Fitch Ratings

29 Sep 2020 | Rating Watch

Fitch Places Bankia on RWP, Affirms CaixaBank on Merger Announcement

Fitch Ratings-Barcelona-29 September 2020:

Fitch Ratings has placed Bankia, S.A. Long-Term IDR of 'BBB' and VR of 'bbb' on Rating Watch Positive (RWP) after the announcement of a merger with CaixaBank, S.A. Should the merger go ahead, Bankia would benefit from the combined entity's stronger national franchise, more diversified business model and earnings power, and from better asset quality and higher coverage resulting from additional provisioning.

Fitch has also affirmed CaixaBank's Long-Term Issuer Default Rating (IDR) at 'BBB+' and its Viability Rating (VR) at 'bbb+'. The Outlook on the Long-Term IDR remains Negative.

A full list of rating actions is included in this rating action commentary.

The rating actions follow the approval by CaixaBank's and Bankia's boards on 17 September 2020 to merge the two entities through an all-share deal. The merger is expected to be completed in 1Q21 subject to shareholder and regulatory approvals, including from anti-trust authorities, and the probability of success is high in our view. The combined entity would have total assets of about EUR665 billion and have leading domestic market shares in loans and deposits (about 25%), increasing the gap versus Banco Santander, S.A. (A-/Negative) and Banco Bilbao Vizcaya Argentaria, S.A. (BBB+/Stable), particularly in terms of scale and market shares in certain segments (i.e. mortgage loans) and regions. The merger should provide revenue upside to CaixaBank's already strong position in domestic bancassurance and asset management businesses.

Key Rating Drivers

IDRS, VR, SENIOR NON-PREFERRED DEBT - CAIXABANK AND BANKIA

Fitch views the strategic rationale from a business and scale perspective as well as from the possibility to achieve recurring cost savings of EUR770 million by 2023 (about 12% of combined operating expenses in 2019) as modestly outweighing the integration risks that are customary in a merger of this magnitude and complexity. The new entity expects to achieve about EUR290 million of revenue synergies (about 2% of combined operating income in 2019) in the next five years from business growth in long-term savings and insurance, and from the exit of Bankia's commercial agreements. The combination of these factors supports CaixaBank's ratings affirmation.

However, Fitch notes that the combined entity will operate with tighter capital ratios as indicated by a fully loaded common equity Tier 1 (CET1) ratio target of between 11% and 11.5% in the medium term, compared with CaixaBank's and Bankia's stronger standalone ratios of 11.8% and 13.3% at end-June 2020, respectively. Despite this, the combined entity's capital encumbrance to unreserved problem assets would remain stable at CaixaBank's standalone level (i.e. just below 30%) thanks to higher problem assets coverage providing it with some headroom to absorb asset-quality shocks.

The Negative Outlook on CaixaBank's Long-Term IDR reflects that Fitch continues to believe that the economic fallout from the coronavirus pandemic represents a risk to Spain's operating environment and a potential threat to the combined entity's performance, credit quality and ultimately capital.

Bankia's ratings have been placed on RWP to reflect our view that they will converge to those of CaixaBank upon the merger.

In our view, the strategic benefits of the transaction outweigh the risks associated with merging two cultures as well as the challenges presented by the pandemic. Fitch views the resulting integration risks as manageable given the two banks' similar business models, geared towards retail banking, as well as both banks' established experience in acquiring and integrating banks.

Asset quality at the combined bank will initially be weaker than CaixaBank's standalone asset quality due to Bankia's larger stock of problem assets, but both banks entered the crisis following large balance-sheet de-risking in recent years. The impaired loan ratio of the combined entity would be 4% (4.8% including net foreclosed assets) but with a higher impaired loan coverage of 66%, providing some additional credit protection than the two banks taken on a standalone basis.

We expect the combined entity's asset quality to temporarily worsen as a result of the economic recession in Spain, the extent of the deterioration will depend on the duration of the crisis and the effectiveness of the public and private support measures. However, in the longer term, we expect the combined entity will aim to operate with a gross impaired loan ratio of below 4%, which should be possible also thanks to the larger post-merger problem asset coverage ratios.

The weaker operating environment in Spain will also challenge the combined entity's performance. 1H20 both CaixaBank and Bankia frontloaded a large part of coronavirus-related loan impairment charges (LICs), bringing the operating profit/risk-weighted assets (RWAs) ratio to low levels. We expect earning pressure to intensify over the next two years as a result of high LICs and the likelihood of subdued business volumes. Bankia guided to an annualised LICs/gross loans ratio of about 80bp, whereas CaixaBank guided to LICs/gross loans in the upper range of 60bp-90bp for the full year.

Our assessment of profitability assumes that earnings will recover to more normalised levels (operating profitability above 1.5% of RWAs) once the crisis abates. Our assessment also assumes that over the medium term the combined entity's pre-impairment operating profitability should benefit from a larger customer base and business volumes, and improved efficiency levels, providing additional financial headroom to absorb higher LICs. However, our negative view on this factor reflects the downside risk to this assumption in case of persistent economic pressure.

The combined entity would be adequately capitalised with a pro-forma regulatory CET1 ratio, assuming the upfront recognition of all impacts from the merger and regulatory framework, of 11.6% (11.3% excluding IFRS 9 transitional arrangements), representing a satisfactory buffer of 250bp-300bp above minimum requirements. At these levels, we believe the combined entity would have headroom to absorb moderate pressures on earnings and asset quality without suffering material capital erosion, although it would remain vulnerable to more severe shocks. The main effects from the merger would relate to restructuring costs (minus 95bp on capital), higher provisions on problem assets (minus 32bp) and other impairments, largely related to the cancelation of joint venture agreements at Bankia (minus 23bp).

We believe that the acquisition will not have a material impact on the combined entity's funding and liquidity profile as both banks benefit from large and stable customer deposits, diversified wholesale funding, particularly CaixaBank, and good liquidity buffers.

CaixaBank's Short-Term IDR of 'F2' is the baseline option for a 'BBB+' Long-Term IDR under our criteria.

Bankia's Short-Term IDR has been affirmed at 'F2', the higher of the two possibilities for a 'BBB' Long-Term IDR based on our assessment of Bankia's standalone funding and liquidity score of 'bbb+', and is already at the same level as CaixaBank's Short-Term IDR.

CaixaBank's senior non-preferred notes are rated at the same level as the bank's Long-Term IDR to reflect Fitch's view that the likelihood of default on the senior non-preferred notes is the same as that of the bank.

Bankia's long-term senior non-preferred notes have been placed on RWP to reflect the likelihood of them being upgraded to the level of CaixaBank's Long-Term IDR and senior non-preferred debt when the merger is complete. Bankia's long-term senior non-preferred notes are rated one notch below its Long-Term IDR, reflecting the prospects of below-average recoveries arising from the possible use of senior preferred debt to meet resolution buffer requirements, and the combined buffer of additional Tier 1, Tier 2 and senior non-preferred debt being unlikely to exceed 10% of RWAs.

SUPPORT RATING AND SUPPORT RATING FLOOR - CAIXABANK AND BANKIA

CaixaBank's and Bankia's Support Ratings (SRs) of '5' and Support Rating Floors (SRFs) of 'No Floor' reflect Fitch's belief that senior creditors of the two banks can no longer rely on receiving full extraordinary support from the sovereign in the event that the bank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, instead of, or ahead of, a bank receiving sovereign support.

DERIVATIVE COUNTERPARTY RATING, DEPOSIT RATINGS AND SENIOR PREFERRED DEBT - CAIXABANK

CaixaBank's Derivative Counterparty Rating (DCR), long-term deposit ratings and senior preferred debt are rated one notch above CaixaBank's Long-Term IDR to reflect protection offered by more junior bank resolution debt and equity buffers. As part of its minimum requirement for own funds and eligible liabilities (MREL) strategy, Fitch expects junior and senior non-preferred resolution buffers to exceed 10% of RWAs on a forward-looking basis (the buffers were 7.5% at end-June 2020 for CaixaBank on a standalone basis), including for the combined entity.

SENIOR PREFERRED DEBT - BANKIA

Bankia's long-term senior preferred notes have been placed on RWP to reflect that the bank's senior preferred creditors could benefit from the same credit protection offered to CaixaBank's senior preferred creditors once Bankia is acquired. At the moment, Bankia's long-term senior preferred notes are rated in line with the bank's Long-Term IDR as we expected these to be part of its resolution buffers and we do not expect more junior buffers to exceed 10% of RWAs on a sustained basis.

SUBORDINATED DEBT - CAIXABANK AND BANKIA

CaixaBank's and Bankia's Tier 2 subordinated debt are rated two notches below their respective VRs to reflect the notes' poor recovery prospects for the notes arising from subordination in case the banks become non-viable.

RATING SENSITIVITIES

CaixaBank

IDRS, VR, SENIOR NON-PREFERRED DEBT

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The ratings are primarily sensitive to CaixaBank's approach to capital management once the merger is complete, especially in light of the announced reduction in the CET1 ratio guidance. CaixaBank's ratings could be downgraded if the fully loaded CET1 capital ratio drops below 11.5% without a credible plan to restore it.

Should evidence emerge that CaixaBank is unable to execute on the transaction as planned or that it results in a distraction such that the existing core business suffers, a negative rating action would be considered. The ratings are also sensitive to emerging integration risks, which at the moment we are expecting to be adequately managed.

A more prolonged coronavirus-related economic downturn than under Fitch's base case could also be negative for the ratings. The ratings of the combined entity would likely be downgraded if the impaired loan ratio exceeds 8% on a more permanent basis, or if a material portion of loans with deferrals will not return to performing status at the end of the forbearance period.

Negative action could also arise if operating profit to risk-weighted assets deteriorates to below 1.5% for a prolonged period of time.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Given the Negative Outlook and pending the transaction, Fitch sees a rating upgrade unlikely in the short term.

Over the medium term, should the economic conditions normalise in Spain and the transaction complete successfully such that CaixaBank's financial performance proves in line with Fitch's baseline expectations, the Outlook could be revised to Stable. The Outlook revision would be based on the combined entity maintaining a conservative risk appetite and the impaired loan ratio returning below 4%, while restoring profitability to pre-crisis levels (i.e. an operating profit/RWAs ratio of about 2%) and a CET1 ratio of at least 11.5%.

DCR, DEPOSIT RATINGS AND SENIOR PREFERRED DEBT

The DCR and senior preferred debt and deposit ratings are primarily sensitive to changes in CaixaBank's IDRs. We would also downgrade the DCR, long-term senior preferred and deposit ratings by one notch should the bank change its strategy to meet MREL over the medium term and no longer plan to operate with combined buffer of qualifying junior debt and senior non-preferred debt at above 10% of RWAs.

SR AND SRF

Any upgrade of CaixaBank's SRs and upward revision of the SRFs would be contingent on a positive change in the sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

SUBORDINATED DEBT

Subordinated debt issued by CaixaBank are primarily sensitive to any change in its VR. The ratings are also sensitive to a change in notching should Fitch change its assessment of loss severity or relative non-performance risk.

Bankia

IDRs, VR, SENIOR NON-PREFERRED DEBT, SENIOR PREFERRED DEBT, SR AND SRF

Fitch expects to resolve the RWP on Bankia's ratings upon completion of the merger, which we expect to take place in 1Q21. If the acquisition is delayed, we could maintain the RWP beyond the typical six-month horizon. Fitch believes that upon a successful merger into CaixaBank, Bankia's ratings will be aligned to those of CaixaBank's and subsequently withdrawn as it would cease to exist as a legal entity. The SR and SRF would be withdrawn.

A failure to complete the acquisition could result in the removal of the RWP and an affirmation of the ratings and Bankia's IDRs and debt ratings would primarily be sensitive to changes in its VR (see "Fitch Affirms Bankia at 'BBB'; Outlook Negative", dated 16 September 2020).

SUBORDINATED DEBT

Subordinated debt issued by Bankia are primarily sensitive to any change in the bank's VR. The ratings are also sensitive to a change in notching should Fitch change its assessment of loss severity or relative non-performance risk.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Bankia S.A.; Long Term Issuer Default Rating; Rating Watch On; BBB; Rating Watch Positive
; Short Term Issuer Default Rating; Affirmed; F2
; Viability Rating; Rating Watch On; bbb; Rating Watch Positive
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----subordinated; Long Term Rating; Rating Watch On; BB+; Rating Watch Positive
----Senior preferred; Long Term Rating; Rating Watch On; BBB; Rating Watch Positive
----Senior non-preferred; Long Term Rating; Rating Watch On; BBB-; Rating Watch Positive
----Senior preferred; Short Term Rating; Affirmed; F2
CaixaBank, S.A.; Long Term Issuer Default Rating; Affirmed; BBB+; Rating Outlook Negative
; Short Term Issuer Default Rating; Affirmed; F2
; Viability Rating; Affirmed; bbb+
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; A-(dcr)
----subordinated; Long Term Rating; Affirmed; BBB-
----Senior non-preferred; Long Term Rating; Affirmed; BBB+
----long-term deposits; Long Term Rating; Affirmed; A-
----Senior preferred; Long Term Rating; Affirmed; A-
----Senior preferred; Short Term Rating; Affirmed; F2
----short-term deposits; Short Term Rating; Affirmed; F2

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Additional information is available on www.fitchratings.com

Applicable Criteria

[Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)](#)

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Dodd-Frank Rating Information Disclosure Form

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Endorsement Policy

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