

Research Update:

Banco De Sabadell Outlook Revised To Positive On Buildup Of Subordinated Bail-In-Able Debt Buffer; 'BBB-/A-3' Affirmed

June 17, 2022

Overview

- Banco De Sabadell (Sabadell) is making progress in strengthening its additional loss-absorbing capacity (ALAC) buffers, which will provide protection to senior creditors in a resolution scenario.
- Meanwhile, Sabadell is entering the second year of its restructuring plan, gradually improving its profitability and domestic competitive position, although significant progress will only come after 2023.
- We revised our outlook on Sabadell to positive from stable and affirmed our 'BBB-/A-3' issuer credit ratings on the bank.
- We also affirmed our 'BBB/A-2' long- and short-term resolution counterparty ratings on Sabadell, as well as all the issue ratings on the bank's debt.
- The positive outlook reflects the possibility of an upgrade over the next 12-24 months if Sabadell delivers on its issuance plan, increasing the size of its subordinated bail-in-able buffer, and provides clear line of sight that its ALAC buffer will remain sustainably above 350 basis points (bps).

PRIMARY CREDIT ANALYST

Lucia Gonzalez
Madrid
+ 34 91 788 7219
lucia.gonzalez
@spglobal.com

SECONDARY CONTACT

Elena Iparraguirre
Madrid
+ 34 91 389 6963
elena.iparraguirre
@spglobal.com

Rating Action

On June 17, 2022, S&P Global Ratings revised its outlook on Banco de Sabadell S.A. (Sabadell) to positive from stable and affirmed the 'BBB-/A-3' long- and short-term issuer credit ratings on the bank.

At the same time, we affirmed our 'BBB/A-2' long- and short-term resolution counterparty ratings on Sabadell, as well as all the issue ratings.

Rationale

Sabadell is strengthening its cushion of subordinated bail-in-able debt. Since the beginning of 2022, Sabadell has continued building its buffer of subordinated bail-in-able debt, issuing about €900 million of senior nonpreferred debt. Consequently, its ALAC ratio has increased to about 3.6% of S&P Global Ratings' risk weighted assets (RWA) as of June 2022, up from 3% at year-end 2021. Equally, Sabadell already meets--by a thin margin--its 2024 minimum requirement for own funds and eligible liabilities (MREL). In particular, as of March 31, 2022, it reported an MREL ratio of 25.33% (versus the 24.84% requirement, including a 2.75% combined buffer requirement), and a 20.87% subordinated ratio (versus an 18.98% requirement). Our ALAC calculation differs from the MREL calculation in that we include only subordinated instruments--senior nonpreferred and Tier II--which we anticipate will provide protection for senior creditors in a resolution scenario. In its existing MREL, Sabadell includes 4.5% of its senior debt as a percentage of regulatory RWAs.

Sabadell plans to further increase issuance of subordinated bail-in-able debt in 2022 and 2023, which if delivered could lead to a higher rating. We revised our outlook to positive to reflect the possibility that a sufficient cushion of subordinated instruments will support the creditworthiness of senior unsecured instruments. In addition to refinancing its maturing instruments, we understand Sabadell aims to continue issuing MREL debt. If accomplished, and completed in the form of subordinated rather than senior debt, its ALAC buffer could be enhanced to 4.0%-4.7% of RWAs over 2022-2023. We acknowledge though that heightened market turbulence in the context of rising interest rates may complicate the bank's plans to place speculative-grade debt in the market. Also, given that Sabadell is already complying with its MREL, including 4.5% of senior debt, it would not need to tap the market under adverse conditions. Therefore, an upgrade will be contingent on clear evidence that the ALAC buffer reaches a level sustainably above the 350-bps minimum threshold we set for one notch of ALAC uplift. We have increased by 50 bps and 100 bps the standard thresholds of 300 bps for a one-notch uplift and of 600 bps for two notches, respectively, reflecting Sabadell's concentration of ALAC in a relatively small number of instruments, which leads to structurally higher refinancing risks.

Our assessment of Sabadell's stand-alone credit profile (SACP) has not changed. Sabadell is progressing on its restructuring plan, but more remains to be done. Since the new plan was launched in late 2020, Sabadell has gradually extracted more value from its domestic franchise, gaining market share in the domestic retail segment in particular, while turning around its U.K. operations, with U.K.-based TSB Bank PLC returning to profits in 2021. Even if Sabadell's bottom-line profitability and efficiency should improve amid more favorable interest rates, we anticipate that they will still lag that of higher rated peers by year-end 2023. We forecast that its return on equity will stand somewhat above 5% by the end of 2023 (versus 3.2% on average in 2018-2021), and its cost-to-income ratio at about 62% by the same date (versus 66% on average in 2018-2021).

Outlook

The positive outlook on Sabadell indicates that we could raise our ratings over the next 12-24 months.

Upside scenario

An upgrade could follow if the bank delivers on its plan of further expanding its buffer of subordinated bail-in-able debt, with evidence that its ALAC buffer will remain sustainably above 350 bps of RWAs over the foreseeable future. We would not upgrade the bank's hybrid instruments in such a scenario, however, since they are rated with reference to the SACP.

The positive outlook also assumes that Sabadell will continue delivering on its restructuring plan to sustainably improve its competitive position and profitability, while maintaining adequate capitalization over the next 12-24 months, with its risk-adjusted capital (RAC) ratio at 8.0%-8.5%. In addition, while Sabadell is structurally more exposed to corporate lenders, and therefore more vulnerable to the emergence of problematic loans from the pandemic and the Russia-Ukraine conflict, we think asset quality deterioration will be manageable.

Downside scenario

Conversely, we could revise the outlook to stable if Sabadell falters on its plan of further building its subordinated bail-in-able buffers. This could also happen if we see pressures on the bank's SACP that offset its increasing ALAC buffer, stemming, for example, from management's failure in its restructuring efforts or our RAC ratio falling below 7%.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB-/Positive/A-3	BBB-/Stable/A-3
SACP	bbb-	bbb-
Anchor	bbb	bbb
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Adequate (0)	Adequate (0)
Risk position	Adequate (0)	Adequate (0)
Funding	Adequate (0)	Adequate (0)
Liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	0	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Implications Of The ECB's Policy Normalization For Interest Rates, The Balance Sheet, And Yields, June 9, 2022
- When Rates Rise: Not All European Banks Are Equal, June 8, 2022
- Banking Risk Indicators: May 2022 Update, May 19, 2022
- Global Macro Update: Growth Forecasts Lowered On Longer Russia-Ukraine Conflict And Rising Inflation, May 17, 2022
- Global Credit Conditions Special Update: Inflation, War, And COVID Drag On, May 17, 2022
- Banking Industry Country Risk Assessment: Spain, April 11, 2022
- Credit Conditions Europe Q2 2022: Seismic Shocks, Security & Supply, March 29, 2022
- Economic Outlook Eurozone Q2 2022: Healthy But Facing Another Adverse Shock, March 28, 2022
- Spain Outlook Revised to Stable From Negative on Balanced Growth; 'A/A-1' Ratings Affirmed, March 18, 2022
- Spanish Bank Ratings Affirmed Under Revised FI Criteria, Jan. 27, 2022

Ratings List

Ratings Affirmed

Banco de Sabadell S.A.

Resolution Counterparty Rating BBB/--/A-2

Banco de Sabadell S.A.

Senior Unsecured BBB-

Senior Subordinated BB+

Subordinated BB

Preferred Stock B+

Ratings Affirmed; Outlook Action

To From

Banco de Sabadell S.A.

Issuer Credit Rating BBB-/Positive/A-3 BBB-/Stable/A-3

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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