FitchRatings

Banks
Trust & Processing Banks
Spain

Banco Cooperativo Espanol, S.A.

Key Rating Drivers

Important Role Within Group: Banco Cooperativo Espanol, S.A.'s (BCE) ratings reflect its strategic importance as treasurer for the members of the Spanish rural credit cooperative association (Asociacion Espanola de Cajas Rurales; AECR), which has proved even more important during the Covid-19 pandemic. This provides the bank with a stable, albeit low-margin, business. The ratings also factor in BCE's moderate risk appetite, adequate risk management and stable liquidity profile.

Central Treasurer of AECR: BCE is the central treasurer of the entities that are part of the cross-support mechanism constituted between AECR members under an Institutional Protection Scheme (IPS). The latter entails the creation of an ex-ante recovery fund to address liquidity and solvency problems for group members. The members remain independent entities from a regulatory and supervisory standpoint, but benefit from lower regulatory requirements.

Treasury Agreement: BCE provides services to AECR members to gain cost and risk-management synergies. A large proportion of BCE's activities are conducted on behalf of the members, regulated by a treasury agreement under which AECR banks guarantee any failure arising from BCE's interbank placements undertaken on their behalf. BCE acts as an intermediary in most of its activities, channelling liquidity from and to AECR banks. BCE also acts as a representative body for AECR members and provides them with ancillary advice.

Modest, but Stable, Profitability: The bank invests the liquidity received from AECR members primarily in Spanish public debt, which results in some counterparty risk concentration, and, to a lesser extent, in securities issued by other European countries and financial institutions. Profitability is modest, but has been broadly stable over the cycle, based on the low net interest margin, adequate cost-efficiency and low loan impairment charges (LICs).

Robust Risk-Weighted Ratios: Regulatory capital ratios are robust for its risk profile with a fully loaded common equity Tier 1 ratio of 34.2% at end-2020. The large proportion of government bonds and cash on balance sheet results in a low risk-weighted density, which explains the 6.9% leverage ratio at end-2020 – a sound and a better indicator of the bank's capitalisation.

Liquid Balance Sheet: BCE's interbank and securities portfolios account for the bulk of its assets. BCE's loan book remains small and mainly comprises loans to large corporates and SMEs. Impaired loans have remained low and fully covered by reserves. We expect some asset-quality deterioration, but the impact to be limited, given the nature of BCE's business.

Rating Sensitivities

Limited Upside: Rating upside is currently limited given BCE's size and the scope of its role within the AECR. In the long term, continued strong relationships with AECR banks, supporting internal capital generation and substantially strengthening the equity base, combined with an improvement of the aggregate financial profiles of AECR banks, could support an upgrade.

Role Within Group: BCE's ratings could be downgraded if its importance within the AECR group diminishes or if the size of the group decreases materially, as this could reduce business volumes and put into question BCE's role in the Spanish cooperative sector, which we view as unlikely in the context of a strengthened cross-support mechanism.

Ratings

Foreign Currency	
Long-Term IDR	BBB
Short-Term IDR	F2
Viability Rating	bbb
Support Rating	5
Support Rating Floor	No Floor
Sovereign Risk	
Long-Term Foreign-and-Local Currency IDR	A-
Long-Term Local-Currency IDR	A-
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-and-Local Currency IDRs	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Revises Outlook on BCE to Stable; Affirms at 'BBB' (June 2021)

Global Economic Outlook (June 2021)

Western European Banks: Asset Quality Cliff-Edge Risk Avoided

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Ratings Navigator

Banco Cooperativo Espanol, S.A.

ESG Relevance:

Banks
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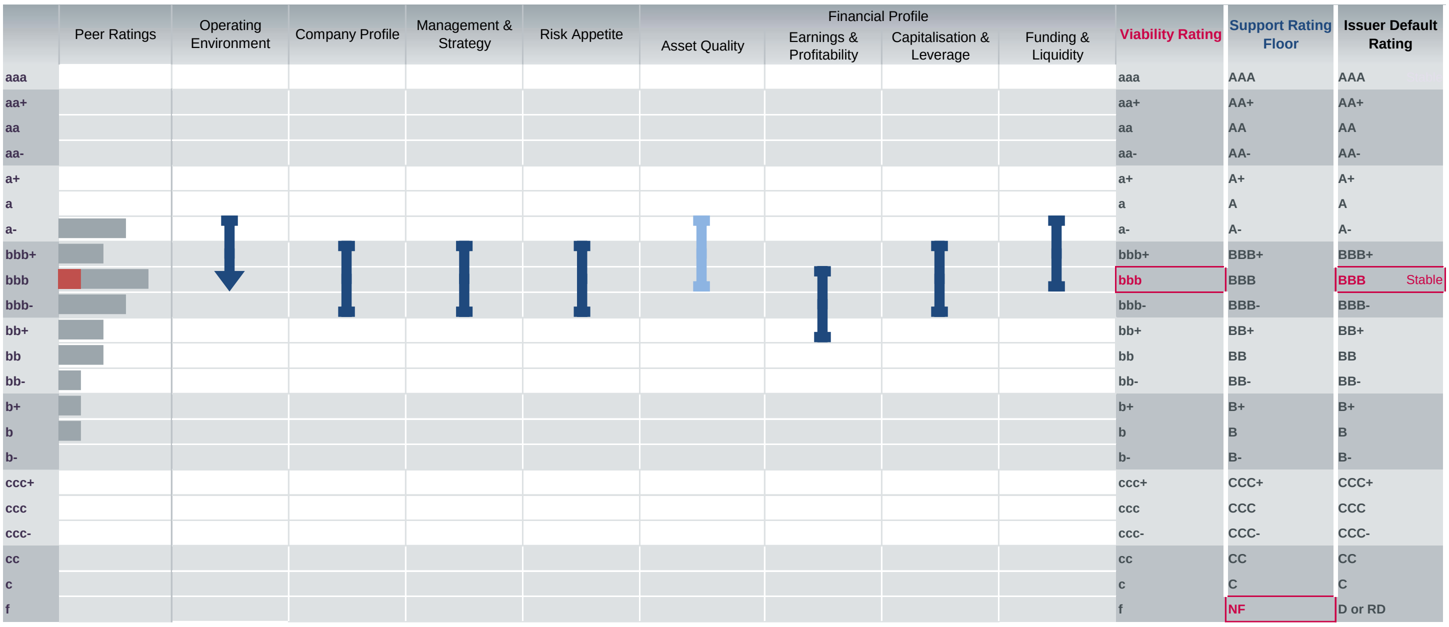


Significant Changes

Spanish Economic Recovery, but Challenges Remain

Spain faced a deeper and more protracted economic contraction than the global average in 2020, but the acceleration in the vaccination programme should support a material economic recovery. Fitch Ratings expects GDP growth of 6% in 2021 and 6.6% in 2022, compared with a previous expectation of 5.4% in 2021 and 6% in 2022. The upgrade is partly due to the shallower contraction in 1Q21, and our expectation that growth in the next two quarters will be boosted by the recent easing in mobility restrictions, the recovery in tourism and the frontloading of government investment spending related to the Next Generation EU funds.

However, the banking environment remains challenged by the prolonged low interest-rate environment and pandemic-related risks, particularly asset-quality risks once government support measures expire.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

Brief Company Summary

Treasurer for AECR members

BCE is the central treasurer for the credit cooperatives that are members of the AECR. The bank's main role is serving AECR member credit cooperatives by offering central treasurer services, channelling liquidity to the cooperatives, helping members to achieve economies of scale and improving their operating efficiency. Part of BCE's total balance sheet relates to activities conducted on behalf of AECR members, which benefits from the treasury agreement, whereby AECR members bear the credit risk. BCE's functions also entail acting as a representative body for AECR members and coordinating IT systems. It also offers a range of wholesale banking services to other institutions and corporations, but this is limited. Fitch believes BCE will remain a significant service provider for AECR members.

The credit cooperatives generally have sound retail franchises in their home regions or provinces, particularly in rural areas of Spain, but their national presence is small. The 29 credit cooperatives have similar business models and share common cooperative values.

Institutional Protection Scheme (IPS)

In March 2018, the group established a more cohesive cross-support mechanism under an IPS (under Article 113(7) of CRR). The latter entails the creation of an ex-ante recovery fund (about EUR277 million at end-2020) to address liquidity and solvency problems within the group members. The fund strengthens both AECR's existing cross-support mechanism to support members undergoing financial distress and BCE's role within the group, even though, on its own, the fund is insufficient to provide support to the entire group.

The IPS members are supervised on an individual basis, but benefit from lower regulatory requirements such as capital relief on intragroup lending, and lower contributions to the Deposit Guarantee Fund. The IPS also entails the creation and adoption of a uniform definition of standards and methodologies for the risk management. However, the structure of the IPS is weaker than European peers given the lack of capital and liquidity fungibility and consolidated supervision.

The set-up of the IPS resulted in the 29 credit cooperatives selling their stake in BCE to Grucajrural, which is a holding company fully owned by the member cooperatives and which now has a majority stake in BCE. The bank's other significant reference shareholder remains DZ BANK AG Deutsche Zentral-Genossenschaftsbank (12%), the central institution of the German cooperative banking group (AA-/Stable).

Focused and Stable Strategy

BCE's executive team is stable and has good depth and extensive experience in the financial services industry, and, in particular, in the cooperative sector. BCE has been consistent in executing its strategy, linked to the quality and efficiency of services offered to member banks, and the setting up of the IPS while maintaining reasonable earnings. The relatively resilient performance of the AECR banks has also helped in the stable performance of BCE in a challenging operating environment due to the pandemic.

Moderate Risk Appetite

BCE's risk management systems and procedures are sound. BCE's activities are generally low-risk, and it has well-developed risk management systems to minimise its exposure to credit, market, liquidity and foreign-exchange risks. Counterparty risk is limited to leading European, OECD and US banks, and is mainly in the form of short-term exposures. At end-2020, about 92% of BCE's counterparty exposures were rated investment-grade. Non-bank lending accounts for a small part of the balance sheet and often relates to clients operating with various cooperatives. The size and equity of the AECR banks limit their ability to extend large loans; consequently, BCE arranges loan syndications or assists its members by providing this service.

BCE's exposure to market risk is largely structural given that trading activities are small; the exposure is also average for the industry, and the bank has appropriate techniques to mitigate risks. Exposure to structural balance-sheet mismatches (interest rate and liquidity) is minimised by the short-term nature of assets and liabilities, which are closely matched in terms of interest rates and maturities.

Summary Financials and Key Ratios

	31 Dec 20		31 Dec 19	31 Dec 18	31 Dec 17
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
		Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	78	64.0	51.6	83.7	55.1
Net fees and commissions	13	10.7	12.0	12.0	15.8
Other operating income	8	6.7	4.2	5.1	8.3
Total operating income	99	81.4	67.8	100.8	79.2
Operating costs	36	29.7	28.1	26.5	26.8
Pre-impairment operating profit	63	51.7	39.7	74.3	52.4
Loan and other impairment charges	-3	-2.8	-4.3	-3.7	0.9
Operating profit	66	54.5	44.0	78.0	51.5
Other non-operating items (net)	0	0.3	-0.2	-0.3	0.0
Tax	15	12.6	11.8	13.8	14.2
Net income	51	42.2	32.0	63.9	37.3
Other comprehensive income	0	0.0	n.a.	-17.8	18.0
Fitch comprehensive income	51	42.2	32.0	46.1	55.3
Summary balance sheet					
Assets					
Gross loans	1,811	1,488.3	1,369.3	639.5	1,277.2
- Of which impaired	3	2.5	1.7	2.1	5.9
Loan loss allowances	24	20.1	22.4	28.2	36.1
Net loans	1,786	1,468.2	1,346.9	611.3	1,241.1
Interbank	2,594	2,132.3	270.1	255.9	401.2
Derivatives	1,547	1,271.8	937.7	804.9	509.0
Other securities and earning assets	6,446	5,298.6	4,964.9	5,327.5	3,782.0
Total earning assets	12,374	10,170.9	7,519.6	6,999.6	5,933.3
Cash and due from banks	3,986	3,276.6	1,558.3	1,471.9	1,360.7
Other assets	67	54.9	44.1	59.0	47.9
Total assets	16,427	13,502.4	9,122.0	8,530.5	7,341.9
Liabilities					
Customer deposits	1,161	953.9	1,026.5	795.7	660.8
Interbank and other short-term funding	9,221	7,579.4	5,388.0	6,079.3	4,856.7
Other long-term funding	1,227	1,008.9	417.5	50.3	370.8
Trading liabilities and derivatives	2,351	1,932.3	1,664.7	1,054.0	762.6
Total funding	13,960	11,474.5	8,496.7	7,979.3	6,650.9
Other liabilities	1,746	1,434.8	53.7	45.2	155.8
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	722	593.1	571.6	506.0	535.2
Total liabilities and equity	16,427	13,502.4	9,122.0	8,530.5	7,341.9
Exchange rate		USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057	USD1 = EUR0.83382

Source: Fitch Ratings, Fitch Solutions, BCE

Summary Financials and Key Ratios

	31 Dec 20	31 Dec 19	31 Dec 18	31 Dec 17
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	3.2	2.8	4.8	2.6
Net interest income/average earning assets	0.7	0.6	1.2	0.6
Non-interest expense/gross revenue	36.5	41.5	26.3	33.8
Net income/average equity	7.4	4.7	10.8	7.3
Asset quality				
Impaired loans ratio	0.2	0.1	0.3	0.5
Growth in gross loans	8.7	114.1	-49.9	11.4
Loan loss allowances/impaired loans	804.0	1,317.7	1,342.9	611.9
Loan impairment charges/average gross loans	-0.2	-0.5	-0.3	0.1
Capitalisation				
Common equity Tier 1 ratio	34.2	35.6	30.5	25.2
Tangible common equity/tangible assets	4.4	6.2	5.8	7.2
Basel leverage ratio	6.9	7.9	8.6	n.a.
Net impaired loans/common equity Tier 1	-3.0	-3.7	-5.2	-6.1
Funding and liquidity				
Loans/customer deposits	156.0	133.4	80.4	193.3
Liquidity coverage ratio	324.8	260.1	281.9	648.3
Customer deposits/funding	10.0	15.0	11.5	11.2
Net stable funding ratio	249.0	244.2	307.1	172.3

Source: Fitch Ratings, Fitch Solutions, BCE

Key Financial Metrics – Latest Developments

Liquid Balance Sheet

BCE's balance sheet is composed of securities (34% of total assets at end-2020), cash (24%), interbank loans (16%) with highly rated counterparties, and the small loan book (11%). Due to its role as the central treasurer for credit cooperatives, BCE's interbank and securities portfolios are large and account for the bulk of assets. Securities mainly include Spanish sovereign debt and public administrations, which results in some concentration, and to a lesser extent debt from Italy and financial institutions and corporates.

BCE's loan book is relatively small in relation to the total balance sheet and comprised mainly loans to large corporates, and SMEs. Impaired loans were small at EUR2.5 million at end-2020, accounting for only 0.2% of gross loans, and were more than covered by reserves. We expect asset-quality pressures to be contained at BCE given its small risk appetite for loans and the well-collateralised profile of its operations.

Treasury Agreement Covers Part of the Credit Risk

The process of investing AECR members' liquidity through BCE is governed by a treasury agreement, through which AECR members guarantee any losses or commitments that could arise from interbank placements made by BCE on their behalf. Any claim under the guarantee is split between the AECR members in proportion to their equity shares in BCE, regardless of the volumes of their activity under the agreement. As a result, BCE is exempt from complying with large exposure limits under the EU capital adequacy requirements. At end-2020, BCE managed EUR1.1 billion liquidity on behalf of the AECR members under this agreement. The funds under the treasury agreement are mostly invested in debt securities (EUR 620 million), mainly Spanish sovereign bonds, and cash and reverse repos (EUR530 million). Interbank loans and reverse repos outside the treasury agreement have increased to about EUR2.7 billion driven by the increased liquidity placed by AECR members.

Modest Profitability

BCE's profitability is modest but has remained relatively stable over the cycle. BCE's revenue mix is dominated by net interest income (66% of total operating income in 2020), reflecting BCE's role as an intermediary for AECR members charging a fixed margin on the volume of funding and liquidity channeled. The operating profit/risk-weighted assets ratio has been at acceptable levels for the past few years, helped by higher business volumes, sound cost efficiency and reversal of LICs. BCE's ability to sustain profitability depends on the interest rate environment, which we expect to remain challenging, and on the business volumes from cooperatives, which we expect to grow following Spain's economic recovery and their ample balance-sheet liquidity.

Robust Regulatory Capital Ratios

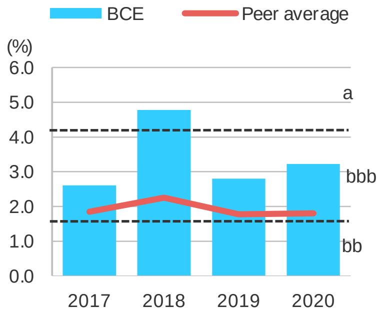
BCE maintains robust risk-weighted capital ratios, with satisfactory buffers above regulatory minimums, although its overall equity base is small. Capital ratios benefit from low risk-weight densities given BCE's balance-sheet structure (the risk-weighted assets/total assets ratio was 12.5% at end-2020). We view the bank's Basel III 6.9% leverage ratio as a better indicator of its capitalisation, which is sound for its risk profile. The liquid nature of its own investments (excluding assets related to AECR members) means BCE has some flexibility to deleverage its balance sheet quickly, if needed. Apart from deleveraging, the main methods available for BCE to improve its capital position are to keep retaining earnings and to raise capital from its members. According to the AECR's statutes, all member banks are obliged to subscribe to BCE's capital increases, as they did in 2009-2010.

Stable Funding and Liquidity

In its role as the central treasurer for AECR member banks, BCE's main function is to provide them with access to funding from the ECB and wholesale markets, and to manage their liquidity. BCE's funding position is relatively stable based on deposits placed by AECR members. Liquidity is comfortable given the bank's business model, and largely placed in highly liquid assets. The bank accessed TLTRO III funding in cooperation with the smallest AECR members. At end-2020, the bank took EUR1 billion of ECB funding, out of which BCE took EUR0.5 billion and the remaining EUR0.5 billion were distributed within some small AECR members.

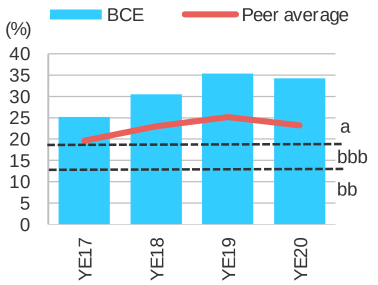
Notes on charts: Black dashed lines represent indicative quantitative ranges for core financial metrics given an operating environment score of 'bbb'. Peers include: BCE (Long-Term IDR/ VR: BBB/bbb), DZ BANK AG Deutsche Zentral-Genossenschaftsbank (AA-/NA); Cecabank S.A. (BBB-/bbb-); Iccrea Banca S.P.A. (BB-/Withdrawn)

Operating Profit/RWAs



Source: Fitch Ratings, Banks

CET 1 Ratio



Source: Fitch Ratings, Banks

Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			BBB+ or BBB
Actual country D-SIB SRF			NF
Support Rating Floor:			**NF**
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

BCE's Support Rating of '5' and Support Rating Floor 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 of or ahead of a bank receiving sovereign support.

Environmental, Social and Governance Considerations

FitchRatings **Banco Cooperativo Espanol, S.A.**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Banco Cooperativo Espanol, S.A. has 5 ESG potential rating drivers

- Banco Cooperativo Espanol, S.A. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

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

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.