Spain – Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (SAREB)

David C. Tam[1]

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Abstract

The Spanish government created SAREB in 2012 to buy impaired real estate assets from troubled banks and sell them over a 15-year period. (Blueprint, 3). Its mandate was "to help clean up the Spanish financial sector and, in particular, the banks that became financially distressed as a result of their excessive exposure to the real estate sector." (About us). SAREB was 55%-owned by private interests and expected to turn a profit. Using state-guaranteed debt, SAREB acquired 200,000 assets valued by SAREB at €50.8 billion from troubled banks at a substantial discount to book value. (About Us). Banks that sold assets to SAREB were either nationalized or supported with government capital injections. SAREB hired first the banks, and following conflict of interest concerns, later third-party servicers, to assist in the divestment process. (See KDD 15 for sourcing). Spain's slow economic recovery hampered SAREB's asset disposition efforts. As of 2018, it had disposed of €16.4 billion of the €50.8 billion worth of assets it had originally acquired and had failed to achieve the expected returns for private investors. (See table 1 sources p5).

Keywords: Asset Management Company, SAREB, Spain, Bank of Spain, Global Financial Crisis

[1] Research Associate, Yale Program on Financial Stability (david.tam@yale.edu)

Spain - SAREB

At a Glance

Summary of Key Terms	
Purpose: "to help clean up the Spanish financial sector and, in particular, the banks that became financially distressed as a result of their excessive exposure to the real estate sector." (About us)	
Announcement Date	July 20, 2012 (MoU, 1)
Operational Date	November 28, 2012 (Activity Report 2013, 16)
Date of First Transfer	December 31, 2012 (Activity Report 2013, 17)
Expiration Date for Transfers	None; Second (and likely final) transfer completed February 28, 2013 (Activity Report 2013, 17)
Program Size	Not specified
Usage	Approximately 200,000 assets valued by SAREB at €50.8 billion acquired. (About Us).
Outcomes	€16.4 billion of €50.8 billion disposed of for a total loss of €3.06 billion as of 2018. (Activity Report 2018, p14 for reduction of portfolio; See Table 1 sources on page 5 for losses)
Notable Features	Use of banks themselves to dispose of former assets before conflict of interest concerns prompted a shift to servicers.

By the middle of 2012, it had become apparent to the Spanish government that dramatic action needed to be taken in response to the deteriorating state of Spain's troubled banking system. Spain's real estate sector was plagued by a high rate of non-performing loans and other problematic assets. Because many banks held these assets on their balance sheets, they faced elevated borrowing costs with counterparties hesitant to lend. (MoU, 2). On July 20, 2012, European authorities and the Spanish government signed a Memorandum of Understanding (MoU) which granted el Fondo de Reestructuración Ordenada Bancaria (FROB), in English known as the Fund for Orderly Bank Restructuring, State aid in the form of an EFSF loan of up to €100 billion for its goals of restructuring troubled banks. (MoU, 1 for date, 15 for 100). Most notably, the MoU provided for the creation of the 'Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria' or 'Asset Management Company for Assets Arising from Bank Restructuring' better known by the Spanish abbreviation SAREB. (MoU).

The task for SAREB was to clean up Spanish bank balance sheets by buying impaired real estate assets and then divesting them over a 15-year period. (Blueprint, 3). SAREB was majority-private, allowing operational autonomy, a for-profit motive in addition to its restructuring mandate, and for its liabilities to not be considered part of the national debt by Eurostat. (Eurostat, 2-4). Using government-guaranteed debt, SAREB acquired its assets from banks that had failed stress tests. (Blueprint, 10; Activity Report 2013, 16). The prices of transferred assets were determined by FROB with reference to a pre-existing Oliver Wyman report that estimated the "Real Economic Value" of the assets. (Activity Report 2013, 64). SAREB maintained its own staff but hired first the banks, and later following conflict of interest concerns, third-party servicers, to assist in the divestment process. (See KDD 15 for sourcing).

Summary Evaluation

SAREB ultimately acquired approximately 200,000 assets valued by SAREB at €50.8 billion. (About Us). As of 2018, it had disposed of €16.4 billion of these assets. Considerable and sustained losses have hampered SAREB's portfolio since its creation. Despite projecting investment returns of at least 14%, (Eurostat, 2) SAREB has in fact suffered sustained losses in the first six years of its existence. (See table 1 sources on page 5). Nevertheless, SAREB's proponents note that despite early struggles, SAREB's ultimate performance remains undetermined. Furthermore, even if it never achieves profitability, SAREB may yet prove to be successful in its broader goal of supporting the financial sector. As of the time of writing of this case, there has been limited scholarship about the effectiveness of SAREB, not least because SAREB is an ongoing program.

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I. Overview

Background

By the middle of 2012, it had become apparent to the Spanish government that dramatic action needed to be taken in response to the deteriorating state of Spain's troubled banking system. Spain's real estate sector was plagued by a high rate of non-performing loans (NPL) and other problematic assets. Because many banks held these assets on their balance sheets, and in part because they were already under-capitalized, they faced elevated borrowing costs with counterparties hesitant to lend. (MoU, 2). Spanish banks had become highly dependent on Eurosystem refinancing, and so the borrowing capacity of Spanish banks had been severely limited by the impact of ratings downgrades on commonly used collateral. To address this, Spanish authorities appealed to European authorities on June 25, 2012 for external financial assistance to support their ongoing efforts to restructure and recapitalize the banking sector. The Spanish government specifically appealed to a program called the Financial Assistance Programme for the Recapitalization of Financial Institutions administered by the European Financial Stability Facility (EFSF)[2]. (MoU, 1). The EFSF and the Spanish government subsequently signed a Memorandum of Understanding (MoU) on July 20, 2012. The MoU granted el Fondo de Reestructuración Ordenada Bancaria (FROB), in English known as the Fund for Orderly Bank Restructuring[3] up to €100 billion in State aid (in the form of an EFSF loan) for its goals but it also came with a number of conditions. (MoU, 1 for date, 15 for 100). Most notably, it provided for the creation of the 'Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria' or 'Asset Management Company for Assets Arising from Bank Restructuring' better known by the Spanish abbreviation SAREB. (MoU, 3 Search for AMC).

The presence of NPLs and other impaired real estate assets created an environment in which the full extent of losses had not yet been realized for the banks that retained them. As long as this was the case, European authorities reasoned, Spanish banks would still be viewed by the broader market as a credit risk. (MoU, 2). The solution that European authorities came to was the creation of SAREB, an asset management company, sometimes referred to as a "bad bank."

Program Description

The groundwork was laid for SAREB's creation with the passing of Spanish Royal Decree-Law 24/2012 on August 31, 2012 (RDL 24/2012) but it wasn't until mid-November that it was formally created and reinforced by Royal Decree 1559/2012 of November 15, 2012 and Law 9/2012 of November 14, 2012 respectively. (RD 1559/2012; Law 9/2012). As SAREB itself states, "Our company was founded in November 2012 to help clean up the Spanish financial

[2] Established in June 2010, EFSF was a "temporary crisis resolution mechanism" which provided assistance to Ireland, Portugal, and Greece. It has subsequently been replaced the European Stability Mechanism. (EFSF overview)

[3] Established in 2009 (About FROB), and operating under the legal regime of Law 11/2015 of June 18, 2015, FROB describes itself as the Spanish Executive Resolution Authority focused on the "recovery and resolution of credit institutions and investment services." (About FROB)

sector and, in particular, the banks that became financially distressed as a result of their excessive exposure to the real estate sector." (About us). Spanish banks identified by authorities as being in need of significant restructuring were to promptly transfer the riskiest and most distressed real estate assets to SAREB so as to clean up their own balance sheets and hopefully lower borrowing costs. It was SAREB's role, in turn, to "carry out an orderly divestment of the distressed assets" over a 15-year period. (About us).

For a number of reasons including the need to facilitate operational and organizational autonomy, SAREB had a public-private ownership structure. Approximately 45% of SAREB was owned by FROB and therefore, indirectly, by the government and ultimately, taxpayers. Approximately 55% of SAREB, meanwhile, was owned by private investors, mainly banks and insurance companies. Of the 21 private investors in SAREB, 14 were Spanish banks, two were foreign banks (Deutsche Bank and Barclays) four were insurers (three Spanish and one French), and one was a Spanish electric company (Iberdrola) (refer to Appendix A for a full list of investors and the capital provisioned). (Capital Increase, p2). The majority-private ownership structure meant that SAREB was not legally considered "state-owned" and its liabilities were not considered to be part of the Spanish national debt by Eurostat. (Financial Stability Review, 117FN11).

In setting up and managing the program, SAREB administrators often relied on a considerable amount of preexisting administrative infrastructure. For example, to determine which institutions would transfer assets, SAREB administrators utilized bank groupings created by FROB based on government-contracted stress tests conducted by Oliver Wyman. These stress tests, and subsequently submitted recapitalization plans, resulted in the creation of four groups, only two of which participated in SAREB. [4] (MoU p4 for explanation of groups; Activity Report 2013, 17).

SAREB also set a number of eligibility requirements for the specific assets it would assume. SAREB would acquire foreclosed real estate assets with an individual minimum asset size of €100,000, all loans to real estate developers with a minimum borrower exposure of €250,000, and ownership interests in select real-estate companies. (Blueprint, p4).

The transfer value, or price at which SAREB would buy assets from banks, was to be based on two components. The first was the "Real Economic Value" or REV of a particular asset or class of assets. (MoU, 10). The REV had been determined by the Bank of Spain with the Oliver Wyman exercise used as a reference. Secondly, after the REV was arrived at, an additional discount was applied to defray management, administrative, and other costs as well as compensate for the timing of divestment. (Activity Report 2013, 64). Ultimately, on average, the discount represented approximately 63% on the gross book value of all foreclosed assets acquired, though there was a considerable amount of variation between different asset classes. (Blueprint, p6).

A provisional business plan was designed for SAREB with a 15-year time horizon. (Blueprint, 3). SAREB managed to raise €4.8 billion in equity and subordinated debt (€3.6 billion of subordinated debt and €1.2 billion in equity, of which €540 million was from FROB) which

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[4] Four of the banks that participated, BFA-Bankia, Catalunya Banc, NCG Banco and Banco de Valencia were already majority-owned by FROB. (MoU p4). The additional three banking groups were Banco Popular, BMN, and a group comprised of the planned merger of Ibercaja, Liberbank and Caja 3.

provided an initial capitalization. (IMF, 20). This capital was not intended to be used to acquire assets. Instead, SAREB was to issue its own bonds (guaranteed by the Spanish government) "as consideration for assets transferred." (Blueprint, 9). This senior debt was to be subscribed by the participating banks and the banks could then use it as collateral to better access Eurosystem refinancing. (Refer to Appendix B).

Initially SAREB employed the very banks that had previously owned the assets to sell them, reasoning that these banks had the most knowledge of the assets in SAREB's portfolio. (Activity Report 2014, 14). Furthermore, SAREB chose to package and sell its assets in bulk in an attempt to raise revenue quickly to service its growing debt burden. In December 2014, in the face of persistent losses, however, SAREB awarded contracts to four loan "servicers". The government was concerned that employing distressed banks to unload SAREB's assets had presented these banks with a conflict of interest since they were simultaneously trying to dispose of similar assets that remained on their own balance sheets. (See KDD 15 for sourcing). At the same time, in the intervening years since SAREB was established, several of the participating banks had sold their loan platforms which had helped to create a burgeoning new industry in loan servicing. (Activity Report 2014, 14). Furthermore, SAREB's management agreements were set to expire in December 2014. The need to renegotiate management agreements anyway coupled with a different market outlook and conflict of interest concerns gave SAREB the opportunity to shift to the new servicers. (Activity Report 2014, 14). The arrival of the new servicers was coupled with a change in asset disposal strategy. Rather than sell assets in bulk, SAREB embraced a sales approach that was smaller and more open to customer preference. (Activity Report 2014, 14).

Outcomes

SAREB ultimately acquired approximately 200,000 assets valued by SAREB at €50.8 billion (About Us). Around 80% of these assets were real estate developer loans and the remaining 20% were real estate assets. (About Us). This €50.8 billion was discounted substantially from a gross book value of €106.9 billion (Activity Report 2013, 45).

It is unclear why SAREB didn't acquire the entirety of the market's bad loans (valued at approximately €167 billion) (Handelsblatt), however there are several possible explanations. For one, some banks were ineligible. Banks that had not failed stress tests did not receive access to SAREB assistance. (Activity Report 2013, 16). Further, because of asset eligibility standards, SAREB did not acquire real estate assets valued less than €100,000 or loans to real estate developers of less than €250,000. (Blueprint, p4).

The acquisition and transfer of assets from troubled banks to SAREB occurred in two phases. In the first phase on December 31, 2012, SAREB acquired 145,125 assets valued at €36.7 billion from BFA-Bankia, Catalunya Banc, NCG Banco-Banco Gallego, and Banco de Valencia, the four 'Group 1' institutions that had failed stress tests and were subsequently nationalized under FROB. (Ortiz Risueno, p24). (see Appendix C).

Then on February 28, 2013, a further 52,349 assets valued at €14.1 billion were transferred to SAREB from Liberbank, BMN, Caja3, and Banco CEISS, institutions that had failed stress tests and received government capital injections from the State through FROB in separate operations. (Ortiz Risueno, p24). (see Appendix C).

Since its founding in late 2012 until the writing of this case in 2019, SAREB has been plagued by numerous problems, most notably by significant and frequent delays in implementation and substantial losses. Despite an ambitious schedule, the implementation and acquisition phases have suffered from various delays. For example, despite the fact that the MoU was signed back in July 2012 (MoU), SAREB languished in regulatory limbo for much of 2012 and wasn't properly established, nor given formal approval to compel banks to transfer assets until November 2012, (Law 9/2012, RD 1559/2012) so SAREB didn't complete its first asset transfer until December 31, 2012. (Activity Report 2013, 17).

Similarly, the pace of sales (and consequently revenue) declined noticeably in late 2014 as SAREB dramatically transformed its sales operations. (Activity Report 2015, 32-34 for description of migration and transformation). After initially relying on the very banks that had transferred the assets to provide aid in disposing of them, SAREB, in response to poor performance and concerns about potential conflict of interest, decided to change its sales approach. (See KDD 15). In late 2014, SAREB formally hired four third-party servicing companies to assist in selling its assets. (Activity Report 2015, 32). These servicers specialize in recovering value from distressed loans and real estate holdings. During the process of hiring the new servicers, the pace of sales declined precipitously as the servicers took time to take stock of the broad new inventory that they were responsible for disposing of. The pace of sales has subsequently picked up. (Activity Report 2015, 38).

Further hampering the pace of sales was the implementation of updated rules for SAREB's valuation of assets which were released in October 2015. As Cas and Peresa explain,

> "The new rules require the assessment of all its assets individually to reflect changes in market prices by end-2016. This resulted in additional impairment provisions of EUR 2.04 billion, of which 90% was applied retroactively to the 2014 and 2015 accounts. For this purpose, SAREB exhausted the buffer provided by its original shareholder equity and in addition had to convert EUR 2.17 billion of its subordinated debt into equity. Following the conversion, it had EUR 0.95 billion in equity and EUR 1.43 billion in subordinated debt. The new valuation standards have implications on its disposal business too, as they require SAREB to focus on operations where the sale price of the asset is above the valuation price to generate profits, causing a temporary slowdown in the disposal of its assets." (Cas and Peresa, 24).

At the time of writing in 2019, SAREB had sold a total of €16.4 billion worth of assets, or about 32.3% of its portfolio. Furthermore, it has only repaid €15.0 billion or 29.6% of its debt. SAREB still retains €34.4 billion of its assets against an outstanding debt of €35.8 billion. (Activity Report 2018, 14). However, there are at least several reasons that suggest the pace and profitability of sales might increase in the future. A SAREB press release from March 2018 noted that SAREB had made a record number of sales in 2017, "selling 18,925 units, an average of 52 per day. This is a 34% y-o-y increase." (19k). This surge in sales is largely attributable to both an improving Spanish real estate market, and the improving performance of servicers who now have four full years of experience working with SAREB's portfolio. Furthermore, 2017 saw SAREB launch an initiative that might further jumpstart divestment. SAREB created Témpore Properties, a so-called SOCIMI (short for Sociedades Cotizadas de Inversión en el Mercado Inmobiliario, basically a Spanish REIT) officially listed on the Alternative Stock Exchange (MAB) in April 2017. (19k). A portfolio of 1,554 assets (of which 1,383 are residential properties), valued at €175 million, was transferred from SAREB to Témpore Properties. (Activity Report 2018, 15). In its first six months of existence, Témpore Properties, which specializes in residential property rentals, managed to raise the occupancy rate of the properties it manages from 84% to 89% while lowering the rate of unpaid rents from 5.5% to 5%. (H1 2018, 57). As of the H1 2018 report, Témpore Properties is expected to continue to expand its range of assets and achieve a 5.5% gross return by 2020. If Témpore Properties continues to succeed, it can also opt to buy additional assets from SAREB, serving as an additional avenue for SAREB to help unwind its portfolio. (H1 2018, 57).

Considerable and sustained losses have hampered SAREB's portfolio since its creation. Despite projecting investment returns of at least 14%, (Eurostat, 2) SAREB has in fact suffered sustained losses in the first six years of its existence. Table 1 documents SAREB's net profit/loss in every year since its founding.

Table 1: SAREB's net losses by year

Year	Profit/Loss (millions of Euros)
2013	-261
2014	-585
2015	-103
2016	-663
2017	-565
2018	-878
Total	-3055

Source: (Activity Report 2014, p34; Activity Report 2016, p68; Activity Report 2018, p57)

The extent of SAREB's losses in its first 6 years of existence may lead to deeper problems. SAREB's initial capital[5] would ultimately be exhausted to pay down SAREB's obligations as the bonds reached maturity even as SAREB failed to turn a profit. (Cas and Peresa, 24). Despite the fact that SAREB was majority-held by private investors, there was speculation from market players that SAREB's continued losses might precipitate a downgrade in the credit rating of the entire Spanish government. These concerns were predicated upon SAREB's funding structure. Government-guaranteed senior bonds had been issued to acquire assets, representing almost 5% of Spanish GDP at the time (Cas and Peresa, 16-17). While these concerns ultimately did not come to fruition at the time, their existence reflects an underlying market concern with SAREB's continued struggles.

[5] SAREB initially raised €4.8 billion in equity and subordinated debt (€3.6 billion of subordinated debt and €1.2 billion in equity, of which €540 million was from FROB). This capitalization wasn't intended to acquire assets but instead to provide a buffer against asset depreciation. See Appendix B.

II. Key Design Decisions

1. The creation of SAREB was an essential component of broader banking sector reform.

The creation of SAREB was a precondition of a broader aid package from European authorities to the Spanish government. In the middle of 2012, in the face of a deteriorating banking sector, Spanish authorities appealed to a European program called the Financial Assistance Programme for the Recapitalization of Financial Institutions administered by the European Financial Stability Facility (EFSF). On July 20, 2012, the Spanish government and the EFSF signed a Memorandum of Understanding, which mandated the creation of an Asset Management Company as one of the preconditions for receiving an EFSF loan of as much as €100 billion. (MoU, 1 for date, 15 for 100). The EFSF believed that an Asset Management Company was an indispensable component of FROB's broader mandate of conducting banking sector reform and restructuring, as it would allow financial institutions that were struggling to borrow, as a result of mistakes of the past, to clean up their balance sheets and lower their borrowing costs. (MoU, 10). In addition to its involvement with SAREB, Spanish authorities engaged in a number of initiatives. These included efforts to "[clean] up banks' balance sheets; [increase] minimum capital requirements; [restructure] the savings bank sector; and significantly [increase] the provisioning requirements for loans related to real estate development and foreclosed assets." (Blueprint, 1). One notable initiative to support these goals includes FROB's ongoing work in analyzing recapitalization and restructuring plans that Spanish banks were required to submit to FROB. (Blueprint, 1-2)

2. To provide legal authority for SAREB, the Spanish government passed Royal Decree-Law 24/2012 of August 31, 2012, Law 9/2012 of November 14, 2012, and Royal Decree 1559/2012 of November 15, 2012 which developed Law 9/2012 still further.

On August 31, 2012, the Spanish government passed Royal Decree-Law 24/2012 on restructuring and resolution of credit institutions which among other things provided, "the necessary legal authority to ensure the AMC [Asset Management Company] is operational by December this year" (RDL 24/2012 Briefing Note, 4). Law 9/2012 of November 14, 2012 provided more authority and greater clarity over the rules of SAREB. Indispensable to the operations of SAREB, Law 9/2012 granted FROB the power to make a credit institution transfer certain impaired assets or assets that are considered potentially harmful to the institution if they remain on its balance sheet, to an AMC, to remove those assets from the balance sheet and allow them to be managed separately (Law 9/2012, Article 36). This gave FROB the authority to compel banks to transfer their distressed assets to SAREB. Finally, Royal Decree 1559/2012 of November 15 2012, implemented and formalized the legal regime required for Spain to establish an Asset Management company and included regulations specific to SAREB. (RD 1559/2012) In essence, while Royal Decree-Law 24/2012 had laid the groundwork for SAREB, Royal Decree 1559/2012 formally created it.

3. **On November 14, 2012, the Spanish Secretary of State for Economic Affairs and Business Support requested an opinion from the ECB on the draft of Royal Decree 1559/2012 that would authorize AMCs (and SAREB in particular). On December 14, 2012, the European Central Bank published the opinion.**

On November 14, 2012, the Spanish Secretary of State for Economic Affairs and Business Support requested an opinion from the ECB on the draft of Royal decree 1559/2012 that would authorize AMCs (and SAREB in particular). Published on December 14, 2012 and signed by Vitor Constancio, the Vice-President of the ECB, the report was largely favorable to the proposed Spanish legislation. (ECB AMC). In this report, the ECB concisely summarized the two primary purposes of SAREB, namely supporting and normalizing the banking system, and recovering value of the distressed assets. It reads:

> "More generally, by facilitating the transfer of non-performing assets into a separate institution, asset removal schemes such as the SAREB assist participating banks in restructuring their balance sheets, which should, in turn, improve their financial soundness. By facilitating banking sector restructuring and recovery, albeit by transferring risk from the banking sector to the State, such schemes should positively contribute to banks' ability to extend credit and support economic recovery. In addition, the value of the distressed assets may be better recovered when consolidated and managed by independent specialists." (ECB AMC, 3-4).

However, the report also raised a number of concerns about potential conflicts of interest arising from Spanish credit institutions taking ownership stakes in SAREB. (ECB AMC, 5). It also pushed for a prohibition on monetary financing and limitations on dividend payments. (ECB AMC, 4-5).

4. **SAREB engages in regular communication with investors, foreign institutions, and the public.**

SAREB regularly issues press releases on its website reporting on its financial performance and promoting new sales initiatives. SAREB also maintains several independent platforms on its website that market loan portfolios to institutional investors and real estate development companies, as well as individual properties to citizens. SAREB staff have also shared their experiences and knowledge formally with a number of delegations from other countries hoping to gain insight into how to address their own NPL troubles. Among these, SAREB has shared its expertise with representatives from Kazakhstan, the State Bank of Vietnam, DUTB (Slovenia's bank asset management company), and the Central Bank of Mongolia. (Kazakhstan; Vietnam; Slovenia; Mongolia)

5. **SAREB had a mixed public-private ownership structure and capitalized itself in part with subordinated debt which would later be converted to common equity.**

SAREB, which formally began operations on November 28, 2012, (Activity Report 2013, 16) was, by design, majority privately held. Approximately 55% of SAREB was held primarily by banks and insurance companies while approximately 45% of SAREB was owned by the taxpayers through FROB. Of the 21 private investors in SAREB, 14 were Spanish banks, two were foreign banks (Deutsche Bank and Barclays) four were insurers (three Spanish and one French), and one was a Spanish electric company (Iberdrola) (refer to Appendix A for a full list of investors and the capital provisioned). (Capital Increase, p2). This ownership structure afforded SAREB a number of benefits from a legal, perception-based, and operational efficiency standpoint.

The approach by which SAREB went about soliciting private investment has been criticized, however, with some suggesting that there was an element of arm-twisting required by the government. Aristobulo de Juan, a former General Manager at the Bank of Spain and former senior financial advisor at the World Bank, has written that these private investors were "'invited' to acquire stakes by the Spanish government in an exercise in moral suasion." (De Juan, 137).

On March 26, 2013, Eurostat issued a letter in response to several letters that had been exchanged between Eurostat and Spain's Instituto Nacional de Estadística (National Statistics Institute) in late 2012 and early 2013. At issue was "the correct ESA95 accounting treatment of the classification of [SAREB.]"[6] (Eurostat, 1). The letter concluded that because of a number of features of SAREB, including its decision-making autonomy, majority private ownership, finite lifespan, SAREB "should be classified outside the general government sector." (Eurostat, 2-3). This was essential because it allowed the debt issued by SAREB (and guaranteed by the Spanish government) to not appear as a liability for the Spanish government on its books, even as SAREB was receiving considerable state support both in the form of a minority equity stake held by FROB, and from lowered borrowing costs thanks to the state guarantee of SAREB's debt (Financial Stability Review, 116FN).

Furthermore, SAREB could be classified as a for-profit institution with the stated purpose of delivering a profit to private shareholders and taxpayers, even in the face of its mandate to assist in the restructuring and resolution of the banking system. (Eurostat, 2).

To fund its asset purchases, SAREB issued €50.8 billion worth of government guaranteed senior bonds to be used "as consideration for assets transferred." (Blueprint, 9). At the same time, SAREB received an initial capitalization of €4.8 billion, of which €3.6 billion was convertible subordinated debt.[7] After the 2015 revaluation exercise revealed SAREB to be experiencing an equity shortfall, the subordinated debt was converted into equity in keeping with the original deeds of issue of this debt. As the 2015 Activity Report describes, "The deed of issue of this debt states that it is contingently convertible in the event of an equity deficit: (i) when accumulated losses are greater than or equal to the sum of the Company's share capital and its reserves or (ii) when the Company is in a situation of mandatory dissolution because accumulated losses have reduced the Company's equity to less than one half of the share capital." (Activity Report 2015, 139).

As Cas and Peresa note, SAREB's subordinated debt holders were partially bailed in. This contrasts with the experience of junior bondholders of SNS REAAL, a Dutch insurance and

[6] The European system of national and regional accounts, known as ESA95, established accounting norms among member states of the EU that "made it possible to describe the total economy of a […] country […] and its relation to other total economies." ESA95 was replaced by ESA2010 in September 2014. (Eurostat explained)

[7] The remaining €1.2 billion was common equity. See Appendix B for SAREB's initial balance sheet.

banking institution which was nationalized by the Netherlands in 2013. In the case of SNS REAAL, junior bondholders were fully bailed in and lost all their investment, though senior bondholders did not experience any losses.

In spite of the conversion of subordinated debt to equity, (or perhaps because of the losses that precipitated it), some observers began to worry that the Spanish government, as guarantor of SAREB's senior debt, might ultimately be responsible for the mounting losses that accrued to SAREB in its first 6 years of existence. Spain had guaranteed €50.8 billion worth of senior debt issued by SAREB totaling almost 5% of Spanish GDP at the time (Cas and Peresa, 16-17). If SAREB defaulted on its debt repayments, the burden would revert to the Spanish government.

6. SAREB maintains a small but experienced staff and has ultimately made use of third-party servicers as well.

In December 2012, SAREB's first month of operation, it had only four employees. Over its first full year, its workforce swelled such that by the end of 2013, SAREB had 207 employees. (Activity report 2013, 96). In its second full year, SAREB hired over 100 new employees and by the end of 2014, it employed 314 employees. (Activity Report 2014, 68). As of the 2018 annual activity report, SAREB reported that it employed 394 employees with an average of about 19 years of experience. (Activity report 2018, 13; About Us for years of experience.) By SAREB's own admission, this remains an insufficiently small staff. "As we did not have enough employees to manage the size of our asset portfolio on their own, we assigned the management and administration of our properties to four external servicers (Altamira Asset Management, Haya Real Estate, Servihabitat and Solvia), who also operate across Spain." (About us).

7. SAREB's governance bodies are the General Meeting, and the Board of Directors. SAREB is overseen by a Monitoring Committee which includes the Bank of Spain and is overseen by the ECB. As part of this oversight, SAREB regularly submits activity reports.

As laid out in the 2014 Activity Report, "SAREB's governance bodies are the General Meeting, composed of the shareholders of the Company, and the Board of Directors, which […] comprised 15 members." (Activity Report 2014, 5). Five of these 15 members are independent, another eight are described as "proprietary directors" who represent the main shareholders of the company, and the remaining two are the Chairman and the CEO. (Activity Report 2014, 5).

The Bank of Spain oversees SAREB's compliance with its objectives and obligations as an AMC as well as regulations pertaining to governance and transparency. (Activity report 2013, 20). In addition, SAREB is also supervised by the National Securities Markets Commission (CNMV), in matters relating to business activity as "an issuer of fixed-income securities." (Activity report 2013, 20). SAREB submits publicly available half-year and annual reports to its Monitoring Committee, which, "in accordance with Act 9/2012 […] was set up for the purposes of overseeing compliance with SAREB's general objectives." (Activity report 2013, 21). The Monitoring Committee is chaired by the Ministry of Economy, Industry and Competition and includes the Bank of Spain, the Ministry of Taxes and Public Authorities, and CNMV. An ECB representative also attends meetings as an observer. (Activity report 2013, 21).

FROB is a major stakeholder in SAREB, owning nearly half of its original common equity and frequently coordinating with it in bank recapitalization and restructuring efforts. FROB, in turn, is governed and administered by an eleven-member Governing Committee which includes FROB's Chairman, four representatives from the Bank of Spain including the Deputy Governor, three representatives from the Ministry of Economy and Business, the Vice Chairman of the CNMV, and two representatives from the Ministry of Finance.

8. SAREB had no specified limitation in size.

SAREB ultimately acquired approximately 200,000 assets valued by SAREB at €50.8 billion. (About Us). This €50.8 billion was discounted substantially from a gross book value of €106.9 billion (Activity Report 2013, 45). Around 80% of these assets were real estate developer loans and the remaining 20% were real estate assets[8]. (About Us).

9. SAREB issued government-guaranteed bonds as consideration for the transferred assets.

The sooner an Asset Management Company becomes active, SAREB's proponents argued, the faster markets will calm. As assets are isolated and removed from banks' balance sheets to SAREB, the theory goes, market participants should grow less concerned about the underlying solvency of financial institutions. There was in 2012, therefore, quite a bit of urgency to make SAREB operational. (Handelsblatt, search for "the sooner it becomes active").

Under the terms of the MoU with the European Commission, SAREB agreed to issue new government-guaranteed debt to participating banks as payment for the bad assets. With such urgency, some have suggested that buying assets with newly issued government guaranteed debt seemed the optimal strategy. SAREB need not wait around either for reluctant private investors to be convinced to invest in SAREB's senior debt, nor for policymakers to approve potentially politically unpopular and bureaucracy-laden fiscal expenditures. This approach also allowed SAREB to replace bad assets on bank balance sheets with very good assets – namely government-guaranteed senior debt of SAREB, thereby strengthening bank balance sheets. While the debt posed a potential threat to the government in the event of a default, if all went according to plan, the profits from disposing of assets could be used in part to pay back the debt that had initially been used to acquire the assets in the first place. (Handelsblatt, search for "pay it back to its creditors").

[8] These real estate assets were both commercial and residential real estate, but primarily residential.

10. SAREB only acquired assets from banks that had failed stress tests and which either had previously been nationalized, or were being forced to accept government capital.

In late May 2012, the consulting firm Oliver Wyman had been contracted by the Bank of Spain (The Spanish Central Bank) to perform an evaluation of the Spanish banking sector. This evaluation, published on June 21, 2012 is titled "Bank of Spain Stress Testing Exercise" and is sometimes referred to as 'the Oliver Wyman stress tests". (Stress Test). Following the release of this report, Oliver Wyman was "commissioned to perform a bottom-up stress test analysis of the fourteen most significant financial groups in Spain." (Bottom Up, 5). This second report, published on September 28, 2012, is sometimes referred to as the 'bottom-up Oliver Wyman exercise. (Bottom Up). As part of this second evaluation, Oliver Wyman projected that in an adverse scenario (which they defined as a GDP decline of 6.5% and in which they anticipated capital ratio requirements would be reduced to 6%), seven of the 14 banks they looked at would exhaust their loss absorption capacity.[9] (Bottom Up, 5).

In the Bank of Spain report on the Oliver Wyman stress tests, published on September 28, 2012, (Independent Eval), the banks were sorted into four groups. Group 1 banks were the four that were already majority-owned by FROB because they had previously failed stress tests and required restructuring. Group 0 banks were those that had passed the Oliver Wyman Stress Tests and had been found to have no capital shortfalls. These seven represented "62% in terms of the analyzed portion of the sector's credit portfolio." (Independent Eval, 13). Banks that had failed the Oliver Wyman Stress Tests were required to submit recapitalization plans. The constituency of Groups 2 and 3 would be determined at a later date after the as-yet un-submitted recapitalization plans had been scrutinized. (MOU p4 for explanation of groups). Group 3 would be made up of those banks for which FROB deemed their recapitalization plans to be effective, while Group 2 was reserved for banks that had failed the Oliver Wyman Stress Tests and had subsequently submitted ineffective recapitalization plans. Banks in Group 1 and Group 2 would be compelled to transfer assets to SAREB, while SAREB would be inaccessible to Banks in Groups 0 and 3. (Activity Report 2013, 17).

11. SAREB only acquired foreclosed real estate assets with an individual minimum asset size of at least €100,000, and loans to real estate developers with a minimum borrower exposure of €250,000.

In addition to limiting the eligibility of institutions that could transfer their assets to SAREB, SAREB only acquired foreclosed real estate assets with an individual minimum asset size of at least €100,000, and loans to real estate developers with a minimum borrower exposure

[9] Four of these, BFA-Bankia, Catalunya Banc, NCG Banco and Banco de Valencia were already majority-owned by FROB. (MoU p4). The additional three banking groups were Banco Popular, BMN, and a group comprised of the planned merger of Ibercaja, Liberbank and Caja 3. Seven banks, meanwhile, would maintain adequate capital ratios even in an adverse scenario. These seven were Santander, BBVA, CaixaBank, Kutxabank, Banco Sabadell, Bankinter, and Unicaja-CEISS, the proposed merger of Unicaja and Banco CEISS. (Bottom Up, 5).

of €250,000. SAREB also took direct ownership stakes in a select number of distressed real estate companies. (Blueprint, p4).

12. There were no individual participation limits for firms transferring assets to SAREB.

There were no individual participation limits on assets that Spanish credit institutions transferred to SAREB. Instead, under Law 9/2012, institutions in Groups 1 and 2 were obliged to transfer eligible assets to SAREB. (Activity report 2013, 16).

13. SAREB used the results of the Oliver Wyman stress tests and a further discount to determine the price at which assets would be transferred to SAREB.

If the transfer price at which AMCs acquire assets exceeds market price at the time of transfer, the operation implies State aid. However, as Cas and Peresa explain, the operation, "can be declared compatible if the transfer price of the assets is not higher than the real economic value [REV] (or underlying long-term economic value) of the assets. […] The difference between the transfer price and the market price of the assets represents State aid." (Cas and Peresa, 19).

In Spain's case, the transfer value, or price at which SAREB would buy assets from banks, was to be based on two components. SAREB used the results of Oliver Wyman's stress tests of banks to inform their REV valuation, though SAREB reserved the right to deviate from Oliver Wyman's findings at their discretion. Secondly, after the REV was arrived at, an additional discount (or "haircut" as the government sometimes referred to it) was applied to defray management and administrative costs as well as allow SAREB room to make a profit when divesting. (Activity Report 2013, 64).

The most extensive explanation of the subsequent discount, and for that matter, of the government's valuation approach in general occurs in the SAREB blueprint published by FROB on November 16, 2012. In it, the government writes, "the starting point for determining the price for transferring loans and real estate under ownership to SAREB is thus the base scenario from the Oliver Wyman Stress Test completed at the end of September 2012." However, the government noted that its own valuation results might vary meaningfully from Oliver Wyman's because of "major conceptual differences" between its own processes and those of Oliver Wyman's. (Blueprint, p5).

To rationalize the additional discount, the blueprint listed a number of SAREB-specific considerations including, "the operating costs associated with owning both loans and real estate assets, the costs of funding the portfolio while it is being held for sale, the fact that the sale to SAREB by each participating bank will be a major single portfolio sale, the overheads of SAREB, the costs of enforcement, the recovery costs of impaired loans." The government argued that "these factors alone justify a significant haircut in respect of the estimated economic value of the assets." (Blueprint, p6). The government refrained from explaining how it planned to quantify these considerations.

SAREB's valuation process was carefully supervised by European Commission officials. As Cas and Peresa explain, "the Commission closely monitored the methodology for measuring the value of the impaired assets transferred to Sareb at end-2012 and 2013 under the EU financial assistance programme. The Commission, assisted by external experts, found the asset transfer in line with State aid rules." (Cas and Peresa, 20).

On average, the discount imposed was estimated to be approximately 63% on the gross book value of all foreclosed assets acquired, though there was a considerable amount of variation within different asset classes. Land, for example, received an average 79.5% discount, unfinished developments a 63.2% discount, and 54.2% for finished housing. In the case of the discount on loans to developers, the aggregate discount was an average of 45.6% including 32.4% for finished projects and 53.6% for loans to finance urban land. (Blueprint, p6).

14. SAREB was conceived of as an AMC that would dispose of its assets over a 15-year time horizon.

SAREB was designed to dispose of its assets over a 15-year period before expiring. (Blueprint, 3).

15. Initially, the Spanish government relied on the very banks that they had acquired assets from to help dispose of the assets before ultimately hiring servicers in order to neutralize potential conflicts of interest.

Initially, the Spanish government had relied on the very banks that they had acquired assets from to help dispose of the assets, reasoning that the banks themselves had the best grasp on the nature of the assets they had once held, as well as an established sales force and the infrastructure to support real estate sales and financing. However, at the same time that the banks were being tasked with aiding the government in unloading SAREB's distressed assets, they were also attempting to unload those distressed assets that remained on their own balance sheets. (Activity Report 2014, 14).

By December 2014, in the face of persistent losses, the government concluded that this conflict of interest was presenting enough of a hurdle that a change of strategy was needed. (Activity Report 2014, 166 Search for "alignment of interest"). SAREB awarded contracts to four loan "servicers": Servihabitat, Altamira, Haya Real Estate, and Solvia. SAREB hoped these companies would streamline efficiency and increase profitability. (Activity Report 2014, 14). At first, however, sales slowed as the servicers spent time figuring out what exactly they were now responsible for selling, and SAREB executives focused on the tens of thousands of distinct property assets and millions of pieces of data that needed to be transferred to the servicers. (Activity Report 2015, 32-34 for description of migration and transformation).

16. The hiring of loan servicers brought with it a change in sale strategy from a bulk to a tailor made approach.

A new sales strategy was also implemented with the arrival of the new servicers. Under the old approach, assets had been packaged and sold in large portfolios in an attempt to shed assets quickly and service SAREB's debt burden. In remarks to SAREB shareholders in 2014, then President Belén Romana reiterated that SAREB's primary goal is to pay off the debt that it issued to purchase its assets. She stated, "the Company's main commitment is the amortisation of debt, and we are all working towards meeting this objective." (2014 amortization). While the old strategy was narrowly successful at raising revenue, the bulk sale approach also helped contribute to losses of €261 million in 2013 and €585 million in 2014. (See table 1 p5).

Under the new strategy, sales were smaller and more open to customer preference. SAREB and the servicers hoped that the personal touch would lead to higher individual sales prices even as it would cut into overall revenue in the short run. (Activity Report 2014, 14).

Cas and Peresa write of this transition in sales approach, "SAREB [switched] from a 'warehouse' to a 'factory' business model. Thus, SAREB transitioned from being an asset liquidator focused on selling at the best prices and with more dependence on the economic cycle, to an asset manager focusing more on creating value added, so that the return from the transaction increases when sold." (Cas and Peresa, 40).

17. There was no asset purchase window. Instead, assets were transferred to SAREB in two discreet phases.

There was no formal asset purchase window. Instead, the acquisition and transfer of assets from troubled banks to SAREB occurred in two discreet phases. In the first phase on December 31, 2012, SAREB acquired 145,125 assets valued at €36.7 billion from BFA-Bankia, Catalunya Banc, NCG Banco-Banco Gallego, and Banco de Valencia, the four institutions that had failed stress tests and were subsequently nationalized under FROB. (Ortiz Risueno, p24). (See Appendix C).

Then on February 28, 2013, a further 52,349 assets valued at €14.1 billion were transferred to SAREB from Liberbank, BMN, Caja3, and Banco CEISS, institutions that had failed subsequent stress tests and, as a result, had received support in the form of capital injections from the State through FROB. (Ortiz Risueno, p24). (See Appendix C).

III. Evaluation

As of the time of writing of this case in 2019, there has been very limited examination of the effectiveness of SAREB, not least because SAREB is an ongoing program and so any scholarly evaluation will necessarily be incomplete. That said, an examination of SAREB's performance and effect on the broader economy was conducted by Stephanie Medina Cas and Irena Peresa in a discussion paper published in 2016 by the European Commission. (Cas and Peresa). In the paper, the two authors compare SAREB with the National Asset Management Agency (NAMA) and FMS Wertmanagement, an Irish and German AMC respectively. Cas and Peresa conclude that the two most important aspects of successful asset disposals are the type of assets that the AMC decides to assume and the broader macroeconomic environment. They also suggest that other factors such as "clean asset documentation and a solid valuation process, a strong legal framework, efficient asset servicing, and skilled staff" play an important but perhaps not decisive role in the performance of an AMC. (Cas and Peresa, 6). The paper ultimately concludes that SAREB has contributed to "banking sector stabilization" but that “the financial backing of the authorities […] has however come at a fiscal cost.” (Cas and Peresa, 1).

Some of SAREB’s proponents contest the notion that SAREB’s losses indict it as an institution. (Handelsblatt, search “However, experts do not see…”).For one thing, they note that despite early struggles, SAREB’s ultimate performance remains undetermined. The Spanish real estate market is still in the midst of recovery (Cas and Peresa, 23-24), which has hampered the performance of SAREB’s disposal efforts thus far. Should the Spanish real estate market bounce back, the remaining assets in SAREB’s portfolio might be able to be sold for more, allowing SAREB to potentially recover its losses and turn an overall profit. SAREB has also transitioned its sales operations to servicers. Regardless of the state of the Spanish real estate market, it is possible that servicers might improve SAREB’s overall performance. (Cas and Peresa, 23-24, Handelsblatt).

Furthermore, even if it never achieves profitability, SAREB may yet prove to be successful in its broader goal of supporting the financial sector. Already, there is some evidence that SAREB’s presence may have helped to revive the Spanish credit system. SAREB acquired about 10% of Spanish credit institutions’ total real-estate related assets as a component of a larger set of restructuring and recapitalization efforts. The participating banks that drafted restructuring plans have fared well since transferring their assets over to SAREB; all participating Spanish banks became profitable in 2013 and capital ratios were well above regulatory requirements for all banks concerned. The Spanish real estate market, too, seems to slowly be recovering, the NPL ratio for real estate loans in Spain has been declining, though it was still at almost 28% at the end of 2015. Unfortunately, even in the face of this positive economic news, the banks have been slow to resume their lending activities because of continued deleveraging in the banking sector. (Cas and Peresa, 25).

While the urgent approach was later pointed to as a reason for losses, SAREB’s proponents argue, even today, that the urgency had positive elements, “It was hard, but it helped” said a SAREB spokesperson, arguing that the urgency helped jumpstart SAREB’s operations (Handelsblatt). On the other hand, the speed of implementation may have caused SAREB managers to overpay, “We bought at a high price” a SAREB spokesperson conceded, “today our assets are worth €3 billion less than we paid for them” (Handelsblatt).

Some observers have been more critical of SAREB’s project. For example, Aristobulo de Juan, a former General Manager at the Bank of Spain and former senior financial advisor at the World Bank is deeply critical of various aspects of SAREB’s structure and performance. He criticizes the process by which SAREB gathered private investment, writing that these private investors were “’invited’ to acquire stakes by the Spanish government in an exercise in moral suasion.” (De Juan, 137). He also criticizes SAREB’s accounting treatment, “SAREB therefore applies unique accounting rules, which allow it not to recognize losses on its assets at the end of each year, but to treat them as offset by the theoretical underlying gains on other assets […] the new accounting rules allowed SAREB significantly to increase the book value of its assets, but this makes their sale even more difficult.” (De Juan, 137-138).

Lastly, he criticizes the sales approach, positing that the one-fourth of assets sold by late 2017 were probably the best, leaving the worst among remaining assets. (De Juan, 138). Ultimately, he concludes, “The losses that are likely to arise under the guarantees granted to back all of the SAREB bond issues, which currently total some €40.93 billion, could also result in a considerable cost for the public purse." (De Juan, 140).

In a speech titled "The Spanish Financial Sector Assistance programme: 7 years later" delivered by Rolf Strauch, Chief Economist at the European Stability Mechanism, in July 2019, Strauch was generally positive on the effect that SAREB had had. He states, "banks stabilized profitability and reduced their stock of NPLs and foreclosed assets, as well as their exposure to the real estate sector thanks to disposals and the transfer of bad assets to SAREB. Bank capital increased thanks to a reduction in risk-weighted assets and to capital injections." (Strauch). At the same time, Strauch cautioned, "several legacy problems also remain in the banking sector. These include larger and more persistant-than-expected losses to SAREB, which pose a contingent liability to the state." (Strauch). Ultimately, however, Strauch seemed to suggest that SAREB was something of a mixed bag, arguing, "SAREB worked well to carve out impaired assets from banks and build financial stability but some complexities, such as the eventual sale price of assets and funding strategy, were underestimated in its creation." (Strauch).

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VI. Appendices

Appendix A: SAREB investors

Company	Sector	Country	Capital Provision (millions Euros)
FROB	Public	Spain	540
Santander	Bank	Spain	207.4
Caixabank	Bank	Spain	149.3
Banco Sabadell	Bank	Spain	83.2
Popular	Bank	Spain	71.7
Kutxabank	Bank	Spain	31.5
Ibercaja	Bank	Spain	17.7
Bankinter	Bank	Spain	17
Unicaja	Bank	Spain	15.8
Caja Mar	Bank	Spain	15
Mapfre	Insurance	Spain	10
Caja Laboral	Bank	Spain	7.4
Mutua Madrileña	Insurance	Spain	6
Banca March	Bank	Spain	4.9
Ceca Bank	Bank	Spain	4.2
Banco Cooperativo	Bank	Spain	3.9
Deutsche Bank	Bank	Germany	3.7
Barclays	Bank	England	3
Catalana Occidente	Insurance	Spain	3
Iberdrola	Electricity	Spain	2.5
Axa	Insurance	France	2
Banco Caminos	Bank	Spain	0.8
Total			**1200**

Source: (Capital Increase, p2)

Appendix B: SAREB's Initial Balance Sheet

Assets	(billions of Euros)	Liabilities	(billions of Euros)
Cash	4.8	Senior bonds	50.7
Loans	39.4	Sub. Debt	3.6
Real Estate Owned	11.3	Equity, of which:	1.2
		FROB	0.5
		Private	0.7
Total Assets	55.5	Total Liabilities	55.5

Source: (IMF, 20).

Appendix C: Table of Assets Acquired by SAREB

Entity	Number of Assets	Value (Millions of Euros)	Date of Transfer
Bankia	89,814	22,317	31-Dec-12
Catalunya Banc	29,425	6,708	31-Dec-12
NCG	17,887	5,097	31-Dec-12
Banco Valencia	6,723	1,962	31-Dec-12
Banco Gallego	1,276	610	31-Dec-12
Banco CEISS	18,115	3,137	28-Feb-13
BMN	16,138	5,820	28-Feb-13
Liberbank	14,120	2,918	28-Feb-13
Caja3	3,976	2,212	28-Feb-13
Total	**197,474**	**50,781**	

Source: (Ortiz Risueno, p24), (Activity Report 2013, 64).