FOREIGN

With markets in their local jurisdictions depressed, many Iberian firms are looking for new frontiers, writes Toby Lewis

Last month Garrigues, Spain's largest law firm, threw a party in Brussels to celebrate the 25th anniversary of its office in the capital of the European Union.

The party could equally have served to toast both Spain and Portugal's entrance into the EU – for Garrigues' Brussels office was opened the day the two countries joined, on 1 January 1986.

Jose Luis Buendia, Garrigues' Brussels head, jokes that the launch date was also impressive because it showed the firm's dedication to work, starting up on New Year's Day. "It must have been difficult after the New Year's Eve party, but we did it."

Cuatrecasas Goncalves Pereira, Spain's second largest firm, began its international expansion that same year by opening a Brussels office. It is arguable in hindsight, looking at how the countries have expanded since, that Spain and Portugal's joint entrance into the EU gave birth to the now ambitious international plans of Iberia's largest law firms.

As the Spanish economy boomed and Portugal was boosted in the decades following the Iberian countries' entrance to the EU, Garrigues, Cuatrecasas and Uria Menendez, the third-largest Spanish law firm, opened international networks that have seen them court business in New York, London and Beijing.

Latin America is the new frontier for many Iberian firms, as the growth of Brazil into an emerging world economic power has made the region an important business hub. The positive economic news from Latin America, it is argued, is a favourable trend which should buoy Iberian firms that have expanded in these markets. Fernando Vives, one of the managing partners of Garrigues, says Latin America is the "natural market of Spanish business" because Spain has "a shared culture and in some cases a shared language" with the region.

Similarly, African countries with strong links to Spain and Portugal such as Morocco, Angola and Mozambique have been key areas of expansion for many firms. These destinations are often name-checked by top lawyers in Iberia as suitable destinations either because of their proximity or because of their shared languages and similar legal structures.

The strategy to grow market share abroad has been coupled by a push to become known as pan-Iberian firms rather than as purely Spanish or Portuguese firms. To this end, it is a mark of pride for firms to have offices in Lisbon and Madrid. Javier Villasante, international practice head at Cuatrecasas, says: "The most important international development for us was our integration with the Portuguese firm Goncalves Pereira more than 10 years ago. From that moment we no longer considered ourselves a Spanish firm but instead an Iberian firm. It was the beginning of our international strategy."

> As firms hunt for business in Latin America, there is much uncertainty as to who will win out, and the Spanish firms have an eye on how US and UK rivals are also attempting to break into the market

Supporting headquarters

As both Portugal and Spain have been two of the European countries hardest hit by the recession, many firms also view globalisation as a possible way of escaping weak growth at home. Maria Joao Ricou, who co-manages Cuatrecasas' Portuguese arm, says: "Our international offices are very important to us and becoming more and more so because of the economic situation."

Joao Vieira de Almeida, managing partner of Portuguese firm Vieira de Almeida & Associados, says: "In a time of crisis businesses have been forced to look abroad for survival. It is amazing

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EXCHANGE

the sheer number of companies of all sizes and industries that these days are working or planning to work in foreign markets with an emphasis on Brazil and Portuguese-speaking Africa."

Manuel Santos Victor, managing partner of Portuguese firm PLMJ, says a marked expansion of Portguese firms' Angolan activities was in large part due to economic fears. "This is clearly a direct result of the crisis of the last few years and the lack of opportunities in Portugal, which meant firms had to be present elsewhere."

However, some are wary of expanding internationally as a way to stave off the crisis. Garrigues managing partner Ricardo Gomez-Barreda says: "We cannot direct ourselves based on the financial crisis, and our handling of the crisis has been to continue with the firm's strategy. We have practised local law in the areas where we believe the firm can be in the first division. Inside those markets, such as Portugal, we are analysing opportunities. Assuming the crisis will end one day, we want to be the reference firm in these areas when that process finishes."

Meeting client demand

Even as the Iberian market has been hurt by the recession, big transactions have been up for grabs in developed market mergers. In January this year Spanish flag carrier airline Iberia merged with the UK's British Airways (BA), with Garrigues advising Iberia and Uria advising BA.

Those Iberian firms which have expanded believe their options in terms of clients have increased. Uria managing partner Luis de Carlos says: "In the 1990s what we did was work for Spanish companies investing in Latin America. Now the scope is broader – we do work for European or Chinese companies investing in Latin America, so the number of potential clients has increased."

De Carlos adds that globalisation works both ways and can lead to more in-bound business to Iberia, as well as being a way to help Iberian clients expand abroad. "We do a lot of work for multinational companies which come to Spain and have been one of the main doors into the Spanish economy. We are also a way to get out and we look to assist Spanish companies in

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'We thought it would be better to move away from an exclusive model working with a particular firm in one country to a more open strategy which allowed us to work with the best independent firms'
Javier Villasante, Cuatrecasas Goncalves Pereira

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their expansion abroad."

Garrigues' Vives says the growth of Iberian law firms had mirrored the ambitions of their clients. "We have followed our clients where they have a desire to invest. In the five years before the crisis it was very common to see them look abroad, and many Spanish companies wanted to invest in other countries."

Some firms remain sceptical about making a push into emerging markets like Latin America. Manuel Martin Martin, managing partner of Gomez Acebo & Pombo, said he would prefer to focus his attentions on the Iberian market, saying: "If I wanted to construct something outside of Spain which had the same level and prestige, it would take me decades to achieve. As there now exist firms which have done that work, I prefer to strike up individual partnerships with them."

Although Iberian firms have expanded their networks to New York and London, they do not expect to compete for legal business with the top firms in these markets. Cuatrecasas' Villasante comments: "Some offices are more like representative offices, such as New York, London and, to a lesser extent, Shanghai. They provide a window to the big markets. We try to be as active as possible in these markets and bring clients to Iberia and the other countries where we practise locally."

If the ambitions of the top Iberian firms in Latin America can be matched with results, the country's firms could arguably cement their futures. Having successfully ridden the growth of the Iberian economy in Europe for the last few decades, perhaps the region's law firms could now ride a second greater growth burst from the Iberian peninsula's former colonies as they are tipped to do well in the coming decade – even as the economies of Iberia face several challenging years ahead.

'The margins within which big firms normally work require a large market. When they are not present, it is not a failure, but a decision that they do not want to be in a certain country'
Fernando Vives, Garrigues

Emerging opportunities

Iberian law firms talk up the opportunity afforded by the rise of Brazil as a poster child of emerging markets, and much emphasis is placed on the strong growth numbers coming out of Latin America. Uria's De Carlos said: "Certainly Latin America has done better than other regions throughout the crisis. Brazil is one of the most rapidly developing countries. Colombia is doing well. Mexico is progressing. Chile is very stable. You have a good group of countries that are doing well and are very interesting."

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There are certainly big transactions available. In January, Uria advised the $1.8bn (£1.1bn) sale of 3,200km of transmission lines in Brazil to the State Grid Corporation of China. This was the largest Chinese acquisition yet in Latin America, according to Uria.

Chinese businesses' expansion globally is also a key area of international opportunity, according to De Carlos, as Iberian firms can look to channel investment to Iberia and Latin America. He says: "We are attempting to attract outbound investment from China to Latin America or Iberia, and so far it has been very successful."

As firms hunt for business in Latin America, there is much uncertainty as to who will win out, and the Spanish firms have an eye on how US and UK rivals are also attempting to break into the market.

Garrigues' Vives says one advantage Iberian firms have in the face of competition from the best Anglo Saxon practices is they do not demand such high profits,

> 'In a time of crisis businesses have been forced to look abroad for survival. It is amazing the sheer number of companies of all sizes and industries that these days are working or planning to work in foreign markets with an emphasis on Brazil and Portuguese-speaking Africa' Joao Vieira de Almeida, Vieira de Almeida & Associados

and so can afford to do business in growing regions that might be of less interest to a magic circle firm. "The problem the big firms have in some of these areas is the high profitability they demand from their work. The margins within which they normally work require that a market is very large. When they are not present, it is not a failure, but a decision in some cases that they do not want to be in a certain country."

Local players are likely to do well in the race to grab a Latin American market share, if the way Spanish firms responded to international pressure is anything to go by. Vives says: "I have a theory why the Spanish firms have survived better the expansion of the UK firms than in other European countries. The reason is not so much to do with the merits of the Spanish firms, but that the UK firms became interested in the country too late in its development. Spanish law firms were too powerful once Spain began to grow quickly. The same may well happen in Brazil. Brazilian firms are very strong and they will co-exist with the international firms."

The 'non-exclusive' partnership model

Cuatrecasas has gone a separate way to its rivals Uria and Garrigues in its attempts to source business in global markets. Its two key rivals have exclusive relationships with individual firms in key countries in a 'best friends' network. By contrast, Cuatrecasas thinks it is helped by an approach of picking and choosing its partners for distinct projects.

Cuatrecasas' Villasante says: "We thought it would be better to move away from an exclusive model working with a particular firm in one country to a more open strategy which allowed us to work with the best independent firms. We are capable of providing the best solution to each case with the right partner rather than a one-size-fits-all option."

Villasante says he believes this approach allows Cuatrecasas to compete more strongly in individual fields with the best international competition: "We are becoming more competitive in Latin America not only in terms of our presence but also in specific fields. For example, five years ago I think we would have found it difficult to compete with the big Anglo Saxon firms to win arbitration cases in Latin America, and now we do."

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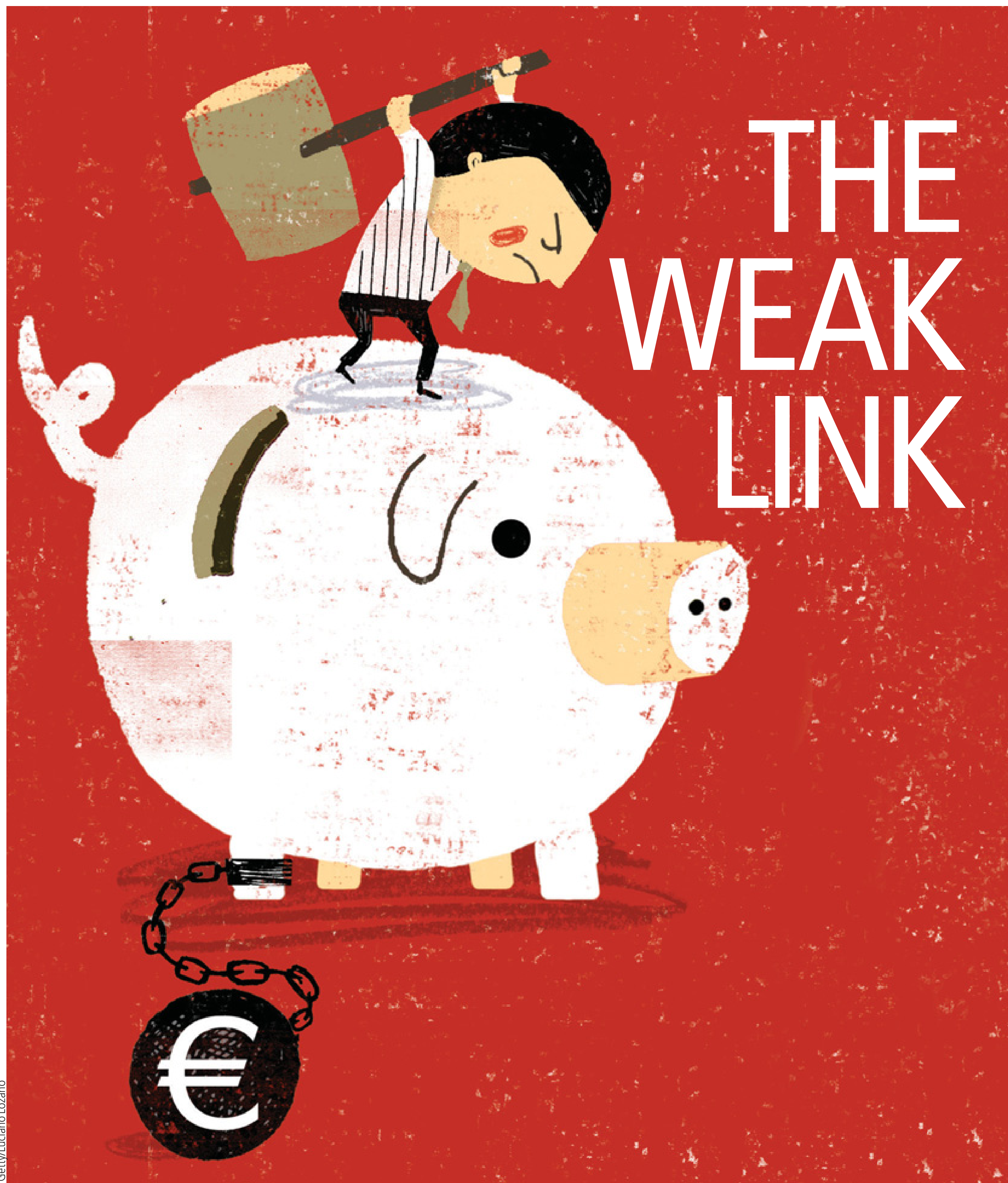
Five out of seven failing banks identified by the European stress tests in 2010 were Spanish savings banks. Rafael Nunez-Lagos reports on their future



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Savings banks (*cajas de ahorro*), are a type of credit entity that represents almost half of volume within the Spanish financial sector. Akin to French *caisses d'epargne* or Italian *casse di risparmio*, savings banks are traditional, locally-orientated entities of variable (but generally limited) size, with strong economic and social ties to their home region.

Although savings banks fully participate in the market, they are a special category within the financial services industry, as they are structured as foundations rather than companies. As a result, they are governed by representatives of collective stakeholders; mainly customers, employees and local authorities.

Any positive result is allocated to social welfare and cultural projects. Owing to their distinctive nature and the social functions they carry out, which are private but of public relevance, savings banks are subject not only to the general regulations governing the activity of credit entities, but also to specific legislation on their establishment, governance and corporate transactions. This legislation is mainly regional in scope and operates within the basic national framework.

The late evolution of the Spanish financial system has shown a tendency towards concentration of interests, mainly for reasons connected with efficiency and profitability in an increasingly mature market. Nevertheless, in the peak of the international financial crisis and with Basel III on the horizon, the issue of solvency has become the key driving force behind this tendency.

Naturally, the same factors also apply to savings banks. However, their consequences are somewhat amplified by some of the peculiarities of these types of entities, namely: (i) their inability to issue shares – they are not companies; (ii) their insufficient scale for the purposes of gaining access to wholesale capital markets; and (iii) their corporate governance, too often lacking a professional, business-oriented structure.

Hence, solvency, size and governance determine the standing of savings banks in a different way to ordinary banks. Most significantly, savings banks have become dependent on wholesale markets. Under the now-prevailing restrictions, this dependence turns them into the weakest link in the Spanish financial system. The European stress tests carried out in July 2010 revealed exactly this: out of a total seven failing entities, five were Spanish savings banks.

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First round of restructuring

Until very recently, few, if any, mergers had been carried out between savings banks. The distinctive features of these institutions, combined with the decision-making power granted to local and regional authorities, were the reason for this fact and explain, in particular, the absence of merger activity between savings banks based in different regions.

In 2010, however, the sector witnessed an unprecedented uproar of consolidating transactions. The pressure of the markets and the supervisors and the introduction of innovative formulae which enabled entities to combine their capacities without altering their stakeholders' status quo, created the conditions for a thorough restructuring. Indeed, the new legislation enacted in the course of the year provided a three-course menu whereby any savings bank could tailor its corporate structure to its actual needs and perspectives:

- Standalone 'bankisation'. A savings bank can split its business and social welfare-related activities by transferring the former to an ordinary bank and keeping for itself those that are purely foundational activities. This is similar to the Italian model after the enactment of the Amato Law in the early 1990s. Entities can further choose to remain as savings banks – carrying out their business indirectly through their banks – or become foundations, in which case they lose their capacity as credit entities.
- Institutional Protection Scheme (IPS) or joint 'bankisation'. A savings bank can also join with others in an IPS (*Sistema de Proteccion Institucional*). This is a specific type of consolidated group formed by several savings banks and a central entity – an ordinary bank – to which the former transfer all or part of their business assets and activities.

The particularity of this arrangement lies in the agreement between the parties whereby the central entity is granted authority to govern the group and the savings banks are bound to follow its instructions in all matters related to the business. Although it may seem odd, savings banks are both the majority shareholders and the subsidiaries of the central entity. This arrangement, albeit new to Spanish law and practice, has been successfully tested in several neighbouring jurisdictions.

- The traditional model. A savings bank is theoretically free to remain as such – ie, to maintain its traditional structure. Nevertheless, as things turn out, this is not a real option except for a few smaller, local and retail-oriented entities in which credit is balanced with deposits. The reorganisation process was further fostered with almost €12.5bn ($10.6bn) in state aid in the form of subordinated capital instruments purchased by the Spanish Government.

At the turn of 2010, after a year of continuous stirring, the process seemed to have come to a standstill. The new entities were prepared to focus on consolidating and positioning themselves in the market. By the beginning of 2011, the sector had changed dramatically: 22 out of 45 existing entities had joined an IPS and 17 had been involved in traditional mergers or similar transactions.

At present, only 12 savings banks are independent from any IPS. Yet, as market pressure on Spain's sovereign debt seems to prove, the actual impact of the reorganisation process is still insufficient, mainly due to the following reasons:

1. Solvency and scale. Its outcome is insufficient in terms of fundamentals. Of the three distinctive features mentioned above, two have been considerably improved: solvency and scale. The average savings bank is now better capitalised as a result of both public support and weaker entities having merged into stronger ones.

It has also become larger and more efficient. Nevertheless, as a result of their corporate structure, savings banks are intrinsically unable to issue shares or merge with ordinary banks. Hence, their ability to grow in size and capital standing by resorting to the markets or carrying out corporate transactions remains limited. From this perspective, bankisation seems the way out.

2. Governance. The governance of

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savings banks remains tied to political and local interests rather than being purely business-oriented. Markets demand comparable governance structures compliant with international standards, favouring professional management and maximisation of value and avoiding, to the extent possible, the multiple goal effect inherent to any multi-stakeholder organisation. From this perspective, bankisation also appears to be the solution, especially if it entails going public and being required to meet the highest corporate governance standards.

Heading for the next round

Bankisation and entering the market are precisely the key principles underlying the latest reforms enacted only a few weeks ago. With this aim in mind, solvency requirements have been made more stringent. On a general basis, the Royal Decree Law requires a so-called capital principal equal to or above 8% of risk-weighted assets. For credit entities that are dependent on wholesale markets by more than 20% of their credits, this requirement is increased to 10%. As an exception, the 8% ratio is maintained when the relevant entity has 20% or more of its capital placed among third parties, either in the stock market or among private investors.

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Although the new capital requirements are in line with Basel III standards, they are specific to the Spanish banking system. The concept capital principal comprises mainly (i) common shares, (ii) retained earnings, (iii) positive valuation adjustments, (iv) third-party minority interests in consolidated entities and (v) the instruments subscribed by the Government within the state aid framework; all of which is to be reduced by certain deductions.

Entities must comply with the applicable capital ratio before 10 March 2011. However, there is an adjustment period for entities that do not meet this deadline which ends on 30 September 2011. This period may be exceptionally extended to 31 December 2011 (or the first quarter of 2012 for entities involved in listing procedures).

The new measures are visibly aimed at savings banks. Though the enhanced capital requirements apply to savings banks and ordinary banks alike, these are predominantly listed companies and therefore subject to the 8% ratio. By contrast, most savings banks are now facing the alternative of complying with the 10% ratio or entering the market.

In either case, whether they choose to raise additional capital or place out 20% of the existing one, they are bound to transform into ordinary banks. Additional measures have been enacted to optimise the use of the above-mentioned bankisation formulae from a legal and financial perspective.

The outcome of the reform may yet be uncertain as regards its final objective, which is to ease the fears in the markets concerning the soundness of the Spanish banking system. Nevertheless, it will surely bring about a new round of restructuring and an abrupt change in the sector's perspectives – whether a change of pace or change of direction is yet to be seen. While preserving the paradigm of the savings bank and its social role, the new legal framework is likely to be a heavy blow for its very foundations.

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