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Spanish Court Rules Against Interest Rate Floors, a Credit Negative for Banks

From [Credit Outlook](#)

Last Thursday, a Spanish court ruled against the interest rate floor clauses applied by more than 40 Spanish banks to their mortgage loans. The court ordered the banks to reimburse the excess amounts charged to customers since May 2013, and the banks' revenue will no longer benefit from the positive effect of the clauses. The ruling is credit negative for Spanish banks, and occurs at a time when their revenue-generation capacity is being severely hit by low interest rates and subdued business volume.

The list of affected banks include some of Spain's largest institutions, including [Banco Santander S.A. \(Spain\)](#) (A3/(P)A3 stable, baa1¹), [CaixaBank, S.A.](#) (Baa2/Baa2 stable, ba1), [Bankia, S.A.](#) (Ba3/B1 stable, b2), [Banco Popular Espanol, S.A.](#) (Ba1/(P)Ba2 stable, b1) and [Banco Sabadell, S.A.](#) (Baa3/Ba1 stable, ba3). Also affected are several midsize institutions.

Given that banks expected this ruling after the Spanish Supreme Court in May 2013 ruled against the floor clauses used by [Banco Bilbao Vizcaya Argentaria, S.A.](#) (A3/Baa1 stable, baa2), [Abanca Corporacion Bancaria, S.A.](#) (Caa1 positive, b3) and Cajamar (unrated), we believe that most of the affected banks had already set aside provisions to cover, at least partially, this contingency. CaixaBank said it set aside €500 million last year, while Banco Popular set aside €350 million, [Liberbank](#) (B1/(P)B1 stable, b1) set aside €80 million, and [Catalunya Banc SA](#) (Ba2/Ba2 review for upgrade, caa1 review for upgrade) set aside €66 million. Other institutions have publicly confirmed the existence of provisions but did not disclose amounts. We note that Bankia, CaixaBank and Catalunya Banc cancelled their interest rate floor clauses last year, and thus we expect the ruling to have a more limited effect on these institutions.

The court cited two reasons for ruling against the interest rate floor clauses. First, it viewed the clauses as having been imposed by banks rather than negotiated with customers. Second, it considers these clauses abusive and a violation of legal transparency requirements. Although the claimant was asking for the cancellation of the floor clauses since loan origination, last week's ruling limited the retroactive effect to May 2013, in line with the Supreme Court ruling. Affected banks must cancel the floor clauses and reimburse customers for the excess amount charged between May 2013 and the ruling date, including the interest legally accrued. The court did not impose fines on the banks.

To some extent, floor clauses helped mitigate the negative effects of low interest rates on net interest margins and subdued business volumes. Although the one-off effect from the reimbursement of the excess amounts charged will likely be absorbed by provisions to different degrees, the cancellation of the floor clauses means that banks will no longer be able to benefit, another hit to already-weak interest margins.

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¹ The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and baseline credit assessment.

The court ruling does not entirely resolve the issue of floor clauses. The European Union Court of Justice is currently deciding on the full retroactive application of the cancelation of interest rate floor clauses going farther back than May 2013. The European Commission has already issued an opinion favourable to such a measure. According to press reports, the European Court ruling could come later this month. Although the case under examination by the European court relates to the individual claim of a Spanish bank customer, the negative consequences of a potential ruling in favour of a full retroactive application would likely affect all banks that have been ordered to remove floor clauses, adding additional negative pressure on banks' earnings.

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