

Research Update:

# Spain-Based CaixaBank Affirmed As Merger With Bankia Announced; Bankia Placed On CreditWatch Positive

September 23, 2020

## Overview

- On Sept. 17, 2020, Spain's CaixaBank S.A. and Bankia S.A.'s boards agreed an all-share merger that they expect will close in the first quarter of 2021. Upon completion, Bankia is to be absorbed by CaixaBank; all of its assets and liabilities will be transferred to the acquiring entity.
- The deal will create by far the largest domestic bank in Spain. It will reinforce CaixaBank's domestic position, giving it nearly 25% of the market in loans and deposits. In the long term, we think this may help the enlarged CaixaBank to alleviate its structurally low profitability. CaixaBank's financial strength should be sufficient to cushion the effect of the acquisition on its credit profile.
- We are therefore placing our long-term rating on Bankia, and our ratings on its nonoperating holding company (NOHC) BFA Tenedora de Acciones, S.A.U., on CreditWatch with positive implications.
- We are also affirming our ratings on CaixaBank and its highly strategic subsidiary Banco BPI S.A. The stable outlooks are unchanged.
- We expect to resolve the CreditWatch placement of Bankia and BFA once the transaction is completed; at that time, we could raise our ratings by one notch to equalize the ratings on Bankia with those on CaixaBank.
- The stable outlook on CaixaBank indicates that the additional risk stemming from weaker-than-expected economic prospects in Spain and the financial impact and execution risk related to the acquisition of Bankia could be balanced by the entity's growing buffer of bail-inable debt instruments.

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## Rating Action

On Sept. 23, 2020, S&P Global Ratings placed its 'BBB' long-term issuer credit rating on Spain-based Bankia on CreditWatch positive. We also placed our long-term resolution counterparty rating (RCR) and the issue ratings on hybrid debt instruments issued by Bankia on CreditWatch positive, and affirmed our 'A-2' short-term issuer credit rating.

In addition, we placed on CreditWatch positive our 'BBB-/A-3' long- and short-term issuer credit ratings on Bankia's parent company, BFA.

At the same time, we affirmed our 'BBB+/A-2' ratings on CaixaBank, as well as its RCR and issue ratings. The outlook remains stable.

Concurrently, we affirmed our 'BBB/A-2' ratings on Portugal-based Banco BPI--a highly strategic subsidiary of CaixaBank--, as well as its RCR and issue ratings. The outlook also remains stable.

## Rationale

The rating actions follow the announcement by CaixaBank and Bankia that they have reached an agreement to merge in an all-share transaction, with no cash consideration. At current prices, this values Bankia at about €4.3 billion, or a 20% premium over the closing on Sept. 3. The deal will result in by far the largest domestic bank in Spain, with consolidated assets of around €660 billion and market shares in loans and deposits of around 25%. If successful, and approved by relevant authorities, CaixaBank will absorb Bankia, which will cease to exist as a separate entity and whose brand will disappear. In this scenario, we would equalize the ratings on Bankia with those on CaixaBank.

Our decision to affirm the ratings on CaixaBank reflects our expectation that the acquisition will reinforce its domestic market position, and that its financial strength should help reduce the downside risks arising from the transaction amid a deteriorated operating environment. That said, we anticipate that the transaction will erode CaixaBank's capital, giving it less capacity to absorb a further weakening in economic conditions in Spain. In such a scenario, we believe that CaixaBank's progress in building up its additional loss-absorbing capacity (ALAC) could protect senior bondholders in a resolution scenario. As a result, we are maintaining our stable outlook. Despite the stable outlook, if we were to lower the stand-alone credit profile (SACP), this would lead us to lower the ratings on the bank's subordinated instruments.

The merger, if successful, will create a national champion and in the long term, should help the entities to alleviate their structural low profitability, once economies of scale and synergies are realized. This is despite some likely business attrition, due to the combined entity's business dominance in certain regions, as well as potential downside risks associated with the restructuring and readjustment of both banks' branch networks and staff, among others. We also consider that execution risks, while considerable, should prove to be manageable. Both entities have solid management teams that have proven their ability to integrate other institutions. Despite the resulting enhanced franchise in Spain--on top of CaixaBank's operations in Portugal through Banco BPI--the group's geographic diversification will still be more limited than that of its largest European peers.

Based on the proposed terms, we consider the transaction will have a manageable effect on CaixaBank's capital position. In particular, we estimate that its risk-adjusted capital (RAC) ratio will likely stand between 7.25%-7.75% by end-2021 and 2022, compared with 7.1% for CaixaBank alone at end-2019, and 9.4% for Bankia. Our forecasts incorporate the benefit of the estimated

€7.5 billion badwill that will be created, part of which will be used to cover €2.2 billion estimated restructuring costs. In addition, our forecasts incorporate the potential for further hybrid instruments to be issued to fulfil regulatory buckets, as well as the realization of close to €0.7 billion net synergies--mostly on the costs side--in the next two years. This would still not give CaixaBank much of a buffer over our 7% threshold and our assumptions may prove to be too benign, given the unfolding external environment.

Although we consider that the current market volatility could somewhat delay CaixaBank's progress in building up its ALAC buffer, we also acknowledge it is successfully fulfilling its regulatory hybrids buckets and we anticipate further progress in the coming quarters. In particular, we now expect that the enlarged CaixaBank's ALAC will likely approach 4% of risk-weighted assets (RWAs) by end-2022. If economic risks in Spain grow more than we currently expect, we consider that this buffer could represent a cushion for the senior unsecured debt ratings.

We anticipate that CaixaBank's asset quality metrics will show some deterioration but remain manageable. Pro forma NPAs for the combined entity will likely be equivalent to about 5% of gross loans at end-June 2020, compared with about 7.1% for the domestic sector, according to our calculations. We take comfort from CaixaBank's tight risk management and underwriting standards, as well as from Bankia's revamped risk function and well-seasoned portfolio, which mainly comprises low-risk residential mortgages. These may at least partly contain asset quality deterioration caused by the COVID-19 economic shock.

Similarly, we do not anticipate any meaningful change in CaixaBank's funding profile, which we consider resilient and conservative, nor in its liquidity, which is prudently managed.

As regards CaixaBank's Portuguese subsidiary, Banco BPI, our affirmation indicates that we expect BPI to remain a highly strategic subsidiary of CaixaBank. As a result, our long-term rating on BPI is capped at one notch below CaixaBank's group credit profile ('bbb+').

## **Outlook**

### **CaixaBank**

The stable outlook on CaixaBank balances the potential pressure on its stand-alone creditworthiness over the next 12-24 months, including from the expected integration of Bankia, against the benefits that it could derive from the accumulation of bail-inable debt, which will protect senior bondholders in a resolution scenario. Despite the stable outlook, if we were to lower the SACP, we would also lower our ratings on the bank's subordinated instruments.

The stable outlook incorporates our assumption that CaixaBank will be able to integrate Bankia relatively smoothly. In our base case, we anticipate that CaixaBank's RAC ratio will remain above 7.0% by year-end 2022, even if the COVID-19 related economic shock will weigh on its earnings and asset quality. However, if our view of economic risks in Spain worsens, the bank's capital would have limited room to absorb a more-severe deterioration, as a change in economic risk in Spain would lower our RAC below 7.0% and could cause us to revise down our SACP.

We could lower the ratings if:

- The integration of Bankia proves to be tougher than we currently anticipate, if it impairs CaixaBank's financial profile beyond our expectations, if it encounters meaningful setbacks, or if we conclude that the resulting earnings performance is weaker than that of CaixaBank stand-alone; or

- Economic risks in Spain increase meaningfully, and we conclude that CaixaBank's ALAC buffer will not be enough to compensate for a deterioration of its financial profile.

Although unlikely in the current environment, we could raise the ratings on CaixaBank if the integration of Bankia proves more successful than we anticipate, or if economic risks abate and the bank makes more substantial progress than expected in building up its bail-inable debt buffer. To benefit from one notch of ratings uplift, CaixaBank's ALAC buffer would have to sustainably exceed 5% of its RWAs.

## **Banco BPI**

The stable outlook on Banco BPI mirrors that on its parent, CaixaBank. As a highly strategic subsidiary of CaixaBank, the ratings on the two move in tandem.

Our base-case scenario is that the ratings will not change. However, we could upgrade BPI if we were to raise the ratings on CaixaBank in the next 12-24 months, provided that we also raise our sovereign ratings on Portugal. Alternatively, we could upgrade BPI if we were to upgrade Portugal, and if we considered that BPI's strategic importance to its parent had increased, so that was core to its parent.

If we were to downgrade CaixaBank, we would also downgrade BPI. Under this scenario, BPI would still benefit from parent support, but because we cap ratings on highly strategic subsidiaries at one notch below their parent, it would receive only one notch of support, instead of the current two notches.

## **CreditWatch**

We intend to resolve the CreditWatch placement once the relevant authorities approve Bankia's merger with CaixaBank and the transaction is completed. We anticipate that this could occur during the first quarter of 2021.

We placed Bankia's long-term rating on CreditWatch positive to indicate that we could raise it by one notch to match our rating on CaixaBank, if the deal is completed as announced and assuming other factors remain unchanged. The upgrade would indicate that Bankia would benefit from its integration within a stronger group and, ultimately, its merger with CaixaBank.

A positive rating action on Bankia would likely trigger a similar action on the bank's long-term RCR and hybrid instruments, as well as on our long- and short-term ratings on BFA.

If the transaction does not go through--contrary to our base case--we could resolve the CreditWatch placement by affirming the ratings on Bankia and BFA, if other factors remain unchanged.

## **Related Criteria**

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July

20, 2017

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

## **Related Research**

- Our Negative Outlook Revision On Spain Does Not Trigger Immediate Rating Actions On Spanish Banks, Sept. 21, 2020
- Spain Outlook Revised To Negative From Stable On Mounting Fiscal and Structural Challenges; Affirmed At 'A/A-1', Sept. 18, 2020
- CaixaBank, Sept. 11, 2020
- CaixaBank And Bankia's Potential Merger Could Kick Off A New Wave Of Consolidation, Sept. 4, 2020
- The ECB Takes Comfort In Likely Eurozone Bank Resilience, July 29, 2020
- Spanish Banks: COVID-19 Changes Everything, July 24, 2020
- Global Banks Outlook Midyear 2020: Temporary Shock, Profound Implications, July 9, 2020
- The \$2 Trillion Question: What's On The Horizon For Bank Credit Losses, July 9, 2020
- Asset Quality Not ECB Liquidity Will Determine Eurozone Banks' Fates, July 2, 2020
- Banking Industry Country Risk Assessment: Spain, June 18, 2020
- Bankia, June 9, 2020
- Outlooks Revised To Negative On Several Spanish Banks On Deepening COVID-19 Downside Risks, April 29, 2020
- Spain-Based CaixaBank Ratings Affirmed Despite Growing Risks Related To COVID-19; Outlook Stable, April 29, 2020
- Spain-Based Bankia 'BBB/A-2' Ratings Affirmed Amid COVID-19 Risks; Outlook Remains Stable, April 29, 2020
- Banco BPI, Jan. 31, 2020

## Ratings List

\*\*\*\*\* BFA Tenedora de Acciones, S.A.U. \*\*\*\*\*

### Ratings Affirmed

#### Bankia S.A.

Commercial Paper	A-2
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### Ratings Affirmed; CreditWatch/Outlook Action

	To	From
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#### Bankia S.A.

Issuer Credit Rating	BBB/Watch Pos/A-2	BBB/Stable/A-2
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Resolution Counterparty Rating	BBB+/Watch Pos/A-2	BBB+/-/A-2
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#### BFA Tenedora de Acciones, S.A.U.

Issuer Credit Rating	BBB-/Watch Pos/A-3	BBB-/Stable/A-3
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#### Bankia S.A.

Senior Unsecured	BBB/Watch Pos	BBB
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Senior Subordinated	BBB-/Watch Pos	BBB-
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Subordinated	BB+/Watch Pos	BB+
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Preferred Stock	BB-/Watch Pos	BB-
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\*\*\*\*\* CaixaBank S.A. \*\*\*\*\*

### Ratings Affirmed

#### Banco BPI S.A.

Issuer Credit Rating	BBB/Stable/A-2
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Resolution Counterparty Rating	BBB/-/A-2
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#### CaixaBank S.A.

Issuer Credit Rating	BBB+/Stable/A-2
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Resolution Counterparty Rating	A/-/A-2
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Senior Unsecured	BBB+
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Senior Subordinated	BBB
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Subordinated	BBB-
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Preferred Stock	BB
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Commercial Paper	A-2
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