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Spain's Bank Mergers Suddenly Drying Up

What Happened to Combining the Cajas? Pay, for One

By SARA SCHAEFER MUÑOZ

Four months after Spain forced a wave of mergers meant to stabilize its teetering regional savings banks, the process of combining the institutions has slowed to a crawl amid political and technical problems.

The Bank of Spain last spring forced a dozen shotgun weddings among the regional institutions, known as cajas, reducing the number of such banks from 45 to 18. Deal partners ranged from tiny southern lender Caja Jaen, to the large La Caixa, which has more than 5,000 branches across the country.

The move was seen as a victory for the Spanish regulator, which was scrambling to fix a sector that was being towed under by a backlog of toxic real-estate loans.

But after the initial flurry, people close to the situation say, the process of combining the local lenders has been mired in governance battles, labor disputes and technical hurdles. Six of the 13 deals haven't been completed yet. Those six deals represent half of the assets in the regional-bank sector.

And those that are complete have made little progress toward tackling the cajas' mountain of bad loans, which represent about half of the €180 billion ($248 billion) in delinquent or "doubtful" loans related to Spain's property and construction sector.

"The mergers have been a way of putting together the accounts of different institutions," said José García Montalvo, chairman of the department of economics and business at the Universitat Pompeu Fabra in Barcelona. "But it is mostly on paper. The cleaning of the balance sheets is moving too slowly."

The mergers have been waylaid on both practical issues—such as reconciling clashing tax rules among Spain's different regions—and small but fierce local battles, such as an outcry by employees of Valencia-based Bancaja over its merger partner's effort to impose Thursday afternoon branch openings.

Bloomberg News

How quickly and successfully the new entities can restructure and address the toxic real-estate assets on their balance sheets is important not just for Spain, but for the stability of the euro zone.

That is because the network of savings banks account for half of the financial sector of Spain, the fourth-largest economy in the euro zone, and their troubles have been a factor in provoking investor jitters and driving up the cost of funding for all banks.

Five cajas failed the "stress tests" of European banks last July. The goal of consolidation was that stronger cajas would absorb those weaker ones, cut costs and shore up needed capital with help from a special fund set up by the Bank of Spain.

Another aim was to strengthen and modernize the opaque lenders, whose governance has included unions, local politicians and, in some cases, the Roman Catholic Church.

Grumbles about the slow integration process have surfaced recently. Officials from the Bank of Spain have urged some cajas to speed the process, according to a person familiar with the matter. Last month, Emilio Botín, the chairman of Banco Santander SA, a global bank whose fate is still partially tied to the Spanish market, said the restructuring "isn't going at the right speed."

A spokesman for the Bank of Spain said officials are in constant contact with banks and declined to comment on the nature of any discussions. He also said the consolidation is progressing well and had been expected "to take some time," but most should be operational by year's end.

Some progress has been made. Banca Civica, a combination of three cajas, has been up and running for several months and is set to receive a €450 million investment from U.S. private-equity firm J.C. Flowers & Co.

The overall integration process is slow in part because it means a rollback in employment in a country where joblessness has reached 20%. Joaquin Maudos, an economics professor at the University of Valencia, said savings banks added 30,600 new employees from 2000 to 2008, for a total of 132,000 employees in the sector at the end of 2009.

Now, Mr. Maudos estimates the sector will need to shrink the work force to pre-boom levels in order for the new entities to compete and survive.

Unions have been lobbying to keep jobs and create attractive early-retirement packages. "We are conscious they have to transform the sector, but we don't want them to do it in a way that is traumatic for the workers," said Antonio Muñoz, national secretary for the savings sector of Spain's General Workers Union.

Other problems are more basic. Caja Madrid's group, to be Spain's largest new savings bank with €337 billion in assets, has yet to name a managing board for its seven-way merger. The new entity led by Cajastur, which will be the third largest in the sector, won final approval two weeks ago from the four bodies involved in its merger with Caja de Ahorros Mediterráneo after six months of negotiation, during which its partner threatened to pull out of the merger over the job protection for the new president.

A Caja Madrid spokesman said the bank aims to be legally constituted before year end and has created working groups to study the integration. A Cajastur spokesman said the process is advancing at a good pace.

Some one-on-one mergers have also hit roadblocks. CajaSur, which faced insolvency when it was seized by the Bank of Spain in May, still hasn't been fully taken over by its stronger partner, Bilbao Bizkaia Kutxa, a lender from Spain's Basque region. Talks have been hindered by complaints from Catholic priests who governed the failed institution, saying they deserve about €20 million in compensation as founders of the 150-year-old caja.

Adding to the slowdown is the unique and relatively untested structure being used in some of the mergers. The structure, called an institutional protection scheme, or "cold merger," was created to make the idea of a merger more palatable to cajas from different regions. It allows them to maintain their branding and corporate governance in exchange for pooling their assets and providing liquidity guarantees within a central holding bank that can eventually go to the markets for funding and equity.

"These cold mergers were nothing more than a concept," said David Franco, a partner at law firm Freshfields, Bruckhaus Deringer LLP in Madrid, who is advising on some of the deals. "We are writing the script as we work on the project."

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