

TLTRO II analysis – Spanish financial institutions

Strong underlying liquidity to mitigate risks from TLTRO II redemptions

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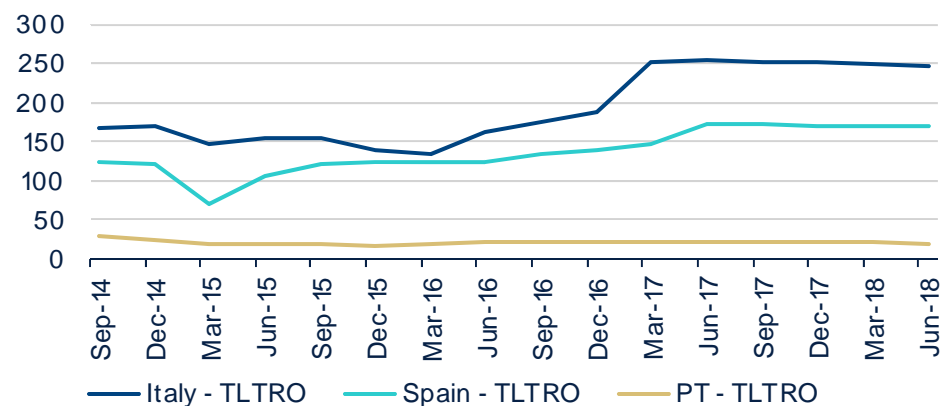
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Regional situation: Italy dominates total uptake

ECB TLTRO II (EUR bn)

Source: Bloomberg, company data and BBVA Credit Research



The TLTRO II (EUR740bn) has to be repaid in full by June 2020 through March 2021

We estimate that **banks in Italy and Spain account for at least 60% of total TLTROs**

First TLTRO II (EUR399bn, EUR11bn already repaid) **matures in June 2020**, which is the **first important cliff, mainly for Italy** (c.EUR140bn) **and Spain** (EUR115bn)

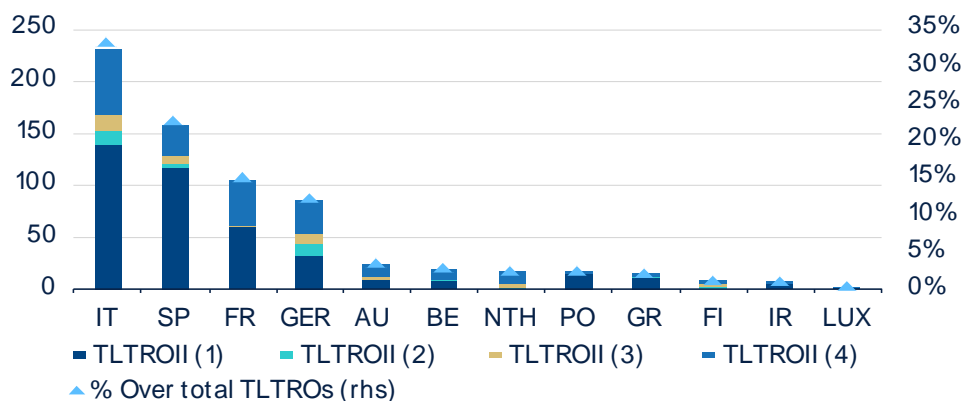
As a percentage of total assets, **Spain** and **Italy** are more or less equal

According to those banks that have reported their TLTRO II positions, most of the redemptions are concentrated in **June 2020**

TLTRO II repayment affects both the **funding strategy of banks** and **their regulatory liquidity ratios**

Country breakdown of TLTRO borrowing at the ECB (EUR bn)

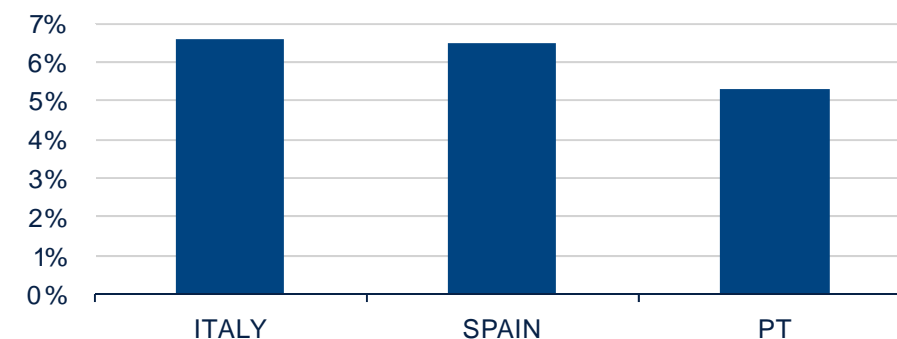
Source: ECB and BBVA Research estimates



TLTRO II as % of total assets (%)

Note: Consolidated balance sheet data

Source: Bloomberg, company data and BBVA Credit Research



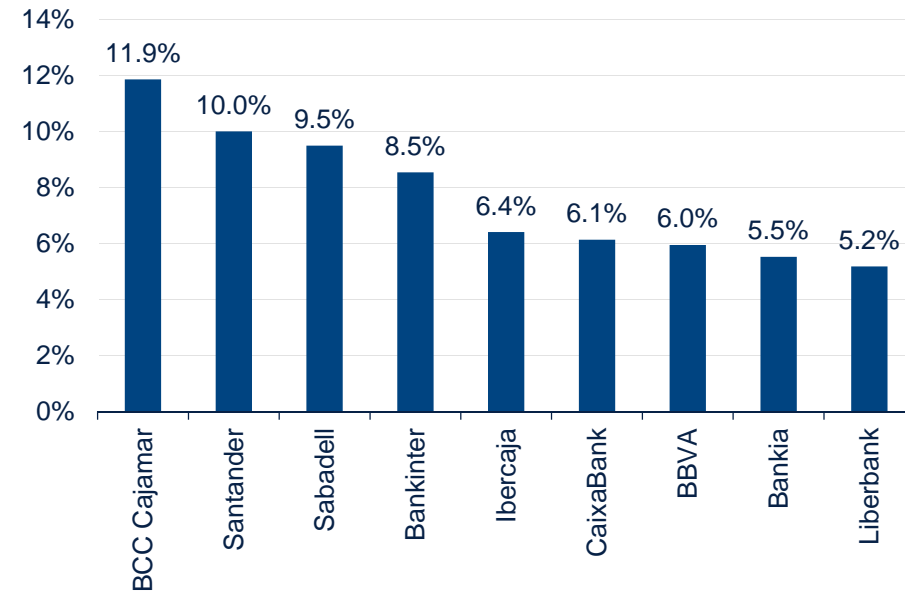
Spanish banks: manageable volume vs. total assets

- Generally speaking, Spanish institutions remain in a healthy position with regards to TLTRO II repayments, despite the **significant uptake** in funds since the introduction of the operation
- The range of TLTRO to total assets is on average 6-9%
- The impact of the impending repayment of TLTRO II funding is expected to be **manageable**, as Spanish banks mostly used the TLTRO II as a cheap medium-term funding alternative and not as a carry-trade play

Spanish banks: TLTRO as % of total assets (2Q18, %)

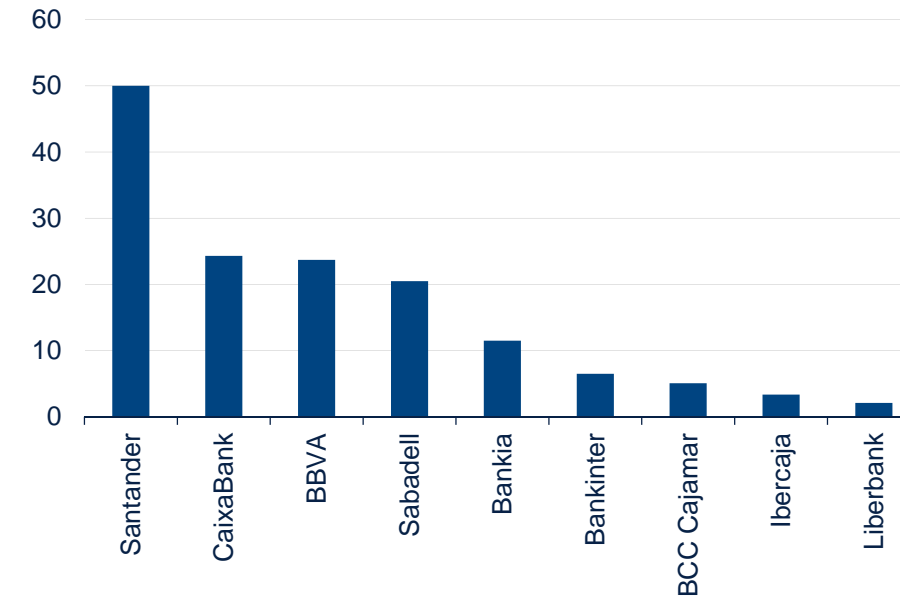
Note: Eurozone balance sheet data

Source: company data and BBVA Credit Research



Spanish banks: TLTRO (2Q18, EUR bn)

Source: company data and BBVA Credit Research

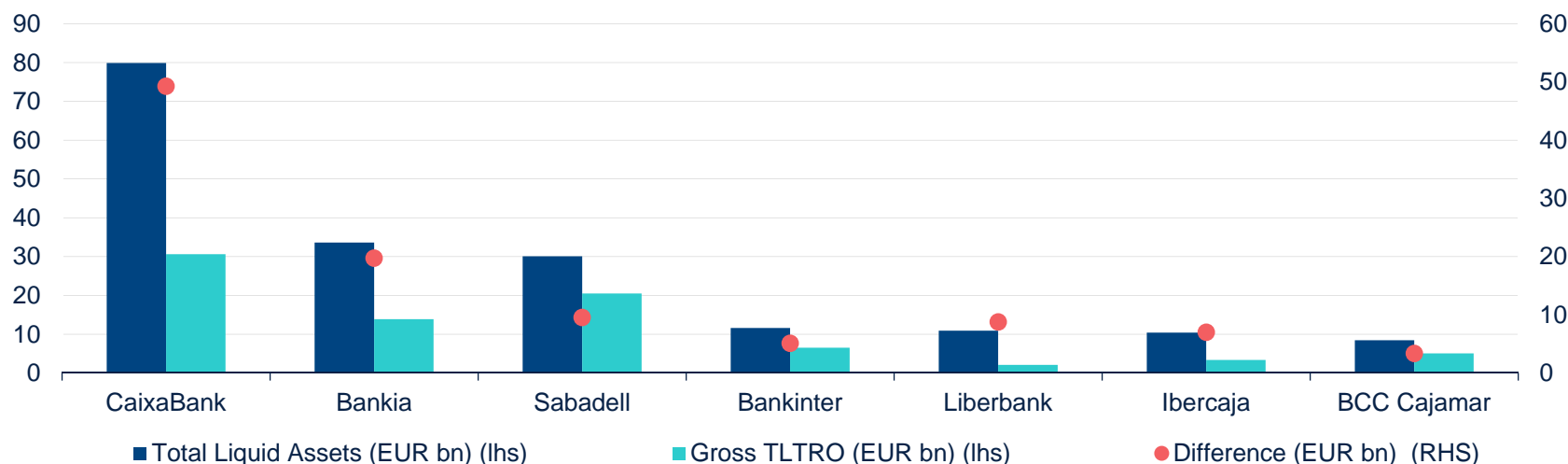


Available liquid assets are not under threat

- Observing the gross levels of both TLTRO and liquid asset positions, we come to a similar conclusion in that, Spanish banks show sufficient levels of liquidity in terms of the repayment of TLTRO II funding

TLTRO vs. liquid assets, gross positions (EUR bn)

Note: Eurozone balance sheet data. Santander and BBVA do not disclose Eurozone HQLA data.
Source: company data and BBVA Credit Research



- It is important to bear in mind that this is an extreme redemption scenario and that, in reality, there needs to be a consideration for any additional cash outflows outside of the TLTRO II redemptions (for example, in the net outflows of the denominator of the LCR ratio, deposit outflows also need to be considered as defined in the LCR delegated act) and **the subsequent knock-on effects that this will have on the various regulatory ratios the bank adheres to**

Breaking down our analysis

- First we find the **liquid asset position** of each institution, using the **gross positions of total and liquid assets as reported in their Eurozone LCR ratio disclosure, if available**, to examine how each firm's exposure may be sufficiently covered
- We then approximate each bank's TLTRO II funding using their **current loans to central banks** disclosures
- This gives us an idea of how much of a burden this TLTRO funding (and subsequent settling) will be for our sample of institutions
- We also examine gross positions as a measure of **hypothetical funding needs for the issuers derived from the TLTRO redemptions**

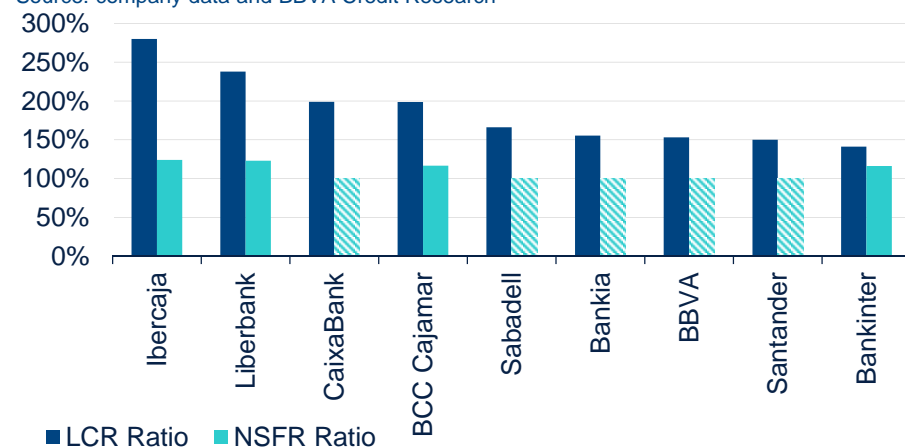
Bank liquidity ratios and TLTRO II repayments

- The banks under our coverage all have a healthy **Liquidity Coverage Ratio (LCR)** and **Net Stable Funding Ratio (NSFR)**
- The impact of TLTRO II redemptions on the NSFR ratios is estimated to be **5-10 pts**, which, even if the majority of the institutions do nothing to replenish their available funding, will still result in **above requirement** levels of NSFR, although the leeway is much more limited than the LCR one
- This suggests that, even without the liquidity provided for by the TLTRO II programme, these banks will remain **sufficiently liquid** in the eyes of the regulators

Reported LCR & NSFR (%)*

*Dashed bars are reported as meeting the 100% target, they have not provided a full ratio figure.

Source: company data and BBVA Credit Research



Net Stable Funding Ratio:

- Designed to assess the funding stability of financial institutions
- Seeks to prevent maturity transformation
- Longer-term assessment than the **LCR**
- More difficult to manage by banks vs the **LCR** given the reduced availability of long-term funding options and the significant size of the denominator (up to 70% of total assets)

$$NSFR = \frac{\text{Available Stable Funding (ASF)}}{\text{Required Amount of Stable Funding (RSF)}} > 100\%$$

Liquidity Coverage Ratio:

- Designed to assess the **short-term resilience** of the liquidity of the financial institutions
- Shorter-term assessment than the **NSFR**
- Does the bank have sufficient **High Quality Liquid Assets (HQLA)** to cover liquidity requirements for **30 days**, given a **liquidity stress scenario**?

$$LCR = \frac{\text{High Quality Liquid Assets (HQLA)}}{\text{Total net cash outflows over 30 days}} \geq 100\%$$

Other considerations: funding and assumptions

- **We have assumed that all banks are planning on waiting until the funds fall due to repay them and do not amortise them gradually over time. This is unlikely to be the case in reality. Banks need to balance** the cost of pre-funding too early (if there is something announced later on) or too late (if they expect some transition and nothing is put in place). They have a number of ways in which they can achieve a gradual amortisation, not captured in this analysis:
 - **Deleverage their balance sheets to generate additional liquidity and the cash position in their treasury.**
 - **Issue covered bonds, senior preferred and other regulatory instruments such as the senior non-preferred (SNP)** in order to continue to meet MREL requirements and cover the TLTRO II redemptions. If clarity is not given regarding both the quality and quantity of the composition of the MREL requirements, as well as when the requirements are expected to be met, this would result in medium-sized banks, which are less likely to meet said requirements, issuing a substantial number of covered bonds to cover the TLTRO II redemptions as a way to mitigate the increased financing costs vs. the TLTRO II in a scenario of margins and profitability remaining under pressure.
 - In this regard, and due to the significant reduction in the outstanding amount of Spanish covered bonds since 2012, the potential issuance capacity is quite substantial, despite the high OC requirements of the Spanish framework, estimated at EUR104bn.
 - **Selling liquidity-generating assets (e.g. real estate or NPL portfolios)** to provide some additional funds with a mitigated impact elsewhere on the balance sheet.
- Institutions expect the ECB to implement a **‘bridging-auction’** to allow firms to mitigate the impact of TLTRO II redemptions, and significantly, the **Fixed Rate Full Allotment Procedure (FRFA)** of Main Refinancing Operations (**MRO**) to continue past December 2019, thus allowing banks to maintain sufficient levels of liquidity, although with a shorter maturity profile.
- An additional implication for the bank's **LCR** is that TLTRO II was collateralised with **Non-high Quality Liquid Assets**, meaning there was **no impact on the LCR** when the funding was received. If, after the redemption of TLTRO II, these institutions were to seek funding in the form of repurchase agreements (repo's) from a **private institution**, they would require HQLA as collateral which in turn would have a negative impact on the LCR ratio of the bank. Furthermore, the private repo market operation is somewhat constrained by the risk limits applied by the clearing houses.
- Regarding the **long-term liquidity ratio (NSFR)**, there would be a negative impact on the numerator of the ratio (ASF) when the residual maturity falls below 12 months (50% of haircut) and 6 months (100% haircut), another driver to foster the long-term issuance by banks through 2019, while the impact on the denominator would be positive but linked to the type of assets that the banks have used to collateralize their TLTRO borrowing (covered bonds, ABS, govies...), given the different regulatory treatment of encumbered vs. unencumbered assets in this ratio.

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