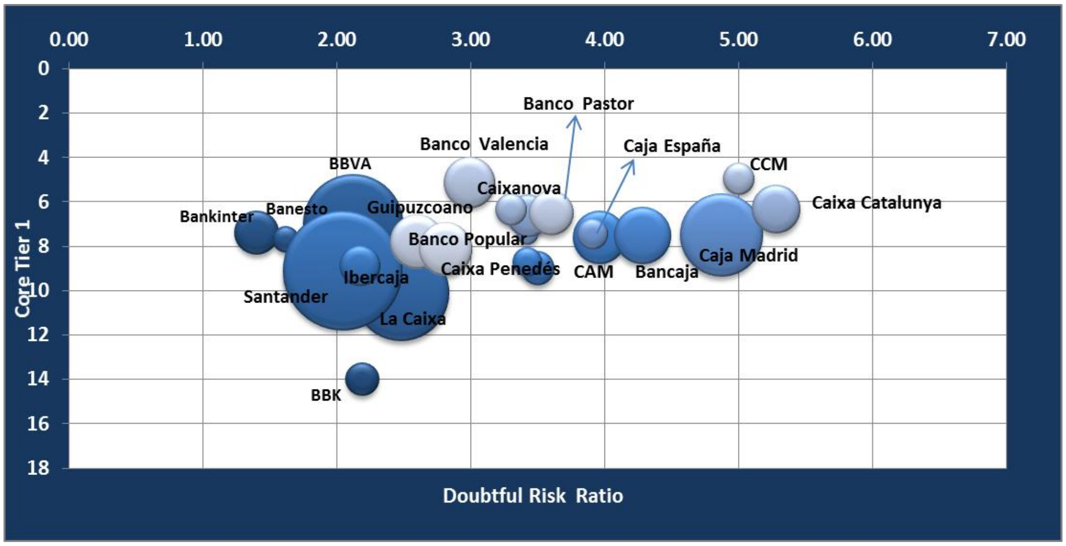


3. THE RISK UNDERTAKEN IN SOME FINANCIAL AND REAL ESTATE ASSETS AND THEIR BANKING EFFECTS IN SPAIN IN 2008-2011

Although many circumstances and factors (both internal and external), can be related to the actual evolution of the banking system in Spain, one that is sometimes forgotten or set aside is the amount of risk that mostly savings banks, contrary to their own financial model and contrary to their own business procedure (in most cases as a consequence from their regional-political control and supervision) ended up by absorbing operations that after some time resulted in total investment failure and a severe and long-term harmful effect on their equity.

If we were to analyse the total assets of each bank (that we shall represent by the size of the circle) and measure the **TIER 1** mass on the ***Y axis***, while at the same time, on the ***Xaxis*** we could in contrast measure the **doubtful risks ratios** and rankings back in 2008, this was the graph[1] the Spanish financial sector was representing:

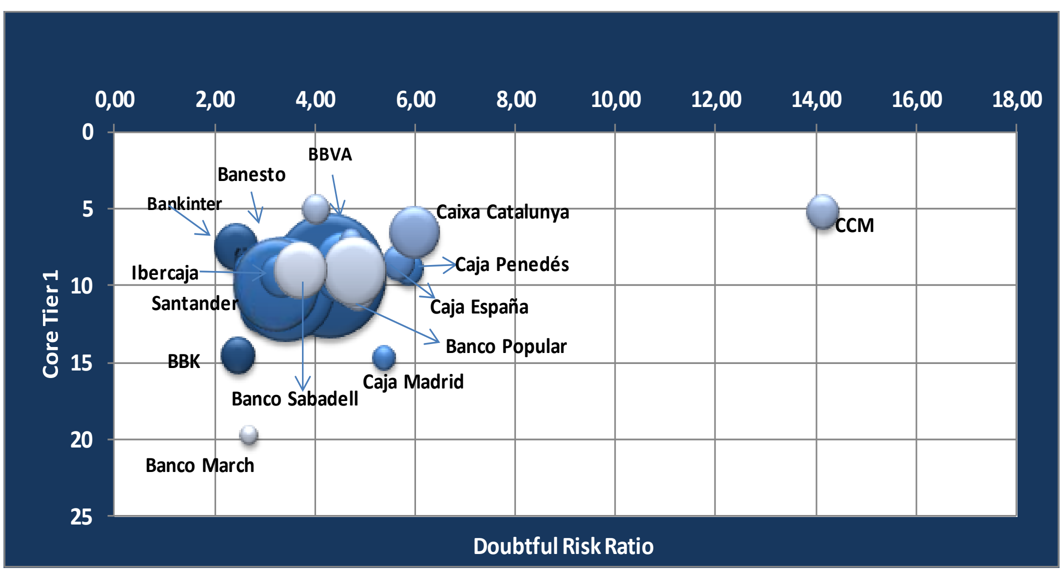
Figure 3. Tier 1 Ratio of the Spanish Banking Sector in 2008.



In this case, we can clearly see that minor (small to mid-sized financial players such as CCM, *Caixa Catalunya* or *Caja Madrid*) were taking a larger-than average risk on their daily operations, were as by their TIER 1 ratio (established[2] as the core measure of a bank's financial strength from a regulator's point of view and composed of equity capital and published reserves from post-tax retained earnings) they were not extremely more funded than other entities nor were their assets larger than others with the same investment and doubtful risk operations amount.

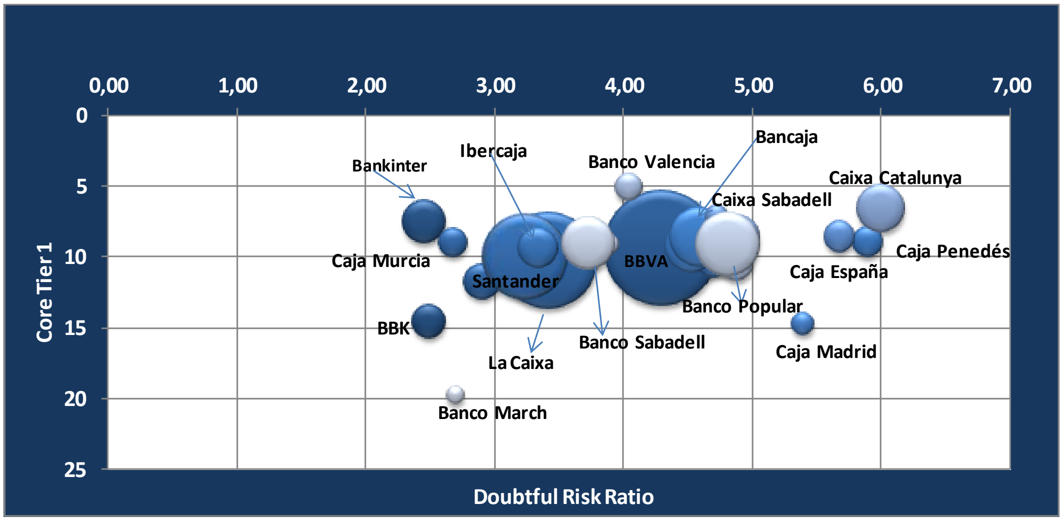
From 2008 and by 2009 we were observing a tendency not to reduce risk, but to stretch further on more risky operations by compensating on the core capital values. ***(Y axis Tier 1; X axis, doubtful and risk operations).***

Figure 4. Tier 1 Ratio of the Spanish Banking Sector in 2009 with CCM.



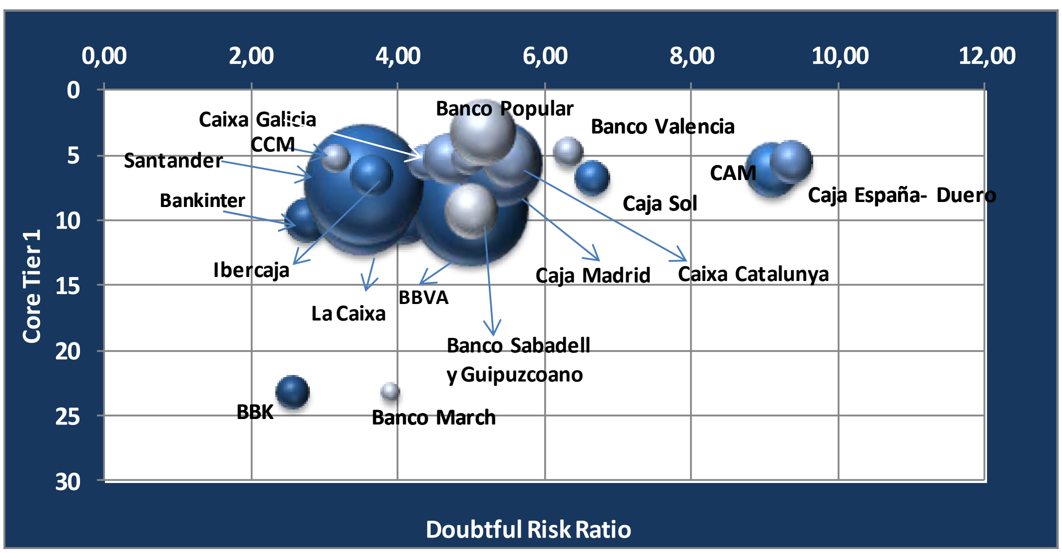
Then again, in 2009, CCM statistically shows a far larger Doubtful Risk Ratio, and therefore, we had to recreate the graph without CCM, the result is shown below:

Figure 5. Tier 1 Ratio of the Spanish Banking Sector in 2009 without CCM.



By 2010 (below) with many M&A operations already undertaken, the overall risk was slightly reduced, although we could clearly see that two entities, Caja España-Duero and CAM were out of the scale in risk terms.

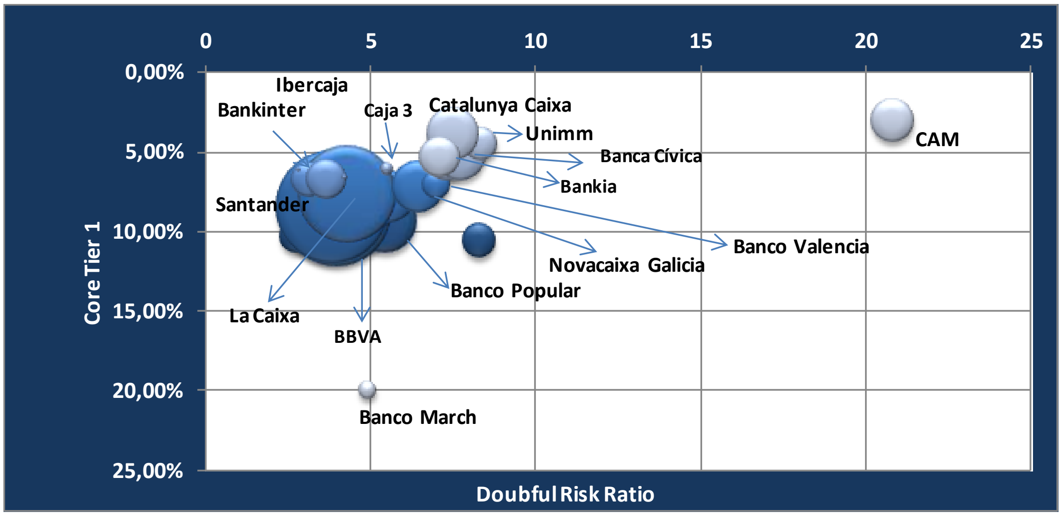
Figure 6. Tier 1 Ratio of the Spanish Banking Sector in 2010.



Also, by this time, we could see some market trends, such as the smaller risk tendencies by some major operators, such as BSCH or even by smaller ones (in comparison) such as BBK and *Banca March (or Banco March)*. By this time, we can also clearly see the next to be out of trend as *Banco de Valencia* and *Cajasol*.

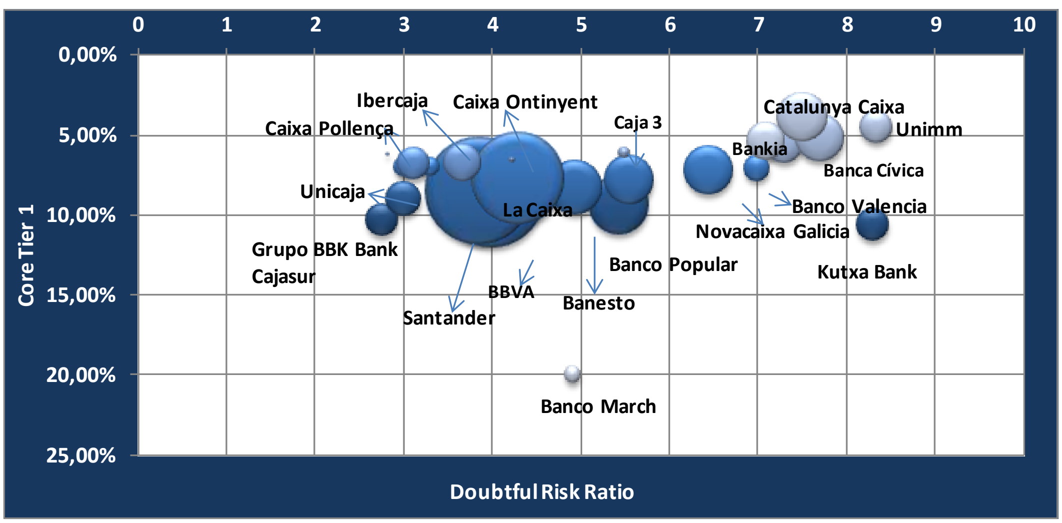
In 2011, the market is completely polarised as we can see in the graph below ***(Y axis Tier 1, X axis, doubtful and risk operations)***:

Figure 7. Tier 1 Ratio of the Spanish Banking Sector in 2011 with CAM.



However, the then CAM and *Banca March* inclusion in the graph distorts the analysis of the group, in which case we opted to eliminate such entity, resulting as follows:

Figure 8. Tier 1 Ratio of the Spanish Banking Sector in 2011 without CAM.



Finally, in not more than three years, we can clearly conclude that the risk that had already been taken by 2008 by several entities (specially the then existing savings banks), was one of the clear and main reasons for the latter demise. Also, this explicitly means that all M&A processes taken in the 2008-2011 period were utterly insufficient for the reduction to significant levels of all the risk in the system and, therefore, were only prolonging the problem and were not the solution of all the financial problems that the new commercial model used by mostly old and insufficiently regulated savings banks had approached and developed.

4. MERGERS AND ACQUISITIONS (M&A) PROCESSES AND OLIVER-WYMAN'S REPORT ON SPANISH BANK'S ASSETS

By September 2012[3], Olive-Wyman's report, on request of the EU Council to the Government of Spain, was published.The report contained Oliver Wyman's conclusions from the bottom-up stress testing analysis undertaken for the Recapitalization and Re-structuring of the Banking Sector of the *Banco de España* and the *Ministerio de Economía y Competitividad*. The objective of this work was to assess the resilience of the Spanish banking system and its ability to withstand a severe adverse stress of deteriorating macroeconomic and market conditions, and to estimate the capital that each individual bank would require in the event of such an adverse scenario.
Such report was based around the top-down stress-testing exercise conducted in June 2012, in which the bottom-up analysis covered fourteen banking groups representing approximately 90% of the total domestic credit of the Spanish financial system. The scope of asset coverage also remained in the report the same as in the top down exercise and included the domestic lending books, excluding other assets, such as foreign assets, fixed income and equity portfolios and sovereign borrowing.
The base and adverse macroeconomic scenarios were also maintained as specified by the Strategic Coordination Committee, with an adverse case implying a 6.5% cumulative GDP drop, unemployment reaching 27.2% and additional drops in house and land price indices of 25% and 60% respectively, for the 3 year period from 2012 to 2014. Therefore, it presented a base macroeconomic situation (considered likely) and another extremely adverse (considered very unlikely), both defined for 2012-2014 period.
These capital requirements were justified by the relationship between the loss-absorbency and the actual institutions' total losses. These were expressed in terms of the weighty assets by degree of risk owned by each entity.
Having said that, the additional capital requirements of the Spanish banking system, of December 31, 2011, according to the report amounted to 59,300 million Euros when the integration processes ongoing and deferred tax assets weren't included. If they were to be considered, this figure drops to 53,745 million given the ongoing M&A operations tax modifications.
While the Oliver-Wyman's report does mention the end result of the M&A operations as stated, it didn't analyse the background of all of them[4]. Since they have been part of the problem, the solution or both, we consider it to be of the utmost importance not only to analyse all of the most important ones, but also to synthesize the final results and effects of all of them.

5. CONCLUSIONS

The private sector credit availability and state tax demand have changed abruptly in these last few years, and to date, signs of an internal crisis have been constantly appearing, both in Spain and in the Valencian Community. The credit in Spain as a whole is following a trend of sharp correction contractions due to the sum of two factors. First, due to exogenous factors, such as restricting international liquidity resulting from the international crisis, which are affecting the uptake of external resources. Second, by endogenous factors, resulting from the contraction of the domestic market (such as tax increases) and strong positions of financial institutions in the construction and domestic sectors. This turn of events of the last few years has resulted in a downturn, with negative values which minimum reached in October 2010, with a variation of -3.8%, the credit liquidity in the system.

If we look closely at the financial credit availability and absorption in the marketin the 2008-2011 period, credit cooperatives are the only type of entity with positive values, all being stable at around 1%, while banks had shown negative values until the summer of 2010, with variation which evolves positively, reaching the value of 4.86% in December 2010. Finally, due to the heavier credit crunch, the savings banks have negative credit values through the period ranging from -0.71% to -3.78%.

Also in the same period, we are able to appreciate the great variation in the granted credit by savings banks, from those that had higher positive values in the first half of 2008, to become those with a higher decline in credit in the second half of 2010 (38.545 million Euros compared to -29.769 million Euros). With regard to banks, the values recovery has seen positive values in 2010 after the fall semester of the variation in credit suffered in 2009. Finally, the credit cooperatives have shown its stable and positive trend in the three years, but with absolute values much lower than the banks and savings banks.

Therefore, we must conclude that all financial institutions have reduced their new credit concession, they have closed all financial means to the SMEs, and have only been there for precise refinancing procedures. However, those with only restructuring-debt operation and never implying the most urgent requirements, were to sustain and develop the industry by lending more financial aid, injected via the EU as financial loans to the Spanish banking sector, and through the forced restructuring of several failed entities.

Such changes and market evolutions have collided with the persistent crisis that has hit southern Europe and most noticeably, Spain. Also, within Spain, many regions have had severe cuts in their public spending against all Keynesian models, yet, the Valencian Community has endured even more changes and cuts than other regions not only in Spain but also in Europe.

These changes have been the cause of the actual financial crisis, internal and external to the system, especially important, have been the changes made in several tax structures and in the revenue-making-process for some industrial sectors.They have had a direct effect on the change in paradigm (adaptation of Jánossy’s 1971 H. model), while existing for the last fifty years, has been in extensive and intensive use for the past decade.

To this extent, during 2012, the Ibex 35 index lost almost five per cent of its value (-4.7%), a far lower evolution than the DJ Stoxx Banks (+23.1%) or the DJ Stoxx 50 (+8.8%). While the real economy is failing to grow, the new born Asset Management Company from the Bank Restructuring (henceforth, SAREB), a private company established under Law 9/2012 of 14 November as part of the process of restructuring and consolidation of the Spanish financial system, is attempting to maximize the value of assets that the restructuring of the banking systems has left out as dubious and high-risk. This new company has its capital provided by private entities (55%) and by the Fund for Orderly Bank Restructuring (FROB) as a minority (45%). Its sole purpose to hold and manage directly or indirectly the administration, acquisition and disposal of assets to be transferred to the banks, established by the Royal Decree-Law 24/2012, of 31st August, to restructure banks, that are majority owned by the FROB or deemed by the Bank of Spain to require the opening of a restructuring or resolution of under Law 9/2012.

The decision by the Bank of Spain is taken after independent assessment of capital needs and asset quality of the Spanish financial system, conducted under the Memorandum of understanding signed between Spanish and European authorities on July 20, 2012. The first case included BFA-Bankia, Catalunya Bank, Banco Gallego Novagalicia Bank and Banco de Valencia, and the second case, consisted of BMN, Liberbank, Caja3 and CEISS.

Further exacerbating this macroeconomic and financial breakdown resulting in the present system credit-crunch, the two main sectors that thrive in the Valencian Community, the industrial sector and the tourist sector, specially this latter one, have been losing their main strengths. They have increased their weaknesses due to new countries offering large competitive leisure and tourist packages with an even more competitive currency.

On the international level, stock markets around the world prepare for one of the best quarters of the past 40 years within the Q2 of 2013, with those of the U.S., UK and Japan in the lead, specially, regarding equity improvement in various emerging markets and in the U.S. However, the local capabilities of the SME's growth factor in the Valencian Community are still limited to credit access and availability.

Although in the future we shall be able to quantify the financial constraints that end up affecting the Valencian Community, we are already able to see that the deep economic crisis in which we find ourselves has resulted in a worrying situation for the increasing loss of homes for many families who are in serious difficulties in meeting their obligations to return the debt incurred by the purchase of their home. And yet, this is just the tip of the iceberg, as currently there are about 500,000 million Euros of mortgage bonds in Spain as well as Spanish mortgage securitization funds distributed worldwide. Notwithstanding, many of these titles serve as collateral in the *Eurosystem* lending operations to our financial institutions, which has become the key funding instrument.

Therefore, what will happen to the regulation affecting the warranty (mortgages) of those securities issued could result in a loss of attractiveness of these values and, consequently, a further obstacle to the development of not only the Spanish mortgage market, and subsequently, reducing the chances of restructuring the financial banks and their debts and liabilities.

This risk does not only revolve around the already existing situation, it also implies that any future growth is compromised by other variables, where the mortgage risk is increasingly high and the defaults could increase significantly in the coming months, since any change in the mortgage laws should also consider the effects of that risk. The mortgage default in the third quarter of 2012 was around the 3.4%, well below the general rate of the banking debtor's rate of 11.38%, but it is expected that this percentage will rise as unemployment, according to recent studies, will not diminish at least until 2014.

Finally, we must conclude that the risks that the financial system has taken over these last few years were not equally distributed across the entities, resulting in an advanced foreclosure of the regional savings banks and in a market-share growth for the commercial banking entities. This process has resulted in creating larger entities and in some cases, exponentially, such as in the Valencian Community. Moreover, this has created a vacuum of regional and local credit entities that in the mid- to long-term will eventually end up in a representative loss on credit availability.

When added up with the private and domestic sectors, furthermore increased by the unemployment rate and the regional and country government indebtedness over these last few years, this regional situation reflects the needfor a paradigm shift and most importantly, new approaches that can result, both nationally and regionally, in the fluidity of the financial system and the eventual recovery of the economy.

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Endnotes

[1] This initial study was published by the financial newspaper *"Expansión"* back in 2009 with data from Central Bank of Spain of the year before and extracting data from the *Spanish Market and Values Commission (CNMV*, the *Comisión Nacional del Mercado de Valores* is the regulatory body of the Spanish Stock Market) following graphs are of the same source, own elaboration.

[2] International Convergence of Capital Measurement and Capital Standards, "Basel Capital Accord I", July 1988 (http://www.federalreserve.gov/pubs/bulletin/2003/0903lead.pdf & http://www.bis.org/publ/bcbsc111.pdf).

[3] On September 28th 2012 the Central bank of Spain (BDE) released a note about the report, however, the full report was disclosed a couple of days later.

[4] Sources: Central bank of Spain (BDE), Spanish Market and Values Commission (CNMV), Oliver-Wyman's report. Own elaboration.