Spain Coaxes Banks to Merge to Purge Losses

By Charles Penty and Emma Ross-Thomas - Feb 3, 2012 11:12 AM GMT+0100

Spain's new government gave banks an extra year to recognize losses if they agree to merge, as it tries to overhaul the financial industry crippled by the collapse of the nation's property boom four years ago.

Economy Minister Luis de Guindos said late yesterday that banks have a year to make 50 billion euros ($66 billion) of provisions against real-estate assets. If they agree by the end of May to merge, they get a further 12 months to take the charges and can tap the state's bank-bailout facility for funds.

Prime Minister Mariano Rajoy, in power since December, is trying to restore the flow of credit to Spain's shrinking economy and improve confidence in lenders saddled with 175 billion euros of troubled real-estate assets. The government wants to remove doubts about the way assets are valued to enhance banks' access to financing while shrinking the oversized industry.

"By improving the transparency and the perception of strength of Spanish banks, they will be able to finance themselves better, and that is going to allow them to make loans," de Guindos said in Madrid.

Troubled Assets

The government will make banks increase the ratio of provisions set aside for land to 80 percent from 31 percent, de Guindos said. For unfinished developments, the provisioning level will rise to 65 percent from 27 percent and to 35 percent for assets including finished developments and houses.

Banco Santander (SAN) SA, Spain's biggest bank, may have to provision an additional 2.7 billion euros to meet the new rules, Nomura International Plc said in a report today. Banco Bilbao Vizcaya Argentaria SA (BBVA) may need to set aside another 2.6 billion euros and the figure for Bankia SA (BKIA), formed from the merger of seven savings banks, may amount to 5.3 billion euros, Nomura said. Bankia is about half the size of BBVA by assets and a quarter the size of Santander. Santander and BBVA haven't said how the measures will affect them, and Bankia said yesterday it

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Cars sit parked outside apartments at the Polaris World Mar Menor Golf Resort in Torre Pacheco, Spain. Photographer: Xabier Mikel Laburu/Bloomberg

Feb. 3 (Bloomberg) -- Spain's new government gave banks an extra year to recognize losses if they agree to merge, as it tries to overhaul the financial industry crippled by the collapse of the nation's property boom four years ago. David Tweed reports on Bloomberg Television's "Countdown." (Source: Bloomberg)

Enlarge image

Mariano Rajoy, Spain's Prime Minister, is trying to restore the flow of credit to Spain's shrinking economy and improve confidence in lenders saddled with 175 billion euros of troubled real-estate assets. Photographer: Jock Fistick/Bloomberg

would meet the new rules without public help.

"The banks are going to argue that they don't have enough time but the government is right to force them because there are some zombies out there," Inigo Lecubarri, who helps manage about $300 million at Abaco Financials Fund in London, said in a phone interview. "There's no question that this is going to be burdensome for the banks but frankly they've had plenty of time already and we need to get some action here."

Buffers

The 50 billion euros total figure includes 25 billion euros of provisions to be taken against earnings. Banks that merge can take the charges against capital instead of profits.

Another 15 billion-euro capital "buffer" will be built for land and unfinished developments. The remaining 10 billion euros will come from a 7 percent provision against healthy developer loans, charged against earnings.

De Guindos said the plan won't affect the budget deficit, which the government is trying to narrow with measures including wage freezes and tax hikes. Still, the Treasury will sell debt to increase the equity of the bank-bailout fund, known as the FROB, to 15 billion euros from 9 billion euros.

Banks that agree to merge will be able to sell contingent convertible bonds to the FROB, de Guindos said. The bonds, known as CoCos, convert into equity if capital ratios fall below a certain level. The FROB has the capacity to borrow as much as 90 billion euros and the debt it sells counts as Spanish public borrowing.

Yields Fall

Spain's 10-year bond yields fell to 4.919 percent today from 4.932 percent yesterday. Spain's public debt amounts to about 67 percent of gross domestic product, according to the previous government's forecasts, below the euro-region average.

The 50 billion euros in new charges compares with 66 billion euros of provisions taken by banks between 2008 and June 2011 to cover specific loan risks, according to the ministry. CaixaBank SA (CABK) Chairman Isidro Faine estimates banks in Spain generated pre-provision income of 24 billion euros in 2011.

While the move creates a "significant additional buffer," more provisions may still be needed if Spain remains in a recession, Daragh Quinn, Nomura's Spanish banks analyst, said in the report. The International Monetary Fund sees Spain's economy shrinking 1.7 percent this year and 0.3 percent in 2013.

"Shareholders of the pure domestic banks face, one way or the other and to varying degrees, the risk of material dilution in light of the new regulation," Santiago Lopez, an analyst at Exane BNP Paribas SA, said in a research note today.

Bank Shares

Shares in Santander, which has most of its business outside Spain, rose 0.6 percent and BBVA climbed 0.5 percent at 10:30 a.m. in Madrid. Bankia slipped 0.03 percent and Banco Popular Espanol SA (POP), which focuses on Iberia, fell 0.5 percent.

The measures by the new government follow a series of attempts by the former Socialist administration to strengthen banks and restore lending. In 2008, the government started buying assets from banks such as mortgage-backed securities.

In 2009, it created the FROB, which spent about 10 billion euros buying preference shares in lenders it encouraged to merge. It then increased capital requirements for banks last year while coaxing unlisted lenders onto the stock market and changed the rules of the FROB so that it would buy ordinary shares with voting rights in the lenders it rescued.

"The years of denial seem to have come at least partially to an end, and gradually, institutions might be forced to align their balance sheets with market reality," Exane's Lopez said.

Rajoy, who leads the pro-business People's Party, had considered creating a so-called bad bank to buy toxic real- estate assets from lenders, two people familiar with the situation said in November, even as he pledged during the campaign not to use taxpayers' money for banks. He also rejected using the euro region's bailout funds for the overhaul.

The Cabinet is set to approve the measures today in a decree law, which goes into effect immediately. Deputy Prime Minister Soraya Saenz de Santamaria holds a news conference after the meeting at about 1:45 p.m. today in Madrid.

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