

### Summary:

## Banco Popular Espanol, S.A.

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## Summary:

# Banco Popular Español, S.A.

**Credit Rating:** A/Negative/A-1

## Rationale

The ratings on Banco Popular Español, S.A. (Popular) incorporate Standard & Poor's Ratings Services' view of the bank's high systemic importance in the Spanish system, solid franchise, resilient revenue generation, outperforming efficiency, and adequate solvency. Counterbalancing these strengths are the bank's high credit risk and stock of problem assets, and higher reliance on wholesale funding and lower diversification than for other Spanish universal banks.

Given Popular's position as Spain's fifth-largest banking group, we consider it to have high systemic importance within the Spanish financial system. As a result, we believe that Popular is likely to receive timely and sufficient extraordinary financial support from the Kingdom of Spain (AA/Negative/A-1+) if necessary. To reflect that view, our long-term rating on Popular incorporates one notch of uplift from our assessment of its stand-alone credit profile (SACP).

Since we consider the Spanish authorities to be "supportive," our SACP on Popular also factors in ongoing implicit state support. By this, we mean the benefits derived from being a bank in a regulated and supervised environment with access to extraordinary liquidity, such as funding from the European Central Bank.

Popular enjoys a sound franchise, particularly in retail banking. The bank has adequate business and geographic diversification, but is less diversified internationally than many other large universal domestic international banks.

Popular's resilient, still-sound revenue generation and excellent operating efficiency remain, in our opinion, its major financial strength. We consequently incorporate into the ratings our expectation that Popular is likely to remain fairly profitable through the downturn. We anticipate that in 2010, Popular's pricing and efficiency advantages, and the interest rate floors on a substantial part of its mortgage portfolio, will cushion it against anemic business volumes, low interest rates (at which the mortgage portfolio will fully reprice), and still high regulatory provisioning needs.

We therefore also expect that Popular will likely maintain generally stable levels of capitalization. Since the capital increase in 2009, when the bank raised equity and mandatory convertibles, we view Popular's solvency levels as adequate relative to its risk profile.

Popular's resilient preprovision performance and enhanced capital position mitigate our concerns about the high credit risk in its loan book and already comparatively weak asset quality metrics. Popular has accumulated a large stock of problem assets mainly because of meaningful deterioration of its large exposure to the real estate sector since 2008. Gross nonperforming loans represented 5.8% of gross loans on March 30, 2010. In addition, the bank has quickly built a large stock of repossessed and purchased assets through the downturn. Write-offs since year-end 2008 represent a further 1.1% of gross loans. We expect Popular's asset quality metrics to continue deteriorating amid the difficult economic environment and the still-adjusting real estate sector, but at a slower pace than in the last 18 months. Moreover, we foresee a prolonged workout of the large stock of problem assets because of our

expectations for a slow recovery of the Spanish economy. Nevertheless, we think that existing reserves, including still available generic loan loss reserves, and resilient operating profitability are likely to help Popular cover expected losses from its problem assets.

Popular remains mainly retail-funded and has reduced the funding gap generated by commercial activities over the past two years. However, the bank still exhibits higher-than-average reliance on wholesale resources and on short-term instruments, which, although manageable under normal market conditions, we view as a ratings weakness because it exposes Popular to tight liquidity on the capital markets. We nevertheless take into consideration the liquidity reserves Popular has built up in the form of assets eligible for discount at the ECB.

## Outlook

The negative outlook reflects the possibility of a downgrade if we lower our assessment of Popular's SACP. A downgrade would not be automatic, though, because we could incorporate additional notches above the SACP for extraordinary government support, in accordance with our criteria.

We could lower our assessment of the SACP if asset quality deterioration accelerates or earnings generation substantially weakens from 2009 levels.

Under our base scenario, we expect Popular's problem assets to grow and peak at comparatively weak levels but believe that the bank can absorb them through its existing reserves cushion and relatively resilient preprovision income this and next year. We also expect the bank to report weaker but still reasonably positive results and adequate capitalization. We could consider Popular's SACP as weaker if we see any signs that these expectations are unlikely to be met.

We could revise the outlook to stable if we see that pressure on Popular's SACP is likely to abate.

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