Credit Rating Announcement

12 July 2019

Scope affirms Bankia's cédulas hipotecarias at AAA/Stable following performance review

The cover pool support continues to drive the rating. Fundamental credit factors also shield the bank's covered bonds against adverse changes to the cover pool, limiting a potential downgrade.

Rating action

Scope Ratings has today affirmed the AAA rating on Bankia SA's (Bankia) cédulas hipotecarias (Spanish mortgage covered bonds). The Outlook remains Stable.

Additional information and research on the issuer and its covered bonds are available on scoperatings.com.

Key rating drivers

Issuer rating (positive). The sound BBB+/Stable issuer rating of Bankia reflects its strong retail franchise in Spain, low-risk business profile and adequate capitalisation.

Fundamental credit support (positive). The six-notch uplift reflects the strength of the Spanish legal covered bond framework, the benefits of the resolution regime, and the systemic importance of covered bonds in Spain, anchoring the additional cover pool-based uplift at AA+. Assuming the issuer rating does not change, fundamental credit support also shields the rating against an adverse migration of the cover pool's credit quality.

Cover pool support (positive). The cover pool provides the maximum credit differentiation of up to nine notches above the issuer rating, of which only seven notches are needed to achieve the highest rating. The full mortgage book provides a generous overcollateralisation of 155.7% for the covered bonds. Overcollateralisation also fully mitigates identified credit and market risks. The pronounced cash flow mismatch remains the key driver for the rating-supporting overcollateralisation while the asset quality of the collateral continues to improve.

Rating-change drivers

Scope's Stable Outlook reflects: i) the continuous availability of high overcollateralisation, which provides a significant buffer against a rise in credit and market risks, thereby maintaining the cover pool-based support; ii) Scope's view that the European covered bond harmonisation will not negatively impact the fundamental support factors relevant for the cédulas hipotecarias; and iii) Scope's Stable Outlook on Bankia. In addition, a one-notch change in the issuer rating is unlikely to affect the covered bond rating.

The covered bond rating may be downgraded if i) Scope's rating on the issuer deteriorated by more than two notches, ii) the mortgage book reduced significantly in size; or iii) Bankia issued significant amounts of cédulas hipotecarias, eroding available overcollateralisation below the rating-supporting level.

Quantitative analysis and key assumptions

The cover pool's credit profile remains similar to that from a year ago. As of March 2019, the combined mortgage book (equivalent to the cover pool) decreased to EUR 70.7bn, slightly lower than the EUR 73.7bn from a year before and reflecting the relatively moderate amounts of newly originated mortgage loans. The cover pool's credit quality and delinquency levels have improved further; however, because of the reference to the whole mortgage book (including non-eligible mortgage loans as well as some developer loans) it remains weak in an international context.

Scope has analysed Bankia's highly granular mortgage book using a normal inverse distribution. Lifetime default rates assumed in Scope's analysis are 15% for residential loans and 30% for commercial loans (excluding land and developers), with coefficients of variation at 70% and 50%, respectively. Scope's assumptions are based on mortgage performance data provided regularly by the Bank of Spain and were adjusted for Bankia's performance. The coefficient of variation for the commercial segment has improved 10pp since the last annual review, reflecting the improved performance as well as benchmarking to comparable SME loans.

Scope's recovery assumptions have improved, mainly reflecting the decrease in the mortgage book's average indexed loan-to-value, to 58.2% from 58.8%. For residential mortgages, the base case (D0) recovery assumptions increased to 76.3% from 75.2% whereas recovery assumptions for the commercial segment increased to 68.5% from 67.2% a year ago. Scope has calculated a stressed weighted average recovery rate of 45.8% for residential loans and 41.1% for commercial loans.

The programme remains strongly exposed to market risks, particularly regarding maturity mismatches. The increase of supporting overcollateralisation to 37.5% from 34% is driven by the increase of the programme's duration gap, to 12.02 years against 11.6 years from a year ago. Scope calculates the assets' duration at 17.94 years, but only 5.91 years for the bonds. Scope expects maturity mismatch risk to continue to drive the rating-supporting overcollateralisation.

Interest rate risk is material: 65% of outstanding bonds pay a fixed rate while 93% of cover assets pay a floating-rate coupon. Newly originated fixed-rate mortgages will reduce the mismatch over time but persistently low interest rates continue to stress the programme's excess spread – which is already at negative levels and thereby adds to the supporting overcollateralisation.

In the stressed analysis, Scope has used a low prepayment rate (0%) together with non-reverting low interest rates that decrease to negative 1% after the second year. All bonds are denominated in euro, while 0.2% of assets are denominated in other currencies. Scope deems this exposure immaterial and therefore did not apply foreign exchange stresses.

The blended servicing fee was assumed at 28bps and the blended refinancing spread at 256bps. Scope did not apply the highest trading spreads under its methodology because assets would need to be sold continuously for more than 10 years and, in the agency's opinion, such spreads are not likely to persist throughout the whole term.

Stress testing

No stress testing was performed.

Cash flow analysis

In order to determine the cover pool-supported rating uplift, Scope performed a cash flow analysis to establish an expected loss for the covered bonds. The cash flow analysis uses the scheduled cash flows of the cover assets and covered bonds as a starting point. Scope applies rating-distance-dependent stresses to simulate the impact to cash flows arising from increasing credit and market risks. The cash flow analysis also includes the impact of stressed asset sales or other variables such as changing prepayment speeds or servicing costs.

Methodology

The methodologies used for this rating and outlook are: Covered Bond Rating Methodology; General Structured Finance Rating Methodology (for the translation of the expected loss into ratings); and Methodology for Counterparty Risk in Structured Finance (for account banks).
The methodologies are available on www.scoperatings.com.
Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scoperatings.com.

Solicitation, key sources and quality of information

The issuer participated in the rating process.
The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, third parties and Scope internal sources.
Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.
Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Regulatory disclosures

This credit rating and rating outlook is issued by Scope Ratings GmbH.
Lead analyst: Karlo Fuchs, Managing Director
Person responsible for approval of the rating: David Bergman, Managing Director
The ratings/outlooks were first released by Scope on 8 July 2016. The ratings/outlooks were last updated on 12 July 2018.

Potential conflicts

Please see www.scoperatings.com for a list of potential conflicts of interest related to the issuance of credit ratings.

Conditions of use / exclusion of liability

About Scope Ratings GmbH

Scope Ratings GmbH is part of the Scope Group with headquarters in Berlin and offices in Frankfurt, London, Madrid, Milan, Oslo and Paris. As the leading European credit rating agency, the company specialises in the analysis and ratings of financial institutions, corporates, structured finance, project finance and public finance. Scope Ratings offers a credit risk analysis that is opinion-driven, forward-looking and non-mechanistic, an approach which adds to a greater diversity of opinions for institutional investors. Scope Ratings is a credit rating agency registered in accordance with the EU rating regulation and operating in the European Union with ECAI status.

Contact

Analyst Karlo Fuchs k.fuchs@scoperatings.com