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PRESENTATION

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Good morning to everyone, and welcome to the third quarter results presentation of Bankia. As we usually do, José Sevilla, our CEO will start by talking about the highlights of the quarter, and then the Financial Director Leopoldo Alvear will go deeper into the results. Then we'll finish with a Q&A session.

(Operator Instructions)

So let's start. Well, thank you very much. And welcome, everyone. We start this third quarter -- quarterly results presentation for the year 2020. The issues I would like to mention, well, first of all, I would like to talk about the merger process. I would like to talk a little bit about the business. Also, I would like to talk about asset quality, the results and the capital ratio evolution. In the field of the merger with CaixaBank, well, there's not many news. You know that the boards have called for the AGMs that will take place in December, beginning of December 2020. And after that, from then, what we'll expect is just the authorizations that we hope will mean that we'll have the legal closing of the merger in the first quarter of 2021. After that, the entity will have its -- it will be a legal entity, a single legal entity, and we like to do the IT integration closing at the end of 2021. So not many changes here when compared to the presentation that we did for the preparation of the merger.

From the business perspective, I will focus on credit that we've done -- as we've done in the past. When we look at the loan and we look at corporate and SME loans, I would like to talk about corporate SME loans, mortgages and consumer finance. For corporate and SMES, we have a strong growth of 17%. As you can see, that is very much based on the growth of the second quarter, in the third quarter, we grew again. The book grew by EUR 600 million, but obviously, at a -- in a less accelerated fashion.

In mortgages, we continue with a good news of previous quarter regarding new mortgage lending, and the truth is that we are growing above 9% year-on-year in new mortgages. And in terms of consumer finance, which is the retail area that has suffered the most, consumer finance during the crisis. Well, it has recovered gradually, but it is still far from the levels that we had a year ago. With regard to corporates and SMEs. Here, you can see the new lending that are growing strongly over than a few first quarters. And what's important is the market share growth, I think, for corporate and SME loans. As you can see between August and August, which is the last data available, we're growing by 50 basis points in market share, and we are now above 8%. We are at 8. 04%. Obviously, this has also been supported by the expansion activities we've carried out regarding the ICO granted lending.

Here, you can see the figures. We've granted EUR 9 billion till September, this will increase slightly in the last quarter of the year. With these market shares that you can see here, with our market share that is growing for medium to large companies in the tranche B than in small and medium-sized companies tranche A.

So as you can see, the total of ICO granted lending covers or accounts for about 21% of our total lending companies. So activity has remained. It has been a quarter that's been less intense than the second quarter, it's normal, also because seasonally, the third quarter tends to have less credit demand, less loan demand due to the summer.

And if we go to mortgages, here, we can see the new mortgage lending. And in 9 months, it's grown by the 9.1% when we look at 9 months like-for-like. And also, if we look at the quarterly, we can see in September, we've had a record figure. It has been the month we have had new -- more new mortgages. If we look at the last quarter, obviously, August is the month with less activity, although this year, we had April. If we aggregated the 3 months, the third quarter have been a total of EUR 800 million of turnover that, as you can see, is 30% higher than what we turned over in 2019.

It's true that the third quarter of 2019 also had some effects due to the introduction of the new mortgage law that reduce some other activity in the third quarter, but we compare it to the third quarter of 2018, we'll be growing at 20%. And so this is the highest third quarter we've had off the last 3 years in terms of new mortgage lending and as part of the strategic plan.

Here, you can see the new production market share is in -- going from 6.6% to 8%. That market share had already grown, we started already the year with higher market share than the previous year. And I think this pricing evolution of the new mortgages, bearing in mind the economic context, I think there are 2 important factors for this: First, probably, that we're doing it better that our network procedures, we are being more capable of -- doing also some subrogation of the development over the last 2 years that have matured. And that has helped us, but it's also true that we are finding new demand, solid, robust, an important demand for mortgages. And I think this is a good sign in the current context of the economic situation.

As you can see, we've also improved the fixed-rate mortgages percentages with loan-to-value that are similar to what we had in the previous quarters for new mortgages and mortgages that I think they are of middle size, but slightly higher than what we had granted until now.

With regard to consumer finance, here, you can see the new lending falling by 53% year-on-year. With this new lending, our market share for consumer finance is more or less flat, it grows by 2 basis points.

It's true we've fallen a little bit versus March, and we mentioned it also, we acted quickly from the first moment because we thought that consumer finance, given the new situation, we were coming into, it was a necessary to know the revenues of our customers and somehow, it was more difficult then. So we find here also a combination of 2 effects. The measures that we have taken to prevent any problems in the current context, but also the fact that we are not finding solid demand, whereas we do find it in the mortgage.

Well, as you can see here the turnover for the third quarter of EUR 235 million is grown by 56% versus the second quarter. But it's true, we're still far from the 500 -- over EUR 500 million that we normally had every quarter.

Just like in the mortgage arena, we hope -- well, we expect that the fourth quarter will be stronger than the third quarter, both for consumer finance and mortgages. And we also said it last time, I mean, 1 thing is not seen the consumer finance demand, but the consumption, but doesn't mean that the consumption has not recovered or hasn't increased. And here, we have 2 sets of information: On the right, you can see the card purchases turnover, both for Bankia and for the sector, you can see that V shape, you can see that after June, which is when we last spoke to you, we've seen an increase, but not so sharp, and we can see how the growth is getting closer to those before the pandemic but still lower. And in green, which is Bankia, you can see that it's growing consistently above the average of the market.

And then on the left, you can see that, that means that the cards turnover in Bankia and the market share for cards that you can see at the bottom left is increasing strongly. Since the 12.94% of the second quarter of 2019 till the 13.63% of the second quarter of 2020. All that has to do with payment methods are having an important effect in Bank. Obviously, they were affected by the lockdown too.

With regards to mortgage and consumer finance, here are the relief measures to help families, people with mortgages and with consumer finance. As you can see, a total of 40,000 mortgages are in moratorium and 49,000 in consumer finance. The evolution is flat between the second quarter and the third quarter. We still do not have any large maturities of the moratoriums. You know that there were 6 months for consumer finance and for -- and 12-month average for mortgages. So it'll take us some time to start having data regarding on when they are -- they mature, these moratoriums.

One part of it, which is for consumer finance, will mature during the fourth quarter of this year. And these are the figures for mortgages, we'll see a bit of an increase in the requests granted for mortgages. Because there was some that were requested before the end of September, but been under study in October, and they will be about EUR 200 million.

Regarding mutual funds, you know that for us this is also a key issue to generate revenues for fees. And in our commercial activities. We have also had positive news, as you can see, we've had net inflows of EUR 421 million above what we had last year, above the second quarter as well.

So we confirm what we saw in the previous quarter of the recovery of mutual funds inflows. And we also expect a last quarter, there will be high for net mutual funds inflows, we expect it to be the highest of the history.

And then at the bottom, you have the market share of mutual funds. For many consecutive months, we've gained market share in mutual funds, and this quarter hasn't been different year-on-year we're advancing by 56 basis points, and versus the previous quarter, we've grown 12 basis points.

With regard to digital customers and sales, both the digital customers and the digital sales are increasing. There's been an acceleration due to the crisis of the coronavirus. The new onboarding of new customers is growing at 25%. And we are also perceiving -- we feel that our digital capabilities in terms of the app, in terms of the internet use, in general, I think are positive.

We are within the top 3 of the banks, whatever ranking we look at.

NPAs. Okay, so here, you can see the NPAs performance that has been very flat this quarter. We repeat the figure that we had just below the closing of 2019. As we are carrying out additional provisions due to the COVID, the coverage of NPAs increases by 3.5 percentage points between December and September, we are now at 52.2%. That means that even though the NPA ratio or the gross ratio is still flat, the net NPA ratios for provisions, it's now slightly below 3. 0%, exactly, we are at 2. 97% if I'm not wrong. And so that target that we set ourselves 3 years ago of reaching an NPA net ratio below 3%. Well, we have achieved this despite the fact that, obviously, the year has been very difficult to what we could have expected.

In terms of extraordinary provisions, here, you have the amount. In the whole year, we've done a provision -- a total provision of EUR 465 million for -- of a total of EUR 145 million , more than half of the provisions are extraordinary provisions related to the COVID-19 crisis. And since, you can see in the last quarter this figure has been EUR 155 million for COVID that as you can see, it's just above 50% of the EUR 298 million provisions that we've done in the third quarter standalone.

The core results, the increase of net interest income plus fees minus Opex. So here, you can see the evolution of the last 3 quarters. You can also see in the accumulative of the 9 months, we are growing at 1.3%, in line with the guidance that we gave at the beginning of the year and that we've maintained over the last quarters of a core resold that was flat. That was our objective for this financial year, despite the fact that the year has become more difficult, and we have a context that is more adverse than what we expected at the beginning. Here, you can see the EUR 342 million figure that's the core result for the last quarter, the third quarter and it's growing at 11.5% versus the same quarter of last year. And on the right, you can see a -- breakdown. This is due to a net interest income fall of 2.7% with an increase of fees of nearly 13% third quarter versus third quarter. With OpEx that has fallen by 3.4%. And so we are happy with the performance of the core results in the third quarter when we compare it with last year.

Here you also have the trading income breakdown before tax and pre-provision -- pre-COVID provisions would have been higher, but the difference versus the previous year would be explained EUR 100 million less of -- due to lower trading income. The COVID provisions put it in a total of EUR 218 million and the net profit at EUR 180 million.

And in terms of capital, here, you can see the evolution, in comparable terms, it has increased by the 13.02%, the CET 1 fully loaded, it has increased from 13.02% to 14.79%. So 177 basis points higher, mainly due to the approval at the beginning of September of the behavioral model. Once we have started implementing it into our models, we've used it. So that the capital ratio gives us an improvement, together with the other effects that we mentioned, the regulatory impact, SME factor, et cetera, that gives us a favor of 17 basis points and 31 from organic generation.

If we look at the quick fix and the IFRS 9 basically we'll be at a ratio of CET 1 fully loaded of 15.48% and we calculate another 29 basis points for the effect of the deduction or the nondeduction of the software that we expect for December, that would take the ratio to 15.77%.

So with these figures, remember that another idea that we had in the strategic plan was to generate an excess capital during the strategic plan of a total of EUR 2.5 billion made up of the dividends that paid, plus the excess of capital above 12% measured with the CET1 fully loaded. So this would be the situation at the closing of the quarter after approving the new mortgage model, we will currently be on EUR 2.535 billion of excess capital, as measured by the strategic plan. And therefore, we would also, at the end of the year, would have met the other goal that we set ourselves. Now I give the floor to Leo, so that he can continue with the next part of the presentation.

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Thank you very much. And good morning to everyone. Now we're going to go to the income statement. First, we stop in this slide to look at the performance over the first 9 months. As Pepe said, briefly, the truth is that it's good performance. We've had a drop on the net interest income as expected. However, the fees are growing above double-digit that we have set ourselves as an objective with a reduction of the OpEx of nearly 3%. That leads us to a core increase that was an objective for the year to be flat versus 2019, and we are increasing it by 1.3%.

We hope that the core of the second half of the year will be higher than that of the first half of the year, as we said in June. We have a level of provisions, recurrent provisions that is very much in line with the figures from last year. And this takes us to a profit before tax that -- well, the difference versus 2019 is due to the EUR 103 million less from trading income that Pepe mentioned. To this, we add the extra COVID provision, and that takes us to EUR 180 million of profit attributable to the group, those what we have accumulated for the year, as Pepe said.

If we look at the quarter result, the truth is that we believe the figures are good, in terms of recurrent results. We have a net interest income that's increased by 5.3%, fees that have slightly gone down due to the seasonality of the summer. But are very close to EUR 300 million that we have set ourselves as a quarter objective, and this should increase in the fourth quarter. We have a total provisions that are behaving in line or slightly better than what we expected given the context. And we have an extraordinary COVID-19 provision, as Pepe said, in the third quarter, that amounts to EUR 155 million.

When we look at the expenses, I mean, we have a core result that increases by 2% that takes us to EUR 37 million of profit attributable to the group.

If we look at the NII, the net interest income is grown by 5.3% due to the good customer margin and also to the volumes, especially from companies and as consumer loans and mortgages, we're still far in terms of consumer finance from the pre-COVID era, but we find that we are quite in line with what we expected, then we can also see the net interest income performance.

You can see the EURIBOR 12 months on the right and the comparison versus 2019. As you can see, nearly until the end of the quarter, the performance, especially the second half of the year has been quite similar to 2019. And so in this quarter, we haven't had many impacts. Yes, versus the second quarter but not versus 2019. I guess, from now on, especially in 2021, we'll see that difference -- that separation between the curves and impact on the net interest income.

In terms of fees, as we were saying before, in the first 9 months, we are increasing by 10.5% our figures. We believe that the second semester fees will be higher than those of the first semester. As we've said, the fourth quarter will be higher than those for the third quarter. And what we can see is the real increase in the gap versus the same period of the last year. Quarter-on-quarter, we used to have a 9% difference in the first quarter versus the 12.7% in this third quarter. So we believe that fees will continue to grow double-digit in this financial year versus 2019. And we keep our guidance.

If we look at OpEx, we can see that they're being reduced by 2.8%, nearly by 3% year-on-year. We keep our guidance and that the OpEx for the total of the year will be reduced around 2% versus 2019, despite the fact that we've had certain differences in the third quarter and the fourth quarter due to the expenses that we'll have to face due to the merger. But even including the merger, we keep our guidance of 4% by 2% versus 2019. And that keeps us with our competitive advantage versus our peers when we measure the operating expenses versus RWAs, as you can see on the right, they are still substantially lower than the sector.

If we look at the cost of risk, as Pepe said, well, we have a recurrent cost that is in line with what we expected, even maybe slightly better than what we expected this third quarter. What we look at it at accumulated -- in an accumulated figure, we have a figure that is nearly the same that what we had in 2019 without COVID. This is due to the good performance and the quality of our assets. As Pepe said, this stability of the NPA ratios.

Then we look into more detail in a minute. So this we have to add the COVID provisions that for the first 9 months of the year have increased up to EUR 465 million. So it's about a 55% of the total provisions that we would have allocated in September.

As we said in June, we expected that the total of provisions and others for the second half of the year should be similar or maybe slightly lower than the first half of the year. And the truth is that this guidance is also maintained.

We believe that the fourth quarter should be a little bit lower than the third quarter. And therefore, we will have a figure in the second half that is quite similar to that of the first. So it will take us to a cost of risk accumulated now for NPLs of 81 basis points. And when we include the foreclosed assets, it's 88 basis points.

If we now look at the credit quality, as Pepe said, we have an LPA ratio that's been quite stable since December, we have an NPL ratio, which reduced to 4.9%, and we have a material increase of over 4 -- of over basis points that take us to 58.2%. And just as another figure that we thought it was interesting to show you, we wanted to show you that upto now, we'll have to see for the fourth quarter in 2021, which is when we'll actually see increase on NPAs. But we can see that the gross entries are performing well. Putting into context the crisis we are experiencing, we can see that the gross entries are still below the data for 2019 and well below the data for 2018.

Finally, if we look at the liquidity, we still have a solid ratio that advance when compared to the second quarter, we have a loan to depo of 92.3%, and LCR at 191% and NSFR of 126%. We have where you can see all the wholesale maturities profile that we have with the maturities profile is quite flat over the next few years, we do not have an avalanche of maturities. And in terms of rating, you can see that we are progressing in all the rating outlooks. Since the announcement of the merger.

In terms of capital, and if we look first at the MREL ratio, right now, we've covered the MREL ratio that we had being allocated by the supervisor, including the quick fix, and we have important capital buffers versus regulatory increases. As you well know. And in terms of the quarter, as we said, as Pepe said before, we've generated 152 basis points of capital, 129 I explained by the change to the behavioral model of our mortgage book. And 23, which are quite relevant, bearing in mind the context and the COVID provision are due to the organic generation of capital that we've had this quarter. And so we reached a total of 14.79%.

When we include the implementation of the IFRS 9, we go up to 15.48%, and if we take into consideration the positive impact that we'll have due to the nondeductibility of the software over the last few years, that will be 29 basis points, we'll have a pro forma ratio of 15.77%. And now I'll give the floor back to Pepe.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

Well, just quickly to conclude, what we said before, the business is going well, the performance is -- for corporates is going well. And for retail, with certain and new answerers there's a clear recovery of the activity in the third quarter. The asset quality with a reduction of NPA is below 3% with important level of extraordinary provisions. And in results, I would just highlight the net interest income on the third quarter and that has been higher than the second quarter.

The fees are very much in line of improvement and therefore, the core result is growing in the first 9 months of the year, in line with the objective that we had for the whole of the financial year. In terms of capital, well, we've seen a new -- the settling of the new capital models and capital excess of over EUR 2.5 billion in the strategic plan. And I will go to the questions.

QUESTIONS AND ANSWERS

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

First of all, we have a question in writing by Britta Schmidt from Autonomous. Well, she he has 2 questions. One, related provisions. If we can explain the EUR 73 million that appear as a net positive of financial provisions in the report. She's asking the reason for this? And if it could be recurrent or how predictable it could be? And if there are any idea 2021. And in terms of capital, even though I think this was explained very well in Slide 32.

First question. I think the profit obtained by the behavioral model is 129 basis points. That is above the 112 basis points that we communicated as a relevant fact on what -- why this is the case. Also, she asks if in BMN, we could improve the expectations that were announced of 48 basis points due to the improvement for the behavioral model? And also a question about the bridge of Page 32, whether we can clarify what are the elements of regulatory profit and quick fix that have affected the capital ratio? And also, if we apply the transitional IFRS 9 of the unrealized gains of the sovereign portfolio?

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

Okay. With regards to the provisions, yes, this quarter, from an accountancy perspective, we've had a reclassification in our provision lines. We have contingency provisions and loan provisions. But I will look at it as a whole. That's why in the presentation, we always show you the figures, the aggregated figures because really, the effort in terms of provisions for the quarter is the EUR 143 million that we saw there. So this is an accountancy technical issue that does not affect the quarterly outlook. And in the future, we will not see that line. We will say it within loan provisions.

The 129 basis points of the behavioral model versus the 112 that we mentioned. Well, it's true that in terms of RWAs when we looked -- when we did an estimate of EUR 5.8 million, EUR 5.9 million, the final figure have been EUR 600 million more, so EUR 6.5 million of RWA reduction.

Why? Well, because when we looked at the models, and we did all the calculations, we see that there is small things that add up and that explain for the difference is technical issues. So we can go into more detail if you're interested. But really, the final figure is slightly better than the estimate that we did at -- in -- with an overview of the model.

Normally people in the banking sector always leave a bit of a buffer, not to get it wrong. So that's what's happened. And I think in the case of the inclusion of the BMN model, we have to see if we are going to be able to take it -- to do it at the end of the year, whether it'll move to the next year?

In any case, maybe there will be a slight improvement in the application of the BMN model, but nothing significant versus what we had calculated at the time. And regarding IFRS 9.

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Yes, just quickly, we are including it by totally immaterial. We're talking about 1 basis point in this quarter.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Okay, thank you very much. Shall we go to the questions from the telephone line, please, if possible. I have a maximum of 2 questions so that you can all participate.

Operator

(Operator Instructions)

The first question is from Ignacio Ulargui from BNP Paribas.

Ignacio Ulargui - *Exane BNP Paribas, Research Division - Analyst*

I have 2 questions. One, regarding net interest income. Would you expect the NII to be like over the next quarters, given what Leo mentioned of the Euribor, and the impact that Euribor may have in the margin? And the second about the fees, I've seen that they've falling by 11%, the account maintenance fees. I would like to understand how much this is due to the fact that customers have left? Whether there's a change of strategy? And if it's a change of strategy, how will we see fees improvement in the fourth quarter and next year?

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Well, the NII, as we were saying, the impact of the Euribor, it has not been relevant yet versus '19 yes, versus second quarter. But in the fourth quarter we'll have to see all the mortgages that mature and they will be charged into the new curve that will be lower. We estimate that for the fourth quarter, the curve impact could be about EUR 8 million. And for 2021, this impact would be higher depending on how the curve pans out, even though it -- the last part of the year should be quite flat versus 2020 since now the curve is reasonably flat from now on.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

And in regards to fees -- with regards to fees and for the maintenance of accounts, we have relaxed a bit the conditions for the application of fees for certain groups due to the crisis. Certain groups, people that have lost revenues or similar situations, people that saw the fee status change. We thought it was not necessary to apply there. We thought it made no sense to carry out that -- a change of fees to them. But if we look beyond that specific one-off, then I say that our idea for the fees is the same. It's true that we've missed EUR 4 million this quarter to make EUR 300 million . I mean you can't -- it really pained me you can't imagine how much. So I'm going to keep those for the fourth quarter to add it. So let's hope that we go above EUR 304 million this last quarter of the year.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Okay, next question.

Operator

The next question is by Andrea Filtri from Mediobanca.

Andrea Filtri - *Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst*

Yes, good morning on capital -- on capital. If we assume the Euribor mortgage models and we are estimating a fully loaded CET1 pro forma at 15.4%. That would imply EUR 2.3 billion of capital above the 12% target that you set for the business plan. That would be 70% of current market cap which is very much in line with your evaluations pre merger with CaixaBank. What would you say to the shareholders in Bankia that are expecting a capital return as per the business plan target, especially as capital with CaixaBank will be much tighter than it is now? And how the structure be considered in the merger ratio with CaixaBank?

Secondly, what are the light end capital gains? And how many mortgage guaranteed loans do you expect from the government?

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

Well, thank you. I'll answer the first part on. And you -- well, in fact, I think the approval of the models is what allows us to generate an important generation of capital. Before I answer the question, just 1 thing I would like to mention because I've read some comments. The approval of the models, the Bankia mortgage models in Bankia has been independent to the announcement of CaixaBank. So there's been no cost and effect on this. You'll remember that in the previous quarter, at the end of June, we already said that we had a commitment to approve this in the third quarter of year. In fact, the draft and the approval was done before the ECB knew about an integration operation between Caixabank and Bankia. I just wanted to state that. Just so that you know there's no relationship.

Well, obviously, the excess -- the capital excess and the capability of capital generation of the models. I mean, we have shared it with all of you quarter-on-quarter, we had practically published it as if it was football match. And in June, we told you that this was going to be -- it will be approved in the third quarter. And then depending on the final ways that the risk-weighted assets would have in our mortgage book, then we'll be see -- we'll able to estimate what will be the effect on capital is true. That we have an important capital excess. It's true that is important capital excess that we have today in terms of bank value is very high. But it's also true that what we have to do with this capital access is to put it into value to make it work.

The ability to return, thinking about the next few months within the pandemic context and with the regulatory restrictions or the regulatory preventions on capital, well, that capability will be reduced, and we thought that will be good too. We invest this capital excess in our merger with Bankia with -- well, first of all, we get a premium of 20% for Bankia shareholders. And also because we start participating about 44% with some synergies that we are calculated at EUR 1 billion per year before tax. And so for the Bankia shareholder, that also leads to an important capital and value generation. We thought that the best way to optimize and make this excess capital work for us was to include it in this merger. And you also asked about capital gains, right?

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Yes, the ones that we have in September in terms of capital, we have EUR 46 million, which corresponds to the reasonable book value. And then we have the latent, the unrealized of the amortized cost which are about EUR 900 million, more or less, that above.

Operator

The next question is from the line of Alvaro Serrano from Morgan Stanley.

Alvaro Serrano Saenz de Tejada - *Morgan Stanley, Research Division - Lead Analyst*

Two questions. One about the outlook for the NII and the other 1 for the activity in general. Regarding the NII layer, you've answered some questions on the issue of Euribor. But if I think about 2021 the Euribor part. Well, in terms of performing volumes will go down, I suppose, due to the NPLs? And so the outlook seems a bit complex. So the question is, from the point of view of the management in terms of spread fixing mix of variable and fixed rate mortgages -- I don't know, could you comment on prices? Prices, we need to bear in mind the price trend for spreads that could somehow mitigate -- levitate mitigate that?

And the second question is you've given data for payments going up 12% in September. I don't know if you can give us some figures about the first few weeks of October, which I guess you are looking into this? I don't know if there's been an impact on payments or in business activity. Are you now seeing a slowdown in October?

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

About the first question, yes. I mean, in fact, we cannot give a lot of guidance. Right now because, as you can imagine, we are in a process of budgeting. And therefore, we have no figures currently for 2021.

What we can say is that in this quarter, what we've seen and as part of the explanation of the NII performance this quarter, we've seen an advancement and increase in the front book prices that have increased by nearly 20 basis points versus the second quarter. This is due to the mix, we've done more consumer finance in third quarter then into second quarter. Also, we've done a bit more corporate and SMEs. And also due to the fact that gradually, we're increasing our mortgage mix into fixed-rate mortgages versus what we did in previous quarters and versus the mix that we have in our back book. Currently, the truth is that we have a front book that is substantially higher than the back book. And this, together with the volumes, has helped us to improve the downside of the Euribor curve.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

With regards to the economic activity of the month of October? Well, we are following this day by day, week by week. Also bearing in mind the bank holidays this year versus last year in October, where we've seen is a slight slowdown versus what you saw in the previous year. In September, for instance, when we look at card payments, but nothing significant, nothing relevant, and in general, we can see that October is very much in line with September. Something different will be that we'll have to see what happens with the rest of the quarter, obviously, because what's clear is that this additional restriction measures and the extension of the COVID and by additional restriction measures, I mean mobility restrictions, curfews et cetera, that could affect November and December's performance. Especially December, as you know, which is a month that is normally very strong in terms of expenditure. We'll have to follow that up.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Next question please, operator?

Operator

The next question is from Mario Ropero from Fidentiis.

Mario Ropero - *Fidentiis Equities S.V.S.A., Research Division - Senior Banking Analyst*

I just wanted to ask you 2 questions. The first question is for COVID provisions. I would like to know what the recession scenario or real estate prices scenario you've seen? And then for the TLTRO NII for this semester.

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

The NII curve, you said -- I didn't hear it.

Mario Ropero - *Fidentiis Equities S.V.S.A., Research Division - Senior Banking Analyst*

For TLTRO.

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

For TLTRO. Okay.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

I'll start with the first and you go with the next. COVID provisions and macro scenarios. Well we're taking as reference, and we published this in the closing report in June, we haven't changed our guidance for the quarter is what we published at the time based on the Bank of Spain scenarios and with wanes that we mentioned there. So will they see such a decrease that will be important for this year. And for 2021, we see a recovery. And we'll have to monitor this quarter-on-quarter. As I said before, the third quarter performance has made us change the scenario, but it's possible that with -- in 4Q, we may have to be more cautious about future scenarios, especially the recovery scenario for 2021. And then the TLTRO, right?

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Yes. Well, about that, the curve that we are -- doing this 1%. So we have EUR 23 billion. So about EUR 60 million per quarter. As we said in June, first, we've taken a new additional EUR 9 billion, and then an increase on the payment of the 50 to 100 basis points for the year, up to June 2021, which is a total of EUR 115 additional million, a little bit more this year, EUR 60 million, EUR 65 million this year and the rest in 2021.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

We'll go to the next question, please.

Operator

The next question comes from the line of Carlos Cobo from Societe Generale.

Carlos Cobo Catena - *Societe Generale Cross Asset Research - Equity Analyst*

A couple of questions, specifically on CET1. Could you tell us -- could you give us your estimate on how much the capital generation has improved versus the figures you presented at the merger? I calculate about 20 basis points for IRV and intangible? And also I would like to ask you why are you not talking about the pro forma ratio, capital ratio for what's remaining to be obtained from a BMN for this new model. I don't know. You do not -- you have not included that. And I'm surprised.

And the other question had to do -- I don't know if you're going to give us much information about this. But could you tell us about the impact of this? I would like to know about new mortgages at variable rate. Normally, they have a fixed rate, a period of 1 or 2 years. And that kind of keeps up the front book crisis, as Leo said, but then you should have a step down. I would like to note, if you know the impact on the adjusted margin due to the fall after the fixed rate period.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

I'll start by talking about capital. And then you can talk about fixed, right?

And you can fill in as you wish. CET1, how does this improve versus what we saw a few weeks back for the merger? I think there's an improvement due to greater capital capturing due to the IRB model, the 17 basis points translated into the integration with CaixaBank. And currently, that is the captured effect that we've seen, right? If I'm not wrong.

And then you said, why we do not include in the pro forma, what's missing from BMN. Well, because we have certain uncertainty, as I said before, about when the effects will take place. We have ahead of us, 2 quarters when we have some uncertainties about how the impact will be included in the fourth quarter of this year and the first quarter of next year. And I'm talking here about BMN, I'm talking also about the pending results for the TRIM. So the loan default model that we had. We had that pending to and also due to the implementation of the new default definition, the new definition of default. That, as you know, is expected for the 1st of January 2021.

Some of these things will require authorizations, approvals from the ECB. The ECB inspection teams are trying to close this new definition of default for all the banks in Europe. So I think they're a little bit busy to say the list with all those topics. And so we will require their attention in order to close BMN. That's why the BMN issue may move to the first quarter of next year. It's about EUR 2.2 billion, I think the estimate that we had for RWAs. Also contrary to this is with regards to TRIM review, we were calculating and this effect is included in the figures that we saw for the Caixa integration of EUR 1 billion more of RWAs due to the TRIM review. So it'll be a net effect of plus EUR 1.2 billion. And then we have the issue of the new definition of default. That in our case, even though you may be surprised, according to our calculation, it gives us an RWA reductions that will have to be confirmed. We will need the certification from the ECB that is expected to take place before the end of the year, so that we can start calculating the capital versus on the new default definition. That impact for now. I'm not going to break it down because it has a high volatility. And it's highly sensitive to different calculations, but we think that it will be an impact that at least will offset the TRIM effect. And that additional impact of the new default definition would not be included in the model that we presented for the CaixaBank merger, mainly because of the uncertainty and because of the huge range that we have. I'm not sure that I've answered your question. If no, you can ask Iñigo again. I'm sure that Iñigo will clear that up for you, but that's the scenario we have. We have some uncertainty. But in general, I think what we have are figures that should improve what we had before the merger with CaixaBank.

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Leopoldo Alvear Trenor

Yes. In fact, the figures should improve, but not on the figures that you mentioned, Carlos, because mainly the improvement of the IRB model that we mentioned before, when we take it to the total RWAs, we're talking here maybe about 3 basis points. The software, the software is already incorporated or the software effect has already been included. We are going to amortize our software. So nothing has changed. With the quick fix has changed individually because now it's 3 years instead of 2, and therefore, the impact that it could have on the software in Caixa, but not in ours. So I wouldn't take that into consideration. And then the impacts that Pepe mentioned, that, yes, could be a little bit better than expected, but also bearing in mind that, that our impact will then have to be taken into RWA base of EUR 225 billion, not to the Bankia RWA base. I'm not sure if that clarifies your question a little bit more.

And with regards to the mortgages, well, I think it makes sense what you say, but it's true that in the front book, we've had 3 years now with a front book that is quite stable. Month-on-month, we are about 1.7%, 1.6%, 1.7% and the truth is that is increasingly more this front book is impacted by the mix on fix of a variable, which this year could be above 60%, 65%. And so yes, the first year, we do have a variable mortgage than the first year is at fixed rate and only the first year, but that would only affect 30%, 35% of the new mortgage lending that we do every quarter. So we see quite stability on that front book for the last 3 years. It's also true that this front book only explains part of the total mortgage back book, which is at 0.98%.

Operator

(Operator Instructions)

And the next question is from Phoosily Cole from Santander.

Unidentified Analyst

Just a couple of questions. First about asset quality. I would like to know what's the cost of risk that you expect for next year? And if you think it could become more normalized in 2022? I mean, it's early to say, but I don't know how you see that If it will take 1, 2 years for pickup of cost of risk, and then will decrease. Then you spoke a lot about cost of risk, but not what it would affect the NPL. So with this cost of risk that you have presented for the first 9 months of the year. I would like to know what's the peak of NPLs that we could find?

Bear in mind, ICOs, et cetera, I would like to know when we'll start to see changes?

And the second question is related to ICO loans. Do you think that it could go beyond a year the maturity because it seems that in the press are talking about it, there's talks about it with the government. So I would like to know, what you think about, how the government is going to pay these ICO loans when they have to be effective? It will be public debt 5 to 10 years? Or it will be different because in the end, this is a way of looking at the implicit cost of risk in the payment of that guaranteed by the government?

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

Thank you very much for your 2 questions. Jokes aside, the cost of risk for next year, we are in the budgetary process. We have to see, but our reviews -- our views has always been that in this crisis in 2020-2021, they should reflect the peak of the cost of risk. In 2020, with more preventive provisions, as we have seen. And in 2021 and we've provisions that are incurred. So 2022 should be more normal in terms of provisions.

Obviously, all of this depends on how the pandemic evolves and the macroeconomic environment. But we want to close the budget for next year, and we'll look -- and look at the provision, provisions that we expect initially, I think they were free from historical provisions that will be very similar to the ones we had in 2020.

NPL that we may find. It's difficult to answer, as you know, because we do not have experience on a crisis such as this. If we look at the models of the past, we do not have experience in a pandemic, we don't have experience on moratoriums or the ICO guarantees. So it's difficult to know.

Normally, for the system as a whole, the increase of the default should be seen from the second quarter of next year which is when in principle, most of the moratoriums mature. And our first -- and especially with our first year of nonpayment. But well, it depends how the entities will try to anticipate what part of that moratorium and ICO portfolio will have problems to pay. Therefore, to recognize the NPLs before that happens.

Now in this third quarter, we are already working on this. We'll continue to do that in the first and second quarter of next year to try and anticipate any stage 3 or NPL in our portfolio.

Extending the moratorium and conversations with the government, I think the conversation goes beyond that. We were trying is to see with the Treasury, the Ministry of Economy, what capability there is to restructure their credits, the loans. Obviously, they acted in a very swift and agile manner, both the treasury and ICO and the banks, when trying to meet the liquidity needs that companies will have due to this crisis.

The problem is that those liquidity needs as quarters go by could condition, but could lead to solvency needs for the companies. And that's where the debt restructuring processes play a role.

It could be light or so -- maybe just by extending it, it can -- that can be repaid or it could be -- there could be others that lead to greater restructuring of the loans, et cetera.

So we'll have to see. The issue is that now the ICO does not have an instrument or a framework to act for those restructuring processes and also that framework is conditioned by Brussels due to the State Aid. Remember the ICO guarantees in Spain, just like it happened with the ones that took place in France or Germany are subject to this EU State Aid. Basically, we're looking at negotiating within Europe, the European framework. Our plan that allows us to flex -- to make more flexible the restructuring of all loans linked to ICO guarantees. So that in the first, second quarter of next year, if needed, we can do that. Part of this could be by extending the deadline, others will require different measures.

And then ICO guarantee. Well, in -- I how will it be paid? Well, in 5 years' time, the objective is to pay in cash. And therefore, it hasn't been put on the table any other way to pay for it except for cash.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Operator, please on last question.

Operator

The last question is from Ignacio Cerezo by UBS.

Ignacio Cerezo Olmos - *UBS Investment Bank, Research Division - Executive Director & Equity Research Analyst*

Just a couple of things. I would like to know the percentage of the total loan book at fixed rate in the back book broken down by segment would be even better. And the second, it's about cost of risk. Do you have any idea about what type of book will give you more problems in provisions, whether the ICO protection corporate or whether do you think retail is more risky? Or do you think it's well balanced between the different books?

Leopoldo Alvear Trenor - *Bankia, S.A. - Deputy General Director of Financial Management*

Okay. I'll talk about fixed rate Ignacio. What we have now is 27% of fixed rate, 73% of variable in the back book. But It's true that for corporate, that as FX at 47%, there is also another important tranche with Euribor zero clause. If we include this Euribor zero clause, we'll talk about a loan book that will be 61% variable and 39% either fixed or fixed with Euribor zero clause.

For companies, 47% is fixed rate. And additionally, we have this Euribor zero clause and for mortgages, 90% is a variable, whereas in consumer finance, 95% is fixed.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

Now with regard to the loan book, what we are more concerned about in terms of provisions? Well, there could be different answers to this. I think, obviously, what will have the higher impact is consumer finance. It's also true that the provisions and due to the consumer finance book, are the ones that will appear sooner in the P&L. A good part of the consumer finance moratoriums mature in this fourth quarter. So we'll start to the recognition of NPLs. We'll see that before the fourth quarter and the first quarter of next year.

But we're talking about a small amount even though the severity of consumer finance is higher. But in our case, it's quite a small volume.

And between mortgages and corporate, I think the corporate and SMEs is what should concern us the most, especially as we go down on the size of companies, and we go from the large to medium-sized to small and to micro. It's true that in our ICO coverage, the ICO coverage is on new additional debt that we gave to those companies. But we have the previous stock of loan that we had given those companies, and that is not protected by guarantees. And so as the company situation worsens for the next few months, then we have it covered, a part is covered, but about 80% of the exposure of those companies is not going to be covered by the ICO loans. So that, I think, is the most concerning aspect is we will see a greater impairment.

And in terms of mortgages, well, it'll really depend on the employment evolution. The truth is that the employment data that we have for the third quarter is good or rather better than what we had expected, but it's also true, as we said before, then we have to see what happens in the 4Q and in the 2021 recovery.

So I think that's more or less the context, consumer finance, small companies and then mortgages.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Well, not sure, we have a question that came by mail from Fernando Gil de Santivañes from Barclays. His line didn't work. So he said, if we can talk about the Supreme Court rulings on IRPH, and the return of mortgage expenses as well.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

Regarding IRPH, we are quite calm. I think that this is settling down also after the famous ruling of the Court of Justice, the EU Court of Justice in March. Well, the Supreme Court has said, we have a press release, not the ruling, but we have the press release, has kind of confirmed the same that the IRPH is a legal index that was published by the Bank of Spain, that, therefore, is valid, basically. Just to give you an idea, since the ruling of the EU Court of Justice, we've had 13 rulings, 6 on first instance and second and 7 on second instance. Of the 13, we've won 12, except for 1, and that 1 is because we had to go from IRPH cash to IRPH branches, which is nonmaterial.

So I think in terms of IRPH, I think we are quite close. And regarding mortgage expenses, there haven't been many changes. I think there was some news yesterday or the day before in the press, so for the ruling, I guess is 1 of our competitors that said that from now on, everyone can claim for this. I don't think that is the case. I think there'll be a clarification of that ruling that we can also go to second instance. Basically, we can also appeal. I think in our case, we explained very well what type of expenses have to be paid by the customer, and what type of expenses have to be paid by the bank.

For the last few years, we've fulfilled that totally. So we are talking about figures that are nonmaterial, not even EUR 7 million. We also have the provisions for that. So I don't think this is a topic that should be of concern.

Iñigo Velázquez - *Bankia, S.A. - Head of IR & Rating*

Well, thank you very much, Pepe, Leo. Thank you to all of you for your attendance, and we'll see you in the presentation of results of the year that will take place at the beginning of 2021. So even though it may seem a bit strange, I would like to wish you a wonderful Christmas holidays. I hope you stay in health.

José Sevilla Álvarez - *Bankia, S.A. - CEO & Executive Director*

You mean in good health. And thank you all very much. Thank you. Goodbye.

[Statements in English on this transcript were spoken by an interpreter present on the live call.]
