BBVA SA
Issuer Rating Report

SCOPE A+ STABLE OUTLOOK

Scope Ratings assigns an Issuer Credit-Strength Rating (ICSR) of A+ and a short-term debt rating of S-1 to BBVA SA, both with Stable Outlook. These ratings do not apply to the unguaranteed subsidiaries of the rated parent. The ICSR was upgraded on 2 February 2017, to reflect the increased protection for the most senior part of the capital structure as the bank moves towards MREL and TLAC compliance.

The ratings were not solicited by the issuer. Both ratings and the analysis are based solely on publicly available information. The issuer has participated in the process. For the full list of ratings see the **ratings list** section at the end of this report.

Highlights

The ratings are based largely on the strength and reliability of BBVA's retail and commercial banking franchises in several countries and on the strong market positioning in its main countries of operation.

The high degree of diversification has helped BBVA deliver significant profits, despite the stressed operating environment in Spain, and enabled it to generate capital organically. The bank has withstood harsh conditions, peaking with a collapse in its domestic real estate market, significant stress to funding markets and sharply rising yields on domestic sovereign bonds in 2011 and 2012. Despite this, the bank's capital base has kept growing throughout.

With the domestic economic environment improving, the burden of Spanish legacy assets on the group's earnings capacity has declined. The recovery, if sustained, should also have a positive impact on the sustainability of public debt, which remains a concern to us. However, we underscore that we do not automatically link BBVA's rating with the credit standing of the Spanish sovereign.

Rating drivers (Summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:
1. Retail-focused, globally diversified revenue and earnings streams with strong market positions in several key markets (Spain, US Sunbelt, Mexico, Turkey, Argentina, Chile, Venezuela, Colombia, Peru)
2. Material exposure to Spanish sovereign risk, which remains a potential weakness
3. Improvements in profitability as legacy real estate non-performing assets are steadily dealt with
4. In extremely stressed crisis scenarios, it is possible that intervention by host or home regulators could limit the mobility of capital and liquidity within the group

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Rating-change drivers

Further improvements in group's relative capital position. While greatly improved in recent years, BBVA's capital position lags behind peers on a fully loaded CRD4 CET1 basis. This is partly the result of the high average risk intensity of the balance sheet. BBVA's fully loaded leverage ratio of 6.5% is significantly higher than peers.

Significant worsening of Mexican earnings capacity and asset quality. BBVA group's profitability currently relies on Mexico contributing 46% of net profit in 2016. Should the earnings capacity and asset quality of this business be dented, the capital generation of BBVA could be impacted.

Renewed tension on Spanish bank and sovereign debt. Tensions surrounding peripheral European assets were sedated for the past few years by a strongly accommodative monetary policy. As economic recovery takes hold in Europe, the European Central Bank will gradually remove its support, starting with a termination of its asset purchase programme in December 2017. Despite not directly affecting the P&L, rising yields on the bank's Spanish sovereign bond holdings would raise questions on the bank's capital levels. To some extent, however, we take comfort in the promising economic performance of Spain after the crisis.

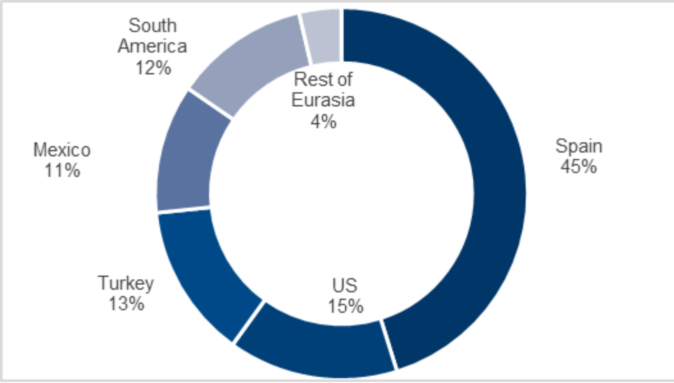
Rating drivers (Details)

Retail-focused, globally diversified revenue and earnings streams with strong market positions in several key markets

BBVA offers predominantly retail banking services to customers in Europe, Asia and the Americas.

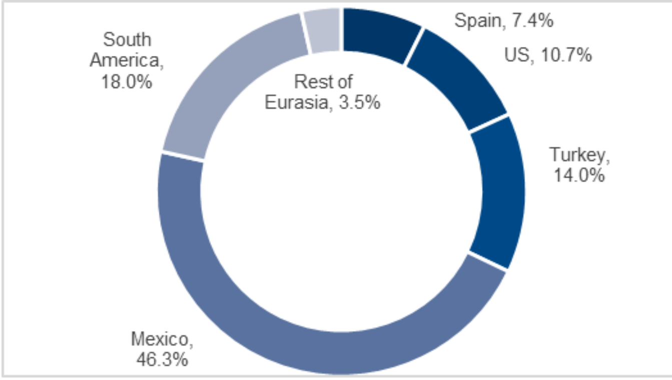
While the bulk of the bank's activity remains in Spain, BBVA's emerging-market operations have not only helped the bank navigate the crisis that engulfed its home country but also offered a good degree of business diversification. The bulk of BBVA's profits is derived from emerging markets, particularly Turkey and Mexico.

Figure 1: BBVA's loan book divisional split (2016)



Source: Company data, Scope Ratings
Note: Excludes Corporate Center

Figure 2: BBVA's net attributable profit, divisional split (2016)



Source: Company data, Scope Ratings
Note: Excludes Corporate Center

The need to provision for deteriorating asset quality in Spain has depressed BBVA's profitability for some years, but non-Spanish income has allowed it to maintain a positive bottom line at group level in most quarters.

More recently, profitability has been improving as the need for provisioning has eased.

Material exposure to Spanish sovereign risk, which remains a potential weakness

Spanish public finances remain fragile, with public debt approaching 100% of GDP and a public deficit at 4.5% of GDP.

BBVA had a EUR 47bn exposure to Spanish sovereign risk as of December 2016, c. 100% of its transitional CET1 capital, including bonds and loans, and excluding exposures in insurance companies. This risk concentration makes BBVA's capital ratios sensitive to potential losses on Spanish sovereign debt.

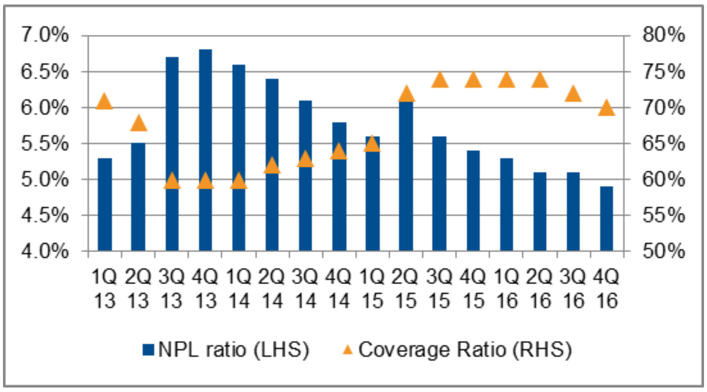
According to Scope calculations, for every 10% loss on Spanish sovereign debt, BBVA's CET1 ratio would decline by about 123 bps, before any tax offset or management actions. That said, such sovereign losses are not our expected scenario, but rather a simplified exercise to assess the group's vulnerability to tail risk. A quarter of the exposure has a maturity of less than one year, which means BBVA could materially reduce its exposure in a relatively short time by not rolling the paper. However, we caution that in periods of real stress and market closure, a large bank can be asked to support the bond issuance of its home sovereign. It is worth noting that in recent years this exposure has been declining.

The risk of a tail event for the Spanish sovereign has receded since the ECB started engaging in increasingly dovish policies in 2012. The launch of quantitative easing has supported the demand for Spanish sovereign bonds while depressing yields.

Improvements in profitability as legacy real estate non-performing assets are steadily dealt with

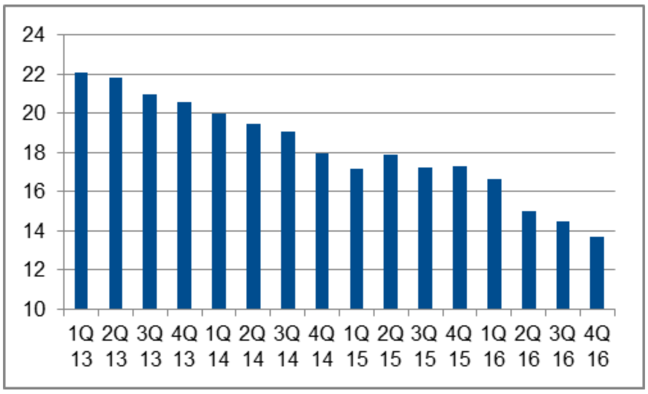
Recent quarterly developments show more-encouraging trends in BBVA's asset quality. The group's non-performing assets (NPAs), after increasing for several years, started declining in 2014, driven by improvements not only in Spanish real estate-related NPAs but also in other deteriorated Spanish assets. The group NPL ratio, which has been improving since the end of 2013, stood at 4.9% at the end of December 2016 with a coverage ratio of 70%.

Figure 3: BBVA's asset quality metrics are improving



Source: Company data, Scope Ratings
Note: includes Catalunya Banc from Q2 2015

Figure 4: Spanish real estate division, total assets (EUR bn)



Source: Company data, Scope Ratings

We expect asset quality to improve as legacy losses are dealt with. We estimate that the lower need for provisions will further boost returns. Indeed, BBVA's profitability has been held back in recent years by the need to make large provisions against rapidly souring real estate assets, although the impact of provisions has already materially declined since its peak in 2012. In order to identify trends in BBVA's profitability we isolated the losses on Spanish real estate assets from the profitability of its core divisions in Spain, Turkey, US, Mexico and South America. Pre-tax losses on Spanish real estate fell from EUR 5.7bn in 2012 to just EUR 0.7bn in 2016, and should continue their decline in coming years as a more supportive macro environment helps BBVA reduce its run-off real estate portfolio further.

In extremely stressed crisis scenarios, it is possible that intervention by host or home regulators could limit the mobility of capital and liquidity within the group

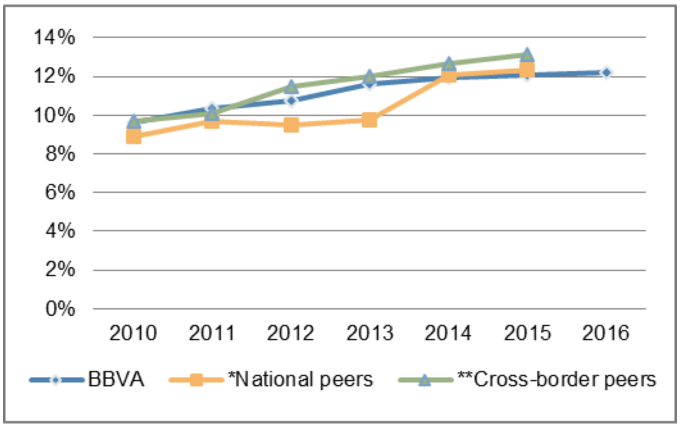
The European sovereign and financial crisis has shown that in a period of stress intragroup capital and liquidity mobility across geographies can significantly diminish, limiting a cross-border banking group's financial flexibility when it is most needed. Faced with such restrictions, some banking groups may take steps ranging from the listing of a minority stake to the disposal of the entire business in order to unlock capital from a subsidiary. The extent to which cross-border banking groups have such alternatives at their disposal represents a mitigant to this risk.

Conversely, we acknowledge that BBVA's subsidiarisation limits the risk of contagion between units. Indeed, we look favourably at cross-border banking organisations that display reassuring capital and liquidity metrics at both group and subsidiary level. We have noted that the European Banking Union should eliminate doubts around the effectiveness of regulation and supervision in individual countries, and allow investors to compare banks across Europe based on their intrinsic credit strength. As such, it should also reduce the risk of regulatory ring-fencing within Europe.

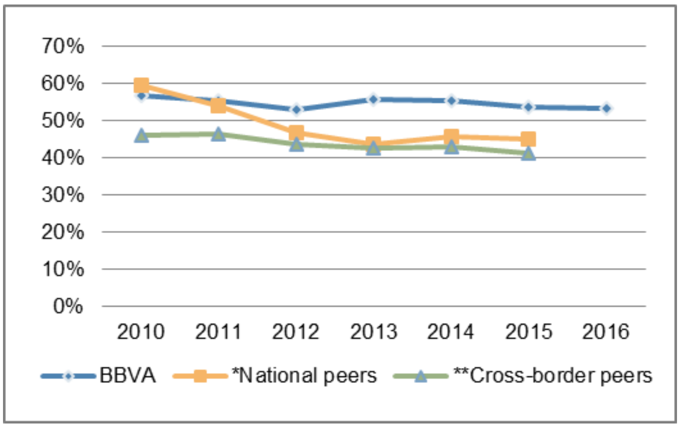
However, while the Banking Union will likely improve confidence in BBVA's home supervision framework, we note that many of BBVA's host supervisors will remain outside of the eurozone and, as such, the risk that capital and liquidity may be ring-fenced at times of stress cannot be excluded.

Appendix A: Peer comparison

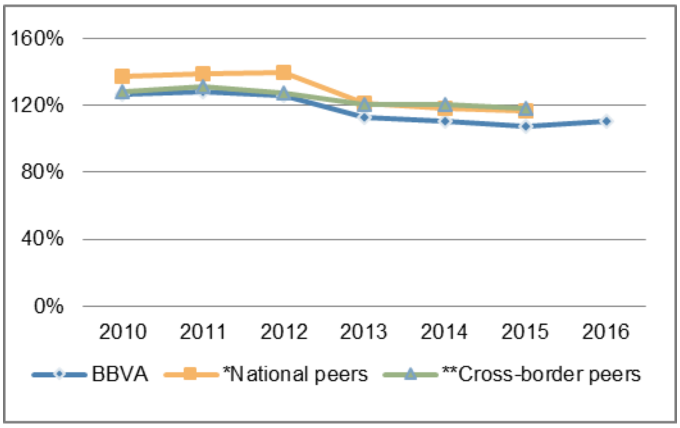
CET 1 ratio transitional (CET 1/RWAs)



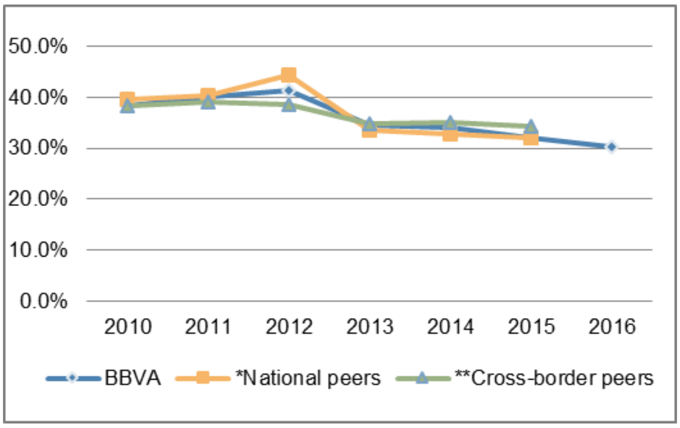
Asset risk intensity



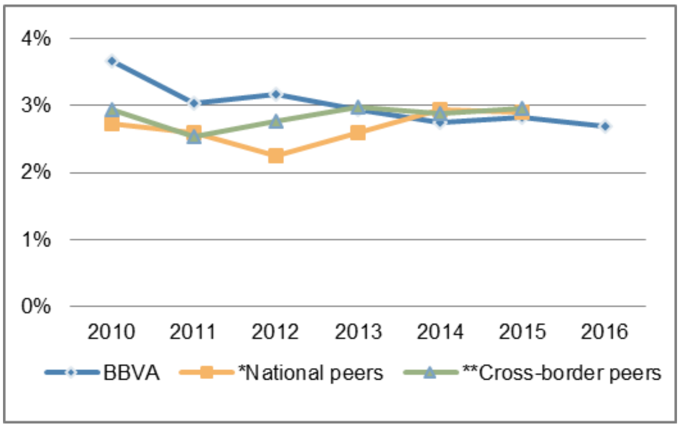
Loans-to-deposits ratio



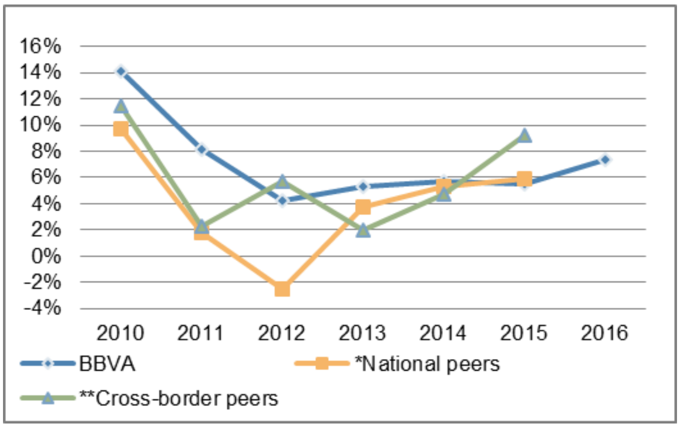
Wholesale funds/total funds ratio



Pre-provision income/RWAs



Return on average equity



Source: SNL, Scope Ratings

**National peers: BBVA, Santander, Banco Popular, CaixaBank, Banco Sabadell, Bankia, Bankinter.

**Cross-border peers based on business model : Santander, BBVA, Unicredit, Erste Bank, Nordea, KBC Group, ING Bank.

Appendix B: Selected financial information – BBVA group

	2012Y	2013Y	2014Y	2015Y	2016Y
Balance sheet summary (EUR bn)					
Assets					
Cash and interbank assets	60.9	61.3	58.5	76.5	80.3
Total securities	168.6	n.a.	190.1	208.0	187.8
Derivatives	53.8	n.a.	46.9	44.5	45.8
Net loans to customers	342.4	334.7	338.8	414.2	414.7
Other assets	7.7	25.6	8.1	8.6	7.3
Total assets	**621.1**	**599.5**	**631.9**	**749.9**	**731.9**
Liabilities					
Interbank liabilities	102.2	87.7	93.4	108.6	98.2
Senior debt	86.3	65.5	58.1	65.9	59.1
Derivatives	52.2	n.a.	47.4	45.2	45.5
Deposits from customers	282.8	310.2	319.1	403.4	401.5
Subordinated debt + non-equity hybrids	11.8	10.6	14.1	16.1	17.2
Other liabilities	4.6	16.0	4.5	4.6	5.0
Total liabilities	**577.5**	**554.7**	**580.3**	**694.6**	**676.4**
Ordinary equity	41.2	42.4	49.0	47.3	47.3
Equity hybrids	0.1	0.1	0.1	0.0	0.1
Minority interests	2.4	2.4	2.5	8.0	8.1
Total liabilities and equity	**621.1**	**599.5**	**631.9**	**749.9**	**731.9**
Core tier 1 / common equity tier 1 capital	35.5	37.5	41.8	48.6	47.4
Income statement summary (USD bn)					
Net interest income	14.5	14.6	14.4	16.0	17.1
Net fee & commission income	4.2	4.4	4.2	4.6	4.7
Net trading income	1.7	2.5	2.1	2.0	1.9
Other income	0.9	-1.2	0.0	-1.3	0.9
Operating income	**21.2**	**20.4**	**20.7**	**21.4**	**24.6**
Operating expense	11.0	11.8	11.7	12.8	14.0
Pre-provision income	**10.2**	**8.5**	**9.0**	**8.5**	**10.6**
Loan-loss provision charges	7.9	5.8	4.3	4.3	3.8
Other impairments	1.1	n.a.	0.7	0.6	0.7
Non-recurring items	0.4	0.0	0.0	0.9	0.2
Pre-tax profit	**1.6**	**2.8**	**4.0**	**4.6**	**6.4**
Discontinued operations	0.4	0.8	0.0	0.0	0.0
Income tax expense	-0.4	0.6	0.9	1.3	1.7
Net profit attributable to minority interests	0.7	0.8	0.5	0.7	1.2
Net profit attributable to parent	**1.7**	**2.2**	**2.6**	**2.6**	**3.5**

Source: SNL, Scope Ratings

Appendix C: Ratios – BBVA group

	2012Y	2013Y	2014Y	2015Y	2016Y
Funding/Liquidity					
Amortised Loans % Deposits	121.0%	107.9%	106.1%	102.7%	103.2%
Liquidity coverage ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans % funded assets	55.1%	55.8%	53.6%	55.2%	56.7%
Impaired loans % gross loans	6.2%	NA	7.8%	6.9%	6.4%
Loan-loss reserves % impaired loans	70.7%	59.5%	62.7%	73.8%	69.7%
Net loan growth (%)	-2.7%	-5.2%	4.7%	22.3%	0.1%
Impaired Loans/ Tangible Equity & Reserves (%)	39.4%	49.6%	38.8%	39.6%	37.2%
Funded assets growth (%)	3.9%	-6.0%	8.5%	18.7%	-2.4%
Earnings					
Net interest margin (%)	2.5%	2.6%	2.6%	2.5%	2.5%
Net Interest Income/ Avg Risk-weighted Assets	4.4%	4.5%	4.2%	4.3%	4.3%
Net interest income % revenues	68.3%	71.8%	69.4%	75.0%	69.3%
Fees & commissions % revenues	19.6%	21.8%	20.1%	21.6%	19.2%
Cost income ratio (%)	52.0%	58.1%	56.5%	60.1%	56.8%
Operating Expense/ Avg Risk-weighted Assets	3.3%	3.6%	3.5%	3.5%	3.5%
Pre-provision income % risk-weighted assets (RWAs)	3.1%	2.6%	2.7%	2.3%	2.7%
Loan-loss provision charges % pre-provision income	77.1%	67.7%	48.1%	50.1%	35.8%
Loan-loss provision charges % gross loans (cost of risk)	2.2%	1.7%	1.3%	1.1%	0.9%
Pre-tax Profit/ Avg Risk-adjusted Assets	0.5%	0.8%	1.2%	1.2%	1.6%
ROAA	0.4%	0.5%	0.5%	0.5%	0.6%
Return on Avg Risk-weighted Assets	0.7%	0.9%	0.9%	0.9%	1.2%
Return on average equity (ROAE) (%)	5.5%	6.4%	6.6%	6.3%	8.5%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	10.8%	11.6%	10.4%	10.3%	10.9%
Common equity tier 1 ratio (%, transitional)	10.8%	11.6%	11.9%	12.1%	12.2%
Tier 1 capital ratio (%, transitional)	10.8%	12.2%	11.9%	12.1%	12.9%
Total capital ratio (%, transitional)	13.0%	14.9%	15.1%	15.0%	15.1%
Tier 1 leverage ratio (%)	6.3%	NA	7.2%	7.0%	7.0%
Asset risk intensity (RWAs % total assets)	53.0%	54.0%	55.5%	53.5%	53.1%
Market Indicators					
Price/ Book (%)	91.7%	121.9%	98.2%	90.2%	88.9%
Price/ Tangible Book (%)	110.9%	151.0%	115.6%	114.6%	112.1%
Dividend Payout Ratio (%)	140.0%	NA	90.2%	99.7%	74.0%

Source: SNL, Scope Ratings

Ratings

Issuer Credit-Strength Rating	**A+**
Outlook	Stable
Senior unsecured debt	A
Additional Tier 1 instruments	BB+
Short term debt rating	S-1
Short term debt rating outlook	Stable
Covered Bonds rating	AAA
Covered Bonds rating outlook	Stable

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund.

The rating analysis has been prepared by Marco Troiano, Director

Responsible for approving the rating: Sam Theodore, Managing Director

Date	Rating action	Rating (ICSR)
01/04/2014	First Assignment	A
22/07/2014	Confirmed	A
21/11/2014	Confirmed	A
02/02/2017	Upgrade	A+

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings without a mandate (unsolicited rating) but with participation of the rated issuer.

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Key sources of Information for the rating

Website of the rated entity/issuer, Annual reports/quarterly reports of the rated entity/issuer, Current performance record, Data provided by external data providers, Interview with the rated entity, External market reports, Press reports / other public information.

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodologies applicable for this rating "Bank Rating Methodology" (May 2016) & "Bank Capital Instruments Rating Methodology" (May 2016) are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on 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 credit rating, definitions of rating symbols and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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Rating issued by

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