Financial Institutions Ratings
BBVA S.A. – AT1 rating report

Security ratings

Outlook	Stable
7% EUR 1.5bn perpetual AT1 notes (February 2014) equity conversion on 5.125% trigger	BB+
6.75% EUR 1.5bn perpetual AT1 notes (February 2015) equity conversion on 5.125% trigger	BB+
8.875% EUR 1bn perpetual AT1 notes (April 2016) equity conversion on 5.125% trigger	BB+
5.875% EUR 500mn perpetual AT1 notes (May 2017) equity conversion on 5.125% trigger	BB+
6.125% USD 1bn perpetual AT1 notes (November 2017) equity conversion on 5.125% trigger	BB+

The ratings were not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

Scope rates the above securities issued by BBVA at BB+/Stable. The ratings are based on the following:

- Senior unsecured debt (eligible for MREL): A, Stable Outlook
- Minimum notches down from the senior unsecured debt rating: 4
- Additional notches: 1

In accordance with our rating methodology, the starting point for notching down when rating capital instruments is provided by the senior unsecured debt rating. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going-concern loss-absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2018 for more details.

The additional notch for these securities reflects the double-trigger structure which limits the benefits of earnings diversification if the domestic profit outlook deteriorates, resulting in the bank no longer being able to upstream earnings from other parts of the group.

The release of this rating report does not constitute a rating action. The last rating action was assigned on 15 June 2017. For further information on the last rating action and regulatory information please click here.

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Issuer credit profile

BBVA has an issuer rating of A+, with a Stable Outlook.

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

A 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, culminating in a collapse in its domestic real estate market, significant stress on 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 lightened. The recovery, if sustained, should also have a positive impact on the sustainability of public debt, which remains a concern to us. However, it should be noted that we do not automatically link BBVA's rating with the credit standing of the Spanish sovereign.

Summary terms

Issuer	BBVA S.A.
Issue date	**February 2014**
Amount	EUR 1.5bn
Coupon	• 7% from February 2014 to February 2019, then switches to 5y mid-swap rate + 6.155% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment • Redeemable at the option of the bank, subject to regulatory consent, from first reset date
ISIN	XS1033661866

Issue date	February 2015
Amount	EUR 1.5bn
Coupon	• 6.75% from February 2015 to February 2020, then switches to 5y mid-swap rate + 6.604% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment • Redeemable at the option of the bank, subject to regulatory consent, from first reset date
ISIN	XS1190663952

Issue date	April 2016
Amount	EUR 1.0bn
Coupon	• 8.875% from April 2016 to April 2021, then switches to 5y mid-swap rate + 9.177% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment; • Redeemable at the option of the bank, subject to regulatory consent, from first reset date
ISIN	XS1394911496

Issue date	May 2017
Amount	EUR 500m
Coupon	• 5.875% from May 2017 to May 2022, then switches to 5y mid-swap rate + 5.779% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment; • Redeemable at the option of the bank, subject to regulatory consent, from first reset date
ISIN	XS1619422865

Issue date	November 2017
Amount	USD 1.0bn
Coupon	• 6.125% from November 2017 to November 2027, then switches to 5y mid-swap rate + 3.870% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment; • Redeemable at the option of the bank, subject to regulatory consent, from first reset date
ISIN	US05946KAF84

Main risks	
Coupon cancellation	• Fully discretionary if the bank deems it necessary or desirable; • Mandatory in case of i) insufficient Available Distributable Items; ii) request from the regulator • Mandatory if distributions exceed the Minimum Distributable Amount • Mandatory if a distribution would cause a breach of regulatory restrictions
Principal loss absorption	• Upon trigger event conversion into equity • Conversion to equity at the point of non-viability
Triggers for principal loss absorption*	• CRD4 transitional CET1 ratio (group) < 5.125% • CRD4 transitional CET1 ratio (BBVA SA) < 5.125%

Source: Prospectuses, Scope Ratings

*Note: the original terms of the May 2013 securities included multiple triggers based on principal capital, EBA Core Tier 1 capital and the Tier 1 ratio. According to BBVA, these ceased to apply following Spanish implementation of CRD4.

Key risks

A. Coupon cancellation

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and subject to distribution restrictions.

Available Distributable Items (ADIs)

The concept of ADI is defined in the Capital Requirements Regulation (CRR; art. 4.1-128) as “the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution’s by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts”.

BBVA reported ADIs of EUR 8.8bn at parent company level as of December 2017, which is approximately 30 times more than its 2017 AT1 coupons. ADIs are calculated as Net Income + Voluntary Reserves - 2017 dividend - AT1 coupons.

This is an ample buffer, in our view. Furthermore, we expect BBVA to increase its ADI over time through retained profits. At this stage we do not expect a lack of ADI to be a factor that would constrain distributions on the AT1 notes.

Combined Buffer Requirement (CBR)

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements.

BBVA’s total CET1 requirement for 2018, including both Pillar 2 and buffers, is 8.44%. This includes a CET 1 minimum requirement of 4.5%, a Pillar 2 requirement of 1.5% and a CBR of 2.4% (including a capital conservation buffer of 1.875%, and an OSII buffer of 0.57%). This calculation does not include the Pillar 2 guidance, which is not binding.

We expect the CBR to increase over time as the capital conservation buffer and the systemic buffer are gradually further phased in (2.5% and 0.75% respectively in 2019).

In future, the bank may be subject to an institution-specific countercyclical buffer as well as to higher systemic buffers.

As of Q1 2018, BBVA’s CET1 transitional (phase-in) ratio stood at 11.1%, 2.7% above the requirement. However, this distance is likely to decline over the coming years through the gradual phasing-in of CRD4 buffers.

We also note that, while investors have mostly focused on the distance to the CET1 requirement in the past, banks have to comply with all capital requirements at all times before CET1 capital can be allocated to meet CBR. In other words, if a bank does not have sufficient Additional Tier 1 or Tier 2 capital (or MREL), CET1 instruments can be used to fill the shortfall instead, provided the same capital cannot be used twice.

As a result, monitoring of coupon-cancellation risk must take into account any weakness in the bank’s capital structure, as this could lead to the CBR not being met and the MDA calculation being activated.

Table 1 shows the calculation of distance to the CBR for BBVA based on CET1, Tier 1 and total capital ratios.

Table 1: Distance to estimated capital requirements

	2017	Q1 2018	2019
Required CET1 associated with distribution restrictions	**7.6%**	**8.4%**	**9.3%**
Combined buffer (CBR)			
- Capital conservation	1.25%	1.88%	2.50%
- Systemic	0.38%	0.57%	0.75%
- Countercyclical	0.00%	0.00%	0.00%
Pillar 2 CET1 requirement	1.50%	1.50%	1.50%
Pillar 1 CET1 requirement	4.50%	4.50%	4.50%
BBVA Group CET1, transitional (%)	11.7%	11.1%	
Distance to CET1 requirement incl. CBR (%)	**3.9%**	**2.7%**	
Distance to CET1 requirement incl. CBR (EUR bn)	**14.7**	**9.6**	
BBVA Group Tier 1, transitional (%)	12.9%	12.8%	
Required Tier 1 incl. CBR (%)	9.1%	9.9%	
Distance to Tier 1 requirement incl. CBR (%)	**3.8%**	**2.9%**	
BBVA Group total capital, transitional (%)	15.5%	15.4%	
Required total capital, incl. CBR (%)	11.1%	11.9%	
Distance to total capital requirement incl. CBR (%)	**4.4%**	**3.4%**	
RWAs (EUR bn)	363	357	

Source: Company data, SNL, Scope Ratings

B. Principal loss absorption

Key risk: principal loss absorption

The mechanism for loss absorption is equity conversion.

The securities have a 5.125% CET1 trigger, where CET1 capital is based on transitional rules. The triggers apply both to the BBVA group and BBVA as parent company.

Distance to trigger

The current distance to the trigger is 6.0% based on the group's capital position. The distance for the parent company is higher at 12.58% (as of December 2017). We believe that this is important as a large part of BBVA's earnings come from emerging markets, and the fungibility of capital among subsidiaries may decrease in times of stress. Hence, the strong capitalisation at parent company level offers protection should future profits from subsidiaries be ringfenced.

Table 2: Distance to trigger

	2017	Q1 2018	2019
Trigger level	5.125%	5.125%	5.125%
BBVA Group CET1, transitional (%)	11.7%	11.1%	
Distance to trigger (%)	**6.5%**	**6.0%**	
Distance to trigger (EUR bn)	**23.6**	**21.4**	

Source: Company data, SNL, Scope Ratings

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