Bankia S.A.
Spanish Mortgage-Covered Bonds – Performance Update

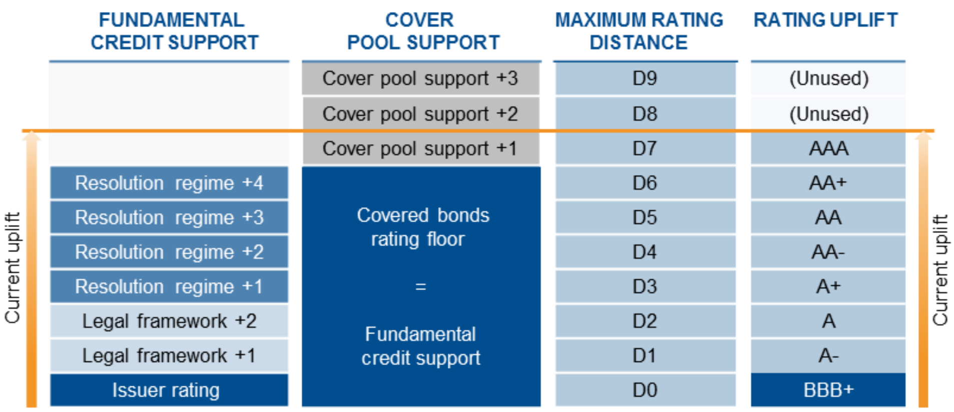
The AAA rating with a Stable Outlook assigned to the Spanish mortgage-covered bonds (cédulas hipotecarias or CH) issued by Bankia S.A. is based on the bank's BBB+ issuer rating, enhanced by seven notches of cover pool support. Six notches thereof reflect our assessment of the strong fundamental credit support provided by the Spanish legal covered bond and resolution framework.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
31 March 2020	EUR 66.2bn	Mortgage loans	EUR 23.6bn	AAA/Stable

Bankia is the fifth-largest Spanish bank by total assets. It is a purely domestic retail and commercial lender, with very strong market shares in the regions of Madrid, Valencia, La Rioja, the Canary Islands and, following the acquisition of Banco Mare Nostrum (BMN) in 2017, in Murcia, Andalusia and the Balearic Islands.

Fundamental credit support factors from the Spanish legal and resolution framework provide a six-notch uplift above the bank's rating. This effectively forms a rating floor at AA+. Cover pool support enables the programme to be rated AAA, with another one notch of uplift reflecting the credit strength of the covered bond programme.

The programme may further benefit from a buffer of two notches against an issuer downgrade as the maximum theoretical uplift constitutes nine notches, as opposed to the seven notches used to achieve the highest rating for these covered bonds.



Stable Outlook

The 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) our view that European covered bond harmonisation will not negatively impact the fundamental support factors relevant for the CH; and iii) Scope's Stable Outlook on Bankia.

Changes since the last performance update

The performance of Bankia's cover pool has continued to improve since our last monitoring review, with the share of non-performing loans (NPLs) now only accounting for 3.4% compared to 5.7% previously. Covid-19 is likely to reverse this trend but ample overcollateralisation will mitigate the impact on the covered bonds' credit quality.

The cover pool has further amortised by EUR 4.5bn, while about EUR 4.1bn of the covered bonds have been redeemed. Other characteristics have remained mostly unchanged.

Ratings & Outlook

Issuer rating	**BBB+**
Outlook	Stable
Last rating action	Affirmation
Last rating action date	09.05.19
Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	10.07.20

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Related Research

Scope affirms Bankia's cédulas hipotecarias at AAA/Stable following annual review
July 2020

Spain plans route to premium covered bonds with Cédulas 2.0
March 2020

Scope updates its issuer rating report on Bankia
May 2019

Covered Bond Framework Analysis - Analytical Considerations
July 2015

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The issuer

Bankia is rated BBB+/S-2 by Scope. Both ratings have a Stable Outlook.

Domestic retail and commercial bank with a strong market share

Bankia originates from the forced merger of seven Spanish savings institutions in 2010. The bank is entirely focused on its domestic market and has very considerable market shares in the regions of Madrid, Valencia, la Rioja, the Canary Islands and, following the acquisition of BMN, in Murcia, Andalusia and the Balearic Islands. Bankia focuses on the central regions of Spain and has a more marginal presence in the northern coastal regions where regional banks still dominate.

Due to its origins, Bankia's business model has its roots in retail and commercial banking. Its largest segment is retail, which caters to mass-market individuals and small businesses. Larger companies are served by the business banking network. Bankia also offers private banking, asset management and bancassurance products, as well as capital markets solutions, but these remain minor compared to its retail and commercial bank products.

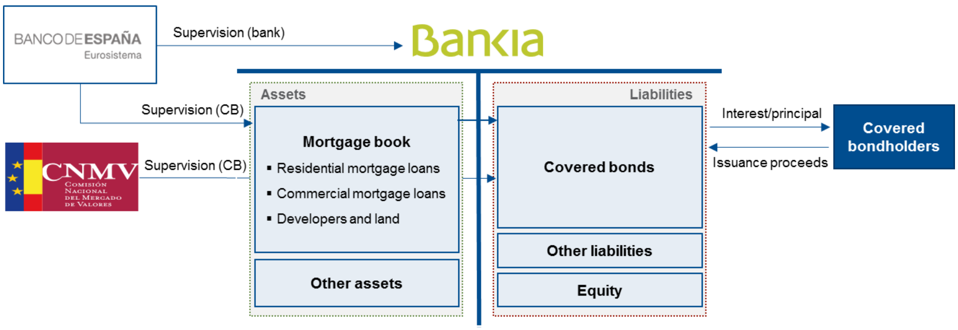
For further details of Scope's bank credit analysis see our full bank rating report available on www.scoperatings.com.

Programme structure

Unique on-balance sheet framework

The Spanish covered bond framework does not define a dedicated cover pool. Instead, Law 2/1981 from 25 March defines eligibility criteria for the cover assets against which covered bonds can be issued. Eligible mortgage assets are not registered in a cover pool which is ring-fenced upon an insolvency of the issuer. Instead, CH investors have full recourse to the bank's mortgage book – excluding securitised mortgage loans or mortgage loans that are potentially pledged in favour of other covered bond types (bonos hipotecarios).

Figure 1: Issuance structure



Source: Scope Ratings.

Fundamental credit support analysis

Fundamental credit support factors enhance the covered bond rating by six notches above Bankia's issuer rating. This is based on our view of: i) the Spanish covered bond legal framework; and ii) the resolution regime and systemic importance of Bankia's covered bonds.

Two notches of uplift based on legal framework analysis…

The current cédulas framework meets our criteria for the maximum two notches of legal framework-driven rating differentiation.

The current Spanish covered bond framework builds on individual acts that provide the legal basis for the issuance of covered bonds and their insolvency remoteness. It does not anticipate a segregation of the cover pool upon insolvency. Instead, CHs have a preferential right to the proceeds of the full mortgage book (not only the eligible cover assets). The Bank of Spain generally supervises the issuance of covered bonds and compliance with established limits and remedies.

The upcoming EU directive to harmonise European covered bond frameworks will lead to material modifications to Spanish covered bonds law. In general, we believe that the European Commission's proposed changes will be credit positive, as they will introduce more transparency for investors and require issuers to actively manage their cover pools in order to maintain sound credit quality and a low cash flow risk profile. Cover pools may become better defined and issuers will be required to enhance liquidity and risk management so that it is more in line with other European covered bond frameworks.

… plus four notches of uplift reflecting resolution regime

Bankia's covered bonds benefit from an extra credit differentiation of four notches, based on our positive assessment of the resolution regime and the systemic importance of covered bonds in general and Bankia as a covered bond issuer. The differentiation reflects: i) the preferential treatment of covered bonds in the event of regulatory intervention with the issuer (no bail-in); ii) our view that Bankia has a viable business model, a sound refinancing structure and sufficient levels of bail-inable debt, which will allow regulators to restructure the bank without impacting its ability to maintain covered bonds as a going concern; iii) the high systemic importance of covered bonds in Spain together with the visibility of Bankia as a covered bond issuer; and iv) stakeholders' strong incentives to support covered bonds as they proved to be a liquidity lifeline during the financial crisis with none of the bank rescue operations impacting Spanish covered bonds.

For more information on our view of the Spanish legal framework as well as our view on the Bank of Spain's consultation to align the domestic framework with the European covered bond harmonisation, due in 2021, see our related research.

Cover pool characteristics

Reporting date	March 2019	March 2020
Balance (EUR bn)	70.7	66.2
Residential (%)	87.2%	87.3%
Commercial (%)	12.8%	12.7%

General information

Reporting date	March 2019	March 2020
No. of loans	865,265	830,880
Avg. size (EUR)	81,719	79,628
Top 10 (%)	1.0%	1.0%
Remaining life (y)	19.9	19.7
WA residential LTV	57.8%	55.4%
WA commercial LTV	61.4%	61.9%
NPL	5.7%	3.4%

Residential property type (%)

Reporting date	March 2019	March 2020
Owner occupied	83.7	84.2
Holiday houses	6.7	6.7
Others	9.7	9.0

Commercial property type (%)

Reporting date	March 2019	March 2020
Industry	51.8	55.0
Developers	9.3	10.9
Land	2.5	2.6
Others	36.4	31.5

Repayment type (%)

Reporting date	March 2019	March 2020
Annuity	99.5	99.6
Interest-only	0.5	0.4

Interest rate type (%)

Reporting date	March 2019	March 2020
Floating	93.0	90.7
Fixed	7.0	9.3

Cover pool analysis

Bankia's mortgage-covered bond ratings are cover pool supported, with seven out of nine possible notches currently needed to support the highest credit quality. Fundamental credit support provides for a six-notch rating uplift and, effectively, a floor against a deterioration in cover pool credit quality.

Since our last review in 2019, the minimum supporting OC needed to achieve the highest rating remained at 37.5% reflecting a stable cover pool performance and unchanged asset-liability mismatches.

Cover pool composition

The credit quality of the cover pool remains moderate in an international context reflecting the high but decreasing share of overdue and delinquent loans as well as the less defined cover pool. However, covered bond investors are compensated for this by recourse to the full mortgage book and the significantly higher levels of minimum OC stipulated by the covered bond framework.

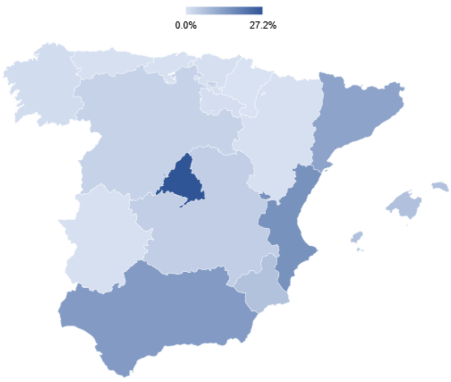
Bankia's cover pool composition reflects its strong focus on residential mortgage lending and moderate market share in commercial lending. We view as positive the low share of developer loans compared to other Spanish issuers, effectively reflecting the 2012 clean-up and support received after the bank was nationalised.

Cover assets are highly granular. The residential segment includes around 790,000 loans with an average loan size of only EUR 73,000. The commercial segment is less granular with only around 40,000 loans. The top 10 commercial exposures only account for 7.5% of the sub-portfolio. The regional distribution mirrors the business focus of its largest pre-merger institutions, Madrid and Valencia.

The cover pool's high seasoning of about 9.5 years is credit positive. Existing borrowers have demonstrated their ability to service loans, even in a stressed environment. Newly originated mortgage loans have been underwritten using prudent criteria. The weighted average (WA) loan/value (LTV) for the residential sub-portfolio is 55.4%, compared to 61.9% for the commercial segment. Average LTVs have decreased for the residential segment and have remained almost unchanged for the commercial subsegment.

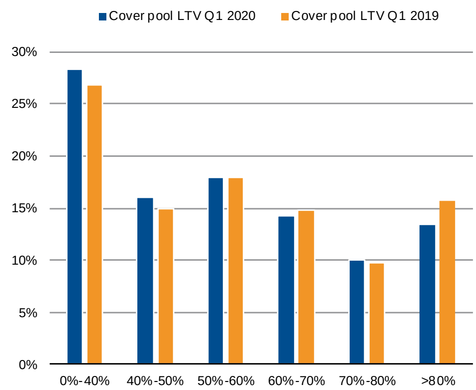
Performance has improved since our last full monitoring review. The ongoing reduction in Bankia's stock of NPLs reflects its active work-out management and the previous benign credit environment. Due to the recent Covid-19 outbreak, however, we do not expect the previous positive trend to continue, at least in the short term.

Regional distribution



Source: Scope Ratings, Bankia.

LTV distribution



Source: Scope Ratings, Bankia.

Asset risk analysis

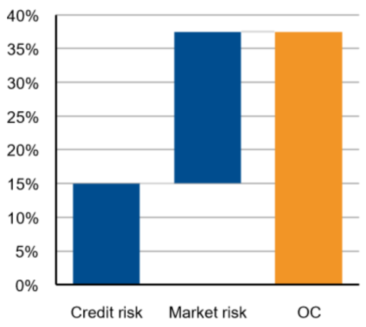
Moderate credit quality translates into higher credit risk

Our projection of default on mortgage loans uses an inverse Gaussian distribution. We assumed an unchanged mean default rate of 15% for the residential segment and 30% for the commercial segment. In addition to the stable default probability we also maintained our assumption of a coefficient of variation of 70% for the residential mortgage assets and 50% for the commercial mortgage assets.

Residential recovery assumptions have improved, mainly reflecting the small decrease in LTV together with positive indexation effects. For residential mortgages o base case (D0) recovery assumptions increased to 80.0% from 76.3% whereas recovery assumptions for the commercial segment increased to 70% from 68.5% previously. We calculated a stressed recovery rate of 48.0% for residential loans and 42.0% for commercial loans.

Cash flow risk analysis

Supporting OC breakdown



Source: Scope Ratings

Asset-liability mismatches

	Assets	Liabilities
EUR	99.8%	100%
Fixed	9.3%	64.1%
Floating	90.7%	35.9%
WAL (years)	19.7*	5.9

*as calculated by Scope

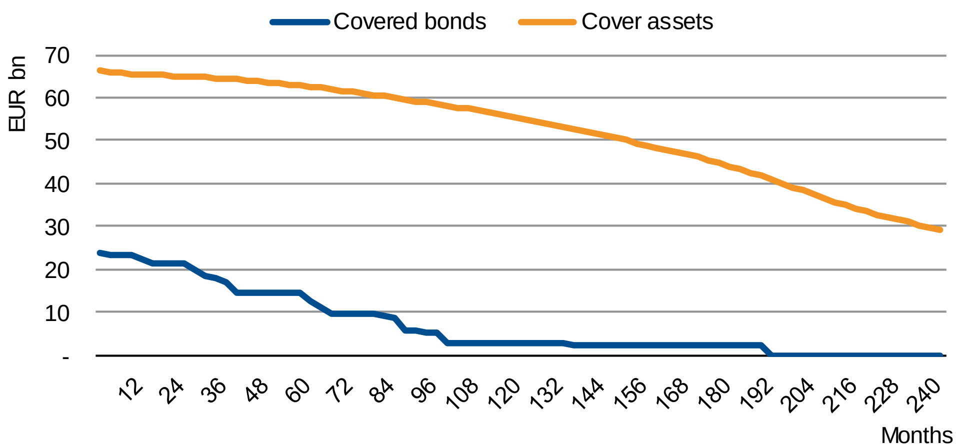
The rating-supporting OC of 37.5% mainly reflects the programme's asset-liability maturity mismatch risk from the slow scheduled amortisation of cover assets compared to a relatively fast redemption profile for the covered bonds and a corresponding sensitivity to low prepayments. Market risk in total accounts for (unchanged) 22.5pp of the supporting OC.

As of Q1 2020, the weighted average life (WAL) of the outstanding covered bonds is 5.9 years. In comparison, the (scheduled) WAL of the cover pool is 19.7 years. In the event of recourse to the cover pool, we assume that assets will be sold at a discount if the cash accumulated from cover pool amortisation is insufficient to pay timely interest and principle on the covered bonds. As is usual for Spanish covered bonds, the cover pool does not include additional, short-term substitute assets, nor does the framework allow the maturity of liabilities to be extended.

Other market risks are also elevated. The programme is vulnerable to a lower for longer interest rate scenario because 91% of the cover pool pays floating rate interest rates, compared to only 36% of the covered bonds. Underhedged foreign exchange risk is minimal, with 20bps of the assets denominated in non-EUR currencies.

Credit risk accounts for the remaining 15pp of the supporting OC. This is also high, reflecting the high lifetime mean default rate and a relatively low stressed recovery rate.

Figure 2: Amortisation profile



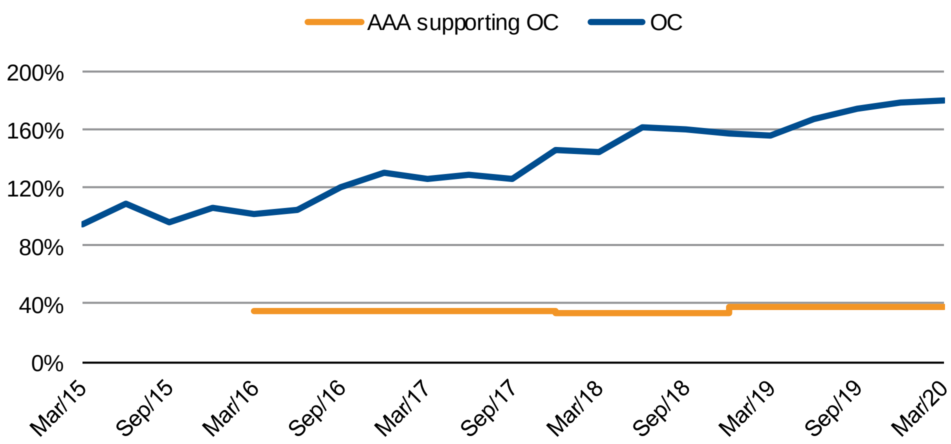
Source: Scope Ratings, Bankia

Availability of overcollateralisation

Bankia's issuer rating of BBB+ allows us to fully consider available OC in our analysis. We monitor the development of available OC and the issuance strategy. As the CHs do not just have recourse to a dedicated cover pool but rather to the full mortgage book, the most significant change in the volume of available cover assets would be effected by either the sale of cover assets or the issuance of CH or mortgage securitisations.

Available OC may be reduced when the European covered bond directive is transposed into national law. Consequently, cover pool support could also be subject to a reassessment if it is constrained by OC.

Figure 3: Available OC versus current rating-supporting level



Source: Scope Ratings, Bankia

Other risk considerations

Counterparty risk mitigated by alignment of interests

The covered bonds are significantly exposed to Bankia as the originator, servicer, bank account provider and paying agent. In our view, the strong alignment of interests between the bank and CH holders ensures bank accounts would be replaced well before any regulatory intervention might prove necessary. Further, the legal covered bond framework establishes that covered bond holders have preferential rights to the mortgage book's cash flows upon an issuer insolvency, largely mitigating bank account risk. However, bank accounts relevant for the covered bonds do not benefit from the structural mitigation that ensures the replacement of an account bank if its credit quality deteriorates.

Sovereign risk currently does not affect the ratings…

Sovereign risk does not limit the ratings on Bankia's CHs. The risks of an institutional framework meltdown, legal insecurity or currency convertibility problems (due to a hypothetical exit of Spain from the eurozone) are currently not material for the CH rating. At the same time, our view on Spain's macroeconomic fundamentals and potential risks due to Covid-19 are factored into the stresses that support the covered bond ratings.

… but macroeconomic outlook has worsened following Covid-19

The current pandemic exacerbates Spain's structural fiscal and labour market imbalances. We expect a deep recession in 2020 (of about -12.5% GDP), a significant rise in the debt-to-GDP ratio (to around 120% of GDP), and, given the widespread use of temporary contracts and about 40% of the employed working in sectors strongly hit by the crisis (including tourism and recreation), a steep increase in the unemployment rate to at least 20%.

No impact from ESG

We have not directly included ESG aspects in our rating of the covered bonds issued by Bankia. The issuer has no specific ESG underwriting guidelines which provide for adjustments to the terms and conditions of a mortgage loans if minimum ESG conditions are met/not met. We were therefore unable to differentiate between ESG and non-ESG compliant assets in our credit risk analysis.

Sensitivity analysis

Two-notch buffer against potential change in issuer rating

Bankia's mortgage-covered bond ratings benefit from a buffer against an issuer downgrade of up to two notches. Assuming the issuer's willingness to support the highest ratings as well as a stable covered bond programme risk profile, a one-notch downgrade would increase the rating-supporting OC to 46.0%.

Reporting date	31 March 2019	31 March 2020
Issuer name	Bankia, S.A.	
Country	Spain	
Covered bond name	Cedulas Hipotecarias (CH) Spanish mortgage covered bonds	
Covered bond legal framework	Spanish legal covered bond framework	
Cover pool type	Mortgage	
Composition	Residential = 87.2% Commercial = 12.8%	Residential = 87.3% Commercial = 12.7%
Issuer rating	BBB+/Stable	BBB+/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Hard bullets	Hard bullets
Cover pool currencies	EUR (99.8%)	EUR (99.8%)
Covered bond currencies	EUR (100%)	EUR (100%)
Fundamental cover pool support	6	6
Maximum achievable covered bond uplift	9	9
Potential covered bond rating buffer	2	2
Cover pool (EUR bn)	70.7 / 54.9	66.2 / 53.3
thereof, substitute assets and deposits (EUR bn)	0.0	0.0
Covered bonds (EUR bn)	27.7	23.6
Overcollateralisation: current / legal minimum	155.6% / 25%	180.5% / 25%
Overcollateralisation to support current rating	37.5%	37.5%
Overcollateralisation upon a one-notch issuer downgrade	42.5%	46.0%
Weighted average life of assets	19.9	19.7
Weighted average life of liabilities	6.0	5.9
Weighted average life gap	13.9	13.8
Number of loans	865,265	830,880
Average loan size (EUR)	81,719	79,628
Top 10 exposures	1.0%	1.0%
Interest rate type – assets	7.0% 93.0%	9.3% 90.7%
Interest rate type – liabilities	64.5% 35.5%	64.1% 35.9%
Weighted average LTV (residential / commercial)	57.8% / 61.4%	55.4% / 61.9%
Geographic split (top 3)	Madrid (26.6%) Valencia (15.8%) Andalucia (13.9%)	Madrid (27.2%) Valencia (15.6%) Andalucia (13.9%)
Default measure	Inverse Gaussian	Inverse Gaussian
Weighted average default rate (residential / commercial)	15% / 30%	15% / 30%
Coefficient of variation (residential / commercial)	70% / 50%	70% / 50%
Base (D0) recovery assumption (residential / commercial)	76.3% / 68.5%	80.0% / 70.0%
Stressed (D9) recovery assumption (residential / commercial)	45.8% / 41.1%	48.0% / 42.0%
Current share of non-performing loans	5.7%	3.4%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	NA	NA
Max liquidity premium (residential / commercial)	250bps / 300bps	250bps / 300bps
Servicing fee (residential / commercial)	25bps / 50bps	25bps / 50bps

D0 and D9 denote the stresses commensurate with the rating distance from the minimum and maximum achievable covered bond uplift

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