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Spain: Deposit Guarantee Fund Asset Management[1]

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Yale Program on Financial Stability Case Study
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Abstract

The global oil shock in 1973-74 occurred at a time when Spain was embarking on a liberalization of its financial system that resulted in many new entrants, particularly small- and medium-sized institutions. The banking crisis that followed from 1977-85 affected 52 of the country's 110 banks, most of them of small- and medium-sized, that comprised over 20% of bank deposits. Spain established the Deposit Guarantee Fund in November 1977 to provide limited deposit insurance, and, in March 1978, established a Banking Corporation to take control of and reorganize troubled banks. However, because the Banking Corporation lacked the legal authority to recapitalize institutions, Spain reconstituted the Deposit Guarantee Fund in 1980 with broad new powers. One key power was the ability to acquire and dispose of non-performing assets from insolvent institutions. During the course of the crisis, the Fund intervened in 29 banks. It acquired a total of 373 billion pesetas ($2.2 billion) in nonperforming assets, real estate, and shareholdings. It disposed of more than 50% of bad assets within five years, but by 2000 still had a small amount of assets. By 1986, it had accumulated losses of 90 billion pesetas.

Keywords: Spain, crisis, banks, asset management company, Fund, NPLs

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering the responses to the Global Financial Crisis that pertain to broad-based asset management company programs.

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Spain: Deposit Guarantee Fund Asset Management

At a Glance

During the 1960s and early 1970s, Spain experienced strong economic growth. However, by the mid-1970s difficulties arose. The global increase in oil prices in 1973-74 contributed to double-digit inflation in Spain. Reforms in 1971 and 1974 paved the way for swift financial liberalization without adequate regulation and supervision.

In 1977, Spain entered a banking crisis that lasted until 1985. It affected 52 of the country's 110 banks, most of them small- and medium-sized, that together comprised over 20% of bank deposits. In November 1977, Spain established a Deposit Guarantee Fund run by the Bank of Spain to provide limited deposit insurance, and, in March 1978, a Banking Corporation to take control of and reorganize troubled banks was added. However, because the Banking Corporation lacked the legal authority to recapitalize institutions, Spain reconstituted the Deposit Guarantee Fund in 1980 as an independent public agency with broad new powers. One key power was the ability to acquire and dispose of non-performing assets from insolvent institutions. During the course of the crisis, the Fund intervened in 29 banks. It acquired a total of 373 billion pesetas ($2.2 billion) in assets, including 270 billion pesetas in loans at face value, 31 billion pesetas in real estate, and 72 billion in shareholdings. It disposed of more than 50% of non-performing assets within five years, but still had a small amount of assets by 2000.

Summary of Key Terms	
Purpose: "To guarantee deposits in banking institutions in the way and to the extent that the government establishes, and also to carry out any such actions as it considers necessary to reinforce the solvency and proper functioning of the banks, in the [defense] of their interests of their depositors and the Fund itself"	
Launch Dates	Established: March 28, 1980
Wind-down Dates	Date of Last Asset Disposal: Unknown. Still operating as of 2000
Size and Type of NPL Problem	Nonperforming loans to total loans of 5.7% in 1985 All loan types
Program Size	Not specified at outset
Eligible Institutions	Nonviable banks that could not be recapitalized by shareholders Closed banks only
Usage	373 billion pesetas acquired at face value ($2.2 billion)
Outcomes	90 billion pesetas in accumulated losses as of 1986
Ownership Structure	Public
Notable Features	Multiple functions carried out by one public-private entity in the face of a crisis limited to small- and medium-sized banks

Summary Evaluation

There is limited evaluation of the Fund despite its central, multi-purpose role in dealing with the Spanish banking crisis (1977-85). Observers have praised its structure and approach to dealing with the crisis, but contextual factors such as a weak legal framework for transferring titles and seizing collateral restricted its efforts at rapid asset disposal. By 1986, the Fund had accumulated losses of 90 billion pesetas in total, including its asset management operations.

Deposit Guarantee Fund Asset Management: Spain Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	$214.6 billion in 1979 $232.8 billion in 1980
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	$5,770 in 1979 $6,209 in 1980
Sovereign credit rating (five-year senior debt)	No ratings data as of 1979 and 1980
Size of banking system	$162.0 billion in 1979 $178.8 billion in 1980
Size of banking system as a percentage of GDP	75.5% in 1979 76.7% in 1980
Size of banking system as a percentage of financial system	Data not available in 1979 and 1980
Five-bank concentration of banking system	Data not available in 1979 and 1980
Foreign involvement in banking system	Data not available in 1979 and 1980
Government ownership of banking system	% in 1979 % in 1980
Existence of deposit insurance	Yes in 1979 Yes in 1980
Sources: *Bloomberg, World Bank, Sheng 1996.*	

I. Overview

Background

During the 1960s and early 1970s, Spain experienced strong economic growth. Annual GDP growth averaged 7% from 1961 to 1974.[3] However, in the mid-1970s, developments emerged that ultimately brought this period of rapid economic expansion to a halt. The global increase in oil prices in 1973 and 1974 contributed to double-digit inflation in Spain. The death of Francisco Franco in 1975 accelerated the political transformation from dictatorship to democracy. Additionally, reforms in 1971 and 1974 paved the way for a swift financial liberalization in the Spanish banking system. These reforms facilitated the opening of new branches and deregulated deposit interest rates and multiple lending rates (De Juan 2019; Sheng 1996).

Between 1973 and 1983, the number of bank offices more than tripled, with significant growth in small and medium-sized institutions. Employment in the banking sector increased from 150,000 in 1975 to more than 180,000 in 1980. This expansion came alongside regulation and supervision that were considered inadequate. And while the banking sector became more innovative and complex, a number of the new entrants lacked banking experience, and in some cases, ethical standards (Sheng 1996).

In 1977, problems in the Spanish banking system—composed of 110 banks—became apparent. A number of insolvent banks characterized their problems as temporary liquidity problems. The Bank of Spain, as lender of last resort, dealt with liquidity problems using its rediscount facility but identified that in many cases, these liquidity problems masked solvency issues. Failed banks had typically breached limits on exposure to related parties or single entities (De Juan 2019; Sheng 1996).

The Bank of Spain lacked experience in dealing with banks in crisis, which made it difficult to identify bank losses accurately. The small group of examiners performed supervision primarily on regulatory compliance (De Juan 2019). At the same time, the Bank of Spain had no ability to sanction wrongdoers, and had no means, nor the legal powers to prevent a bank failure (Sheng 1996).

In November of 1977, as a first response to the escalating problems in the banking sector, the Spanish legislature created the Deposit Guarantee Fund (Fund), administered as an account within the Bank of Spain.[4] It provided deposit insurance for up to 500,000 pesetas (approximately $10,000).[5] Its ongoing operations were funded equally by the Bank of Spain and banks, which each contributed 0.1% of all bank deposits (Deposit Guarantee Fund 1981). These funds, however, could only be used to return funds to depositors after a bank was closed (Sheng 1996). In January 1978, Spain passed legislation that allowed the Fund, for

[3] See Appendix A: Macroeconomic indicators (1970-89) for data on GDP growth, inflation, and the exchange rate.

[4] See Appendix B for the timeline of legislation during the Spanish Banking crisis (1977-85).

[5] Based on an average exchange rate of 1997 approximately Spanish pesetas 50 = $1 USD (Sheng 1996).

reasons of public interest and with a three-fourths approval from the Fund's advisory committee, to use the funds when a distressed bank was in danger of insolvency, rather than wait for the bank's liquidation (Spain 1978).

In March 1978, the Bank of Spain created a public-private management company called the Banking Corporation (Corporación Bancaria S.A.) to complement the deposit insurance scheme of the Fund. The Corporation would be a resolution authority: it would take over, clean up, and sell banks in crisis (Sheng 1996). The Corporation started with a fund of 500 million pesetas, which came from equal contributions by the Bank of Spain and the banking industry (Malo de Molina and Martín-Aceña 2011). If the existing shareholders were unwilling or unable to recapitalize a bank, the Corporation gained ownership and, eventually, management rights of the bank by buying a controlling interest of shares for one peseta—a symbolic price—per share (Sheng 1996). It would then seek a buyer for the bank. The Bank of Spain required this intervention as a condition for accessing its newly created liquidity facility (De Juan 2019). The first bank intervention by the Corporation occurred in March 1978 (Seminario 1984).

However, the Corporation lacked the legal authority to recapitalize insolvent institutions and struggled to sell "rehabilitated" banks. The Corporation did not close until many years later due to legal battles. In 1980, the Spanish government reconstituted the Deposit Guarantee Fund as a separate legal entity and granted it legal powers to intervene and "rehabilitate" banks in a crisis. Unlike the Corporation, the government gave the Fund the power to inject capital and to purchase and manage non-performing assets (Sheng 1996; Malo de Molina and Martín-Aceña 2011).

Program Description

In March of 1980, the passage of Royal Decree-Law 4/1980 reconstituted the Fund as a public body governed by the rules of private law (Spain 1980). The enhanced Fund combined the deposit guarantee scheme with the management activities previously performed by the Corporation, but now with increased legal powers. Initially, it was independent from the Corporation, but later the Fund acquired the Corporation's working teams (Malo de Molina and Martín-Aceña 2011). More specifically, beyond deposit insurance, the Fund was now empowered "… to carry out any such actions as it considers necessary to reinforce the solvency and proper functioning of the banks, in the [defense] of their interests of their depositors and the Fund itself" (Spain 1980). The Fund became known as the "Bank Hospital" (De Juan 2019).

The new powers enabled the Fund to recapitalize a distressed bank, make it viable, and sell it to another bank within a year. The Fund could gain bank ownership, extend credit to banks at any rate or in any form, acquire all types of assets (shares, loans, real estate, etc.) at book value, provide guarantees to acquiring banks, absorb losses to restore solvency, and recapitalize banks and nonbanks. While the Bank of Spain continued to provide emergency liquidity as lender of last resort, it was through the Fund that insolvency problems were addressed (De Juan 2019).

The Board of Directors of the newly constituted Fund followed the model adopted by the Corporation, with eight members—half from the Bank of Spain and half from the banking industry. The Deputy Governor of the Bank of Spain served as the chair and would cast the decisive vote in the event of a tie (De Juan 2019). The Secretary General of the Fund acted as the executive director and managed a staff of 120 employees at its peak (Klingebiel 2000).

Contributions to the Fund remained equally distributed between the Bank of Spain and the banking industry. Banks' contributions ranged from 0.1% to 0.3% of deposits. Legislation also authorized the Bank of Spain to make long-term loans to the Fund at the rediscount rate, and with no limit (De Juan 2019). The Fund's total debt was 506 billion pesetas at the end of 1986 (Deposit Guarantee Fund 1987). The Fund closely coordinated its operations with the Bank of Spain. In providing initial liquidity support to troubled banks, the Bank of Spain would evaluate their viability. Those banks identified as needing additional capital would be asked to have their shareholders provide capital. Banks whose shareholders were unwilling or unable to provide that capital were then forced to transfer control of the banks to the Fund at a nominal price; otherwise, they faced the loss of liquidity support from the Bank of Spain and possible suspension of their banking charter (Sheng 1996).

Once the Fund gained majority ownership via this mechanism, new management would come in and clean up the bank. The Fund would force the banks' directors to resign. If they refused to resign, the Fund fired them directly after gaining control of the bank. In all cases, the Fund recruited new executives from the market, appointed a new Board, and restructured management (De Juan 2019). The newly appointed management would introduce administrative reforms and enhance operational efficiency. The Fund's interventions rested on the assumption that banks would remain viable even after the Fund concluded its support (Sheng 1996). The Fund would then implement a financial package to attract a buyer.

The main measure that the Fund took to attract buyers was to acquire a bank's non-performing assets at face value. In doing so, the Fund absorbed substantial losses that typically exceeded the bank's capital (De Juan 2019). The Fund purchased the non-performing assets of the insolvent banks at face value because Spanish authorities considered it impossible to agree on a market price (De Juan 2019). The Fund would end up purchasing a large portion of non-performing assets, which it could sell even after the Fund released control of the bank (Sheng 1996).

After a bank was "rehabilitated," the Fund prepared to sell it to a "healthy" bank that could meet the qualifications and solvency requirements. By law, the offer had to be publicized and occur within a year after the Fund gained control of the bank (De Juan 2019). If a suitable buyer appeared right away, the Fund would try to sell the bank immediately with the intention to avert any further loss of confidence in the bank and depletion of its capital base. In some cases, an external accounting firm would conduct a comprehensive audit and identify potential buyers (Sheng 1996).

The Fund, together with the Bank of Spain, arranged a prospectus for the sale of a troubled bank with a deadline for bids. The prospectus would be sent to selected domestic and foreign banks and included the maximum value of and specific conditions in which bad assets could be carved out by the Fund. This turned out to be a key issue in negotiations between the Fund and potential buyers. The offer also outlined the specifics on the support to be provided by the Fund and the Bank of Spain (e.g. subsidized interest rates, regulatory forbearance, guarantees against "hidden liabilities," etc.). Potential buyers could make counterproposals, which the Fund's Board of Directors would review. Buyers were required to renounce any future claims or legal actions against the Fund that would result from differences between expected and realized asset returns. Lastly, the Board would communicate to the Ministry of Finance the offer chosen. Then, the Ministry had fifteen days to exercise its option to purchase the shares when the national interest was a concern. This two-stage mechanism provided checks and balances to the restructuring efforts (Sheng 1996).

As for the loans that the Fund could not sell to the new investors of a bank, sale of mortgage loans and real estate were most successful (Klingebiel 2000). In every instance, the Fund tried to minimize losses by maximizing recovery of assets acquired at face value, and by repossessing any guarantees collected as collateral for nonperforming loans (Sheng 1996).

Outcomes

The Spanish banking crisis of 1977-85 affected 52 of the country's 110 banks—most of them of small- and medium-size—that comprised over 20% of bank deposits (De Juan 2019). Of all the banks affected by the crisis, 90% were established between 1973 and 1978. None of the banks established during the financial liberalization of the 1970s survived as an independent bank. By 1985, 85% of total deposits were held by eight banking groups. The seven largest Spanish banks were minimally affected by the crisis and together with the Spanish Bankers' Association, established in 1977, assisted in resolving almost all of the small failed banks, although under considerable pressure from the government (Sheng 1996).

Figure 1: Banks Affected by the Crisis, 1978-84

Year	Number of Banks Treated	Deposits and Credits in $ Million*			Number of Accounts (Thousands)	Number of Branches	Staff
		Deposits	*Credits*	*Total*			
1978	4	245	145	390	185	120	1,977
1979	2	214	51	265	201	61	1,026
1980	9	1,361	325	1,686	775	371	6,553
1981	4	564	294	858	362	151	2,143
1982	11	3,415	872	4,287	1,829	726	10,761
1983	21	4,859	1,686	6,545	1,946	1,193	13,204
1984	1	270	16	286	110	33	625
Total	**52**	**10,928**	**3,389**	**14,317**	**5,408**	**2,655**	**36,289**
Exchange rate of 1984 was Spanish Pesetas 175 = $1 USD.							

Source: De Juan 2019.

Three small banks were liquidated. The Fund intervened in 29 banks with assets amounting to 1% of the financial system. Spain dealt with 20 banks related to the "politically sensitive" Rumasa industrial conglomerate outside of the Fund, through a special nationalization and reprivatization program in 1983 (Klingebiel 2000; Sheng 1996).[6]

By law, the Fund had to release control of a bank within a year of takeover, encouraging quick resolution and resale. By 1985, 22 banks were sold to domestic banks and five to foreign banks (Sheng 1996). Banks restructured by the Fund were sold after an average of 13 months, including the 20 banks of the Rumasa group. Many cases were resolved within six months (Sheng 1996; De Juan 2019). Initially, Spanish domestic banks were not interested in acquiring the "rehabilitated" banks. However, after the Fund sold two banks to foreign institutions, Spanish banks—in light of foreign competition—were incentivized to buy banks from the Fund, even by absorbing short-term losses in some cases (Sheng 1996; Klingebiel 2000). None of the banks sold by the Fund suffered a relapse (De Juan 2019).

[6] In 1983, the Rumasa group of more than 200 industrial companies and 20 banks of small and medium size was nationalized instead of being rehabilitated via the Fund. The case was politically sensitive, in part because the Rumasa group employed over 50,000 people. The financial resources required to rescue Rumasa would have greatly exceeded the Fund's capacity: the companies were highly leveraged, and the banks exhibited negative capital of 21 billion pesetas ($146 million). Spanish authorities viewed intervening in Rumasa's banks via the Fund as likely to trigger the failure of its industrial companies. However, they rejected any Fund assistance for Rumasa's non-bank companies as inappropriate to the Fund's mission (Sheng 1996).

Figure 2: Bank Interventions by Deposit Guarantee Fund, 1978-85

Bank	*Date of initial intervention*	*Date of sale*	*Buyer*
Navarra	January 1978	—	Closed for liquidation (May 1978)
Cantabrico	February 1978	July 1980	Banco Exterior de Espana
Meridional	April 1978	July 1981	Banco de Vizcaya
Valladolid	December 1978	March 1981	Barclays Bank
Granada	January 1979	December 1980	Banco Central
Credito Comercial	January 1979	January 1980	Banco de Vizcaya
Asturias	February 1980	November 1980	Banca March
Lopez Quesada	April 1980	June 1981	Banque Nationale de Paris
Promocion de Negocios	April 1980	November 1981	Banco de Bilbao
Catalan de Desarrollo	May 1980	May 1980	Banco Espanol de Credito
Industrial del Mediterrano	July 1980	January 1981	Banca Catalana
Occidental	July 1981	July 1982	Banco de Vizcaya
Comercial Occidental	July 1981	July 1982	Banco de Vizcaya
Descuento	November 1981	July 1983	BCCI Holding (Luxembourg)
Pirineos	December 1981	—	Closed for liquidation (December 1981)
Union	March 1982	April 1982	Banco Hispano Americano
Prestamo y Ahorro	March 1982	April 1982	Banco de Vizcaya
Mas Sarda	March 1982	April 1982	Banco de Bilbao
Levante	October 1982	July 1983	Citibank/Banco Zaragozano
Catalana	November 1982	May 1983	Group of fourteen banks
Industrial de Cataluna	November 1982	May 1983	Group of fourteen banks
Industrial del Mediterraneo	November 1982	May 1983	Group of fourteen banks
Barcelona	November 1982	May 1983	Group of fourteen banks
Gerona	November 1982	May 1983	Banca March
Alicante	November 1982	May 1983	Banco Exterior de Espana
Credito e Inversiones	November 1982	May 1983	Banco Central
Simeon	December 1983	a	Banco Exterior de Espana
Urquijo-Union	July 1985	a	Banco Hispano Americano
Finanzas	September 1985	a	The Chase Manhattan Bank

— Not applicable.
a. The fund did not arrange these rescues, but it did collaborate in the financial reorganization.
Source: Deposit Guarantee Fund; Cuervo 1988.

Interventions from 1978 until March 1980 were performed by the Corporation (Corporación Bancaria S.A.).

Source: Sheng 1996.

In all instances, bank shareholders took the first losses by losing their equity. Depositors only experienced losses when the three small banks were liquidated. Losses absorbed by the Fund after taking control of banks were split equally among the Bank of Spain and the banking industry. Contributions from the banks totaled 0.12% of liabilities per year (10% of annual profits). By the end of 1984, these contributions reached only $0.5 billion, significantly less than the total losses incurred by the Fund. Therefore, the Bank of Spain had to lend an additional $2.9 billion to the Fund through long-term loans at a 7.25% annual interest rate (Sheng 1996).

The Fund would restructure the banks with the objective to sell them. To clean up the banks, the Fund acquired 373 billion pesetas in total assets: 270 billion in loans, 31 billion in real estate, and 73 billion in shareholdings. The Fund continued with the asset purchases through 1985, and in line with the rapid-asset-disposition objective, disposed of more than 50% of them within five years. By 1986, it registered losses of 25.7 billion pesetas for cleaning up the banks and a cumulative 90 billion pesetas of overall losses. By 2000, the Fund only held a small fraction of the assets it had acquired (Klingebiel 2000).

The Fund's estimates suggested it would be able to repay the Bank of Spain's loans completely by the end of the 1990s, based on its reserves (Sheng 1996). However, it is not clear from public sources whether the Bank of Spain or Spanish taxpayers ultimately bore losses on these loans to the Fund. The Fund's debt was 506 billion pesetas at the end of 1986 and 349 billion pesetas at the end of 1989 (El Pais 1990; Deposit Guarantee Fund 1987).

II. Key Design Decisions

1. Part of a Package: The Deposit Guarantee Fund was a multi-purpose facility that combined purchases of non-performing assets with other types of interventions such as deposit insurance, capital injections, and guarantees.

Two early attempts by the Spanish government to address the banking crisis that emerged in 1977—the initial establishment of the Deposit Guarantee Fund merely as a deposit insurance provider and the establishment of the Banking Corporation in 1978 to take control of troubled banks—addressed liquidity problems but could not solve underlying solvency issues. Spain therefore decided to significantly expand the legal authority of the Fund to include the ability to purchase assets, inject capital, and provide guarantees to acquiring banks, so that these tools could be used in tandem to rehabilitate failed banks.

After the Bank of Spain identified a significant capital shortage in a bank, the Fund would take over ownership of the distressed banks. The Fund would assess the bank's financial situation, replace management, and determine a financial assistance package to return the bank to viability and reprivatize the bank. One significant component of the Fund's ability to resell the banks was the purchase of assets, which would make the bank more attractive in a bidding procedure among solvent banks (De Juan 2019).

2. Legal Authority: Spain passed the Royal-Decree Law 4/1980 on March 28, 1980, to significantly expand the legal authority of the Fund, giving it the ability to purchase assets among other new powers.

In March 1980, the passage of Royal Decree-Law 4/1980 established the Deposit Guarantee Fund for Banking Institutions as a public body governed by the rules of private law and significantly expanded its authority (Spain 1980). The enhanced Fund combined the deposit guarantee scheme with the management function performed up until this point by the Banking Corporation, but now with increased legal powers. The Fund became known as the "Bank Hospital" (De Juan 2019).

3. Special Powers: The Fund had the authority to recapitalize distressed banks, take over bank ownership, provide credit or guarantees, and acquire any type of asset.

Special authority was granted to the Fund when it was reconstituted in 1980, after it became clear that the Banking Corporation's powers, specifically its inability to recapitalize banks, were "inadequate … for dealing with impending crises" (Sheng 1991). The Fund was granted authority to recapitalize distressed banks, take over bank ownership, extend credit to banks at any rate or in any form, acquire assets at book value, provide guarantees to an acquiring institution, and absorb losses to restore banks to solvency (De Juan 2019). The Fund remained responsible for the administration of the deposit insurance scheme (Sheng 1991).

4. Mandate: The Fund had a broad mandate to protect depositors, restructure banks, and restore bank solvency; for its asset management functions, it had the objective to quickly dispose of assets and maximize recovery.

In 1980, the Fund's mandate expanded beyond its initial objective to protect depositors and prevent bank runs. The Fund was mandated "to carry out all the operations deemed necessary to reinforce the solvency and operation of the banks, in [defense] of the interest of the depositors and of the Fund itself" (Sheng 1996; Spain 1980).

After the Fund became the primary owner of a distressed bank, it developed a financial assistance package, which could include the purchase of assets and long-term lending. The financial assistance package was an important factor for the eventual sale of a bank, as the Fund could carve out bad assets that a buyer would be unwilling to take on (Klingebiel 2000). After reaching a sales agreement, the Fund would purchase the nonperforming assets at book value and then manage and liquidate the assets (De Juan 2019). The Fund was required to resell the bank within one year, and it had the objective to maximize recovery value on the problem assets it acquired (Klingebiel 2000).

5. Communication: Spain described the expansion of the Fund's authority as part of its efforts to protect depositors, particularly small depositors.

The stated purpose of the Fund as it was reconstituted in 1980 was "to guarantee the deposits held in banking institutions in the way and to the extent that the government establishes, and also to carry out any such actions as it considers necessary to reinforce the solvency and proper functioning of the banks, in the [defense] of their interests of their depositors and of the Fund itself" (Spain 1980).

The Deposit Guarantee Fund issued annual reports detailing its operations (Deposit Guarantee Fund 1981; 1987). The Fund also had an Administration and Control department responsible for financial recordkeeping and preparing the annual budget and financial plan (Sheng 1996). Furthermore, the governance structure of the Fund and its relationship to the Bank of Spain "fostered a public perception of fairness" (Sheng 1996).

6. Ownership Structure: The Deposit Guarantee Fund was government-owned.

The Fund was publicly owned and "operated as an independent public agency under private law" (Klingebiel 2000).

7. Governance/Administration: The Fund was governed by a Board of Directors composed half of representatives of the Bank of Spain and half of representatives of the banking industry.

The Board of Directors consisted of eight members—four bankers from industry and four Directors from the Bank of Spain. The Deputy Governor of the Bank of Spain served as chair and cast the decisive vote in the case of a tie. The four bankers served in their individual capacities and not as representatives of their banks. They were nominated by the Bank of Spain and appointed by the Ministry of Economy (De Juan 2019).

The operations of the Fund were closely coordinated with the Bank of Spain, especially in the initial and final stages of a bank intervention.

The responsibilities of the Board of Directors of the Fund included:

a) Informing and advising the Bank of Spain on the Fund's operations;

b) Preparing and approving the Fund's financial statements, and requesting advances from the Bank of Spain to the Fund when necessary;

c) Notifying the Bank of Spain which banks experienced financial difficulties that could require Fund intervention;

d) Determining the form of payment of annual premiums contributed by the banks;

e) Stipulating the requirements for admitting new banks to the Fund, and informing of any changes in membership;

f) Requesting external audits of member banks and determining the frequency and extent of these audits, and if necessary requesting external audits of associated companies;

g) Suspending payment of deposit guarantees to any depositor directly associated with the financial troubles of a bank;

h) Authorizing asset purchases from banks in crisis, explicitly limiting further involvement of the Fund, and without precluding requests to the bank management to take further remedial actions (Sheng 1996).

The Fund was comprised of three departments: Legal, Administration and Control, and Asset Management. The Legal Department could start legal or criminal action against former administrators of banks the Fund intervened on or temporarily controlled. It also served as legal counsel for the other departments (Sheng 1996).

The Department of Administration and Control oversaw internal matters of the Fund and of the banks controlled by the Fund. It was responsible for the recovery of claims, maintaining timely records, and servicing obligations of fixed assets (e.g. property taxes). The Department coordinated the sale of assets and bank reprivatizations with the other Departments. It prepared the Fund's annual budget and financial plan, and requested advances from the Bank of Spain to the Fund when necessary (Sheng 1996).

The Asset Management Department administered the sale of assets owned by the Fund that were not directly related to banking. It assessed their financial viability, minimized any additional financial commitments, and attempted to sell the best assets as fast as possible. The Department appraised, or subcontracted appraisal of, the fixed assets of the Fund. It also focused on improving the least attractive assets while it searched for buyers (Sheng 1996).

8. Size: There was no pre-defined limit on the scope of the Fund's purchases of non-performing assets.

The legislation that established the Fund did not set a size limit on the Fund's asset purchases. In total, it acquired 270 billion pesetas in loans at face value, 31 billion pesetas in real estate, and 72 billion in equity in banks (Klingebiel 2000).

9. Funding Source: The Fund was funded primarily by loans from the Bank of Spain; the Fund would repay those loans over time with the help of annual, equal equity contributions from the Bank of Spain and the banking industry.

The Fund met its annual costs with the help of equal contributions from the Bank of Spain and the banking industry. Also, by law, the Bank of Spain could make long-term loans to the Fund at the rediscount rate, with no limit (De Juan 2019). Ultimately, the Bank of Spain provided substantial loans to the Fund, which the Fund expected to pay back over time through asset sales and the continuing contributions from the banks and the Bank of Spain.

The industry's and the Bank of Spain's annual contributions each equaled between 0.1% and 0.3% of all bank deposits of member banks (De Juan 2019). Initially, annual contributions were set at 0.1% (Spain 1980). Contributions from the banks totaled 0.12% of liabilities per year (10% of annual profits). By the end of 1984, these contributions reached only $0.5 billion, significantly less than the total losses absorbed. Therefore, the Bank of Spain had to lend $2.9 billion to the Fund through long-term loans at a 7.25% annual interest rate (Sheng 1996).

The Fund's estimates suggested it would be able to repay the Bank of Spain's loans completely by the end of the 1990s, based on its reserves (Sheng 1996). However, it is not clear from public sources whether the Bank of Spain or Spanish taxpayers ultimately bore losses on these loans to the Fund. The Fund's debt was 506 billion pesetas at the end of 1986 and 349 billion pesetas at the end of 1989 (Deposit Guarantee Fund 1987; El Pais 1990).

10. Eligible Institutions: The Fund intervened in banks identified as non-viable whose shareholders did not recapitalize them.

Typically, the Bank of Spain would provide initial liquidity support to struggling banks and in doing so determine the viability of the recipients. In some cases, the Bank of Spain determined that a bank would be viable if remedial actions were taken, and agreed to a plan of action. In other cases, the central bank identified and assessed the extent of insolvency and demanded recapitalization by existing shareholders with the threat that the Fund would take control unless such recapitalization occurred. The Bank of Spain allowed Fund appraisers to be involved in the assessments so the Fund could be better prepared to tackle specific problems, even before acquiring full control of the bank (Sheng 1996).

Insolvent banks were pressured to recapitalize or give control to the Fund. Banks whose shareholders were unwilling to recapitalize them could stop receiving liquidity support from the Bank of Spain and even lose their license to operate. The General Corporate Law was amended to reduce the quorum of shareholders necessary to approve recapitalizations. This allowed the Fund to expedite the process of interventions in insolvent banks (Sheng 1996).

The Fund gained control of a bank at a shareholders meeting, which had to be convened within seven days of the Bank of Spain requesting it. The Bank of Spain would inform shareholders of the scope of the problems the institution faced, such as the extent of losses and the effect of write-offs on bank capital and reserves. If the bank had no capital and its shareholders were unwilling to recapitalize it, they had to "volunteer" to sell capital to the Fund for a symbolic price of one peseta per share. This price could be more if the bank's capital was not fully depleted or if shareholders were "innocent" and deserved protections (Malo de Molina and Martín-Aceña 2011; Sheng 1996). A process called the "accordion operation" consisted of first, an erosion or dilution of shares held by former shareholders, followed by recapitalization provided by the Fund, with the fund taking majority ownership (De Juan 2019). It served two purposes: to amortize potential bank losses and to penalize shareholders by significantly diluting or writing off their participation (De Juan 2019). In some instances, the Fund gained control only after applying the accordion operation to the holding company (Sheng 1996).

The government directly nationalized the politically sensitive Rumasa group, rather than use the Fund. The group included 20 of the 52 banks affected by the crisis (Klingebiel 2000).

11. Eligible Assets: The Fund could purchase all types of assets, including shares, loans, and real estate.

The Fund purchased problem assets that were considered undesirable to potential acquirers, as its goal was to ultimately reprivatize the intervened bank (Sheng 1996). It could acquire any type of asset, including loans, shares, real estate, or other asset types (De Juan 2019). The Fund did not acquire performing loans, as those were part of the acquisition and reprivatization (Klingebiel 2000).

12. Acquisition – Mechanics: The Fund determined the specific assets to purchase from insolvent banks based on negotiations with the institutions acquiring these banks.

The Fund, together with the Bank of Spain, arranged a prospectus for the sale of a troubled bank with a set deadline for bids. The prospectus would be sent to selected domestic and foreign banks and included the maximum value of and specific conditions under which bad assets could be carved out by the Fund. This turned out to be the key issue in recurrent negotiations between the Fund and potential buyers.

The offer also outlined the specifics on the support provided by the Fund and the Bank of Spain (e.g. subsidized interest rates, regulatory forbearance, guarantees against "hidden liabilities," etc.). Potential buyers could make counterproposals, which the Fund Board of Directors would review. Buyers were required to renounce any future claims or legal actions against the Fund that would result from differences between expected and realized asset returns. Lastly, the Board would communicate to the Ministry of Finance the offer chosen. Then, the Ministry had fifteen days to exercise its option to purchase the shares when the national interest was a concern. This two-stage mechanism provided checks and balances to the restructuring efforts (Sheng 1996).

13. Acquisition – Pricing: The Fund purchased assets at face value.

The Fund purchased the non-performing assets of the insolvent banks at book value—that is, at the nominal value of loans less provisions—because Spanish authorities deemed it impossible to determine a market price. In doing so, the Fund absorbed any related losses. As those losses were typically greater than a bank's equity, this policy was the main restructuring measure that the Fund adopted. According to the former head of the Fund, "the share capital increases carried out were intended for recapitalization and were insufficient for this purpose" (De Juan 2019). Overall, real estate and other asset purchases accounted for about 80% of Fund transactions and bank equity purchases accounted for 20%. The 24 restructured banks had initial capital of 56 billion pesetas; they wrote off 40 billion pesetas on bad loans and received 71 billion in capital from the government (see Appendix C). In comparison, the Fund spent more than 300 billion pesetas to acquire non-performing assets and real estate in order to facilitate transactions with acquiring banks.

14. Disposal: The Fund's objective was to dispose of the assets purchased as fast as possible, while maximizing their recovery value.

In terms of asset management, the main goal of the Fund was to dispose of the assets purchased as fast as possible while maximizing their recovery value (Klingebiel 2000). By law, the Fund had to release control of the banks in which it intervened within a year, but the assets acquired could be sold beyond that timeframe (Sheng 1996).

The Fund sold assets including (a) stock holdings of the Fund in firms or holding companies or liquidations; (b) real estate; (c) securities; and (d) loans. As for the loans that the Fund could not sell to the new investors of a bank, sale of mortgage loans and real estate were the most successful (Klingebiel 2000).

At the time of this writing, there was public data available on the amount the Fund recovered on the disposal of assets. By the end of 1986 the Fund had accumulated losses of 90 billion pesetas (Deposit Guarantee Fund 1987).

15. Timeframe: The Fund did not have a pre-established sunset date.

The Fund did not have a defined sunset date. It was legally required to offer the intervened banks for sale within a year, but the asset management activities did not have a defined timeframe. The Fund continued to manage assets as of 2000 (Klingebiel 2000).

III. Evaluation

There is limited evaluation of the Fund despite its central, multi-purpose role in dealing with the Spanish banking crisis (1977-85). The institutional reforms adopted in Spain to deal with the banking crisis evolved rapidly as financial conditions deteriorated. Although the authorities initially underestimated the extent and depth of the banking crisis and provided only limited deposit guarantees, they soon developed an approach to resolving individual bank failures that Andrew Sheng, a former World Bank official, has characterized as "fair, flexible, and pragmatic" (Sheng 1996). Sheng points to the Fund's private-public structure and close relationship with the Bank of Spain as having "mitigated the likelihood of bureaucratization and politicization and fostered a public perception of fairness." Moreover, Sheng argues that the separation of the problems of the Rumasa group from the scope of Fund intervention indicates they were realistic in assessing the appropriate limits of the Fund's capabilities (Sheng 1996). The Fund focused on smaller banks, which were "politically easier" to resolve than the banks in the Rumasa group, according to Daniela Klingebiel, another World Bank official (Klingebiel 2000).

Klingebiel has argued that the Fund was established with appropriate funds and appropriate powers. She concludes that it was relatively successful compared to asset management companies established in other countries because it had a targeted mission to dispose of assets as fast as possible while maximizing the recovery value of the assets. She also notes that the extent of non-performing loans in the Spanish banking system—under 10%—was relatively limited compared to other banking crises (Klingebiel 2000).

However, there were several challenges associated with the Fund's operations. The Spanish framework for foreclosures and seizures of collateral was inadequate and hampered the rapid sale of assets. Additionally, the Fund encountered problems with transfer of titles, and there was lackluster demand for real estate assets. Despite succeeding in selling 26 banks, the Fund was much less successful in achieving its aim of "rapid disposal of bad assets" that had been carved out from banks' balance sheets. This difficulty occurred in the context of a generally benign macro-environment and increasing real estate prices (Klingebiel 2000).

In the opinion of Aristóbulo de Juan, former CEO of the Fund and the Corporation, the Fund played a leading and effective role in resolving the majority of bank problems in Spain. He has pointed to several features that he believes were critical to its operations, including the contribution of private-sector entities to the cost of the rescues and the transfer of assets at face value to avoid the technical and litigation-related challenges that an appraisal-based approach would involve (De Juan 2019).

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Legal/Regulatory Guidance

Royal Decree 54/1978. Real Decreto 54/1978, de 16 de enero, por el que se modifica el Real Decreto 3048/1977, de 11 de noviembre, por el que se crea el «Fondo de Garantía de Depósitos en Establecimientos Bancarios» (Spain 1978).
The legislation amending the decree that established the Fund in 1977.
https://ypfs.som.yale.edu/library/real-decreto-ley-41980-de-28-de-marzo-por-el-que-se-dota-de-personalidad-juridica-al-fondo.

Royal-Decree Law 4/1980 of March 28th, Granting the Deposit Guarantee Fund for Banking Institutions Legal Personality, and other Auxiliary Measures (Spain 1980).
The legislation providing the Fund with the legal authority to intervene in distressed banks and recapitalize them.
https://ypfs.som.yale.edu/library/real-decreto-ley-41980-de-28-de-marzo-por-el-que-se-dota-de-personalidad-juridica-al-fondo.

Media Stories

Aprobado un Nuevo Mecanismo de Salvación en Bancos en Crisis (El País 1980).
A newspaper article announcing the expansion of the Fund's activities.
https://ypfs.som.yale.edu/library/aprobado-un-nuevo-mecanismo-de-salvacion-en-bancos-en-crisis.

Key Academic Papers

From Good to Bad Bankers. Lessons Learned from a 50-Year Career in Banking (De Juan 2019).
A book by a leading Spanish official with a chapter about the bank crisis of the late 1970s and 1980s.
https://ypfs.som.yale.edu/library/good-bad-bankers-lessons-learned-50-year-career-banking-0.

La crisis bancaria en España: 1977-1985: causas, sistemas de tratamiento y coste.
A book about the bank crisis in Spain and the resolution methods (Cuervo 1988).
https://ypfs.som.yale.edu/library/la-crisis-bancaria-en-espana-1977-1985-causas-sistemas-de-tratamiento-y-coste.

Use of Asset Management Companies in the Resolution of Banking Crises. Cross-Country Experience (Klingebiel 2000).
A paper analyzing the effectiveness of the design and operations of different AMCs.
https://ypfs.som.yale.edu/library/use-asset-management-companies-resolution-banking-crises-cross-country-experiences.

The Spanish Financial System: Growth and Development since 1900 (Malo de Molina and Martín-Aceña 2011).
A book about the Spanish financial system and its evolution from the 20th century.
https://ypfs.som.yale.edu/library/spanish-financial-system-growth-and-development-1900.

Bank Restructuring: Lessons from the 1980s (Sheng 1996).
A World Bank report on bank resolution with a chapter about the Spanish financial crisis of the late 1970s and 1980s.
https://ypfs.som.yale.edu/library/bank-restructuring-lessons-1980s.

Reports/Assessments

Crisis bancarias, soluciones comparadas: Seminario desarrollado en la Universidad Internacional Menéndez Pelayo (Seminario 1984).
A book, in Spanish, about the Spanish banking crisis and the government's response.
https://ypfs.som.yale.edu/library/crisis-bancarias-soluciones-comparadas-seminario-desarrollado-en-la-universidad.

VI. Appendixes

Appendix A: Spain Macroeconomic Indicators: 1970-89

Table 5.1 Macroeconomic indicators, 1970–89

(percent unless otherwise specified)

Year	*Real growth in GDP*	*Current account/GDP*	*Terms of trade (1980=100)* [a]	*Inflation rate* [b]	*General government financial balance/GDP*	*Bank nominal interest rate* [c]	*Exchange rate (pesetas/U.S. dollar)*
1970	4.1	2.2	153.1	5.7	0.7	n.a.	70.0
1971	4.6	2.0	159.8	8.2	–0.6	n.a.	69.4
1972	8.0	1.1	155.8	8.3	–0.2	n.a.	64.2
1973	7.7	0.8	146.4	11.4	0.8	n.a.	58.2
1974	5.1	–3.6	108.2	15.7	–0.3	n.a.	57.6
1975	0.5	–3.3	117.9	16.9	–0.5	n.a.	57.4
1976	3.3	–3.9	114.0	14.9	–1.0	n.a.	66.9
1977	3.0	–1.6	108.0	24.5	–1.3	14.0	75.9
1978	1.4	1.1	114.9	19.8	–2.3	15.0	76.6
1979	–0.1	0.6	114.7	15.7	–2.1	15.7	67.1
1980	1.2	–2.4	100.0	15.6	–2.5	17.1	71.7
1981	–0.2	–2.6	85.1	14.5	–3.8	16.7	92.3
1982	1.2	–2.4	91.3	14.4	–5.4	16.4	109.8
1983	1.8	–1.6	86.8	12.2	–4.6	16.7	143.4
1984	1.8	1.3	89.3	11.3	–5.3	16.9	160.
1985	2.3	1.7	89.8	8.8	–6.9	15.8	170.0
1986	3.3	1.7	104.6	8.8	–6.0	14.6	140.0
1987	5.5	0.0	98.3	5.3	–3.2	15.7	123.4
1988	5.0	–1.1	103.0	4.8	–3.3	15.3	116.4
1989	4.8	–2.9	105.5	6.8	–2.8	16.3	118.3

a. Ratio of the index of average export prices to the index of average import prices.
b. Consumer price index.
c. Does not include regulated or special rates for private banks. Rates are averages of selected rates for commercial discounts, credits, and loans.
Source: IMF and World Bank data; Bank of Spain.

Source: Sheng 1996, 88.

Appendix B: Legislation Timeline

Legislation Timeline		
Date	**Law**	**Purpose**
Aug/09/1974		Bank reforms of 1974 led to liberalization of the banking industry. The new measures facilitated opening new banks. Deposit interest rates and many lending rates were deregulated.
Nov/11/1977	Royal Decree 3048/1977	The Deposit Guarantee Fund is created. It was merely a deposit insurance for up to 500,000 pesetas ($6,500 at the time).
Jan/16/1978	Royal Decree 54/1978	The Fund was able to anticipate funds for banks facing problems, for reasons of public interest and with a vote of 3/4 of the Board. Therefore, the Fund did not have to wait for insolvency.
Mar/01/1978		The Banking Corporation (Corporación Bancaria S.A.) is created. It was a private management company owned equally with the private banks, introduced to handle banks in crisis. The fund was 500 million pesetas ($6.5 million). Equal contributions came from the banking industry and the Bank of Spain.
Mar/06/1978	Decree-Law 5/1978	The Bank of Spain is authorized to temporarily suspend the executive/administration of a bank. It was applied to: Asturias, Promoción de Negocios, and Occidental y Comercial Occidental, which were sold to other bank institutions soon after being intervened.
Mar/28/1980	Royal Decree-Law 4/1980	The Deposit Guarantee Fund for Banking Institutions is institutionalized as a public body governed by the rules of private law. The Fund combined the management functions carried out by the Corporation with the deposit guarantee function. The insured deposits increase from 500,000 pesetas to 750,000 pesetas.
Jun/13/1981	Royal Decree 1.620/1981	Insured deposits increase from 750,000 to 1,500,000 pesetas. The ceiling for the Bank of Spain to make contributions to the Fund is removed.
Sep/24/1982	Royal Decree-Law 18/1982	The Deposit Guarantee Fund for Credit Cooperatives is created. Both the Fund for Credit Cooperatives and Savings Banks are given legal powers similar to the Deposit Guarantee Fund for Banking Institutions. It is established that if the Bank of Spain anticipates contributions to the Fund for more than four times the amount given by the banks, then the Bank of Spain could increase the banks' percentage of annual contributions from 0.1% to up to 0.2%.
Feb/23/1983	Royal Decree-Law 2/1983	Nationalization (expropriation) of the Rumasa group—20 banks

Appendix C: Deposit Guarantee Fund Control and Subscription of New Values

Annex 5.2 Deposit Guarantee Fund control and subscription of new values
(millions of pesetas)

Bank	*Means of acquisition*	*Initial capital*	*Writeoffs against capital value*	*Capital increase*	*Final capital*	*Capital increase/ initial capital*
Cantabrico	1 peseta per share	764	267	795	1,292	1.04
Meridional	1 peseta per share	1,125	1,012	1,102	1,125	0.90
Valladolid	1 peseta per share, plus 700 million pesetas to cancel debt of previous owners	2,200	1,100	4,400	5,500	2.00
Granada	1 peseta per share	2,247	786	3,054	4,515	1.36
Credito Comercial	Controlled through its holding banks	776	0	0	776	0.00
Asturias	—	936	468	936	1,404	1.00
Lopez Quesada	—	1,621	810	3,100	3,911	1.91
Promocion de Negocios	—	1,444	722	1,444	2,166	1.00
Catalan de Desarrollo	—	2,625	2,625	3,000	3,000	1.14
Industrial Mediterraneo	—	2,100	1,050	2,500	3,550	1.19
Occidental	1 peseta per share	4,630	4,621	7,000	7,009	1.51
Comercial Occidental	Controlled through its holding banks	1,625	1,621	500	504	0.31
Descuento	1 peseta per share	2,250	2,245	2,500	2,505	1.11
Union	50 percent of the nominal price of each share	7,723	0	0	7,723	0.00
Prestamo y Ahorro	Controlled through its holding banks	2,256	2,233	1,500	1,523	0.66
Mas Sarda	—	2,283	1,529	3,000	3,754	1.31
Levante	1 peseta per share	1,992	1,990	5,500	5,502	2.76
Catalana	—	5,754	5,748	15,344	15,350	2.67
Industrial de Cataluna	Controlled through its holding banks	4,258	4,254	4,500	4,504	1.06
Industrial del Mediterraneo	Controlled through its holding banks	3,550	3,543	3,500	3,507	1.00
Barcelona	Controlled through its holding banks	568	567	1,137	1,138	2.00
Gerona	Controlled through its holding banks	397	0	0	397	0.00
Alicante	Controlled through its holding banks	1,594	1,592	2,500	2,502	1.57
Credito e Inversiones	1 peseta per share, controlled through holding banks	1,595	1,592	3,500	3,503	2.19

— Not applicable.
Source: Deposit Guarantee Fund; Larrain and Montes-Negret 1986; author's calculations.

Source: Sheng 1996, 97.