FitchRatings

03 Jul 2020 | Affirmation

Fitch Affirms Banco Cooperativo Espanol at 'BBB'; Outlook Negative

Fitch Ratings-Barcelona-03 July 2020:

Fitch Ratings has affirmed Banco Cooperativo Espanol S.A.'s (BCE) Long-Term Issuer Default Rating (IDR) at 'BBB' with a Negative Outlook and the bank's Viability Rating (VR) at 'bbb'.

A full list of rating actions is below.

Key Rating Drivers

IDRs AND VR

The ratings of BCE reflect its moderate risk appetite, sound management and capital ratios, strategic importance to the members of the Asociacion Espanola de Cajas Rurales (AECR; the Spanish rural cooperatives association) and stable but low profitability. The ratings also take into account the set-up of a cross-support mechanism between member entities and BCE to achieve a unified cooperative banking group by pooling strategic goals, common services and IT/risk management systems.

The Negative Outlook on BCE primarily reflects the impact of a deteriorating economic environment on the financial profile and prospects of the members of AECR, which are BCE's main shareholders and counterparties. BCE's business volumes are largely dependent on that of the Spanish rural cooperatives and its treasury activities bear counterparty risks with potentially weaker sovereigns as a result of the pandemic.

The cross-support mechanism between AECR members and BCE includes a private guarantee fund to address liquidity or solvency problems within the banking group's member banks, including BCE. The guarantee fund is targeted to reach EUR300 million or 1% of AECR's risk-weighted assets by 2024, in the form of direct contributions from member entities. Although the targeted amount is insufficient to provide support to the entire group, it strengthens both AECR's existing cross-support mechanism to support members undergoing severe liquidity or solvency problems and BCE's role within the group.

From a regulatory standpoint, each credit cooperative will remain supervised on an individual basis. However, they benefit from a 0% risk-weighting for exposures between AECR members and lower contribution to the Spanish Deposit Guarantee Fund.

BCE provides essential financial and non-financial services to AECR members to gain cost and risk-management synergies. As the central treasurer for AECR members, a large proportion of BCE's activities are conducted on behalf of AECR banks, regulated by a treasury agreement under which AECR banks guarantee any failure arising from BCE's inter-bank placements undertaken on their behalf. BCE acts as an intermediary in most of its activities, channelling liquidity from and to AECR banks.

BCE's risk-management systems and procedures are sound. The bank's adequate liquidity is primarily invested in Spanish public debt, which results in some counterparty risk concentration and, to a lesser extent, in securities issued by financial institutions.

Profitability is modest but has been broadly stable over economic and interest-rate cycles. Risk-weighted capital ratios are robust for its risk profile with a fully loaded Common Equity Tier 1 (CET) ratio of 35.6% and a Basel leverage ratio of 7.9%. The low risk-weighted asset density (below 20% of total assets) reflects the large proportion of government bonds, which are 0% risk-weighted, and lower risk-weighting on exposures between BCE and AECR members. High capital ratios compensate for high counterparty risk concentration to Spanish sovereign debt (about 5x CET1 at end-2019).

BCE's 'F2' Short-Term IDR is the higher of the two options that map to a 'BBB+' Long-Term IDR, reflecting our 'bbb+' assessment of the bank's funding and liquidity profile. This reflects our view that BCE's liquidity benefits from its role as the central treasurer for AECR member credit cooperatives.

SUPPORT RATING AND SUPPORT RATING FLOOR

BCE's Support Rating (SR) of '5' and Support Rating Floor (SRF) of 'No Floor' reflect Fitch's belief that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that BCE becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors to participate in losses, instead or ahead of a bank receiving sovereign support.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-Rating upside is limited. In the long term, continued strong relationships with AECR banks, supporting internal capital generation and strengthening the capital base, combined with an improvement of the aggregate financial profile of AECR member banks, could support an upgrade.

-The Outlook could be revised to Stable if the bank's operating environment stabilises and if BCE successfully manages the challenges arising from the economic downturn, limiting downside risks to its asset quality and profitability, while maintaining current capital levels.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-BCE's ratings would likely be downgraded if prospects that the health crisis is resolved globally in 2H20 become less likely, which would make a sharp recovery in global growth in 2021 more remote. A delay to this sharp recovery could reduce BCE's importance within the group and business volumes and put sustained pressure on profitability.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations
The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Banco Cooperativo Espanol, S.A.; Long Term Issuer Default Rating; Affirmed; BBB; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F2
; Viability Rating; Affirmed; bbb
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status

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