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ABBREVIATIONS*

€	Euro
AIAF	Asociación de Intermediarios de Activos Financieros (Association of Securities Dealers)
ABCB	Asset-backed commercial paper
ATA	Average total assets
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BLS	Bank Lending Survey
bn	Billions
bp	Basis points
CBE	Banco de España Circular
CBSO	Banco de España Central Balance Sheet Data Office
CCR	Banco de España Central Credit Register
CDOs	Collateralised debt obligations
CDS	Credit Default Swap
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CIs	Credit institutions
CNMV	Comisión Nacional del Mercado de Valores (National Securities Market Commission)
CPSS	Basel Committee on Payment and Settlement Systems
DIs	Deposit institutions
EAD	Exposure at default
ECB	European Central Bank
EMU	Economic and Monetary Union
ESFS	European System of Financial Supervisors
ESRB	European Systemic Risk Board
EU	European Union
FASB	Financial Accounting Standards Board
FROB	Fund for the Orderly Restructuring of Banks
FSA	Financial Services Authority
FSAP	Financial System Assessment Program
FSB	Financial Stability Board
FSR	Financial Stability Report
FVCs	Financial vehicle corporations
GDI	Gross disposable income
GDP	Gross domestic product
GVA	Gross value added
GVAmp	Gross value added at market prices
IASB	International Accounting Standards Board
ICO	Instituto Oficial de Crédito (Official Credit Institute)
ID	Data obtained from individual financial statements
IFRSs	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
LGD	Loss given default
LTV	Loan-to-value ratio (amount lent divided by the appraised value of the real estate used as collateral)
m	Millions
MiFID	Markets in Financial Instruments Directive
MMFs	Money market funds
NPISHs	Non-profit institutions serving households
OTC	Over the counter
PD	Probability of default
PER	Price earnings ratio
pp	Percentage points
ROA	Return on assets
ROE	Return on equity
RWA	Risk-weighted assets
SCIs	Specialised credit institutions
SMEs	Small and medium-sized enterprises
SIVs	Structured investment vehicles
SPV	Special-purpose vehicle
TA	Total assets
TARP	Troubled Asset Relief Program

* The latest version of the explanatory notes and of the glossary can be found in the November 2006 edition of the *Financial Stability Report.*

VaR	Value at risk
WTO	World Trade Organisation

CONTENTS

Introduction

Following the publication of the last Financial Stability Report (FSR) in March 2010, there was a further bout of tension on international financial markets. At its root were Greece's fiscal sustainability problems, which gave rise to a crisis in confidence that particularly affected the European countries over which investors had most doubts in respect of public finances and growth capacity.

The Spanish markets were among those affected by this episode of tension. This was reflected in an increase in risk premia, in stock market declines and in the difficulties banks faced in gaining access to international wholesale funding markets, especially in 2010 Q2.

Since late July 2010, accessibility to funding has improved. Contributing to this have been the measures approved by the public authorities. These measures include a fiscal consolidation plan, structural economic reforms, the restructuring of the savings bank sector and the publication of the stress tests for virtually all banks and for all savings banks. Interbank markets, especially the repo market, have reopened. And, at the same time, a group of Spanish banks, with differences in terms of the amounts placed and the price of such placements, has issued debt on wholesale markets.

For this improvement in investor confidence about the Spanish banking sector to firm, the restructuring process undertaken in the savings bank sector, involving 40 out of a total of 45 such institutions (94% of the sector's assets), in different integration processes must prosper. In addition, the structural economic reforms and the fiscal consolidation programme must be seen through. All these matters are vital to fully regain investor confidence and to restore growth to the Spanish economy, without which pressure will persist for the banking sector.

Credit to the resident private sector continues to post negative year-on-year rates of change, although these rates are not as sharp as in previous months. It is likely in the coming months that credit will continue to trend downwards. This trend is the natural outcome of an ongoing household and corporate adjustment, following the increase in their indebtedness during the years prior to the crisis.

The growth rate of the resident private sector's doubtful assets continues to ease, which feeds through to likewise more modest increases in doubtful assets ratios. This ratio is higher in the most cyclical economic sectors, and in particular in the construction and real estate development sector.

The real estate sector is undergoing an adjustment in Spain. Credit to households for house purchases continues to show low doubtful assets ratios and the loan-to-value ratio (LTV) stands, on average, at a relatively low level. Potential problem loans and receivables in the construction and real estate development sector, which include sub-standard loans and foreclosed assets, as well as doubtful assets, are covered by specific provisions at somewhat over 26%, a percentage that rises to 33% if general provisions for business in Spain are included. Banks should convey detailed information to the markets about their potential problem loans in the construction and real estate development sector, the degree to which such loans are covered and their management strategies. At a time of adjustment in the real estate sector, a lack of information may lead to a perception that the situation is worse than actual circumstances at each bank warrant.

Since the onset of the crisis in summer 2007, wholesale funding markets have functioned with serious difficulties. This has necessitated action by the ECB, whose balance sheet has since increased. The public debt crisis in the first half of 2010 led to the close of wholesale markets. At the height of the tension, banks with excess liquidity deposited funds at the ECB, while those who were resorting to the wholesale markets to obtain funding were obliged, since such markets had dried up, to apply for liquidity from the central bank to a greater extent. In the case of Spanish banks, this translated into an increase in the weight of liquidity applied for from the Eurosystem relative to what the Eurosystem provided to the euro area as a whole.

Since July 2010, however, the situation has progressively and substantially improved. The interbank markets have gradually opened up and a group of Spanish banks has been able to issue significant amounts of debt on the wholesale markets. Further, the debt held by Spanish banks is scheduled to mature predominantly in the medium and long term, which softens the risk of refinancing. In any event, banks should pay attention to refinancing, lengthening maturities insofar as market conditions allow it.

Given the difficulties on wholesale funding markets, commercial banks and savings banks have continued to step up retail deposit-raising, albeit at a less sharp pace than in previous quarters.

Spanish deposit institutions' consolidated earnings in the first half of 2010 fell in relation to the same period a year earlier. This is firstly because provisioning requirements, which are relatively stable in relation to 2009, remain high. And secondly, because the net interest margin has fallen compared with the previous year, when it had been the main positive item on the income statement.

The narrowing of the net interest margin is due to the contraction in activity and to the petering out of the positive effect of interest-rate cuts, which had fed through more quickly to the cost of liabilities than to returns on assets. Competition to raise retail deposits translates into a higher cost of new deposits, which exerts further pressure on income statements.

In light of the factors exerting downward pressure on earnings, a containment of operating costs is apparent. Nonetheless, these efforts should be stepped up both by those banks immersed in restructuring and those that are not. In a scenario of narrowing margins and high provisioning requirements, cutting operating and structural costs is the most important adjustment mechanism available to commercial banks and savings banks.

Banks continue to shore up their solvency, and in particular their core capital, which is growing more than the increase observed in capital requirements. This favourable situation in terms of solvency, and in particular of that of core capital, places the Spanish banking sector in a relatively favourable starting position to undertake the changes recently introduced into capital regulations (Basel III).

In sum, the overall situation remains difficult. This is because the economy has not yet dispelled the uncertainty surrounding it, because of the exposure to the construction and real estate development sector, and due to the situation of the international funding markets, despite the improvement witnessed since late July 2010. The banking sector will continue to be subject to pressure insofar as investor confidence is not fully restored and growth does not resume in the Spanish economy. For these reasons it is vital to entrench the measures adopted by the public authorities, in respect both of fiscal consolidation and structural economic reforms, and of restructuring processes in the banking sector, the latter being strengthened by the notable impulse the amendments to savings bank legislation will provide.

1 Macroeconomic risks and financial markets

There was a bout of instability on European markets, which also affected Spain. The measures applied by European and national authorities and the publication of the stress tests of financial institutions have contributed to a degree of normalisation.

Since the publication of the last FSR, there has been a further bout of tension on European financial markets. While rooted in Greece's fiscal sustainability problems, the episode gave rise to a crisis in confidence which particularly affected the economies whose budget deficits had most deteriorated, or which had built up sizeable imbalances. The turbulence spread to stock and foreign exchange markets and to the euro area banking sector. It also affected, albeit to a lesser extent, the financial system of other economic areas. Nonetheless, the progressive deployment of the measures taken by the European and national authorities and, above all, the decision - on the initiative of the Banco de España - to make public the results of the stress tests of European credit institutions and subsequently publish them, were conducive to helping the markets stabilise as from late June.

The Spanish markets were among those affected by this episode of tension. This was reflected in a considerable increase in risk premia, in stock market declines and in limited fixed-income securities issues by credit institutions. Indeed, there was a negative net issue in Q2. The subsequent improvement has taken the form of a fall in risk premia, a pick-up in stock market indices, greater buoyancy on the primary debt market for financial institutions and a reduction in the recourse by these institutions to the liquidity provided by the Eurosystem.

More recently, market developments have been affected by doubts over US growth, while there has been fresh tension in some euro area sovereign debt markets.

More recently, international financial market developments have been affected by the doubts over the sustainability of the economic recovery in the United States. This followed the publication of several adverse macroeconomic indicators, once the effects of the different stimulus measures had petered out. As a result, questions relating to macroeconomic developments came to the fore, with the financial situation of the public and banking sectors playing less of a leading role. Nonetheless, tensions have once again arisen in recent weeks in certain euro area sovereign debt markets (Ireland and Portugal), with Spain on this occasion not among the countries most affected by this outbreak of turbulence.

The upshot was a tightening of financing conditions on the markets, though this has been partly reversed more recently…

Against this background, financing conditions on international markets were seen to tighten both for certain public-sector issuers and for the private sector, especially so in the latter case for credit institutions (see Charts 1.1.A and 1.1.B). However, a degree of improvement since late June has resulted in a higher volume of primary market issues and in a decline in risk premia.

… declining yields on US, UK and German government debt, a widening of spreads within the euro area…

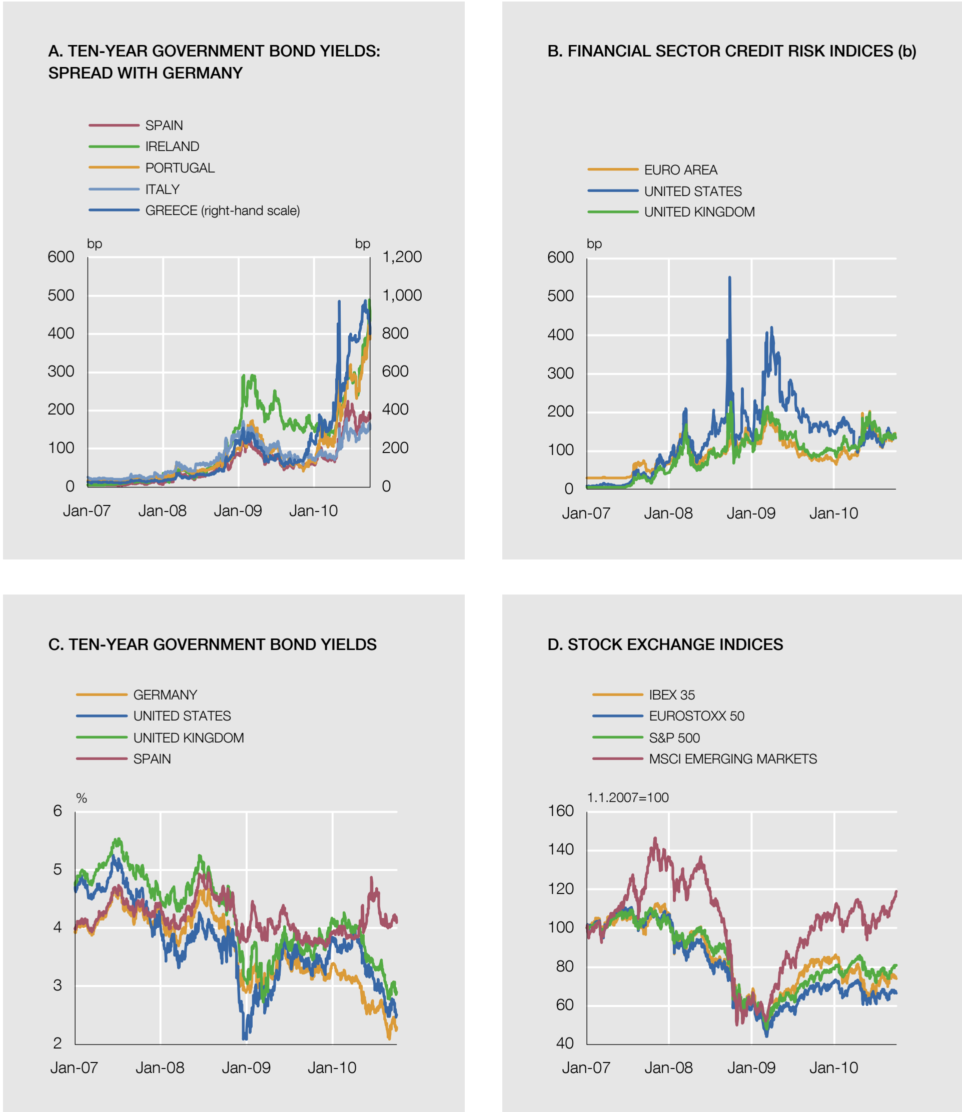
On the government debt markets, there was a decline in the long-term yields on the public debt of the main industrialised economies such as the United States, the United Kingdom and Germany, which reached historically low levels in early September (see Chart 1.1.C). This is partly due to the role of these securities as safe-haven assets and also to the doubts over global economic growth, which emerged from late July. In parallel, in the euro area, there was an increase in yield spreads over the German Bund (see Chart 1.1.A).

… and slides in stock market indices and rises in volatility.

Stock markets were also affected by the greater uncertainty. Indices fell over the course of the period under analysis (end-March to early October) while volatility rose, although in recent weeks there has been some recovery in prices, accompanied by a reduction in volatility (see Chart 1.1.D). This correction in valuations, resulting from the climate of uncertainty and the diminished appetite for risk, was partly checked by the favourable course of business earnings. Once again, emerging countries' stock markets performed better than the

MARKETS (a)

CHART 1.1



SOURCE: Datastream.

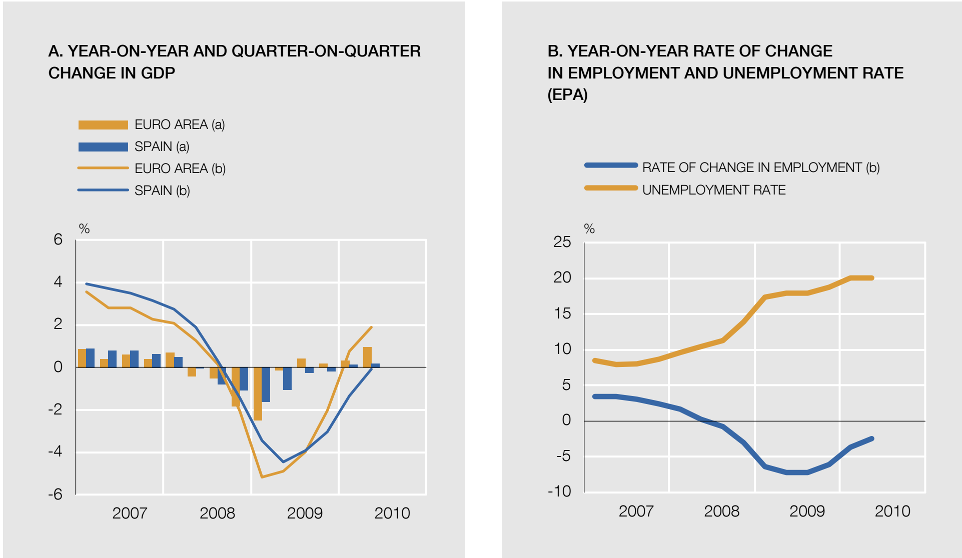
a. Latest data are for 1 October 2010.
b. Euro area: ITRAXX fianancial, 5-year. United Estates and UK: mean comercial bank 5-year CDS.

developed economies, with the exception of Eastern Europe, whose markets trended similarly to those in the rest of Europe.

Global economic activity in the first half of 2010 continued to firm, led by the emerging economies…

In the first half of 2010, global economic activity continued to strengthen. Global GDP expanded at an approximate rate of 5%, somewhat higher than that in the second half of 2009. The pick-up in activity continued to be led by the emerging countries, particularly the Asian economies and Brazil, where growth exceeded 7%. In contrast, in the industrialised economies, growth was only slightly above 3%, largely thanks to the scale of the fiscal and monetary support received. The inventory cycle and the subsequent recovery in world trade and in gross capital formation proved to be key supporting factors in this period, while private consumption remained constrained by ongoing deleveraging and weak labour markets in the main industrialised economies. Against this backdrop, there were signs as from the end of Q2 of a slowdown in activity in the United States and Japan.

GDP AND EMPLOYMENT CHART 1.2



SOURCES: INE, Eurostat and Banco de España.

a. Quarter-on-quarter rates.
b. Year-on-year rates.

… while economic growth in the euro area was notably dynamic in Q2, partly as a result of temporary factors.

In the euro area, economic activity was notably buoyant in 2010 Q2. Supporting factors were the dynamism of the world economy and also, in part, certain temporary domestic factors. On Eurostat's initial estimate, euro area GDP increased at a quarter-on-quarter rate of 1%, 0.7 pp up on the previous quarter. That made for a year-on-year rate of 1.9%, 1.1 pp up on the related rate in Q1 (see Chart 1.2.A).

There are signs of global economic activity weakening in 2010 Q3…

The latest economic indicators show some weakening in the momentum of global activity, which may be attributed to the progressive dilution of the fiscal stimuli and to the completion of the restocking process initiated from very low levels. This slowdown highlights doubts over the capacity of private demand alone to entrench the economic recovery, which has contributed to delaying the "exit strategies" for monetary policy. Nonetheless, growth forecasts for 2010 and 2011 have held stable or have been revised downwards only slightly in some of the main economies, while there have been continuing upward revisions in the emerging economies. Despite the fact growth forecasts for 2010 and 2011 have held stable for the main economies as a whole, the composition of the forecasts has altered somewhat, proving more favourable for the euro area at the expense of the United States.

… and in the euro area, in the short run, a slowdown is expected, pointing to a sluggish and uneven recovery shrouded in high uncertainty and with certain downside risks.

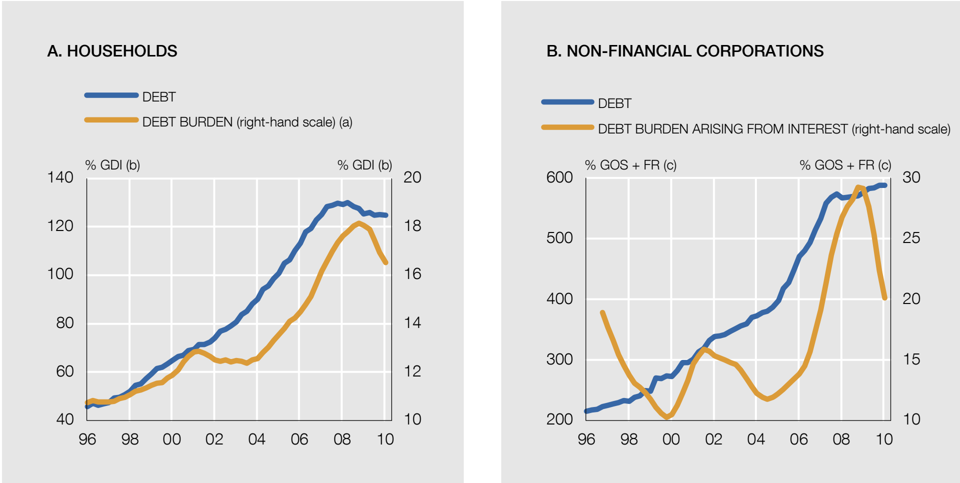
In the euro area, economic activity is expected to slow in the short term, compared with the figures for Q2, giving rise to a slow and uneven recovery shrouded in still-high uncertainty and with some downside risks. This assessment is reflected in the ECB's September forecasting exercise, which envisages GDP growth of between 1.4% and 1.8% in 2010 and 0.5% and 2.3% in 2011, marking, nonetheless, something of an upward revision on the June forecasts.

GDP in Spain grew once more in the first two quarters of 2010, albeit weakly, and this was reflected in an

Spanish economic activity once again grew - albeit at a weak rate - in quarter-on-quarter terms during the first half of 2010, following seven quarters of declines. The specific rate of GDP between April and June compared with the previous three months was 0.2%, although a slight fall of 0.1% was posted in year-on-year terms (see Chart 1.2.A). In line with these developments, the rate of decline of employment eased. On EPA figures, employment fell by

DEBT RATIO AND DEBT BURDEN

CHART 1.3



SOURCES: INE and Banco de España.

a. Estimated interest payments plus debt repayments.
b. Gross disposable income.
c. Gross operating surplus plus financial revenue.

easing of the rate of job destruction…

2.5% year-on-year in Q2 and the unemployment rate edged up to 20.1%, set against the pick-up in the labour force (see Chart 1.2.B).

… and some stabilising of private-sector financial positions, although debt ratios remain at high levels.

The improved macroeconomic setting combined with the weak increase in household and corporate debt contributed to some stabilising of these agents' financial positions; however, their lacklustre earnings are hampering any reduction in their debt ratios, which remain at high levels (see Charts 1.3.A and 1.3.B). Household net wealth fell off further during the opening months of 2010, albeit only slightly so, as a result of the decline in both the real estate and the financial components, the latter to a lesser extent.

General government debt is slowing, although it continues to grow at a high rate, which is reflected in increases in debt and the interest burden.

General government debt continued to slow, although its rate of expansion remains very high (19% in July 2010 compared with 29% in December 2009). This strong expansion in raising funds, together with the weak pace of GDP, has seen further increases in the debt/GDP ratio (56.7% in June against 53.2% at end-2009) and fresh rises in the associated interest burden.

2.1 Deposit institutions

2.1.1 BANKING RISKS

Financial markets were beset by difficulties…

Following the publication of the last FSR in March 2010, international financial markets have been beset by difficulties. These difficulties have been the result of the contagion effect of the Greek debt crisis, which increased perception of country risk, especially for those economies about which there was more uncertainty in terms of their fiscal sustainability and growth capacity.

At the times of greatest stress, financial institutions were unable to resort to wholesale funding markets, including the interbank markets. This phenomenon was especially severe in those countries affected by the loss of investor confidence.

… which tended to ease following the publication of the stress tests.

Since the publication of the results of the stress tests (see Box 2.1) which, in the case of Spain, were applied to practically the whole banking system, there have been signs of improvement in international funding markets. Spanish institutions have obtained funding on the interbank market, at the same time as a group of them, including some medium-sized commercial banks and some savings banks, have issued debt on wholesale markets. The foregoing was reflected in a fall in August and September in the liquidity that Spanish institutions obtained from the Eurosystem.

In Spain, the stress tests are part of an important process to restructure the banking sector, especially savings banks.

The stress tests in Spain are part of a broader set of measures which have contributed to improving investor confidence. These measures include the process to restructure the savings banks sector within the framework of the FROB —Fund for the Orderly Restructuring of the Banking Sector— (see Box 2.2) and are aimed at reducing excess capacity and guaranteeing the medium-term profitability of participants by strengthening their solvency. The measures adopted also include amendments to the Savings Banks Law (see Chapter 3) which provide these institutions with new instruments that will permit them to issue top quality capital, at the same time as they subject themselves to greater market discipline and introduce further improvements to how they are managed. Structural reforms and the fiscal consolidation programme have also made a positive contribution.

Building upon the improvement seen in investor confidence in the Spanish banking sector involves pressing ahead with the restructuring process, fiscal consolidation and structural reforms.

Building upon the improvement in investor confidence in the Spanish banking sector seen since end-July requires consolidating the restructuring processes under way in the savings bank sector. It also requires completion of the structural economic reforms and the fiscal consolidation process. All of the foregoing is necessary for a full recovery of international investor confidence and for the Spanish economy to return once again to a growth path. Until these conditions prevail, the pressure on the banking sector will persist.

The **total consolidated assets** of Spanish deposit institutions grew in June 2010 at a rate of 3% with respect to the same period of the previous year (see Table 2.1). This increase is similar to that already seen in December 2009, but is considerably lower than that posted in previous years (10.4% in June 2009 and 8.1% in June 2008).

Credit to the resident private sector continues to post negative year-on-year rates of change.

The low rate of increase in assets is explained essentially by the performance of financing to the private sector (credit plus fixed income) and, in particular, by that of credit to the resident private sector in Spain which, as analysed below, posted a negative rate of change of 0.9% in June 2010. This performance of credit is explained by the weakness of the real economy, involving lower demand from corporations and households, and the deteriorating credit quality of borrowers, prompting institutions to be more cautious in their lending. It is also

CONSOLIDATED BALANCE SHEET TABLE 2.1
Deposit institutions

ASSETS	JUN-10	CHANGE JUN-10/ JUN-09	RELATIVE WEIGHT JUN-09	RELATIVE WEIGHT JUN-10
	(€m)	(%)	(%)	(%)
Cash and balances with central banks	110,313	1	2.9	2.9
Loans and advances to credit institutions	204,152	-9	6.0	5.3
General government	84,562	22	1.8	2.2
Other private sectors	2,415,488	0	64.3	62.5
Debt securities	515,693	8	12.8	13.4
Other equity instruments	62,672	-11	1.9	1.6
Investments	47,673	33	1.0	1.2
Derivatives	210,922	23	4.6	5.5
Tangible assets	49,329	11	1.2	1.3
Other (a)	161,846	20	3.6	4.2
TOTAL ASSETS	3,862,650	3	100	100
MEMORANDUM ITEMS				
Financing to private sector	2,557,101	0	68.3	66.2
Financing to general government	357,088	21	7.9	9.2
Total doubtful assets	121,610	17	2.8	3.1
Total doubtful assets ratio	3.78	50 (c)		
Provisions for bad debts and country risk	73,839	17	1.7	1.9

LIABILITIES AND EQUITY	JUN-10	CHANGE JUN-10/ JUN-09	RELATIVE WEIGHT JUN-09	RELATIVE WEIGHT JUN-10
	(€m)	(%)	(%)	(%)
Balances from central banks	170,485	9	4.2	4.4
Deposits from credit institutions	500,698	1	13.2	13.0
General government	91,775	-15	2.9	2.4
Other private sectors	1,804,763	5	45.6	46.7
Marketable debt securities	578,984	-9	16.9	15.0
Derivatives	187,004	18	4.2	4.8
Subordinated debt	103,225	0	2.8	2.7
Provisions for pensions, tax and other	33,961	-6	1.0	0.9
Other (a)	162,518	22	3.6	4.2
TOTAL LIABILITIES	3,633,413	3	94.3	94.1
MEMORANDUM ITEMS				
Eurosystem net lending (b)	97,682		1.89	2.5
Minority interests	14,342	39	0.3	0.4
Valuation adjustments relating to total equity	-2,438	-61	-0.2	-0.1
Own funds	217,333	4	5.5	5.6
TOTAL EQUITY	229,237	8	5.7	5.9
TOTAL LIABILITIES AND EQUITY	3,862,650	3	100	100

MEMORANDUM ITEMS TOTAL ASSETS OF:	JUN-10	RELATIVE WEIGHT JUN-09	RELATIVE WEIGHT JUN-10
	(€m)	(%)	(%)
Five largest banks	2,357,805	59.6	61.0
Twenty next largest banks	901,264	24.1	23.3
Other banks	603,581	16.3	15.6

SOURCE: Banco de España.

a. The remaining assets and liabilities entries not explicitly considered, including valuation adjustments, are included in "Other".
b. Difference between funds received in liquidity providing operations and funds delivered in absorbing operations. Average figures for September 2010.
c. Difference in basis points.

STRESS TESTS FOR SPANISH BANKS AND SAVINGS BANKS

BOX 2.1.

On 23 July the results of the **2010-2011 EU-wide stress tests** were published. The exercise was coordinated by the Committee of European Bank Supervisors (CEBS) in collaboration with the ECB, and involved various European supervisory and policy institutions. The Banco de España, which had previously announced its intention to conduct and publish the results of the stress tests of Spanish banks, resolutely supported conducting the joint exercise EU-wide, since in this way greater transparency and comparability was ensured. Precisely with the aim of maximising such transparency, the **Banco de España** decided that the **exercise** in our country should be as **extensive as possible**, as regards **both the number of institutions and the information provided**[1].

As to the participating institutions, it was agreed at the European level that they should represent at least 50% of the national banking sector. In Spain's case, 27 institutions (all listed banks and all the savings banks resulting from the reorganisation process under way) were included, making for **coverage of more than 90% of the system**.

The other differentiating factor of the stress tests undertaken in Spain was the degree of additional detail. This included a **breakdown of banking books** (with particular attention to credit for real estate activities), and the **public aid** earmarked before the conducting of the stress tests.

The starting point for conducting the stress tests was end-2009. Thereafter, stressed impairment losses were calculated for the two-year period 2010-2011 under the two scenarios designed for the European exercise: the benchmark scenario and the adverse scenario.

Under the **stressed adverse scenario**, the pressure took the form of a decline in GDP in 2010-2011 of 2.6 pp, on top of the strong economic contraction in Spain in 2009 (-3,6%). This assumption lies outside the forecasting ranges of the various national and international agencies and of private analysts. The **level of capital** agreed by Ecofin to determine whether institutions would pass the tests was set as a tier 1 capital ratio of **6%**, 50% higher than the legally required minimum.

As part of the information presented by the Banco de España both on a bank-by-bank basis and for different groups, a breakdown was given of the gross hypothetical impairment losses on the main banking book, detailing the items that absorb these losses until arriving at the final impact on tier 1 capital. For the **aggregate of the system as a whole under the stressed adverse scenario**, the **main results, which show the soundness of the Spanish banking sector**, are summarised below:

- The hypothetical impairment losses that would arise in 2010 and 2011 would amount to €207,473 million, 7.3% of total assets (9.5% for savings banks).

  The most significant source of these impairment losses was in the banking book, for an amount of €173,619 million (i.e. 84% of total impairment losses) and, hereunder, those in the real estate development portfolio (€76,012 million, 44% of total impairment losses due to credit risk).

- The provisions set aside would enable 34% of these impairment losses to be absorbed, while income-generating capacity would absorb a further 48% (29% at savings banks), even assuming a severe reduction in average net operating income compared with 2009.

- Tier 1 capital as at December 2009 stood at €181,865 million for the entire banking sector, representing a tier 1 ratio of 9.5% (9.2% for savings banks). Stressed tier 1 capital as at December 2011 would fall to €148,339 million (a ratio of 7.7%) for the entire banking sector and to €45,024 million (a ratio of 5.5%) for savings banks.

- Under the stressed adverse scenario, only four savings banks failed to reach the minimum level of 6%. This situation **does not entail** a current or expected **failure** by these four institutions **to comply** with the minimum legal capital requirement, since it reflects an extreme situation, in the face of highly stressed assumptions that are very unlikely to occur. However, these institutions must submit an additional capitalisation plan, not out of legal necessity, but to obtain greater room for manoeuvre and to dispel any doubts about their future. Depending on the market situation, funds will be raised from private sources or from additional aid from the FROB, which has been extended to 31.12.2010 in this connection.

- The total support calculated as necessary so that all institutions might stand above the 6% tier 1 capital threshold as at December 2011 under the adverse scenario (including the support received by the two savings banks seized by the Banco de España and by those that requested aid for integration, and the estimated additional aid) would amount to €16,193 millions, of which the FROB and the DGF had already previously provided or committed €14,358 million.

The stress tests should be seen as part of the **far-reaching reform of the Spanish financial system**, centred on savings banks, on which institutions have been working for more than two years. Key elements of this reform are the integration of savings banks, the recapitalisation of many of them and the new savings bank legislation, which places them on an equal footing with banks in respect of both the possibility of issuing top-quality capital and making their governing bodies more professional. The undertaking of these tests sought to dispel doubts over the Spanish banking system, doubts largely centred on the situation of savings banks and on their exposure to the real estate sector.

1. The results of the stress tests for the Spanish banking sector can be viewed at http://www.bde.es/prensa/test_cebs/resultados_cebse.htm.

accounted for by the banks' reliance on wholesale funding markets which experienced considerable strain in 2010 Q2. Aside from these considerations, the negative rates of change in credit reflect a natural adjustment process by households and corporations following some years of a sharp increase in their indebtedness.

Sluggish credit to the private sector contrasts with buoyant financing (credit plus fixed income) to general government (21% in June 2010), although its growth rate eased noticeably, from 42% in December 2009.

The rate of increase of doubtful assets ratios has eased.

The total doubtful assets at consolidated level continued to post positive rates of change (17%), although these rates are significantly lower than those recorded throughout 2009 and 2008 (48% in December 2009, 171% in June 2009 and 239% in December 2008). The moderation of the rate of increase of doubtful assets resulted in a lower growth rate of the total doubtful assets ratio at consolidated level which, nonetheless, continued to rise (by 50 bp from June 2009 to 3.78% in June 2010).

Wholesale funding markets experienced strains, particularly in 2010 Q2…

The first half of 2010 and, particularly, 2010 Q2, were marked by severe strains in wholesale **funding markets**, both in money markets and primary markets. These strains arose from the Greek public debt crisis and its contagion effect in terms of market perception of the fiscal sustainability of other euro area countries and of the euro area as a whole. This uncertainty, which had a negative effect on the European banking sector and, in particular, on countries perceived by investors as having the largest fiscal and growth problems, abated for Spain in August and September, partly due to the publication of the stress tests.

… which eased as reflected by the fall in Spanish banks' use of the Eurosystem's liquidity…

In such a complex setting, Spanish banks, to a varying degree, had greater recourse to the Eurosystem's liquidity, which was reflected in a sharp rise in net lending (the funds received in liquidity providing operations minus those deposited in liquidity absorbing operations). Their use of this liquidity was nonetheless reduced in August (–16% in relation to July 2010) and in September (–11% in relation to August 2010) and represented 2.8% of the deposit institutions' consolidated balance sheet, on the basis of average data for August, and 2.5% on the basis of average data for September, in line with relatively low values of 2% observed in previous quarters.

… and the possibility of new fixed-income securities issuance from end-July.

The difficulties on international markets were also observed on primary markets, which was reflected in the stagnation of subordinate debt issuance in June 2010 in relation to June 2009 and in the negative year-on-year rate of change in June 2010 (–9%) for the issuance of marketable securities. However, a group of Spanish deposit institutions has returned to primary markets since end-July.

Retail deposits continued to grow, but less sharply than in 2009.

As for retail funding, Spanish deposit institutions have stepped up deposit-taking, although the rate of increase in this variable is less sharp than in previous quarters (5% year-on-year in June 2010, compared with 6% in December 2009 and 12% in June 2009).

Spanish banks continued to strengthen their own funds.

As in December 2009, deposit institutions have strengthened their **own funds.** After growing at a rate of 4% in June 2010 in relation to June 2009, they represent 5.6% of the consolidated balance sheet (5.5% in June 2009).

The risks arising from business abroad,

Business abroad represented 25.9% of total consolidated assets in June 2010 (23.5% in June 2009). Spanish banks' business abroad is undertaken through subsidiaries which are financially independent and focus their activity, as in the case of their parents in Spain, on

THE SPANISH BANKING RESTRUCTURING PROCESS. SAVINGS BANKS

BOX 2.2

More than three years have elapsed since the start of the international economic and financial crisis. Most Spanish deposit institutions evidenced then and now considerable strength, as demonstrated by the results of the EU-wide stress tests last July. However, the Spanish banking sector, and most especially savings banks, were prone to a series of weaknesses, the solution to which necessarily involved the orderly restructuring of our financial system through integration processes:

- Capacity in the sector had been attuned to a period of excessive growth marked by very high business volumes. The fall in the demand for financial services highlighted excess capacity, which needs to be absorbed.
- With significant differences from one institution to another, this growth was underpinned by the real estate and construction sector, and in many cases it was funded on the wholesale markets. The increase in bad debts and greater difficulties in gaining access to funding exerted pressure on institutions' income statements, making the generation of synergies vital.
- Savings banks faced added difficulties in increasing their capital through means other than retaining profits, given the lack of attractiveness of their non-voting equity units.

Against this background, the Fund for the Orderly Restructuring of the Banking Sector (FROB) was set up pursuant to Royal Decree-Law 9/2009 of 26 June 2009. Its main aim was to support integration processes between viable institutions with a view to enhancing their efficiency in the medium term by strengthening their capital, thereby promoting the improved competitiveness and credibility of the financial system. The FROB also has a second aim, namely to provide for crisis resolution at non-viable institutions when a solution cannot be reached under the traditional framework based on the deposit guarantee funds (DGF). In short, the FROB contributes on one hand to redimensioning and recapitalising the Spanish banking system, and on the other it complements the capacity of the DGF to resolve individual crises. In scarcely a year since the Fund's design, a far-reaching reorganisation of the banking sector has taken place.

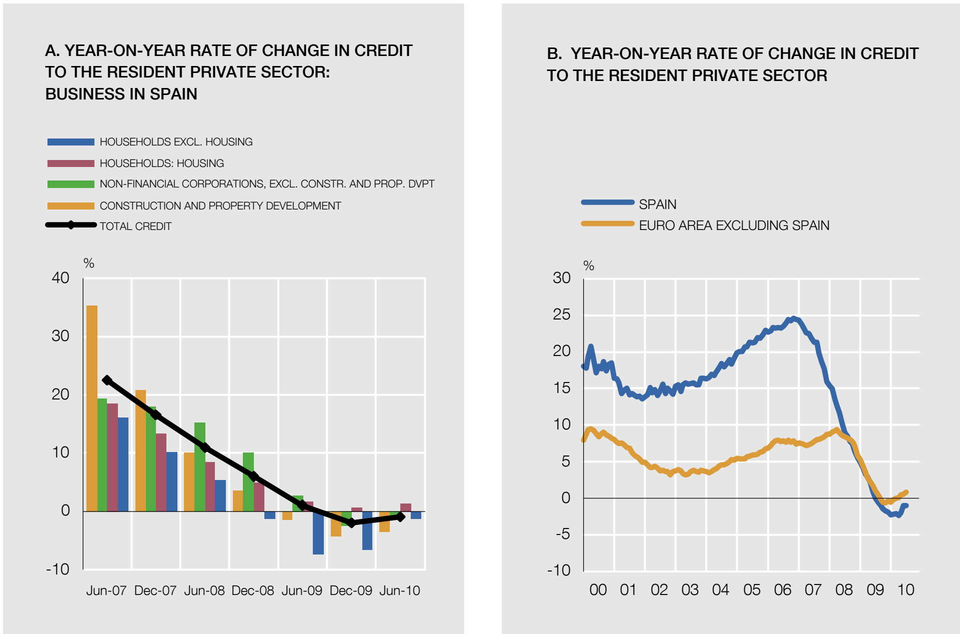
Turning to the savings banks, 40 out of a total of 45 of them are participating in some type of integration process. These 40 institutions, which account for 94% of the sector in terms of assets, are immersed in 13 integration processes based on two different legal structures (mergers or institutional protection systems). Of these 13 processes, eight have requested financial support from the FROB for a total amount of €10,581 million. Practically in its entirety, this aid has taken (or will take) the form of the acquisition of preference shares redeemable within five years (extendable under certain circumstances to seven years) and with a minimum annual remuneration of 7.75%. These plans include reductions in the number of branches and in staff of 10%-30% and 11%-27%, respectively. From 45 institutions with an average total assets of €28,504 million, the sector is now made up of 18 institutions (or groups of institutions) with average assets of €71,260 million.

On two occasions, the Banco de España adopted the exceptional measures envisaged for circumstances in which the institutions' viability might be jeopardised. On 29 March 2009, under the traditional framework for action of the DGF, it was resolved to replace the directors of Caja Castilla-La Mancha (CCM) by others designated by the Banco de España. With the restructuring process concluded, CCM's banking business has finally been integrated into the Cajastur group. The financial aid from the DGF to CCM, after a dation of assets in payment by the latter, amounts to €596 million relating to losses (which may vary depending on the results that the asset divestment plan yields), in addition to an asset protection scheme (APS) for €2,475 million relating to specific loans and receivables assigned to the Cajastur group. On 21 May 2010 it was resolved to replace the directors of CajaSur, with the FROB being appointed as provisional administrator. The plan drawn up by the Steering Committee of the FROB envisages the full assignment of assets and liabilities to Bilbao Bizkaia Kutxa and an APS for a maximum total of €392 million.

The restructuring process has not been confined to savings banks but is also affecting, to a lesser extent, other types of institutions such as credit cooperatives and commercial banks, although none have requested support from the FROB. To properly assess the total resources earmarked to address losses, in addition to the amounts committed by the FROB and the DGF, the write-downs made and charged to income in this period by institutions and the amounts drawn down on general provisions (€41,900 million and €18,200 million, respectively) must be added.

CHART 2.1

CREDIT TO THE RESIDENT PRIVATE SECTOR
Deposit institutions. ID



SOURCES: ECB and Banco de España.

undertaken through financially independent subsidiaries, remained contained.

retail and commercial banking. Banks have diversified by geographical area by increasing their presence, which was initially focused on Latin America, in other EU countries and, to a lesser degree, in the United States. In the current setting, Spanish banks' business abroad has brought advantages associated with the geographical diversification of activity.

Credit to the resident private sector continued to post negative, albeit more moderate, year-on-year rates of change.

Credit to the private sector resident in Spain continued to post negative year-on-year rates of change (see Chart 2.1.A), although they were more moderate than in previous months (–0.9% in June 2010 compared with –2.1% in March 2010 and –2% in December 2009). The latest available data, for August 2010, showed similar year-on-year rates of change to those in June (–0.8%).

This general trend is seen in the various sectors of activity, but to a differing degree.

Credit fell less steeply in June 2010 in relation to the previous year, which can be seen in all sectors of activity (see Chart 2.1.A), although differences remain. Within household credit (which grew in total by 0.9% in June 2010), lending for house purchase grew at a rate of around 1% (0.7% in December). Other household financing continued to post a negative year-on-year growth rate (–1.3% in June 2010), although its rate of decline has moderated gradually since June 2009.

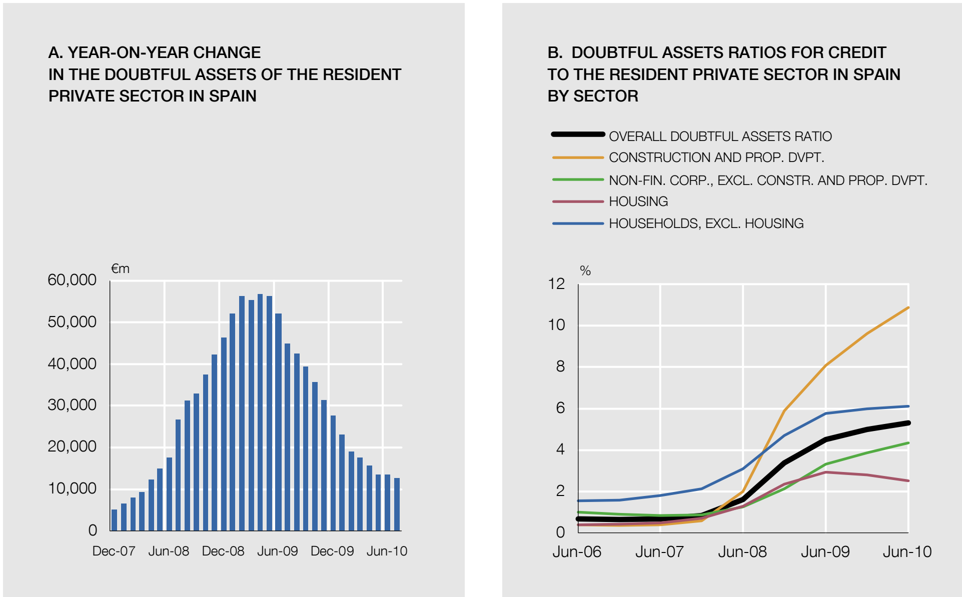
As for corporations, the rates of change are negative for lending to construction and real estate development firms (–3.4%) and for other corporations (–1% in June 2010). In both cases these negative changes are less sharp than in March 2010 and in December 2009 (see Chart 2.1.A).

Negative rates of change in credit cannot be ruled out in coming months, which shows a natural adjustment

The ongoing uncertainty about the performance of the real economy and about wholesale funding markets, despite the signs of recovery in August and September, point to credit continuing to perform adversely in coming months. This performance of credit, in any event, reflects a natural adjustment process by households and corporations, following the sharp

DOUBTFUL ASSETS
Deposit institutions. ID

CHART 2.2



SOURCE: Banco de España.

process by households and corporations.

rise in their indebtedness in the past. From a more medium-term perspective, and in view of how credit has performed in Spain and in the euro area in the last decade (see Chart 2.1.B), it will foreseeably in Spain follow a more similar pattern to that observed for the euro area as a whole.

The rate of increase of doubtful assets continued to slow...

The doubtful assets of the resident private sector in Spain continued to post positive year-on-year rates of change (16.5% in June 2010, 15.3% in July 2010 and 13.8% in August 2010), although they were less marked than in previous months. Thus, the year-on-year rate of change in the volume of doubtful assets has gradually slowed since mid-2009 and currently stands at similar levels to those of April 2008 (see Chart 2.2.A).

… which fed through to the doubtful assets ratios for the various sectors of activity.

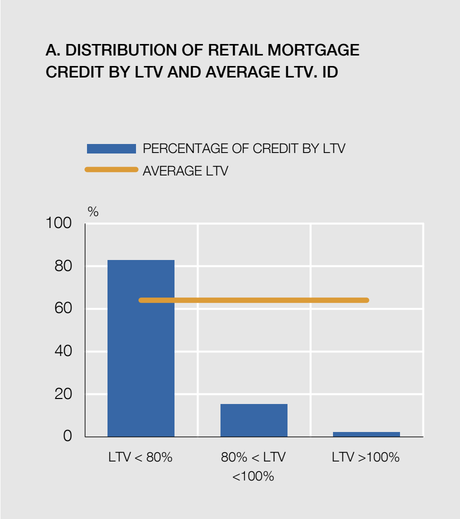
Changes in credit and the growth of doubtful assets explain the persistent growth trend in the **doubtful assets ratio of the resident private sector in Spain** (5.3% in June 2010, compared with 4.98% in December 2009 and 4.5% a year earlier). Nevertheless, the rate of increase in this ratio has gradually been lower (the doubtful assets ratio was 5.4% in July 2010 and 5.6% in August 2010). This can be seen for various sectors of activity although the ratios are higher and have increased more sharply in those sectors which behave more cyclically (see Chart 2.2.B).

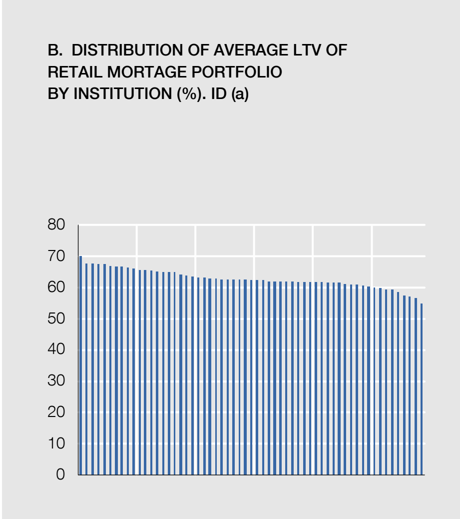
Significant differences remain in household credit between credit for house purchase and other credit, which recorded doubtful assets ratios of 2.5% and 6.1%, respectively, in June 2010 (see Chart 2.2.B).

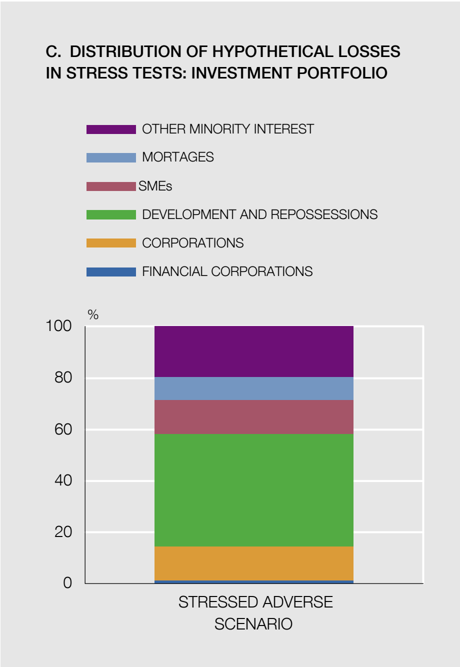
The doubtful assets ratio of household credit for house purchase is moderate. This type of lending also has a relatively low LTV ratio.

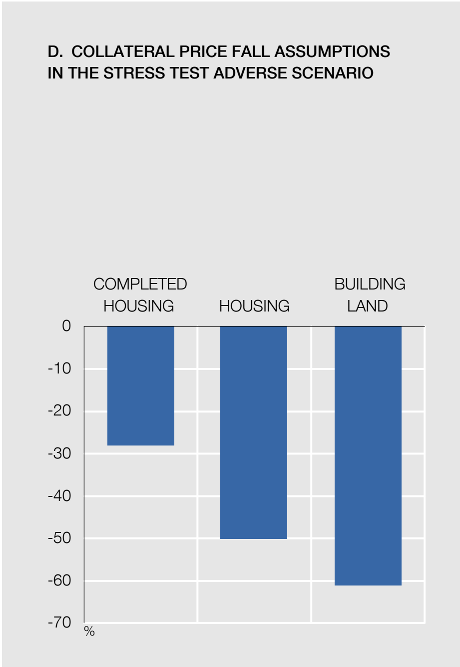
The lower doubtful assets ratio of housing loans has not only been seen during this period of expansion of doubtful assets but also in previous recessions in Spain. This is explained by the type of business in which Spanish banks engage (traditional retail banking), by the structural characteristics of the housing market in Spain (high weight of owner-occupied housing) and by existing specific regulations (guarantees supplementing for the mortgaged asset). Furthermore, lending for house purchase involves collateral which limits potential losses for banks, all the

LTV RATIO AND STRESS TEST SCENARIOS CHART 2.3
Deposit institutions









SOURCE: Banco de España.

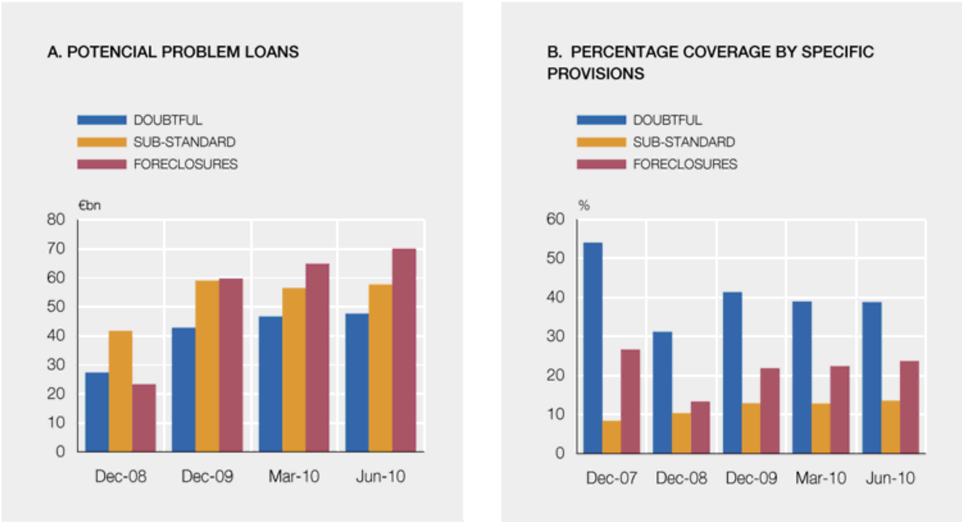
a. The institutions represented account for 95% of total credit and include all saving banks, as well as the major commercial banks.

more so considering that for Spanish banks the loan to value ratio (LTV) is 62% in the retail mortgage portfolio (see Chart 2.3.A). This situation is relatively homogeneous across deposit institutions (see Chart 2.3.B), the highest average LTV ratio stands at approximately 70%, and the banks are distributed relatively uniformly around the average level.

The stress tests published in July 2010 (see Box 2.1) show that the hypothetical losses in the extreme scenario, which has a low probability of occurring, are lower than those in other portfolios, except for that of financial institutions (see Chart 2.3.C). This was the case even though an extreme macroeconomic scenario, including highly substantial hypothetical falls in house prices, was considered (see Chart 2.3.D).

CHART 2.4

CONSTRUCTION AND REAL ESTATE DEVELOPMENT SECTOR: POTENCIAL PROBLEM LOANS AND PROVISIONS
Deposit institutions. ID



C. BREAKDOWN OF POTENCIAL PROBLEM LOANS AND THEIR COVERAGE. JUNE 2010

	Amount €bn	% of investiment	Specific provisions €bn	% coverage
Loans and receivables	439.0			
Doubtful	47.9	10.9	18.5	38.6
Sub-standard	57.6	13.1	7.8	13.5
Foreclosures and repossessions	70.0	15.9	16.6	23.7
Write-offs	5.3	1.2	5.3	100
Potential poblem loans	180.8	41.2	48.2	26.6
MEMORANDUM ITEM				
% coverage, including general provision				33.0

SOURCE: Banco de España.

The doubtful assets ratio is higher for construction and real estate development loans…

As for credit granted to non-financial corporations, notable differences persist between the doubtful assets ratio for lending to construction and real estate development firms (10.9% in June 2010), and that for lending to other business activities (4.3% in June 2010, see Chart 2.2.B).

… as seen in previous crises (1993). The stress tests reflect the higher hypothetical losses associated with this activity.

Construction and real estate development lending has a very pronounced cyclical profile. For this reason, in recessions the related doubtful assets ratio increases significantly above average. At present, the real estate development sector is undergoing a notable adjustment process. Therefore, it cannot be ruled out that the doubtful assets ratio of this sector, despite the moderation of its rate of increase, will continue to rise in coming quarters. The stress tests considered a highly unlikely very adverse scenario, which included substantially notable declines in the prices of the collateral typically associated with this type of financing (see Chart 2.3.D). The results of the tests showed that this type of lending recorded the highest hypothetical losses (see Chart 2.3.C).

In credit to the construction and real estate development sector both doubtful and foreclosed assets have grown…

The doubtful assets ratio compares doubtful assets[1] with the volume of credit extended. Similarly, Banco de España accounting regulations also require that certain operations be classified in the sub-standard category (see Chart 2.4.A), if generic weaknesses associated with a sector or group are observed or if weaknesses are apparent in certain operations, even if these operations do not qualify individually for classification as doubtful or write-off. This classification involves the obligation to make specific provisions. These provisions increased and in June 2010 represented 13.5% of the sub-standard assets associated with construction and real estate development activities, compared with 12.9% in December 2009 (see Charts 2.4.B and 2.4.C).

Most of the exposures to the construction and real estate development sector, due to their nature, have various types of collateral. Faced with the deteriorating credit quality of firms in this sector, deposit institutions have actively managed this collateral through foreclosures and dations in payment, limiting the negative impact of this impairment on borrowers' credit quality. The Banco de España supervises these operations so that they do not lead to a delay in the recognition of losses and, in fact, has modified its guidelines for estimating impairment, which are included in accounting regulations, in order to make them sounder. This reform recognises the value of the collateral (which is subject to certain haircuts), accelerates the need to record a provision for the part of the loan not covered by the value of the guarantee (100% coverage in one year) and establishes precise requirements for the specific provisions for foreclosed assets (see Box 2.3). The Banco de España already required the recording of specific provisions for foreclosed assets since institutions should not accumulate real estate assets indefinitely on their balance sheets.

…in which connection, as in the case of sub-standard loans, the Banco de España requires specific provisions be made.

Since December 2008, as a result of these collateral management practices, foreclosed assets and dations in payment have grown. In June 2010 they amounted to €70 billion (see Charts 2.4.A and 2.4.C). The specific provisions recorded for these exposures represented 23.7%, compared with 21.8% in December 2009 (see Charts 2.4.B and 2.4.C).

The potentially troubled exposure to the construction and real estate development sector (doubtful assets, sub-standard loans, foreclosures and write-offs)…

The potentially troubled exposure of the banking sector to construction and real estate development, as defined in the last FSR (see Box 2.3), includes doubtful assets, sub-standard loans, foreclosures and loan write-offs. It amounted to €181 billion in June 2010 (€166 billion in December 2009).

… entailed coverage with specific provisions of 26.6%.

The specific provisions available for covering the losses associated with these assets have increased commensurately with such assets. This is reflected in the stability of the coverage ratios (see Chart 2.4.B), which amounted to 26.6% for the potentially troubled exposure aggregate, 1 pp higher than in December 2009. If, in addition to the specific provisions, the general provisions set aside for business in Spain are taken into account, the coverage ratio would rise to 33% (see Chart 2.4.C).

There are differences in banks' exposure to the construction and real estate development sector and, consequently, in their potentially troubled loans and the related provisions. The detailed information published in the stress tests has contributed to improving investor confidence in the Spanish banking sector. At a time of strong adjustment of the real estate sector, a lack of information may give rise to a perception of the banks' situation which is worse than it actually is. For this reason, it would be appropriate for Spanish banks to make more efforts to inform market participants about the situation of their potentially troubled exposure to the construction and real estate development sector, the provisions they have set aside and their strategic decisions to tackle any problems that might exist.

1. For the purposes of this ratio, loans in which some instalment has not been paid for a period of more than 90 days, or for which banks have reasonable doubts as to total repayment under the terms agreed when they were granted.

BANCO DE ESPAÑA CIRCULAR (CBE) 3/2010 OF 29 JUNE 2010: REVISION OF ANNEX IX OF CBE 4/2004

BOX 2.3

The experience gained in the analysis and coverage of risk on the basis of Annex IX advised amending certain aspects regarding both credit policies and the methodologies for estimating asset impairment.

CBE 4/2004 marked a far-reaching change in that it incorporated the international financial reporting standards adopted by the European Union into the accounting regulations governing Spanish credit institutions. However, this did not alter the practice of offering guidelines on covering the most significant banking risks.

The revision approved by the Banco de España refined the methodology for estimating asset impairment to take into account the conditions under which credit risk currently develops and to reflect appropriately actual asset impairment and its transmission to the market through the financial data published by banks. The revision was three-pronged:

- Credit policies, methods and procedures;
- Estimation of impairment losses on debt instruments classified as doubtful; and
- Estimation of real estate assets received in payment of debt.

Credit policies, methods and procedures

The amendment addresses common problems often found in the reviews of supervised institutions' financial information, such as insufficient generation of cash flow by borrowers and excessive reliance on the collateral provided, along with rather unrealistic financial restructuring plans.

The revision of policies includes recommendations that help prevent the emergence of problems in credit portfolios. These recommendations are deemed essential for promoting prudent and robust credit risk management. They include the need to take all due caution combined with professional judgment in enlisting external professional services in the risk management process; the need to set limits on the financing of real estate projects, including a maximum ceiling of 50% on lending for the acquisition of land; and the need for a debt rescheduling policy that includes at least minimum requirements regarding years of experience with the borrower and a sufficiently broad limit on the frequency of reschedulings.

Estimation of impairment losses on debt instruments classified as doubtful

The recognition of the estimated value of the real estate collateral using different schedules proved partial and gave rise to incongruencies, including the lack of coverage of potential losses over long periods of time and the obligation to set aside 100% provisions for loans despite the existence of collateral that would lessen the final loss.

The revision in respect of estimation, without overlooking past experience, entails a change in focus since the collateral provided is considered directly. First, a single schedule is generally established for estimating impairment for all classes of transactions, so that the portion not collateralised by personal and real estate property is assimilated to an unsecured loan.

Further, the valuation of claims on real estate collateral received is referenced to the lower of cost and appraised value. Haircuts are applied to this valuation to reflect both the heterogeneity of the collateral and the different possibilities of conversion into liquidity. These haircuts are 20% for the borrower's principal dwelling, 30% for rural land and multi-purpose offices, and commercial and industrial premises, 40% for other finished housing and 50% for developable land parcels and building plots.

In turn, for entities with sufficient past experience in the management of personal property acting as collateral for credit transactions, the revision included the possibility of this being used in estimations of losses on this type of transaction, taking into consideration the existence of secondary markets with readily observable prices underpinning both the valuation and the ease of conversion into liquidity.

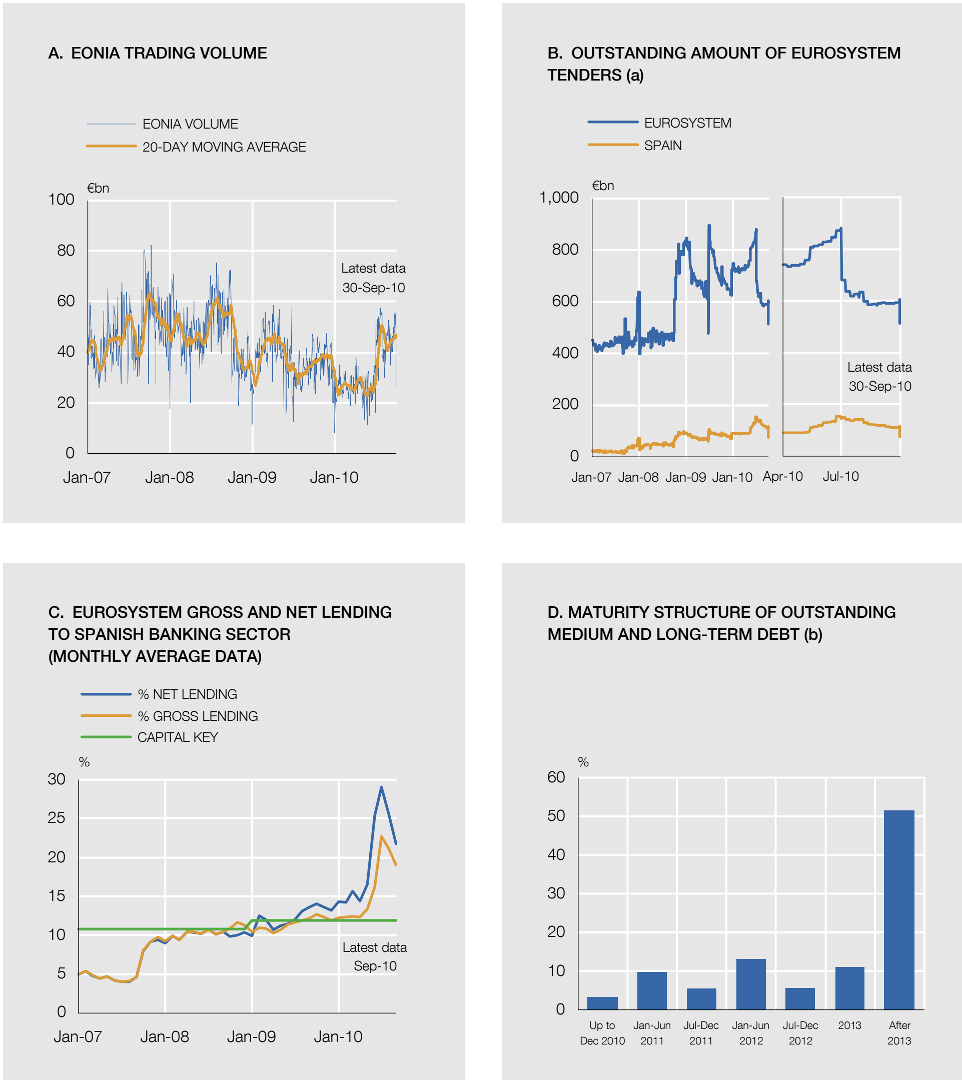
Real estate assets received in payment of debt

Finally, the different practices used by entities to settle credit transactions through the acquisition of real estate assets have been unified. The market situation of some of these assets occasionally hampers the recovery of liquidity within the desired terms; accordingly, on the basis of the experience gained in past years, a comprehensive methodology has been incorporated to avoid dilatory practices in recognising the impairment of these types of assets. The methodology establishes, as a general rule, a minimum impairment of 10% of the assets acquired, which, depending on the time they remain on the balance sheet, could increase to 20% or 30% if the time elapsed is more than one or two years, respectively.

Impact

The revision of Annex IX will not be applied retrospectively, and its initial quantitative impact will be recognised in the results for 2010 Q3.

WHOLESALE FUNDING MARKETS CHART 2.5



SOURCES: Datastream, ECB and Banco de España.

a. Average monthly figures.
b. Not including asset securitisations because in the case of Spain they have no associated refinancing risk since the maturities of the liabilities are linked to those of the assets.

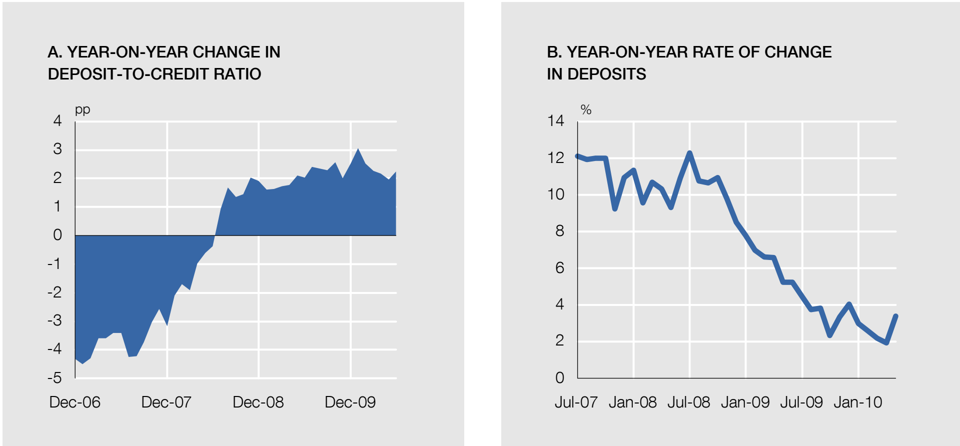
The financial markets experienced a further bout of tension...

There has been a further bout of tension on **financial markets** which was particularly acute in 2010 Q2. It stemmed from the loss of investor confidence due to Greece's fiscal sustainability problems (see Chapter 1) and affected on the primary markets and the interbank market, as shown by the EONIA trading volume (see Chart 2.5.A). Since the publication of the stress tests, the interbank market and especially the repo market have opened up again and a group of Spanish deposit institutions have accessed the wholesale markets, although the volumes and prices of the financing obtained have varied. This is reflected in the reduction of liquidity obtained from the Eurosystem in August and September.

Since the outbreak of the crisis in summer 2007, funding markets have experienced notable malfunctioning. This has compelled the ECB to intervene in the markets by providing liquidity and accepting any surplus in the form of deposits from banks. This action of the ECB is shown in the growth path followed by the outstanding amount of refinancing provided

DEPOSITS OF HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS
Deposit intitutions. ID

CHART 2.6



SOURCE: Banco de España.

through Eurosystem tenders, which until the end of 2010 Q1 increased for most countries in the euro area (see Chart 2.5.B)

…which resulted in larger requests for liquidity from the Eurosystem, especially from banks in the countries hit by the bout of tension.

At the height of the sovereign debt crisis, in 2010 Q2, there was no access to the interbank and primary funding markets. Banks with surplus liquidity deposited it with the ECB. Conversely the banks that turned to the wholesale markets for funding requested liquidity from the Eurosystem. Spanish banks are in the latter group, which was reflected (see Chart 2.5.C) in the gross lending requested by Spanish banks which, as a percentage of the total for the euro area, amounted to 22.7% in July (29.1% in terms of net lending, that is, the difference between the liquidity injected and the funds deposited in liquidity absorbing operations).

EUROPEAN CENTRAL COUNTERPARTY CLEARING HOUSES

BOX 2.4

In 2010 Q2, the international funding markets closed for banks as a result of sovereign debt developments. In Spain's case, the perception of double risk (from the country of origin of the credit institution and from the country of origin of the issuer of the collateral, in this case Spanish public debt) practically led to the disappearance of repo operations with non-resident institutions using Spanish public debt as collateral. That forced Spanish banks to resort to the Eurosystem to raise funds.

However, in recent months the situation has improved significantly. One of the factors contributing to this recovery is the access by Spanish institutions to the central counterparty clearing houses (CCP). Non-resident entities reduce their risk with Spanish institutions in Spanish public debt repos through the intermediation of a CCP, which assumes the counterparty risk. That enables them to once again undertake or even increase the foregoing repo operations without the above-mentioned double risk. Since July 2010 a larger number of Spanish institutions has obtained funding from non-resident institutions, either as members or through intermediaries, through operations backed by the main European fixed-income CCP: the UK London Clearing House (LCH) and the German Eurex Repo. Since August Spanish public debt securities have been accepted by LCH as collateral for repos. Although there was already a CCP in Spain to guarantee fixed-income securities operations, namely Meffclear, the absence of non-resident institutions restricted its use.

The main function of a CCP is to intermediate securities clearing and settlement processes, essentially in contract novation and managing the risk arising from intermediation by means of demanding collateral. The novation agreement leads to the annulment of the participants' obligations in the clearing house in favour of the CCP itself, which assumes these obligations and then acts as a counterparty both to the buyer and to the seller, thereby ensuring operations are successfully completed. That is to say, the presence of a CCP frees the participating institutions from counterparty risk. Moreover, the use of a CCP has other advantages for banks, as it makes the use of capital more efficient and facilitates the obtaining of short-term funding at a cost similar to that signalled by interbank market rates.

INCOME STATEMENT
Deposit institutions

TABLE 2.2

	JUN-10		JUN-09	JUN-10
	€m	% CHANGE JUN-10/ JUN-09	% ATA	% ATA
Financial revenue	59,738	-24.1	4.57	3.36
Financial costs	25,870	-39.9	2.50	1.46
Net interest income	33,868	-5.3	2.07	1.91
Return from capital instruments	1,513	0.7	0.09	0.09
Share of profit or loss of entities accounted for using the equity method	1,743	36.4	0.07	0.10
Net commissions	11,275	3.0	0.63	0.63
Gains and losses on financial assets and liabilities	5,970	1.8	0.34	0.34
Other operating income	-147	–	0.01	-0.01
Gross income	54,223	-2.4	3.22	3.05
Operating expenses	23,803	3.5	1.33	1.34
Net operating income	30,420	-6.5	1.89	1.71
Asset impairment losses (specific and general provisions)	15,282	0.4	0.88	0.86
Provisioning expense (net)	1,305	44.5	0.05	0.07
Operating profit	13,833	-15.8	0.95	0.78
Asset impairment losses (assets other than loans and credits)	1,813	38.5	0.08	0.10
Income from disposals (net)	1,581	37.0	0.07	0.09
Profit before tax	13,601	-16.4	0.94	0.77
Net income	11,090	-15.8	0.76	0.62
MEMORANDUM ITEM				
Income attributable to the controlling entity	10,038	-18.5	0.71	0.56

SOURCE: Banco de España.

This situation was reversed for Spanish banks in August and September…

Recourse to Eurosystem liquidity continued to represent a small percentage of the consolidated balance sheet of Spanish banks (2.5% in September 2010) and, in any event, the difficult situation in 2010 Q2 has eased significantly as funding markets have opened up again. Consequently, Spanish banks' use of Eurosystem liquidity has fallen in recent months (see Chart 2.5.C). Thus, Spanish banks' gross lending as a percentage of total Eurosystem lending fell to 21.2% on average in August (25.6% in terms of net lending) and to 19.1% on average in September (21.8% in terms of net lending). This gradual decline continued throughout September and reached 13.9% at the end of that month (18.9% in terms of net lending).

… as interbank funding began to be available again…

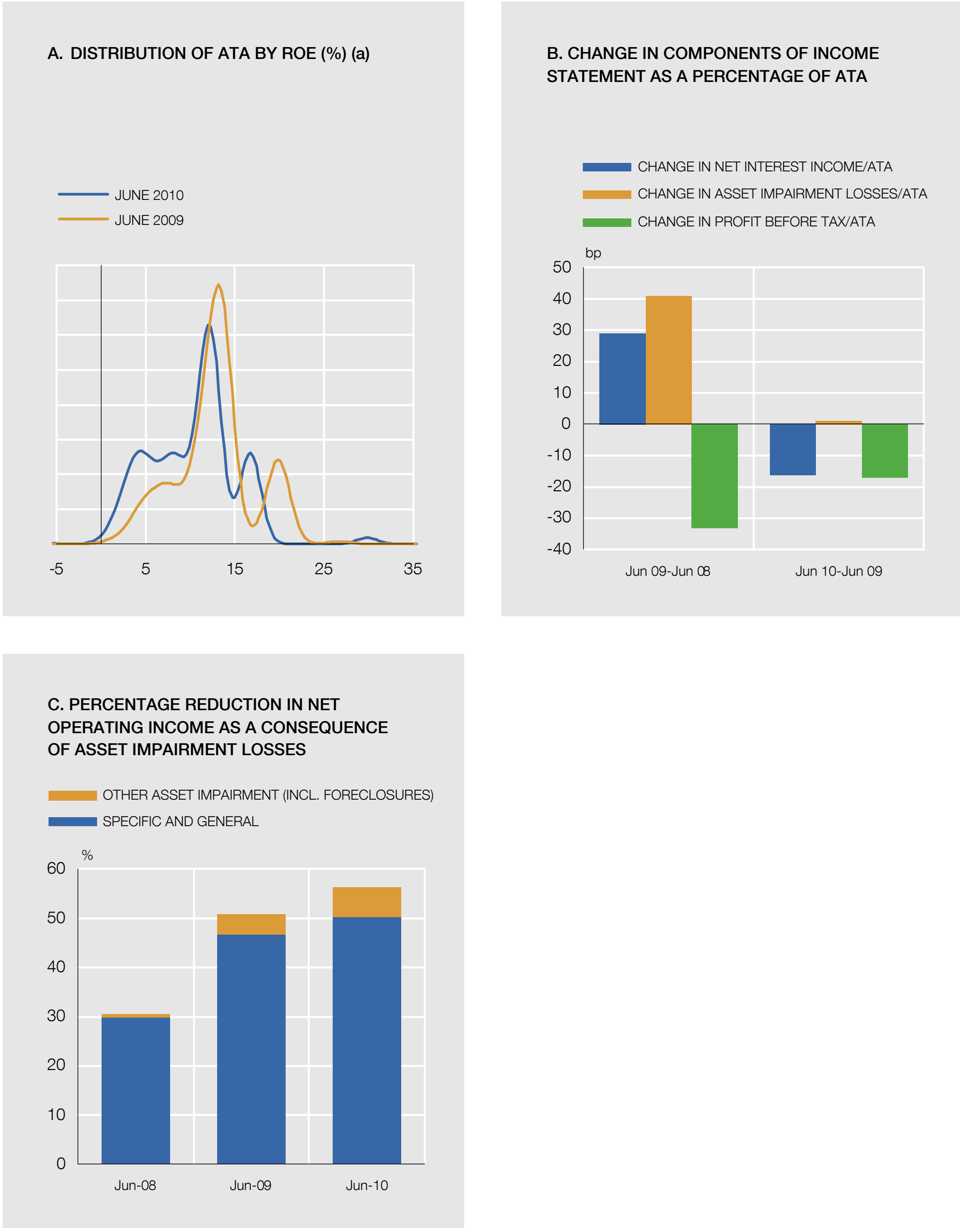
The improvement in funding markets is perceptible on the repo market, which began to open up again for banks. The main European clearing houses, by accepting Spanish government debt securities as eligible collateral in repo operations, have also contributed to this, since in this way the counterparty risk is eliminated through the interposition of the clearing house (see Box 2.4).

… and several Spanish banks accessed primary markets from end-July.

The primary markets have also opened up. Since end-July an improvement has been seen in the ability of Spanish banks to access these markets, not only the biggest banks but also some medium-sized commercial banks and savings banks. This occurred on the mortgage

RESULTS OF DEPOSIT INSTITUTIONS

CHART 2.7



SOURCE: Banco de España.

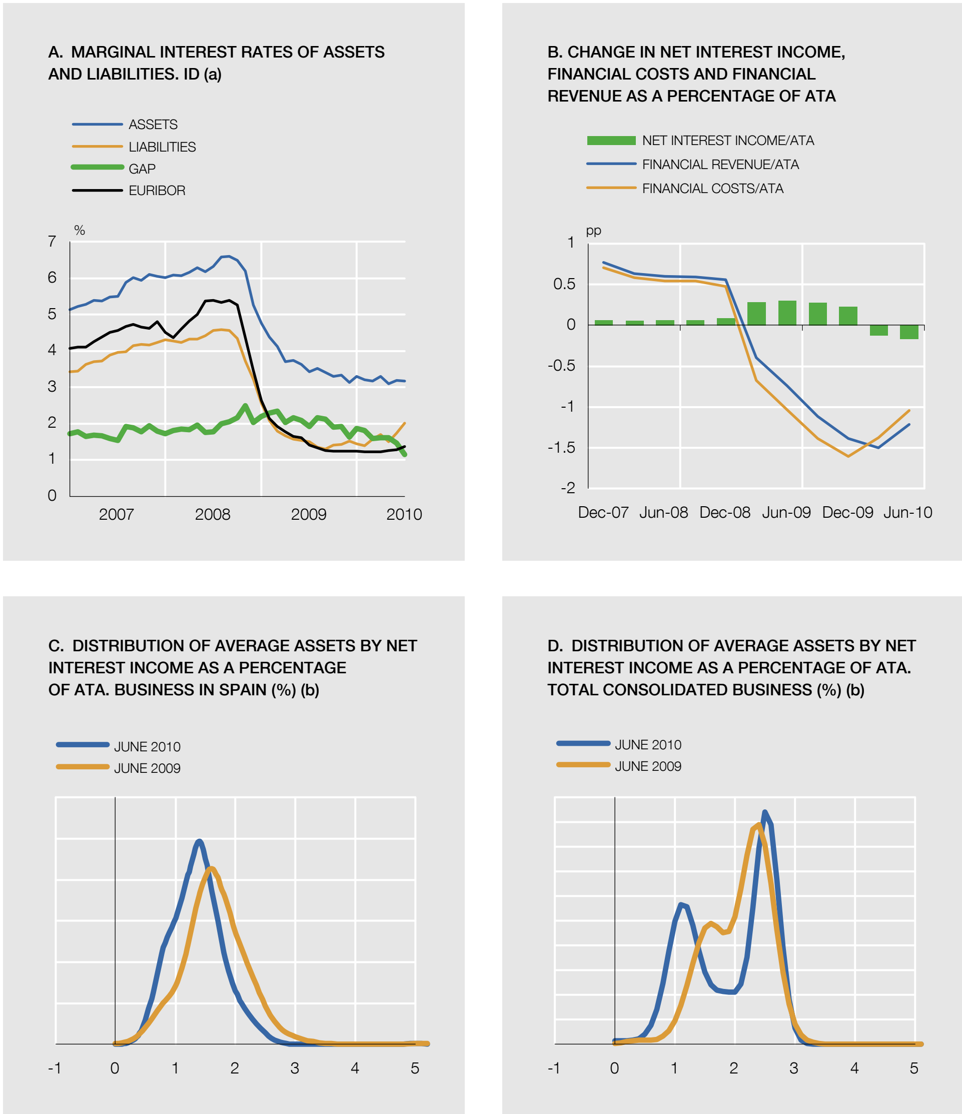
a. Non-parametric estimation of the density function, which provides a continuous and smoothed graphic representation of such function.

covered bond market, where since July several Spanish banks have issued an overall amount of around €12.5 billion, and on the bonds and notes market, where approximately €16 billion have been issued since the same date.

Issues in recent months, albeit different, have been placed with high spreads in relation to the usual spreads seen in the past. The relationship between the sovereign debt spread and the risk premium demanded by markets from banks' issues, implies that the former tends to act as a floor. For Spanish banks this means higher rates on their issues in comparison with those assumed by institutions in countries where sovereign spreads have remained more moderate, irrespective of the specific situation of each bank.

NET INTEREST INCOME
Deposit institutions

CHART 2.8



SOURCE: Banco de España.

a. The marginal interest rates are those established in transactions initiated or renewed during the month prior to that of reference, such transactions being weighted by their volume. The asset-weighted marginal rates include, inter alia, those applied to house and consumer finance and credit to non-financial corporations, while the liabilities ones include, inter alia, fixed-term deposits and repos.
b. Non-parametric estimation of the density function, which provides a continuous and smoothed graphic representation of such function.

The bulk of the maturities on medium and long-term debt is concentrated at the longer term.

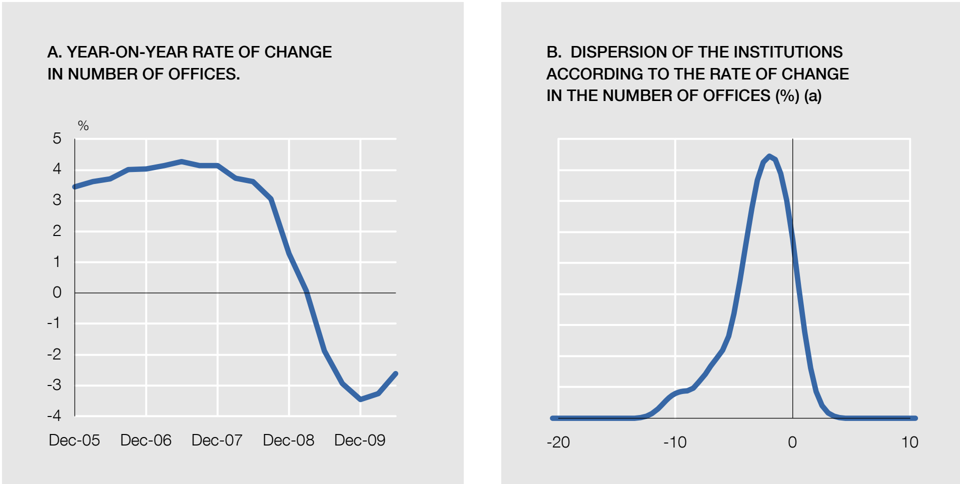
The bulk of the maturities on the outstanding amount of Spanish banks' medium and long-term debt is concentrated at the longer term (see Chart 2.5.D). This maturity structure mitigates the refinancing risk. This applies, even if asset securitisations are excluded. The securitised assets mature at very long term. Consequently, when they are excluded, as is the case in Chart 2.5.D, the maturities of the outstanding amount (excluding securitisations) tend to be concentrated, comparatively, at the shorter term. However, the reason for excluding the securitisations is that in the Spanish case there is no refinancing risk associated with them since the maturities of the liabilities are tied to those of the assets.

Banks must pay attention to refinancing by lengthening

Despite the positive signs of changes in the funding markets, the concentration of medium and long-term debt maturities at the longer term and the absence of refinancing risk

NUMBER OF OFFICES
Deposit Institutions. ID

CHART 2.9



SOURCE: Banco de España.

a. Non-parametric estimation of the density function, which provides a continuous and smoothed graphic representation of such function.

maturities as permitted by market conditions.

associated with assets securitised by Spanish banks, banks must pay attention to refinancing by lengthening maturities as permitted by market conditions.

Spanish institutions have continued to increase their retail deposit taking …

The international financial crisis has meant drastic changes on wholesale funding markets in relation to the situation prevailing in previous years. Spanish deposit institutions, which during the extended expansion process, like their European peers, obtained part of the funds necessary to sustain the rate of increase in activity on wholesale markets, are having to adapt to the new situation. This involves stepping up the amount of savings taken from households and non-financial corporations, with the result that the deposit-to-credit ratio has posted uninterrupted rises year-on-year since July 2008 (see Chart 2.6.A).

… albeit at lower rates than in previous months.

Since summer 2007 until end-2008, the banks have taken deposits at a high rate, posting year-on-year growth rates of approximately 10%. This sustained pace of growth in deposit-taking began to fall off from the beginning of 2009 (see Chart 2.6.B), partly because its rate of increase has been continuous and steep in recent years and partly due to the economic scenario facing Spanish firms and households.

2.1.2 PROFITABILITY

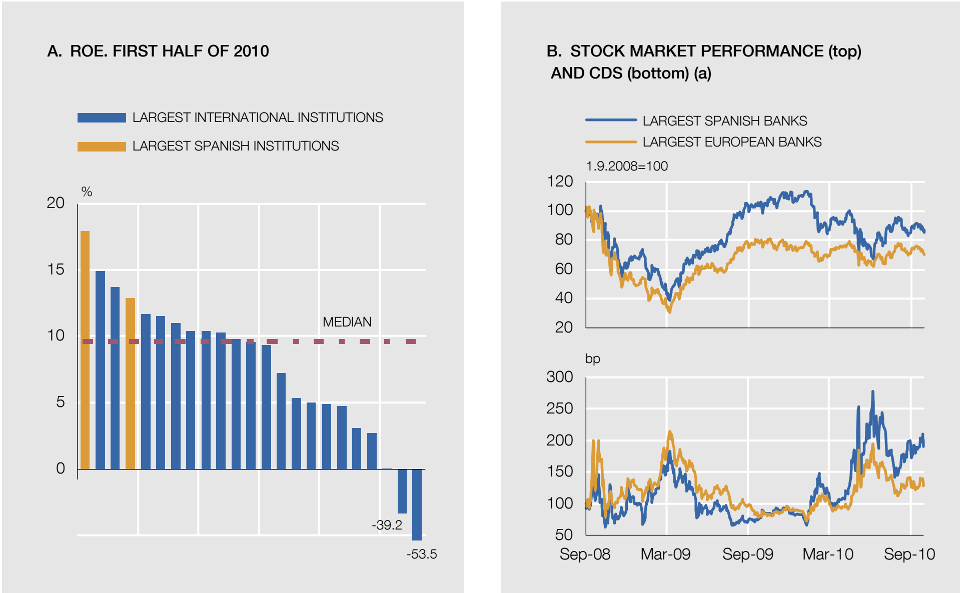
The consolidated profit of Spanish deposit institutions fell in 2010 H1 in year-on-year terms by 18.5%.

The **group net income** of Spanish deposit institutions fell by 18.5% to June 2010 in relation to the same period in 2009 (see Table 2.2). The decline in income implies a fall of 15 bp in ROA from 0.71% to 0.56% in June 2010 (17 bp, if it is calculated with profit before tax, down from 0.94% to 0.77% in June 2010). For its part, ROE has also come under downward pressure, decreasing from 12.2% in June 2009 to 9.4% in June 2010. ROE has fallen across the board for the banks, although there are differences between them in terms of the level of ROE and the sharpness of its decline (see Chart 2.7.A).

Coverage requirements, in terms of average assets, including those arising from foreclosures, although they have remained stable, continue to be high. Net interest income, also in terms of average assets, fell between June 2009 and June 2010 (see Chart 2.7.B).

INTERNATIONAL COMPARISION AND MARKET INDICATORS

CHART 2.10



SOURCES: Datastream, information published by institutions and Banco de España.

a. Latest data corresponds to 5 October 2010.

Impairment losses continue to put pressure on income statements.

Impairment losses, which include specific and general provisioning requirements, have posted a year-on-year rate of change of 0.4% in June 2010 (83.3% in June 2009), as a result of the lower pace of increase in doubtful assets. Impairment losses on assets other than loans and receivables, that reflect the provisions associated with repossessions, grew by 38.5%, which was also a less steep rate of increase than in previous quarters. Total provisions in June 2010 as a percentage of average assets (0.96%) remained at the levels recorded in the same period in 2009 (0.96%). Likewise, they subtracted a similar percentage from net income as in June 2009 (see Chart 2.7.C). Nevertheless their weight remained high and will continue to put downward pressure on income statements in the coming months.

Net interest income fell in the first half of 2010 in relation to the same period in 2009.

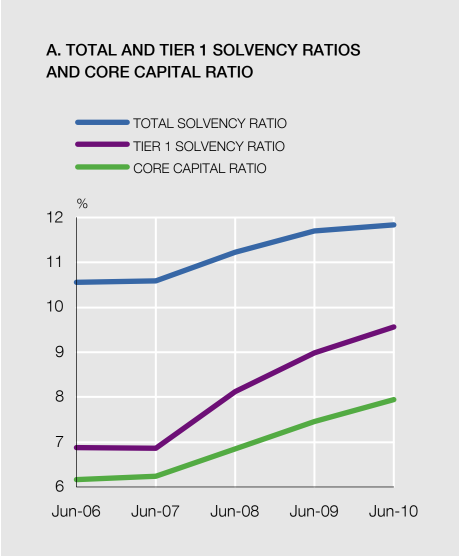
Net interest income fell 17 bp in terms of average assets in June 2010 compared with an increase of 29 bp in June 2009 (see Chart 2.7.B). The narrowing of this margin is explained by several factors. On the one hand, it is accounted for by the increase in the cost of new time deposits (see Chart 2.8.A) in a more competitive environment. On the other, it is due to the changes in activity, to the repricing of loans at lower interest rates and to doubtful assets which do not accrue income. The foregoing is reflected in a sharper drop in average financial revenue than in average financial costs which implies that net interest income fell in the first two quarters of 2010 (see Chart 2.8.B). Net interest income, as a percentage of average assets fell across the board for banks' business in Spain (see Chart 2.8.C) but this was not the case for the consolidated business which includes the activity of subsidiaries abroad. Banks with a larger international presence slightly increased their net interest income (see Chart 2.8.D). In Spain the activity of the largest international groups, which is undertaken through subsidiaries and is based on traditional retail banking, has benefited from the geographical diversification of risk.

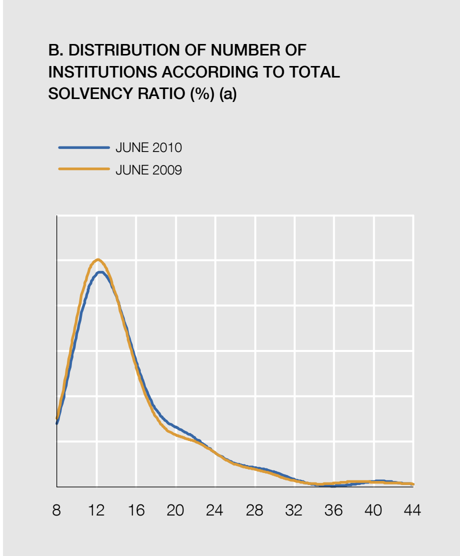
Banks have begun to contain operating costs, albeit to a different degree. The efforts in this area

Under these circumstances banks will have to find ways to strengthen income generation and to step up their efforts to contain costs. These efforts have already been seen in recent quarters. Operating expenses grew 3.5% in June 2010, a lower year-on-year growth rate than that posted a year earlier (9.4%). The rate of increase of operating expenses of the

SOLVENCY
Deposit institutions

CHART 2.11





SOURCE: Banco de España.

a. Non-parametric estimation of the density function, which provides a continuous and smoothed graphic representation of such function.

should be stepped up to cushion the impact of negative factors on the income statement.

business in Spain is more modest and stood at 0.1% in year-on-year terms in June 2010 compared with 1% in June 2009. Spanish banks have gradually been reducing the number of their offices since mid-2009 (see Chart 2.9.A). This trend, however, is not even across banks, not only because their rates of office closure differ, but because not all of them have the same needs to reabsorb excess capacity (see Chart 2.9.B). In any event, containing operating costs, in particular for banks showing greater weakness, involves adapting the sector's capacity to the new financial situation prevailing in Spain and internationally. It is necessary to reduce operating costs because income statements will continue to come under downward pressure as a result of provisioning requirements associated with doubtful assets and repossessions and due to the narrowing of the net interest margin.

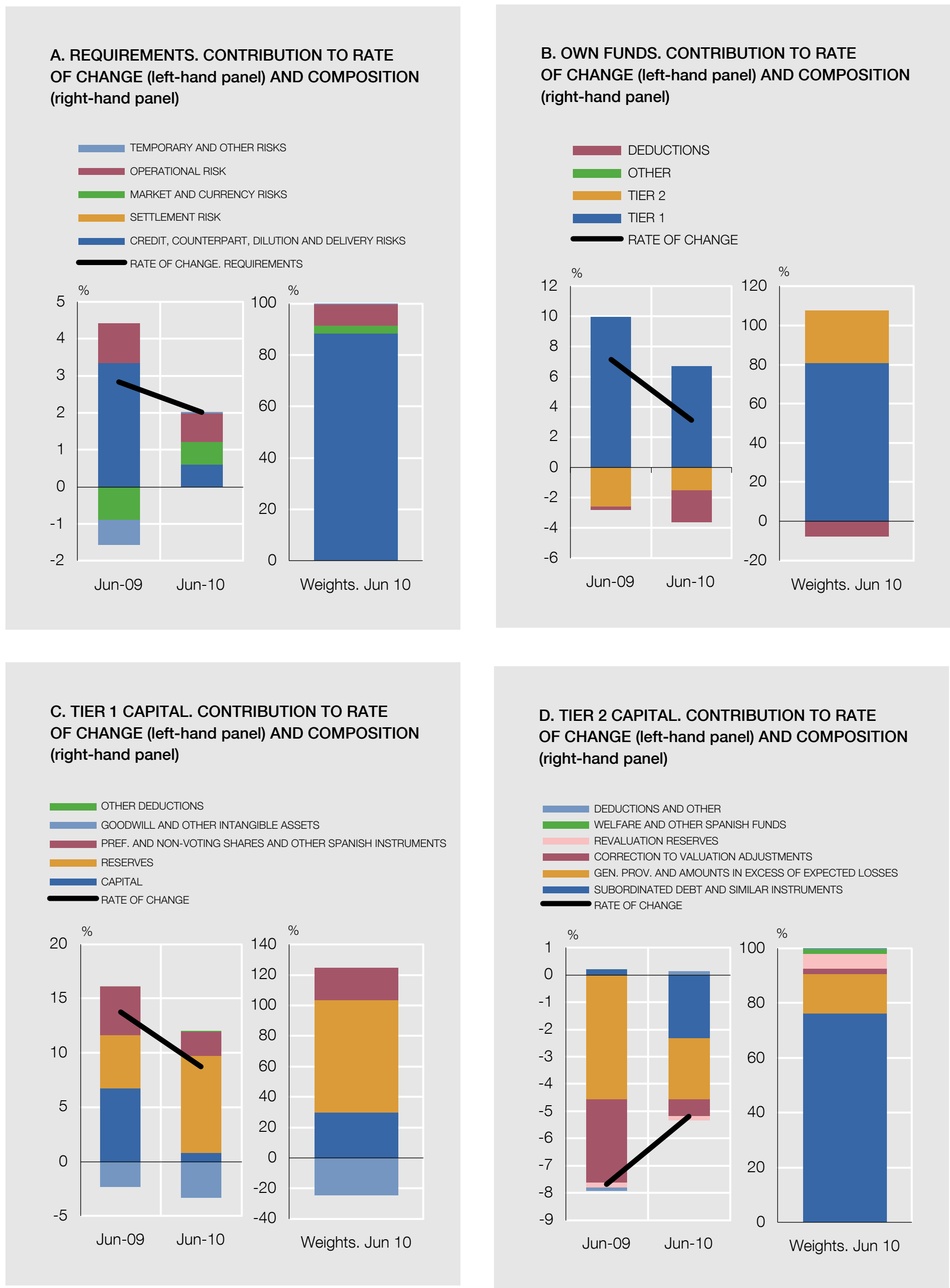
The strategy to raise retail deposits should be accompanied by a bolstering of the cost-cutting policy and by increased efficiency, along with active bank balance sheet management.

The rise in the cost of wholesale funding associated with the tensions on sovereign debt markets has stepped up Spanish institutions' interest in raising new retail deposits. While the greater cost of wholesale funding persists for Spanish institutions, financing costs will be pressured upwards, in particular owing to the effects of the retail deposit-raising strategies pursued in Spain by banks. This pressure will feed through to each bank's margins and to the banking system as a whole. Accordingly, banks pursuing these strategies should assess, on the basis of their strengths and their profitability, the challenges ahead for them.

To mitigate this pressure, banks should undertake different measures aimed at compensating for their forgone profitability (passing on the increase in financing costs and risk premia borne, offloading unprofitable assets, improving the quality and quantity of services provided to customers, etc.), improving their operational efficiency (reducing and optimising unit operating costs) and enhancing the credit quality of their portfolios (making for lesser future write-down requirements).

CAPITAL REQUIREMENTS AND OWN FUNDS
Deposit institutions

CHART 2.12



SOURCE: Banco de España.

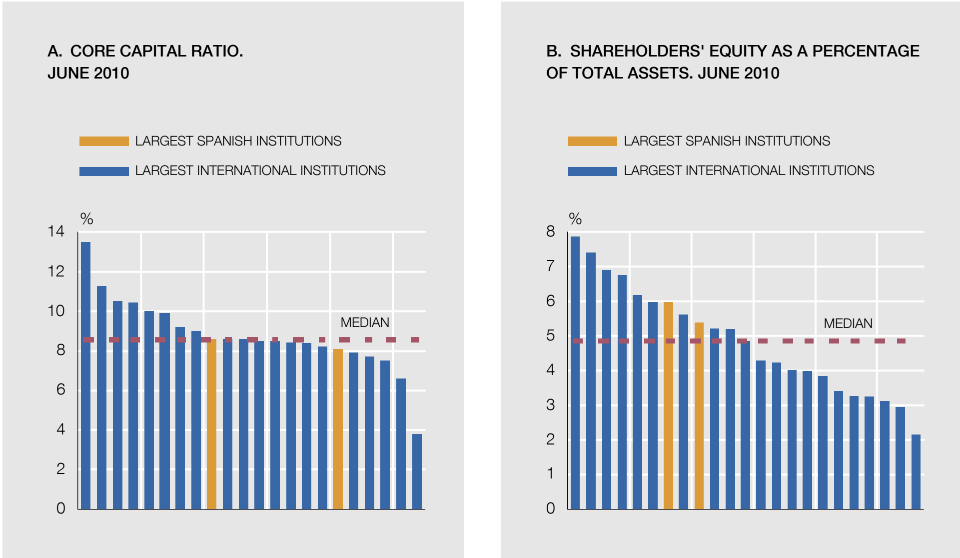
Nonetheless, in the case of institutions that have received public funds from the FROB, particular prudence will be called for when pursuing retail deposit-raising strategies precisely because of the public support received, and it will be necessary to speed through their integration and restructuring plans.

In comparison with their European peers, the largest Spanish banks posted favourable earnings in 2010 H1.

A comparison between the earnings of the largest Spanish banks in the first half of 2010 and those of their **European competitors** shows that, as in recent years, the former were more profitable (see Chart 2.10.A). Despite the relatively favourable position of Spanish banks with respect to their European competitors in terms of profitability, market indicators show that 2010 is proving to be difficult (see Chart 2.10.B). However, it should also be taken into account that while in 2008 and

INTERNATIONAL COMPARISON OF SOLVENCY

CHART 2.13



SOURCES: Company reports and Banco de España.

2009 the stock market performance of the largest European banks was very poor, that of the Spanish banks was even more favourable following the intensification of the financial crisis in September 2008. The CDS spreads of Spanish banks have fallen, although they are still higher than those of their European counterparts (see Chart 2.10.B).

2.1.3 SOLVENCY

Spanish banks have strengthened their solvency ratios, in particular those reflecting higher quality capital.

Spanish deposit institutions have again, on the whole, shown robust **solvency** ratios in June 2010. The overall solvency ratio reached 11.8%, up 10 bp from mid-2009, while the tier 1 ratio reached 9.6%, up 60 bp from a year earlier (see Chart 2.11.A). At the same time, the core capital ratio (capital and reserves, net of goodwill, as a proportion of capital requirements) also increased by 50 bp, rising from 7.5% to 8% over the last twelve months. The disaggregated analysis shows that the increase in solvency also occurred in a number of institutions (see Chart 2.11.B).

This strength in the solvency ratios puts Spanish banks in a favourable position to meet the stricter requirements of Basel III (see Chapter 3), especially taking into account that the increase in solvency in June is explained by the fact that the rise in risk-weighted assets was more than offset by the strengthening of own funds, especially top quality own funds.

Risk weighted assets grew in June 2010...

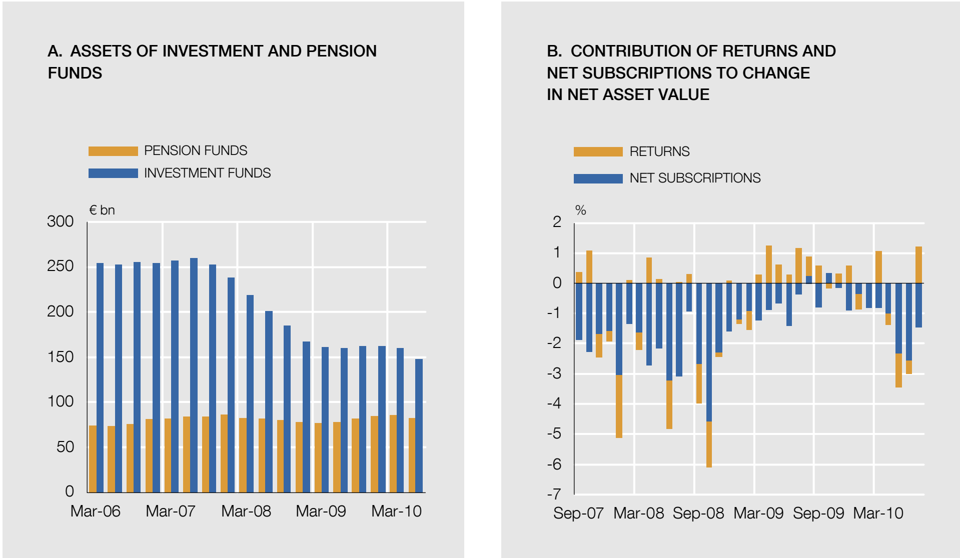
The growth rate of risk-weighted assets, the denominator of the solvency ratio, slowed by 82 bp to 2% in June 2010, against a background of lending restraint (see Chart 2.12.A). Credit risk requirements, those with by far the greatest weight, remained practically unchanged from the previous year, with growth of 0.7%, while the other requirements recorded stronger growth rates. Depending on whether institutions used the standardised or IRB approach in their calculations credit risk performed differently. Thus, while the requirements obtained from using the standardised approach, whose weight in total requirements was 63% in June 2010, decreased 1.4%, the risk requirements under the IRB method increased by 4.3%.

… but own funds, especially reserves, grew more strongly.

Total own funds grew at a year-on-year rate of 3.1% in June 2010. This was attributable to the growth of tier 1 capital (8.7% in June 2010), and in particular retained earnings, which offset the increase in deductions and the decline in tier 2 capital (see Chart 2.12.B). The

INVESTMENT AND PENSION FUNDS

CHART 2.14



SOURCES: INVERCO and Banco de España.

growth of tier 1 capital, in spite of the slowdown in eligible capital (to 2.6%, from 23.2% in June 2009), is explained by the favourable behaviour of reserves, which grew by 12.5% (twice the rate a year earlier), and, to a lesser extent, issuance of preference shares (which grew by 5%); (see Chart 2.12.C). The decline in tier 2 capital moderated as a consequence of a smaller fall in general provisions and corrections to valuation adjustments (see Chart 2.12.D).

The capital ratios of the largest Spanish banks stand at the average of those of their European competitors.

The largest Spanish banks have capital ratios that are around the median of those of their **European competitors** (see Chart 2.13.A). In terms of leverage – understood as the banks' accounting own funds as a proportion of their total assets – Spanish institutions are in a favourable position relative to the largest European institutions (see Chart 2.13.B).

2.2 Insurance companies, investment funds and pension funds

The European insurance sector is currently subject to similar pressures to those mentioned in the last FSR, which have actually been present since 2008. First, the difficulties associated with financial market developments remain. Second, the real economy is still showing signs of weakness, which is having a negative impact on insurance companies, especially in certain segments.

The insurance sector faces financial risks and the consequences of the current economic situation.

In Spain, the sector is also affected by financial risks, although to a lesser extent, as already argued in previous FSRs (owing to the low weight of equity holdings and real estate exposure), and by the adverse economic situation. The information available on the second quarter of 2010[2] indicates that, in the sector as a whole, premiums grew at a negative year-on-year rate of 5.2%, as against a negative rate of 3.7% in the previous quarter. In the life segment premiums fell by 10%, although managed savings grew by 2.9%. The non-life segment, which has recorded negative year-on-year growth rates in recent quarters, grew by -1% in the second quarter. In the case of non-life premiums, 36% are attributable to the automobile segment, which continued to record negative growth in the three months to June 2010 (-1%). Multirisk business, associated with mortgage loans and health, which in total represents 20% of premium volume, recorded positive growth (of 2% and 4.2%, respectively), while the other non-life segments declined at a year-on-year rate of 7.1%.

2. ICEA data.

The assets of investment funds were again under pressure, especially owing to the net withdrawal of funds.

Following a relatively favourable performance in the second half of 2009, the international financial markets experienced significant strains in 2010, especially in the second quarter. This had an impact on the assets of investment funds, not only due to pressures on returns, but also, and fundamentally, because net subscriptions declined again. Apart from financial market developments, in a setting that is still complicated by bouts of stress that may dissuade investors owing to a higher perception of risk, investment funds will face greater competition from the banks for the savings of households and firms (see Charts 2.14.A and 2.14.B).

3 Other issues

Progress in international financial regulation is proving intense. Notable headway has been made by the Basel Banking Supervision Committee, which has agreed to what has become known as **Basel III**. The first part of this chapter focuses on this. The second part addresses the reform of the legal regime for savings banks, an enormously important development.

The calibration of the Basel III capital proposals and the timetable for implementation of the attendant measures, which in some instances have been amended since July, were agreed on 12 September.

The BIS Governors and Heads of Supervision (GHoS), the body to which the Basel Committee reports, agreed on 12 July 2010 on the general design of the reform of the capital and liquidity regulations (**Basel III**). The key features of the reform are the definition of capital, the treatment of counterparty risk and the inclusion of a leverage ratio and a liquidity standard (the definition of the capital buffers will be finalised at the end of the year). On 12 September, GHoS agreed on the capital proposals and on the timetable for the implementation of the new measures.

Regarding the definition of capital, it was decided that minority interests in bank subsidiaries could be partly included in common equity (capital plus reserves less deductions). In the case of deferred tax assets from timing differences and of significant investments in unconsolidated financial institutions, it was proposed that, contrary to their full deduction from common equity as set out in the December document, an allowance subject to an individual and aggregate limit be set so that only the amount in excess of this allowance were deducted. The individual limit is set at 10% of common equity, and the aggregate limit at 15%.

As to the measurement of counterparty credit risk, the July resolution amends the consultative document, reducing the calibration and making the simple method proposed to calculate capital requirements to cover the so-called credit valuation adjustment more risk-sensitive. Elsewhere, the proposal to increase capital requirements for credit risk to interbank exposures to large entities, defined as those with total assets exceeding $100 billion ($25 billion in the previous proposal), has been maintained.

The Committee agreed on the design and calibration for the leverage ratio, which will serve as the basis for testing during the trial period. Final design and calibration have been postponed until 2017, once the functioning of this ratio and its interaction with the risk-based requirement has been analysed. The ratio has been designed with a view to becoming a requirement under Pillar 1 in January 2018, once it has been duly revised and calibrated. To conduct this analysis, there was agreement on a definition of the ratio using Tier 1 capital as a numerator (although the impact of using total regulatory capital and common equity will also be analysed) and, as a denominator, an exposure value that softens the treatment proposed in the consultative document for certain items and accepts Basel II netting for derivatives and repos. The proposed calibration during the trial period is 3%.

Turning to the measures set out in the December consultative document to lessen procyclicality, the Committee has maintained the design of the capital conservation buffer and has issued for consultation a countercyclical buffer proposal, whose final design will be published at the end of the year following the public consultation stage. The Committee is likewise analysing measures to reduce the excessive cyclicality of the minimum capital requirements and is in discussions with accounting standard-setters concerning the best means of including accounting provisions based on expected losses in the regulations; at the same time, the Committee continues to study the specific treatment that should be given to systemic banks.

GHoS also agreed on amendments to the December 2009 document on liquidity standards. In the case of the short-term ratio, whose aim is to cover foreseeable fund outflows over a stressed one-month period, the stress scenario has been eased and the definition of liquid assets broadened. Regarding the structural ratio, work has not yet finished. The Committee is expected to have a revised ratio ready by December 2010. As with the leverage ratio, the effects of the ratio be assessed over an observation period, its design will be revised and it will be set as a minimum standard in January 2018.

Minimum requirements of 4.5%, 6% and 8% have been set for common equity, tier 1 capital and total capital, respectively, along with a conservation buffet at 2.5% of common equity.

At its September meeting, GHoS agreed on the calibration of the new measures. The minimum common equity requirement was set at 4.5%, that for tier 1 capital at 6% and that for total regulatory capital at 8%. The calibration for the capital conservation buffer was also established, at 2.5% of common equity. The capital buffer is designed for use in periods of stress, so that banks may absorb the losses incurred and remain above the minimum requirements. While the capital conservation buffer is not fully covered, banks will have restrictions on profit distribution (whether by dividend distribution or variable remuneration to their employees), which will be all the greater the smaller the buffer they have set up.

Calibration of the countercyclical buffer, which is only applicable at times of excessively expanding credit, has set its maximum at 2.5%. The type of capital needed to cover this buffer has not yet been defined.

The entry into force of the measures will be gradual.

The new package of capital and liquidity measures will come into force on 1 January 2013, but a timetable has been set for their gradual implementation which, in the case of the capital measures, should be fully in place by 1 January 2019. The short-term liquidity ratio will be introduced on 1 January 2015, and the structural liquidity ratio on 1 January 2018.

The new savings bank legislation provides for …

The main points of the recent reform of the **legal regime governing savings banks**, approved pursuant to Royal Decree-Law 11/2010 of 9 July 2010 on governing bodies and other aspects of the legal regime for savings banks, are as follows:[1]

- To provide for their access to capital markets, so they may issue core capital instruments.
- To contribute to making their management and governing bodies more professional.
- To subject savings banks to effective market discipline.

The new regulations seek to resolve the shortcomings in the capitalisation alternatives open to savings banks in two ways: though the creation of equity units with voting rights and by paving the way for new models through which to pursue their business. That will enable them to better face the greater solvency requirements arising from Basel III.

…the issuance of equity units with voting rights …

By being able to issue equity units with voting rights, savings banks can readily opt to continue pursuing their business in the traditional manner and raise top-quality capital on the market. The main changes in their legal regime are:

1. Errata (Official State Gazette of 17 July 2010). Validated by Parliament through the Resolution dated 21 July 2010. The Upper House has formulated a series of amendments that could change the text currently in force.

- For the first time, equity units allow their holders to participate in the governing bodies of the issuing institution, in proportion to their share in the total net worth. The ceiling on the volume of equity units in circulation is maintained (it may not exceed 50% of the saving bank's equity), but the limit on the holding of equity units by a holder (5% of the units in circulation to date) is eliminated. The regime governing significant holdings in credit institutions[2] will be applicable to the equity units.
- The principle of freedom of issuance is applicable, but not the regime governing takeover bids.

… the pursuit of activity through new business models …

The text paves the way for savings banks to pursue their activity using new models, thereby responding to the initiatives of those institutions with a business outlook that extends beyond their traditional markets and businesses. There are three alternatives here:

- Integration into an Institutional Protection System (IPS). The reform does not create the model, but rather reinforces it by attributing to the Banco de España the competence to assess, prior to a savings bank exiting the system, the viability of the bank and that of the other participants following the rupture. Further, in IPSs involving savings banks, the central institution will be a public limited company in which they have at least a 50% share.
- To assign all financial business to a commercial bank controlled by the savings bank, holding at least 50% of its capital, and retaining savings bank status. In the event of a loss of control, the following alternative shall be used.
- Conversion into a foundation that segregates financial activities from social and welfare-related activities, thereby assigning its business as a credit institution to a commercial bank in which it has a holding.

… and management improvements.

Participation by new interest groups in governance structures will pave the way for the use of more professional and independent management criteria. Further, it will reduce the maximum weight of public-sector powers in the governing bodies from 50% at present to a maximum of 40% of total votes; positions as elected politicians and senior public-sector officials will be incompatible with membership of savings banks' governing bodies; greater professionalism and experience will be required of the members of governing bodies; higher majorities will be set for the adoption of fundamental resolutions, and all savings banks shall be obliged to publish annually a corporate governance report, a demand hitherto only made of those that had issued tradeable securities on official markets.

Further to all these changes, savings banks will be more subject to market discipline.

All these reforms entail subjecting these institutions to greater market discipline, in respect in any event of their social role and function. The actual exercise of market discipline will contribute to enhancing the soundness and solvency of the savings bank sector, and therefore of the entire Spanish banking system. This will improve the outlook for and competitive position of savings banks, providing for the flow of credit towards the productive economy.

2. Title VI of Law 26/1988 of 29 July 1988 on the Discipline and Intervention of Credit Institutions.

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