15 Jul 2019 | Affirmation

Fitch Affirms Eurocaja Rural at 'BBB'/ Stable; Upgrades Short-Term Rating to 'F2'

Fitch Ratings-Madrid-16 July 2019: Fitch Ratings has affirmed Eurocaja Rural, Sociedad Cooperativa de Credito's (Eurocaja) Long-Term Issuer Default Rating (IDR) at 'BBB' and Viability Rating (VR) at 'bbb'. The Outlook on the Long-Term IDR is Stable.

At the same time, Fitch has upgraded Eurocaja's Short-Term IDR to 'F2' from 'F3' following the application of Fitch's updated Short-Term Ratings Criteria. The rating has been removed from Under Criteria Observation (UCO), where it was placed following the publication of the updated Short-Term Ratings Criteria on 2 May 2019.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IDRS AND VR

Eurocaja's ratings reflect the bank's resilient asset-quality metrics throughout the cycle, sound capital position, and comfortable funding and liquidity. The ratings also factor in the bank's geographically concentrated franchise, modest profitability, large exposure to Spain's sovereign debt, which results in counterparty risk concentration and market risk, and a small equity base.

Eurocaja's asset quality indicators have remained stable and stronger than peers' through-the-cycle, as reflected in the low variability of the bank's metrics compared with peers'. At end-2018, its problem asset ratio (which includes non-performing loans (NPL - stage 3 loans) and foreclosed assets) was close to 3% (down from 3.3% at end-2017) which is below that of domestic and many international peers.

In our assessment of Eurocaja's credit risk profile, we also give credit to the bank's exceptionally high NPL coverage ratio, which at 124% at end-2018 protected the bank from asset quality and collateral valuation shocks. This is against a large, albeit declining, exposure to Spain's sovereign debt, which brings counterparty risk concentration and exposes the bank to spread and interest rate risks.

Eurocaja maintains satisfactory capital buffers above regulatory requirements. At end-2018 the bank's CET1 ratio of 17.1% was well above the bank's supervisory review and evaluation process (SREP) requirement of 7.91% for the CET1 and 11.4% for the total capital ratio. Capital was fully protected from unreserved problem assets at end-2018, which mitigated risks from the bank's small equity base.

Eurocaja's overall profitability is modest due to the bank's fairly large low risk/low-yield retail mortgage portfolio and low interest rates. Despite significant contribution from the bank's large securities portfolio, it has not prevented a decrease in interest income. Revenues have been supported by higher fee and commission income over the last years. We expect profitability to remain modest absent an increase in interest rates but resilient due to sustained lower impairment charges given strong NPL coverage ratio.

Eurocaja has an ample and granular retail deposit base, which fully funds its loan book. The bank also makes extensive use of wholesale funding (about 30% of funding at end-2018), mostly in the form of repos, covered bonds and ECB funding to fund its securities portfolio. The bank's liquidity position, which consists of highly liquid assets, is more than adequate to cover short-term liabilities, which was reflected in a solid liquidity coverage ratio of 481% at end-March 2019.

Fitch's updated Short-term Ratings criteria amended the correspondence table between Long and Short-Term IDRs to provide a substantially more differentiated analytical view of short-term risk among issuers. For Eurocaja this allows its Long-Term IDR of 'BBB' to correspond to a 'F2' or a 'F3' Short-Term IDR. The upgrade of the bank's Short-Term IDR is largely based on our 'bbb+' assessment of the bank's funding and liquidity profile. In particular, Eurocaja benefits from customer deposits in excess of its loan portfolio on a sustained basis, which results in a relatively structurally strong liquidity position.

SUPPORT RATING AND SUPPORT RATING FLOOR

Eurocaja'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 Eurocaja 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.

RATING SENSITIVITIES

IDRS AND VR

Rating upside is currently limited. In the long-term, an upgrade would require a meaningful and sustained improvement of core banking profitability, combined with a strengthening of the bank's franchise and business model. A further reduction of risk concentration from the bank's securities portfolio would also be rating-positive.

Negative rating pressure could arise from a sharp deterioration in asset quality, increased risk appetite as a measure to offset low margins, or a deterioration of the bank's capitalisation, although we currently view this as unlikely.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support Eurocaja. While not impossible, this is highly unlikely, in Fitch's view.

The rating actions are as follows:

Long-Term IDR: affirmed at 'BBB', Outlook Stable
Short-Term IDR: upgraded to 'F2' from 'F3'
Viability Rating: affirmed at 'bbb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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