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## **DBRS Confirms Banco Cooperativo Español's Long-Term Issuer Rating at BBB, Trend Changed to Positive**

**Industry: Fin.Svc.--Banks & Trusts**

DBRS Ratings Limited (DBRS) confirmed the ratings of Banco Cooperativo Español S.A. (BCE or the Bank), including the Long-Term Issuer Rating of BBB, and the Short-Term Issuer Rating of R-2 (high). The Trend on the ratings was revised to Positive from Stable. Concurrently, DBRS confirmed the Group's Intrinsic Assessment (IA) at BBB and the Support Assessment at SA3. A full list of rating actions is included at the end of this press release.

### **KEY RATING CONSIDERATIONS**

The confirmation of BCE's ratings considers the Bank's important role as the central clearing bank and liquidity provider for the Cajas Rurales (CRs) that are members of the Asociación Española de Cajas Rurales (AECR). It also considers the Bank's low risk profile, its stable profitability which allows it to build up capital through retained earnings, and the benefit it receives from its funding relationship with the AECR members, who provide a stable deposit base. BCE's ratings also take into account the Bank's size and scope, its low business diversification, small equity base and its sizeable risk concentration to Spanish sovereign bonds.

The trend change also considers the likely positive benefits for BCE's franchise from the Bank's membership of the newly created Institution Protection Scheme (IPS). In addition, the positive trend takes into account the improvement in the Kingdom of Spain's credit quality, to which the bank has a sizeable exposure, following DBRS's upgrade in April 2018 of the rating of the Kingdom of Spain to A with stable trend from A (low) with stable trend.

### **RATING DRIVERS**

Further upward rating pressure could be achieved if BCE continues to demonstrate a track record of preserving its solid profitability levels under the new IPS framework. Negative rating pressure could also come from a material increase in the risk profile, including increasing unsecured counterparty risks. Given its large exposure to Spanish sovereign bonds, a downgrade of Spain's sovereign rating could also have negative rating implications.

### **RATING RATIONALE**

BCE acts as the central treasurer and liquidity provider for the members of the Asociación Española

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de Cajas Rurales (AECR), the largest cooperative Group in Spain by asset size. Moreover BCE's role within the AECR has been strengthened with the creation of a new IPS between the AECR, BCE and the Holding Company "GrucajRural". The IPS was officially recognised by the Bank of Spain at end-March 2018. The IPS had a market share in Spain of around 3.5% of loans (EUR 35.3 billion) and around 3.65% of deposits (EUR 46.2 billion) at end-2017.

The structure of this new IPS does not create a consolidated Banking group, as the IPS members remain autonomous institutions. However, there are significant benefits for supervisory treatment, such as 0% risk weights for exposures to other IPS members and liquidity waivers. In addition, the IPS has created a uniform definition of standards and methodologies for the risk management of the member banks. At the same time, the members have created an ex-ante fund of EUR 170 million to provide support in the event that a member institution has severe financial difficulties. The goal of the IPS is to increase the size of this fund to around EUR 300 million or 1% of the AECR combined RWAs by 2024. DBRS considers BCE's membership of the IPS brings significant benefits, such as access to a well-developed common technology system, stable funding and recurrent revenues through wholesale banking commissions charged to the members of the IPS.

DBRS sees BCE's earnings profile as resilient. The Bank has generated stable profits over recent years, with similar net results each year since 2013. However, BCE has limited revenue diversification, and revenues are mainly linked to the supply of financial services to the AECR members. However, sound cost control and low impairment charges support profitability. BCE reported net income of EUR 31.6 million in 9M18, up 13% Year-on-Year (YoY), as a result of increasing operating income, even though the Bank's net interest income is still being impacted by the low interest rate environment (-2.9% YoY). Trading gains and net fees and commissions significantly supported profits in 9M18. Net fees were up 26% YoY and were mostly related to the placement of financial products to AECR members. Albeit decreasing, NII represents the main part of operating revenues (55% in 9M18) with net fees and trading gains representing around 20% each of total operating revenues.

BCE has a generally low risk profile driven by its low-risk business mix and specialised franchise. BCE's main risks are its material exposures to financial institution (40.5% of total assets), Sovereign bonds (35% of its total assets), and its loan book to direct clients (9% of total assets). BCE's counterparty risk to financial institutions was around EUR 4.8 billion at end-September 2018, however, around EUR 2.2 billion was secured lending in the form of repo-agreements. DBRS views the counterparty risk as mitigated by the fact that BCE has a Treasury Agreement with the AECR members, whereby they guarantee any credit-related losses or commitments that could arise from interbank placements that BCE makes on their behalf. Reflecting BCE's business model as part of its



intermediary role for the AECR members, BCE has EUR 4.2 billion of Sovereign bonds representing a substantial 8 times its equity. Most of this exposure relates to Spanish Sovereign bonds (86%). DBRS considers that the credit profile of BCE's sovereign bond profile has improved during the last year as reflected in DBRS's upgrade of the rating of the Kingdom of Spain to "A". Credit risk linked to direct customer lending is marginal (9% of total assets at end-September 2018), and this largely explains the Bank's better than most domestic peers non-performing loans (NPL) ratio of 0.4%.

BCE's funding and liquidity position is underpinned by a large and stable deposit base from credit institutions (excluding repos), representing 51% of total funding at end-September 2018, a large part of which is backed by the members of the AECR, who deposit their excess liquidity at BCE in the form of bank deposits. BCE invests those funds in sovereign bonds and interbank lending of up to a maximum 18 months maturity. Short-term funding in the form of repurchase agreements is significant, totaling 34% of BCE's funding. Deposits from customers account for 11% of total funding. At end-September 2018, the Bank had a solid liquidity position with liquid assets of EUR 2.2 billion after regulatory haircuts. Overall DBRS considers BCE's liquidity position as solid, although the diversification of funding sources is limited.

DBRS views BCE as having adequate regulatory capital ratios given its low risk profile. Although BCE does not aim for profit maximisation, the Bank's sustainable profits have supported the build-up of capital organically in recent years. However, DBRS views the Bank's nominal total capital as relatively small, which provides a limited amount of loss-absorbing capacity for any potential shocks. BCE's non-consolidated Common Equity Tier 1 (CET1) phased-in ratio was 23.8% at end-September 2018 up from 22.3% at end-September 2017. This compares to a minimum Overall Capital Requirement (OCR) for total capital of 11.89% for 2019 according to the Supervisory Review and Evaluation Process (SREP). DBRS views BCE's membership within the IPS positively as it provides potential support from the ex-ante fund should BCE face severe financial difficulties.

The Grid Summary Grades for Banco Cooperativo Español are as follows: Franchise Strength – Good/ Moderate; Earnings – Good/ Moderate; Risk Profile – Good; Funding & Liquidity – Good; Capitalisation – Moderate.

#### Notes:

All figures are in EUR unless otherwise noted.

The principal applicable methodology is the Global Methodology for Rating Banks and Banking Organisations (July 2018). This can be found can be found at:

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Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Banco Cooperativo Español S.A.	Long-Term Issuer Rating	Trend Change	BBB	Pos	Dec 11, 2018



Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Banco Cooperativo Español S.A.	Short-Term Issuer Rating	Trend Change	R-2 (high)	Pos	Dec 11, 2018
Banco Cooperativo Español S.A.	Long-Term Senior Debt	Trend Change	BBB	Pos	Dec 11, 2018
Banco Cooperativo Español S.A.	Short-Term Debt	Trend Change	R-2 (high)	Pos	Dec 11, 2018
Banco Cooperativo Español S.A.	Long-Term Deposits	Trend Change	BBB	Pos	Dec 11, 2018
Banco Cooperativo Español S.A.	Short-Term Deposits	Trend Change	R-2 (high)	Pos	Dec 11, 2018

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