Spanish Banks' Capital Regime: More Clarity Entering 2016

Following the Bank of Spain's latest communication on systemic buffers, the EBA's December clarification on the positioning of Pillar 2, and Spanish banks' own disclosures of the total SREP capital requirements, we now enter 2016 with improved visibility over solvency levels. The major Spanish banks are well ahead of their 2016 CET1 requirement and hold excess capital buffers of 200-350 bps of risk-weighted assets (RWAs).

The EBA opinion 24/2015 published on December 18 also clarifies that Pillar 2 requirements stack below the combined buffer requirement (CBR) and have to be complied with at all times, hence reinforcing Scope's view that they need to be considered when assessing the risk of coupon non-payment in the analysis and rating of AT1 securities. They are also relevant to other restrictions on distributions detailed in article 141 of CRD IV, such as on dividends, buybacks and bonuses.

Since 1 January, the new CRD IV capital buffer regime has been operational. On 29 December, the Bank of Spain clarified the requirements for systemic and countercyclical buffers in Spain, adding significant clarity to the capital requirement framework in the country. This comes on top of the earlier disclosure on 24 December, by major Spanish banks themselves, of their total SREP requirements.

The countercyclical buffer was set at 0% (to be reviewed quarterly, citing the negative credit/GDP gap of 58% as of June 2015).

The systemic buffers in Spain were set as follows for 2016:

- Santander 0.25 %
- BBVA 0.25 %
- Caixabank 0.0625 %
- Bankia 0.0625 %
- Popular 0 %
- Sabadell 0 %

As the systemic buffers are subject to phased-in implementation over four years, the disclosed 2016 requirements imply 2019 buffers of 1% for BBVA and Santander, and 0.25% for Bankia and Caixabank.

However, we note that the list presented by the Bank of Spain refers to buffers for both global systemically important institutions (G-SII) and other systemically important institutions (O-SII).

BBVA will in effect be subject to a lower charge going forward as it was recently dropped from the list of global systemically important banks (G-SIB), and the G-SII requirement will cease to apply from 2017. At that point, it will still be subject to a domestic systemic requirement (O-SII), which the bank disclosed at 0.5%, to be phased-in over 4 years.

The following table summarises the total requirement for the main Spanish institutions for 2016 as well as their latest reported CET1 ratio.

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Figure 1: Spanish banks' CET1 requirements

	Santander	BBVA	Caixabank	Bankia	Sabadell	Popular	Bankinter	Liberbank	Kutxabank
	2016	2016	2016	2016	2016	2016	2016	2016	2016
Pillar 1 minimum requirement	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Pillar 2 including CCB	5.00%	5.00%	4.75%	5.75%	4.75%	5.75%	4.25%	5.75%	4.55%
Countercyclical buffer	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Systemic buffer	*0.25%*	*0.25%*	*0.063%*	*0.063%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
Total CET1 requirement	***9.75%***	***9.75%***	***9.31%***	***10.31%***	***9.25%***	***10.25%***	***8.75%***	***10.25%***	***9.05%***
CET1 ratio (Sept 2015)	12.39%	11.70%	12.80%	13.20%	11.60%	12.65%	11.85%	13.70%	14.13%
Buffer over CBR requirement	**2.64%**	**1.95%**	**3.49%**	**2.89%**	**2.35%**	**2.40%**	**3.10%**	**3.45%**	**5.08%**

Source: Scope Ratings, Banks

All of the banks are ahead of their requirements, with excess buffers ranging from 1.95% at BBVA to 5.08% at Kutxa.

It is important to note that the Pillar 2 requirements set out in the 2015 SREP decisions on capital already took full account of the fully loaded capital conservation buffer requirements, as specified both by the ECB and by some of the banks' own disclosure[1].

Based on the above we can identify the residual Pillar 2 requirements which reflects specific risks not covered in Pillar 1. These range from 1.75% at Bankinter to 3.25% at Bankia, Popular and Liberbank.

Figure 2: Isolating bank specific Pillar 2 requirements

	Santander	BBVA	Caixabank	Bankia	Sabadell	Popular	Bankinter	Liberbank	Kutxabank
SREP Requirement	9.50%	9.50%	9.25%	10.25%	9.25%	10.25%	8.75%	10.25%	9.05%
ow Pillar 1	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
ow frontloading of CCB in Pillar 2	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
ow Other Pillar 2	***2.50%***	***2.50%***	***2.25%***	***3.25%***	***2.25%***	***3.25%***	***1.75%***	***3.25%***	***2.05%***

Source: Scope Ratings, Banks

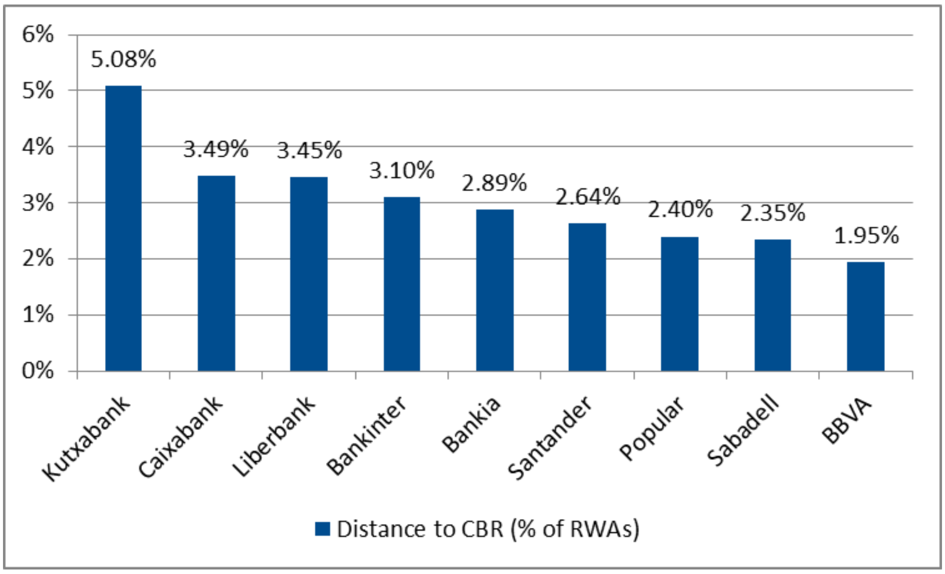
Although Pillar 2 requirements were historically not publicly disclosed, a trend has recently been established towards more disclosure. Swedish banks, for example, have disclosed their total capital requirements, including Pillar 2 buffers, and more recently Italian and French banks have also moved to disclose their total SREP capital requirements -- from which we can infer the Pillar 2 requirements. Spanish banks' disclosure follows what we believe is an emerging standard for transparency – one which Scope welcomes.

Going forward, we believe that the level of excess capital over SREP capital requirements may develop as a new key indicator for solvency. In time, as regulatory disclosure improves, we would expect investors and other market participants to increasingly focus on this metric when assessing banks' fundamentals.

At present, the total requirement, including Pillar 1 and Pillar 2 as well as the buffers, is relevant to the distribution risk of AT1 securities. The calculation of distance-to-CBR is an important measure in the assessment of coupon non-payment risk. For Spanish banks, our calculation of such distance is reported in Figure 3 overleaf.

[1] https://www.bankingsupervision.europa.eu/banking/html/srep.en.html

Figure 3: Distance to CBR (% of RWAs)



Source: Scope Ratings Estimates

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