

Frequently asked questions on the ESM financial assistance programme for Spain and the country's successful exit

➤ 1 – Why did Spain need financial assistance?

The disproportionate growth in the real estate sector, along with the expansion of credit needed to finance it, was the main reason behind Spain's economic imbalances. In the real estate sector, a spiral of growth in demand, prices and supply fuelled a major bubble, which burst when the impact of the international financial crisis was felt in Spain. The massive scale of loans granted to construction and property development activities caused an excessive exposure of the banking industry to those sectors. In particular, Spain's savings banks (*Cajas de Ahorros*), whose weight in the sector was close to 50%, were affected by solvency problems.

A restructuring process was started by the Spanish authorities in 2010. However, the economic downturn turned out deeper and more protracted than expected. The funding costs for Spain as well as Spanish banks significantly increased. These tightening market conditions raised widespread concern that private and public resources would be insufficient to support the banking system with capital.

➤ 2 – How much was the financial assistance for Spain?

On 25 June 2012, the Spanish government made an official request for financial assistance for its banking system to the Eurogroup for a loan of up to €100 billion. The results of a diagnostic exercise, commissioned by the Spanish authorities to external evaluators, indicated that the additional capitalisation needs of the Spanish banking sector as a whole could be estimated in the range of €51-62 billion. Including a safety margin, it was assessed that these capital needs would remain within the envelope approved by the Eurogroup of up to €100 billion.¹

On 3 December 2012 the Spanish government formally requested the disbursement of €39.47 billion for the recapitalisation of the banking sector. The funds were transferred in the form of ESM notes on 11 December 2012 to the Fondo de Reestructuración Ordenada Bancaria (FROB), the bank recapitalisation fund of the Spanish government. The FROB used these notes for the recapitalisation, in an amount close to €37 billion, of the following banks: BFA-Bankia, Catalunya-Caixa, NCG Banco and Banco de Valencia. Additionally the FROB was to provide up to €2.5 billion to SAREB, the asset management company for assets arising from bank restructuring.

On 28 January 2013, the Spanish government formally requested the disbursement of €1.86 billion for the recapitalisation of the following banks: Banco Mare Nostrum, Banco Ceiss, Caja 3 and Liberbank. The funds were transferred to the FROB in the form of ESM notes on 5 February 2013.

No further requests for disbursement were made, thus the overall amount of financial assistance provided by the ESM to Spain was €41.33 billion.

➤ 3 – Who determined which financial institutions would receive funds?

This was decided by the Bank of Spain in agreement with the European Commission in liaison with the

¹ For the Eurogroup statement following Spain's intention to seek financial assistance on 9 June, <http://estaticos.elmundo.es/documentos/2012/06/09/eurogrupo.pdf>

ECB, EBA and the IMF, and following a stress test of all banking groups.

➤ 4 – Did the ESM provide loans directly to Spanish financial institutions?

No. The FROB, acting as agent of the Spanish government, eventually received the funds and channelled them to the financial institutions concerned. This is a loan to the sovereign and the Spanish government remains responsible for its repayment.

➤ 5 – What is the status of ESM financial assistance for Spain?

As the financial assistance for Spain was originally to be provided by the EFSF, the Eurogroup decided that the ESM assistance programme would maintain the status of EFSF loans (i.e. parri passu) rather than follow the preferred creditor status of ESM loans.² This was reaffirmed by the euro area summit of 29 June 2012.³

➤ 6 – How were the funds raised?

For the initial disbursement of €39.47 billion, the ESM launched and priced two bills and three floating rate notes for the financial assistance to be provided for the Spanish banking sector via FROB. For the second tranche of assistance, amounting to €1.86 billion, the ESM launched and priced a floating rate note.⁴

➤ 7 – When will Spain have to repay the loans?

Spain will repay the loan principal starting in from 2022, and the repayment is scheduled to end in 2027. The average maturity of the loan tranches is 12.5 years. The payment of annual fees and interest, in line with the ESM Pricing Policy, has already started.⁵

➤ 8 – What were the conditions attached to the financial assistance?

The bank-specific conditionality comprised three key elements. First, identifying individual bank capital needs through an asset quality review of the banking sector and a bank-by-bank stress test. Second, recapitalising and restructuring weak banks based on plans to address any capital shortfalls identified in the stress test. Finally, problematic assets in those banks receiving public support (without any credible plans to address their capital shortfalls by private means) were to be segregated and transferred to an external asset management company (Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria – SAREB).

In addition, so-called ‘horizontal conditionality’ was also applied in order to strengthen the banking sector as a whole. This included regulatory capital targets, bank governance rules, an upgrade of reporting requirements and improved supervisory procedures.

➤ 9 – What were the conditions for the Commission to approve state aid for banks?

The approval process is linked to the existence of a credible restructuring plan, which demonstrates in

² http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/131309.pdf

³ http://consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf

⁴ For more information on the notes issued by the ESM, please consult the ESM press release: <http://www.esm.europa.eu/pdf/ESM%20press%20release%20ESM%20issues%20bonds%20for%20the%20reca%20of%20Spanish%20banks%2004122012.pdf>

⁵ <http://www.esm.europa.eu/pdf/Pricing%20guideline.pdf>

a convincing manner how the bank will return to viability without needing further state aid. The plan has to show as well how the bank minimises the cost for the taxpayer and measures for mitigating competition concerns. Such a plan was submitted in the form of a legal commitment by Spain. In that context, the Commission has provided detailed guidance regarding the pricing of State guarantees, recapitalisations and asset relief measures respectively in the Banking Communication, the Recapitalisation Communication and the Impaired Assets Communication as well in the Communication of 1 December 2011.⁶

The restructuring plans were submitted for Commission approval as foreseen by the Memorandum of Understanding (MoU), agreed between Spain and the Eurogroup in July 2012.

On 28 November 2012 the European Commission concluded⁷ that the restructuring plans of the four Spanish banks BFA/Bankia, NCG Banco, Catalunya Banc and Banco de Valencia were in line with EU state aid rules. A similar decision concerning the four other banks receiving support (Banco Mare Nostrum, Banco Ceiss, Caja 3 and Liberbank) was taken by the Commission on 20 December 2012.⁸

➤ 10 – Was the IMF involved in the financial assistance for Spain?

Yes, though only in an advisory and monitoring capacity. The IMF did not make a financial contribution because it does not have a sectoral financial assistance tool matching the one provided by the ESM.

➤ 11 – Has ESM financial assistance helped Spain to restructure its banking sector?

Yes. ESM assistance was key in cleaning the balance sheets of troubled banks, improving their capital base and overcoming market fears about the depth of the problems in Spain's financial sector.

According to a statement published following the conclusion of the 5th quarterly review of the ESM programme in December 2013,⁹ the process of restructuring of banks having received state aid is well underway, guided by the restructuring plans as adopted by the European Commission. Compliance with the horizontal policy requirements in the MoU is nearly complete, which translates into higher resilience of the banking sector going forward.

Moreover, the efforts undertaken by the Spanish authorities have been acknowledged by financial markets. The yield on Spain's 10-year bonds has fallen considerably (from 7.5% in July 2012 to 3.9% in November 2013), which has allowed the Spanish government to obtain long-term financing.

➤ 12 – Will the Spanish economy be subject to surveillance now that the ESM financial assistance programme expired?

The ESM Treaty requires the ESM to establish an early warning system to ensure that beneficiary countries are capable of repaying their obligations. Therefore, the ESM will continue to monitor developments in the Spanish economy until full repayment of the outstanding ESM loans. The "Two-Pack" regulation established moreover the post-programme surveillance procedure, according to which the European Commission in liaison with the ECB will monitor the country. The post-programme surveillance does not entail any new policy conditionality beyond reforms requested under the European

⁶ For further information, please consult the respective Communications at the website of the European Commission's Directorate General for Competition:

http://ec.europa.eu/competition/state_aid/legislation/temporary.html

⁷ http://europa.eu/rapid/press-release_IP-12-1277_en.htm

⁸ http://europa.eu/rapid/press-release_IP-12-1432_en.htm

⁹ http://europa.eu/rapid/press-release_MEMO-13-1153_en.htm

governance framework.