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Y COMPETITIVIDAD

Financial Sector Reform

May 2012

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Financial sector situation by 31 December 2011

Real estate assets linked to loans to developers (€ 307 billion)

Problematic assets (€ 184 billion)

Land and on-going development projects

- Total (approx.): € 91 billion
- Provision coverage: around 32% on average

Other troubled assets: finished properties and housing

- Total (approx.): € 93 billion
- Provision coverage: around 30% on average

Performing assets (€ 123 billion)

- Land : € 25 bn → 21% of portfolio
- On going development projects: €16 bn → 13% of portfolio
- Finished housing : € 60 billion → 49% of portfolio
- Personal Guarantee & 2nd mortgage : € 18 bn → 15% of portfolio
- Others: € 3 bn → 2% of portfolio
- Provision coverage : 0%

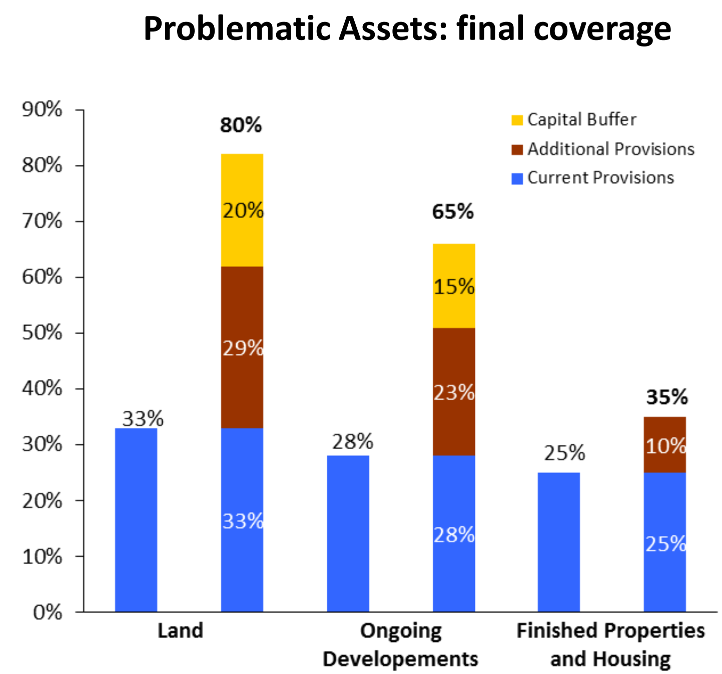
Financial sector reform . 1st Phase. February 2012: Increase in provisions & capital buffers (€ 54 bn)

Provisions/capital buffer to be added to existing coverage

Deadline→ 31 December 2012		Specific Provisions *(against profits)* *	Capital add-on *(against retained earnings, capital increases or conversion of hybrids)*	Generic Provisions *(against profits)*
Problematic Assets *(€ 184 bn)*	Land *(33% ---> 80%)* (€ 73 bn)	33% ---> 60%	20%	
	Ongoing developments (28% ---> 60%) (€ 15 bn)	28% ---> 50%	15%	
	Finished properties and Housing (€ 87 bn)	25% ---> 35%		
Performing Assets *(€ 123 bn)*	Construction and real estate developers normal portfolio			7%

* Except in concentration operations

TOTAL INCREASE IN PROVISIONS AND CAPITAL BUFFERS→ € 54 bn



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Financial sector reform. 1st Phase. February 2012: Calendar & Mergers framework

- **Implementation calendar full on track. Milestones**:
  - **March 31st**: all institutions presented cleanup plans
  - **April 20th**: assessment of plans by Banco de España
  - **June 30th**: deadline for mergers proposals
  - **July 31st**: mergers approved by the Ministry of Economy
  - **December 31st 2012**: end of process. Compliance with all the cleanup measures

- Strict **conditionality of new integration processes**…
  - **Submission of integration plan** to the Ministry of Economy by June 30th to be fully operative as of January 1st 2013
  - Resulting entity with **balance sheet 20% higher** than largest participating institution
  - Improvements in **corporate governance**
  - **Reduction of exposure to RE** and construction
  - Increase in **credit to productive activities**

- …but also rendering some **advantages**
  - **Deadline** for provisioning and capital buffer increase **extended one additional year**
  - **Writedown** of impaired assets **against equity** allowed
  - **Extension of FROB's margin of action** allowing for acquisition of Co-Co's

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Financial sector reform. 1st Phase. February 2012: Results from February to May

- Three mergers have taken place and one entity has been transferred

- Banks have accelerated their compliance with the new provision and capital requirements

- Limitation of wages for managers of entities participated or intervened by the FROB

- Throughout 2012, the situation of the 3 remaining banks intervened by the FROB will be solved, finalising the restructuring process of the most vulnerable entities in the Spanish system. These entities account for 15% of the system, with total assets amounting to 50% of GDP

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Financial sector reform 2nd phase. May 2012

The objective: to increase generic provisions for performing real estate assets

The rationale: to anticipate the clean-up for an hypothetical worsening of the performing real estate portfolio, therefore dispelling doubts about its quality

- For performing loans in the real estate sector (€ 123 bn 31 Dec. 2011) **to increase** the current provision level from **7% to 30%** by December 2012.
- It implies around **€ 30 bn of additional provisions**
- The Financial Institutions in need of capital as a result of the new provisioning requirements will have to fund themselves either through the market or could receive financial support from the FROB.

Financial sector reform 2nd phase. May 2012:
Additional increase in provisions for Performing assets (€ 30 bn)

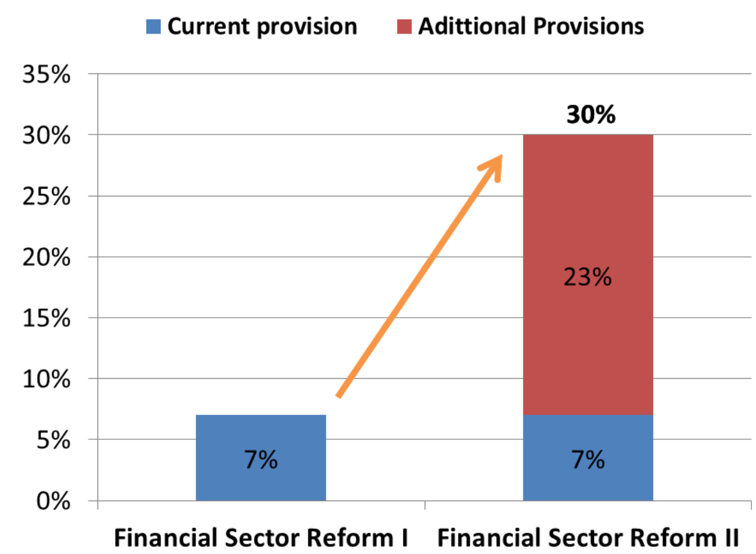
Provisions to be added to existing coverage

Deadline→ December 2012		Specific Provisions *(against profits)* *	Capital add-on *(against retained earnings, capital increases or conversion of hybrids)*	Generic Provisions *(against profits)*
Problematic Assets *(€ 184 bn)*	Land *(33% ---> 80%)* (€ 73 bn)	33% ---> 60%	20%	
	Ongoing developments (28% ---> 60%) (€ 15 bn)	28% ---> 50%	15%	
	Finished properties and Housing (€ 87 bn)	25% ---> 35%		
Performing Assets *(€ 123 bn)*	Construction and real estate developers normal portfolio			7% --->30%

* Except in concentration operations

TOTAL ESTIMATED INCREASE IN PROVISIONS → € 30 bn

Performing Assets: FINAL COVERAGE



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Financial sector reform 2nd phase. May 2012: Additional increase in provisions for Performing assets (€ 30 bn)

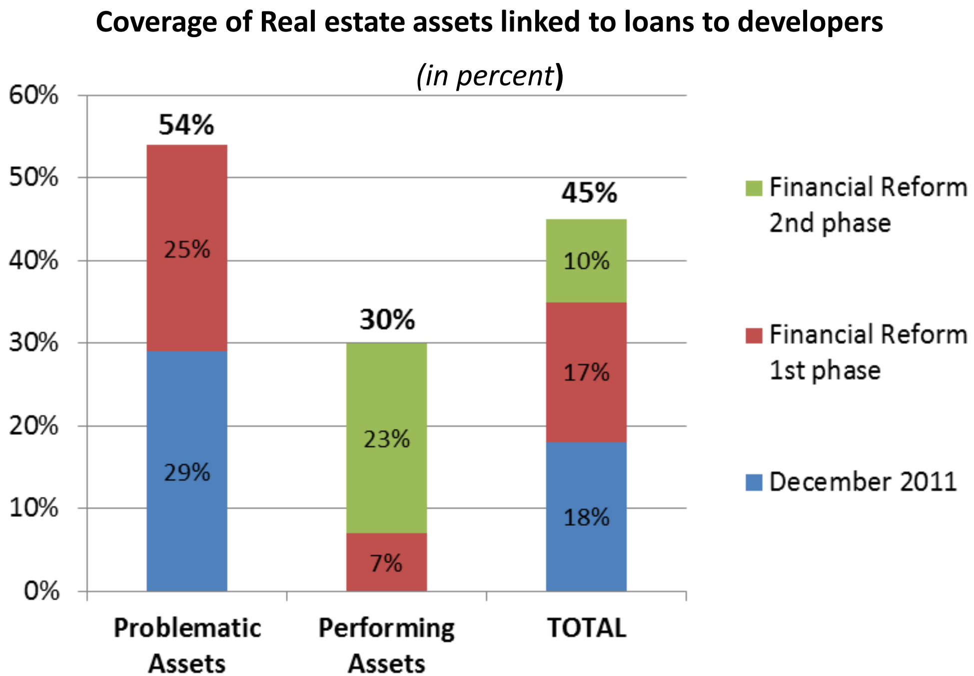
Provisions to be added to existing coverage per type of asset

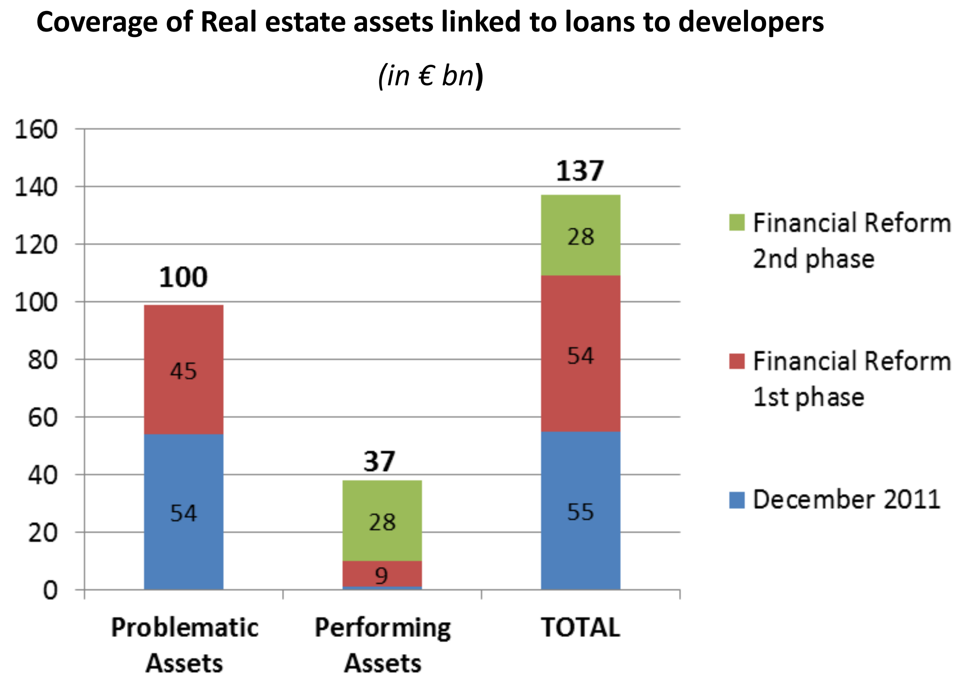
Deadline→ December 2012		1st Phase Provisions	2nd Phase Additional Provisions	Total 1st and 2nd phase Provisions
Performing Assets *(€ 123 bn)*	Land (€ 25 bn)	7%	45% (€ 11.5 bn)	52% (€ 13 bn)
	Ongoing developments (€ 16 bn)		22% (€ 3.5 bn)	29% (€ 4.5 bn)
	Finished properties and Housing (€ 61 bn)		7% (€ 4 bn)	14% (€ 8.5 bn)
	Personal Guarantee & 2nd mortgage (€ 18 bn)		45% (€ 8 bn)	52% (€ 9.5 bn)
	Other Assets (€ 3 bn)	-	22% (€ 0.6 bn)	52% (€ 1.5 bn)*
TOTAL		€ 9 bn	€ 28 bn	€ 37 bn
Average Provision		7%	23%	30%

*including a 30% provision by 31 December 2011

Financial sector reform 2nd phase. May 2012:

Coverage of Real Estate assets linked to loans to developers (€ 307 billion)





Problematic Assets

- Total provisions + capital buffer → € 100 bn
- Total Balance → € 184 bn

Performing Assets

- Total provisions → € 37 bn
- Total Balance → € 123 bn

TOTAL

- Total coverage → € 137 bn
- Total Balance → € 307 bn

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Financial sector reform 2nd phase. May 2012

CALENDAR

- **June 11th 2012**: deadline to present the compliance plans for new provisions
- **In the following 15 working days**: assessment of plans by the Banco de España (BdE) → if the plans entail a shortfall of own funds or capital:

  A. BdE will require new measures to avoid shortfalls and an execution plan within the next five months

  B. If BdE considers compliance is unlikely → additional measures will be required, including financial support from the FROB

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FROB FINANCIAL SUPPORT

- Entities that after the new provision requirements need **to increase capital**, will have to fund themselves in the market, or they could be able **to request financial support from the FROB**.
- The FROB will be able to **inject capital** under two modalities: **shares or COCOS**.
- There will be **no implicit public aid** or subsidy, **nor a premium for the banks**. The **COCOS will be remunerated** at a interest rate of approximately **twice the cost of the Spanish Treasury's funding costs** for the same maturity, 5 years. After this period, the COCOS principal will be paid back.
- Banks opting for FROB funding will have to submit a **Restructuring Plan**.

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Financial sector reform 2nd phase. May 2012

ASSET MANAGEMENT COMPANIES (AMC)

The target: to put aside problematic real estate assets from the bank’s balance sheets

Options :

- Initial transfer **of only foreclosed problematic assets**
- Transfer price **at reasonable value** (book value net of provisions, considering high provisioning level of these assets)
- **Compulsory for all** Financial Institutions.

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Financial sector reform (2nd Phase) May 2012

INDEPENDENT THIRD PARTY VALUATION

Objective: independent third party risk valuation of the entire financial sector asset portfolio

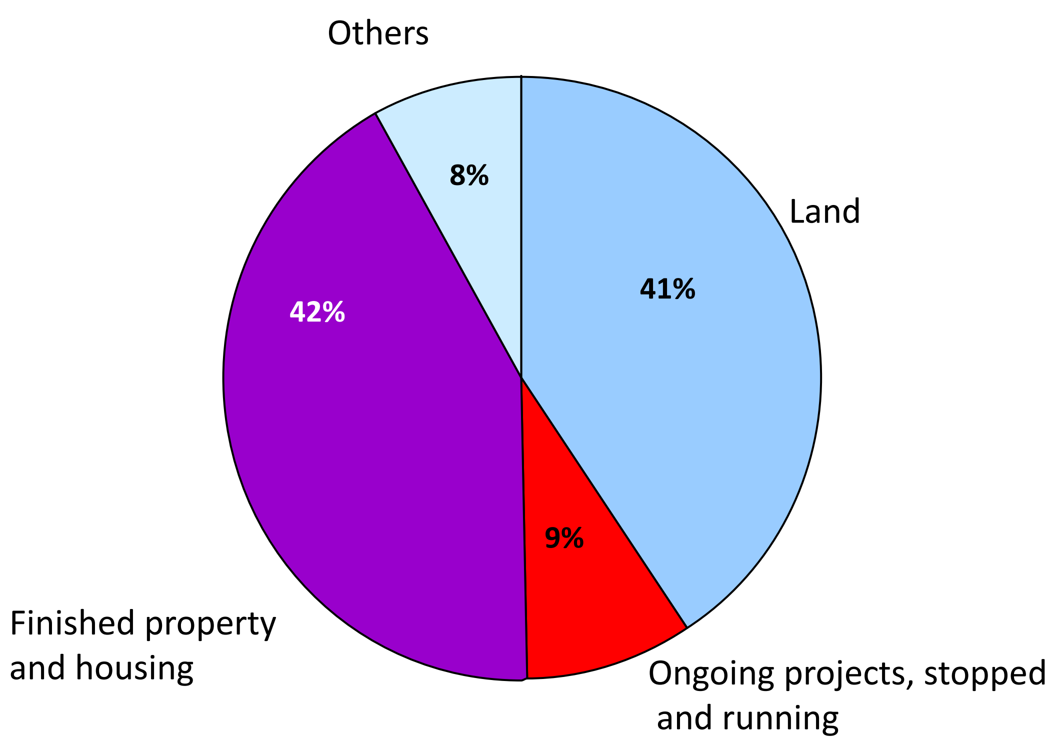
Elements :

- **Two independent risk valuations** from reputed independent experts will be requested
- The valuation will comprise **the entire portfolio**, not only the real estate portfolio

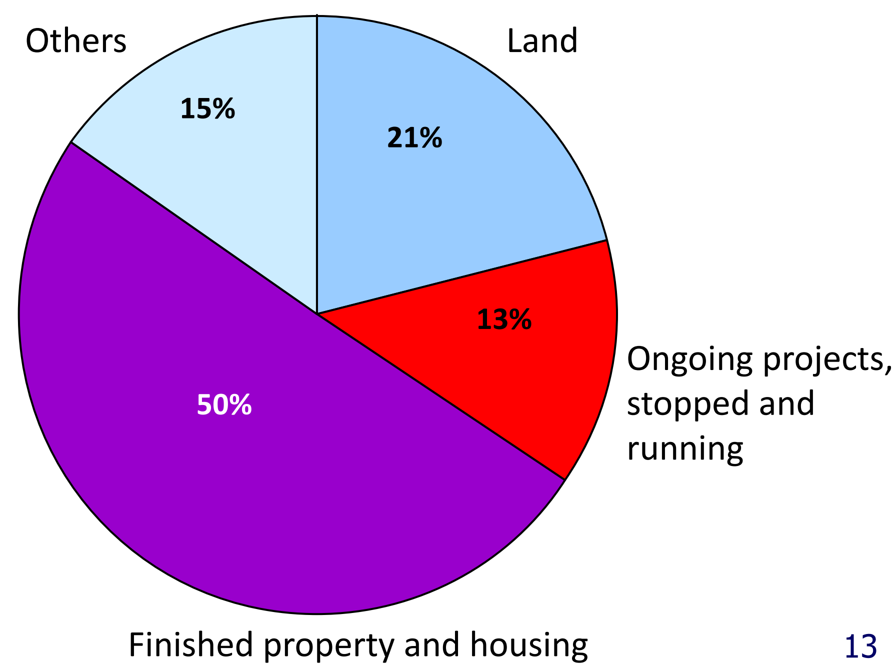
Financial sector reform 2nd phase. May 2012: Rationale of the proposal

- The **composition and quality** of the performing real estate portfolio is **very different** from the problematic portfolio. For instance, problematic land (€ 74 bn) represents **<u>24%</u>** (74/307) of total assets linked to loans to developers, while non-problematic land (€ 25 bn) represents **<u>8%</u>** (25/307) of total assets linked to loans to developers

Problematic Portfolio



Performing Portfolio



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STRESS TEST: 75% MIGRATION OF PERFORMING ASSETS TO PROBLEMATIC ASSETS

1. Under an **unrealistic scenario** where 75% of performing assets (0.75 x 123bn = € 92.2 bn) turn to be problematic, **the coverage ratio of the final stock** of problematic assets (184 bn + 92.9bn = € 276 bn) would be of **<u>50%</u>** ([100+37]/276 = 50%)

2. This would imply that **close to 90%** (276/307 = 90%) of **total assets** linked to **real estate** developers would have an **average coverage of 50%.**