Banks
Retail & Consumer Banks
Spain

Caja Rural de Navarra, Sociedad Cooperativa de Credito

Key Rating Drivers

Capital, Prudent Risk Appetite: Caja Rural de Navarra, Sociedad Cooperativa de Credito's (CRN) ratings are driven by its sound capitalisation, including low capital encumbrance by unreserved problem assets, and conservative underwriting standards that have remained stable through business cycles. The ratings also reflect strong asset-quality metrics, which have been significantly better than the sector average through economic cycles, and stable funding and liquidity.

Robust Capitalisation: CRN maintains relatively strong capital buffers above regulatory requirements, supported by its high earnings retention rate. The bank's regulatory Common Equity Tier 1 (CET1) ratio of 16.8% at end-2019 is high by Spanish and international standards and remains well above the regulatory requirements. Capital at risk from unreserved problem assets was low at 7% of regulatory CET1 at end-2019.

Sound Asset Quality: CRN has managed to maintain stronger-than-peers and stable asset-quality indicators through the cycle thanks to its conservative underwriting standards and exposure in regions with better economic fundamentals than the rest of Spain. CRN's problem asset ratio, which includes impaired loans and foreclosed assets, was low at 2.4% at end-2019.

Expected Earnings Pressure: CRN's underlying profitability remains moderate, and we expect earnings challenges to intensify due to lower business volumes and rising loan impairment charges (LICs) in 2020 and 2021, as the bank provisions for increased risks despite the easing of regulatory loan classifications.

Stable Funding and Liquidity: CRN largely funds its retail-oriented loan book with a granular and stable customer deposit base. The bank also accesses wholesale debt markets, primarily issuing covered bonds. The bank's liquidity buffers, although concentrated in Spanish public debt securities, are adequate for the bank's limited forthcoming maturities.

Large Exposure to Sovereign Debt: Fitch Ratings expects the bank to make use of 'ECB's TLTRO-III and maintain a significant exposure to Spain's sovereign debt, which represented about 187% of CRN's CET1 capital at end-2019 (excluding the insurance business). This will continue supporting net interest income, although it brings sovereign risk concentration.

Rating Sensitivities

Capitalisation, Asset-Quality: The most likely trigger for a downgrade would be CRN's inability to maintain capitalisation, including capital encumbrance from unreserved problem assets, at about current levels (CET1 ratio of 16.8% at end-2019) without a credible plan to restore it in a timely manner. This could be caused by asset quality deterioration resulting in a sharp increase of capital encumbrance from unreserved problem assets or a material and structural deterioration in profitability.

A further pronounced deterioration in the bank's operating environment linked to the pandemic would also put pressure on the ratings.

Pressures Well Managed: The Outlook could be revised to Stable if CRN's operating environment stabilised and if the bank managed the challenges arising from the economic downturn successfully, limiting downside risks to its asset quality and profitability, while maintaining current capital levels.

Ratings

Foreign Currency	
Long-Term IDR	BBB+
Short-Term IDR	F2
Viability Rating	bbb+
Support Rating	5
Support Rating Floor	NF
Sovereign Risk	
Long-Term Foreign- and Local-Currency IDR	A-
Outlooks	
Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Foreign- and Local Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Global Economic Outlook (September 2020)

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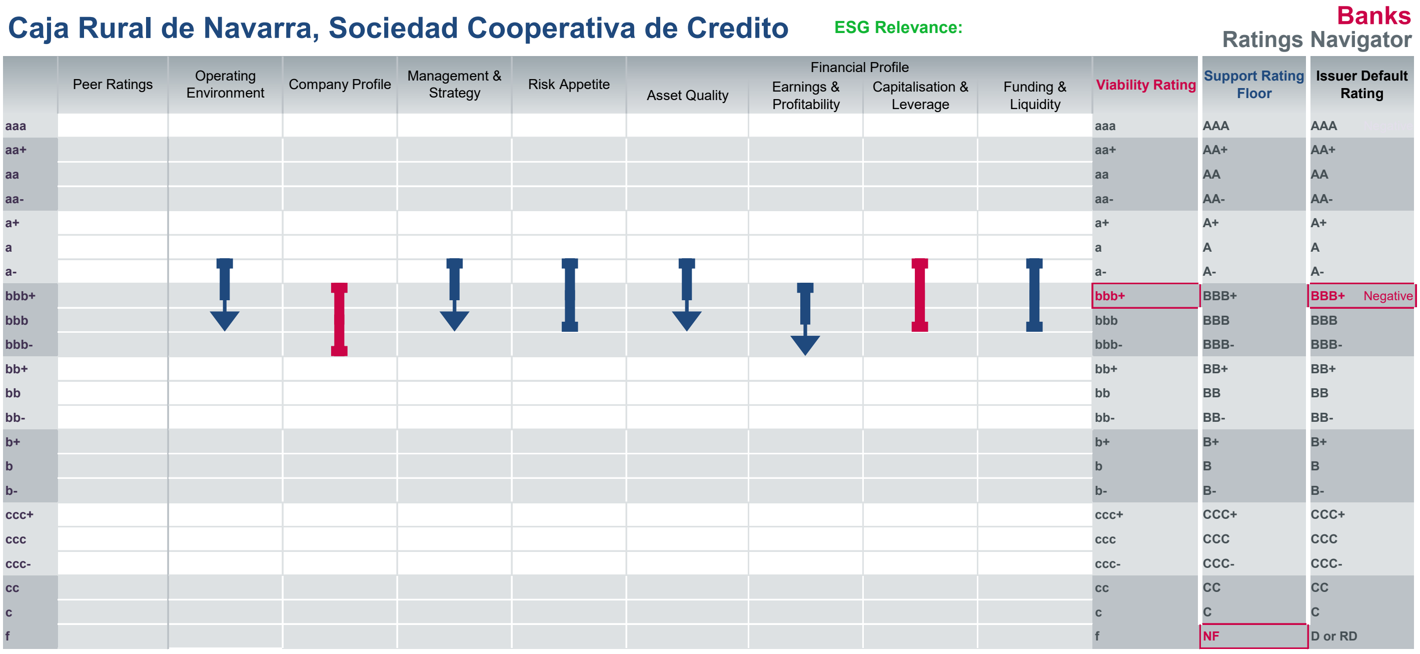
Ratings Navigator



Significant Changes

Spain Highly Affected by the Coronavirus Crisis

Spain is one of the most affected countries by the coronavirus outbreak in Europe. Under Fitch's forecasts, which are based on an extended lockdown to halt the spread of the virus, Spain's GDP is expected to contract by 13.2% in 2020 before seeing a partial recovery of 6.2% in 2021.

The unprecedented scale and scope of policy responses will help to limit the extent of the collapse in activity through the lockdown and will support economic recovery. However, job losses and great pressure on SMEs and the self-employed, which are key parts of the Spanish economy, will heavily weigh on post-crisis activity levels. As a result of these challenges, Fitch changed the outlook of the operating environment for banks operating in Spain to Negative from Stable in March 2020.

Government and Regulatory Support Measures Are Risk Mitigants

A number of measures introduced by Spain's government should be beneficial to the banks' financial profiles by reducing near-term credit risks. These measures include the introduction of a sector-wide debt moratorium suspending interest and principal repayment for at least three months for residential mortgage and consumer loans, and the provision of up to EUR100 billion of state loan guarantees (of which EUR74 billion had already been disbursed at end-August 2020) for the self-employed, SMEs and corporates. The Spanish government also announced on 3 July a new line of loan guarantees of up to EUR40 billion to support new investment in businesses in the areas of environmental sustainability and digitalisation.

Although we expect some regulatory flexibility on the recognition of problem assets, this may only delay credit losses and protection will only be limited in an adverse durable stress scenario extending throughout 2021.

The ECB's response to the coronavirus pandemic includes capital-relief measures and extensive monetary-policy support facilities that will alleviate the economic difficulties for European banks. While all these measures should support the flow of funds to the economy, we expect credit demand to be hit.

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

Sound Regional Franchise

CRN is Spain's third-largest credit cooperative by total assets at end-2019. It focuses on banking services to households and SMEs. CRN's market shares in its core market of Navarra stood at 29% for deposits and 26% for loans at end-March 2020, which provides it with some degree of pricing power in retail banking activities. These have consistently grown in recent years as the bank benefitted from banking sector consolidation, which reduced the number of competitors. CRN has also built a meaningful presence in neighbouring autonomous communities, with a market share of about 6% for loans.

Cooperative Model

CRN is a member of the Spanish rural credit cooperative association (Asociacion Espanola de Cajas Rurales; AECR), which comprises 29 credit cooperatives sharing common cooperative values. In December 2017, the AECR members further strengthened the existing cross-support mechanism, which includes a private guarantee fund that will be available to deal with any liquidity or solvency problems within the banking group's member banks. In Fitch's view, this strengthens AECR members' existing cross-support mechanism to support members undergoing severe liquidity or solvency problems. The mechanism does not imply the mutualisation of solvency, liquidity or profits.

From a regulatory standpoint, each credit cooperative will remain supervised on an individual basis. However, credit cooperatives should benefit from lower risk-weighting on exposures between AECR members and lower contribution to the deposit guarantee fund.

Effective Management

CRN's senior management team has good depth and stability and comprises executives with ample experience in the cooperative sector and with deep knowledge of the regional economy. The management team has shown an ability to execute the strategy set by the board despite a sometimes challenging economic environment. This is demonstrated by CRN's consistent outperformance of its asset-quality metrics throughout the crisis and its stable risk appetite.

CRN's strategic objectives remain focused on expanding its business and on improving profitability by increased cross-selling, while maintaining consistent underwriting criteria and capitalisation at current levels (target to maintain the CET1 ratio around 16%). Growth is primarily expected to be driven by organic growth in its home region of Navarra, but also in neighbouring areas (especially the Basque Country). In our opinion the deteriorated operating environment will make it difficult for CRN to grow as originally planned and to improve operating profitability in the near-term.

Conservative Risk Appetite

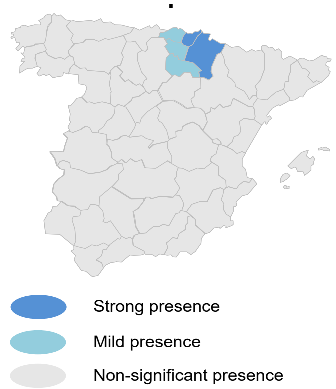
Credit risk arising from lending activity is the bank's main risk exposure. CRN is particularly exposed to retail mortgage loans and SME lending. The bank's prudent stance towards risk taking and growth has remained unchanged throughout the economic cycle and has supported consistently better-than-sector-average asset-quality indicators. In the current environment, the bank is offering relief measures to individual clients, including payment holiday extensions to mortgage loans, and liquidity credit line or medium-term loans to businesses that are partially guaranteed by the government.

Debt securities portfolios (about 30% of total assets or 325% of CET1 at end-2019) are primarily related to Spanish sovereign debt and results in counterparty risk concentration.

The bank's exposure to market risk is modest and mostly arises from the interest-rate risk on its large securities portfolio, which is largely at amortised cost with duration of almost four years. CRN's exposure to interest-rate risk is measured by gap, duration and simulation analysis. The bank has calculated that a 200bp decrease in interest rates would result in a 17.6% decrease in net interest income at end-2019.

Fitch expects the cross-support mechanism between the AECR members to result in a better degree of risk management within the group, through the implementation of a more uniform and homogeneous risk-appetite framework.

CRN's Geographical Presence in Spain



Source: Fitch Ratings, CRN

Summary Financials and Key Ratios

	31 Dec 19 Year end (EURm) Audited - unqualified	31 Dec 18 Year end (EURm) Audited - unqualified	31 Dec 17 Year end (EURm) Audited - unqualified	31 Dec 16 Year end (EURm) Audited - unqualified
Summary income statement				
Net interest and dividend income	154.6	142.0	150.3	153.4
Net fees and commissions	68.3	66.8	64.4	59.9
Other operating income	71.0	68.0	64.0	53.4
Total operating income	293.9	276.8	278.7	266.7
Operating costs	167.3	165.7	155.7	145.7
Pre-impairment operating profit	126.6	111.1	123.0	121.0
Loan and other impairment charges	13.1	8.5	14.0	-41.5
Operating profit	113.5	102.6	109.0	162.5
Other non-operating items (net)	-4.5	3.4	-17.6	-86.3
Tax	10.6	12.5	-1.0	6.7
Net income	98.4	93.5	92.4	69.5
Other comprehensive income	29.7	-32.5	-52.0	13.5
Fitch comprehensive income	128.1	61.0	40.4	83.0
Summary balance sheet				
Assets				
Gross loans	8,295.0	7,923.0	7,472.9	7,014.6
- Of which impaired	162.8	140.1	150.1	181.6
Loan loss allowances	126.3	144.2	138.1	165.5
Net loans	8,168.7	7,778.8	7,334.8	6,849.1
Interbank	108.4	100.0	115.8	112.6
Derivatives	13.5	7.4	3.6	5.2
Other securities and earning assets	4,021.1	3,544.4	3,487.3	3,386.1
Total earning assets	12,311.7	11,430.6	10,941.5	10,353.0
Cash and due from banks	412.4	351.4	343.5	260.3
Other assets	409.0	420.8	441.2	472.3
Total assets	13,133.1	12,202.8	11,726.2	11,085.6
Liabilities				
Customer deposits	8,729.5	8,011.9	7,514.7	7,054.2
Interbank and other short-term funding	232.2	155.4	148.6	678.7
Other long-term funding	2,702.2	2,581.8	2,597.9	2,005.2
Trading liabilities and derivatives	0.9	1.0	1.1	1.2
Total funding	11,664.8	10,750.1	10,262.3	9,739.3
Other liabilities	208.8	323.6	375.4	298.3
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.
Total equity	1,259.5	1,129.1	1,088.5	1,048.0
Total liabilities and equity	13,133.1	12,202.8	11,726.2	11,085.6

Source: Fitch Ratings, Fitch Solutions, CRN.

Summary Financials and Key Ratios

	31 Dec 19	31 Dec 18	31 Dec 17	31 Dec 16
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.6	1.5	1.7	2.8
Net interest income/average earning assets	1.3	1.3	1.4	1.6
Non-interest expense/gross revenue	57.2	60.6	56.4	54.9
Net income/average equity	8.3	8.5	8.6	6.9
Asset quality				
Impaired loans ratio	2.0	1.8	2.0	2.6
Growth in gross loans	4.7	6.0	6.5	5.9
Loan loss allowances/impaired loans	77.6	102.9	92.0	91.1
Loan impairment charges/average gross loans	0.2	0.1	0.2	-0.6
Capitalisation				
Common equity Tier 1 ratio	16.8	16.4	15.9	16.2
Fully loaded common equity Tier 1 ratio	16.6	16.4	15.8	17.0
Total capital ratio	16.8	16.4	16.6	16.8
Tangible common equity/tangible assets	9.3	8.9	9.1	9.2
Basel leverage ratio	8.8	8.8	n.a.	n.a.
Net impaired loans/common equity Tier 1	3.0	-0.4	1.2	1.7
Funding and liquidity				
Loans/customer deposits	95.0	98.9	99.4	99.4
Liquidity coverage ratio	370.0	510.0	n.a.	n.a.
Customer deposits/funding	74.8	74.5	73.2	72.4
Net stable funding ratio	153.0	153.4	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, CRN.

Key Financial Metrics – Latest Developments

Sustainably Better-Than-Peers Asset-Quality

CRN's gross loan book accounted for about 63% of total assets at end-2019. The loan portfolio remains dominated by loans to individuals (59% of total lending), mainly residential mortgage lending, and SMEs lending (30%). Lending to real estate developers (5%) is low in regions with a more stable housing market and has been recently built, indicating that the majority of the portfolio reflects post-crisis property values. Exposures to legacy foreclosed assets account for a low 0.3% of total assets and are well covered by reserves.

CRN's asset-quality metrics have been consistently among the best in Spain owing to the bank's conservative underwriting standards and its regional exposition to Navarra and Basque Country, two regions with better economic fundamentals compared to those of the rest of Spain. The problem asset ratio decreased to 2.5% at end-2019 from the peak of 6.4% peak at end-2013 due to lower new NPL entries, higher recoveries and foreclosed asset sales.

The impaired loan coverage ratio (78% at end-2019) and the relatively high exposure to secured loans (43% of gross loans) provide some protection against asset-quality pressures in the current economic environment. In addition, the small amount of applications for the loan moratoriums received at this stage signals that borrowers' repayment capacity remains adequate and therefore asset-quality deterioration for the stock of loans to individuals should be contained in the near term.

Modest but Stable Profitability

CRN's underlying profitability is moderate given its large exposure to low-risk/low-margin residential mortgage lending but relatively stable

We expect earnings challenges to increase in the current economic environment due to rising loan impairment charges and lower business volumes and as low economic activity decreases business volumes and limits fees and commissions. In 1H20, the impact of the pandemic outbreak was still contained in the bank's revenue (virtually stable ytd) and business volumes. The annualised operating profit-to-risk weighted assets ratio decreased to 1.2% from 1.6% in 2019 as the bank anticipated loan impairment charges (LICs) related to COVID-19, leading to an annualised LICs/gross loans of 0.3% (0.15% in 2019).

Robust Capital Buffers

CRN's capital position is commensurate with its risk profile and remains supported by its high earnings retention rate. The bank maintains sound capital buffers that compare favourably with those of domestic peers. At end 2019, CRN's fully loaded CET1 of 16.6% was comfortably above the bank's 2019 Supervisory Review and Evaluation Process requirements (including capital conservation buffers) of 7.88% for CET1 and of 11.38% for total capital. CRN will comply with ECB's recommendation to not distribute dividends until October 2020 but in any case its pay-out ratio has been historically low. We also expect the bank to benefit from the upcoming Capital Requirements Regulation, particularly from the SME support factor. CRN uses the standardised approach for measuring credit risk, which leads to a relatively high leverage ratio of 8.8% at end-2019.

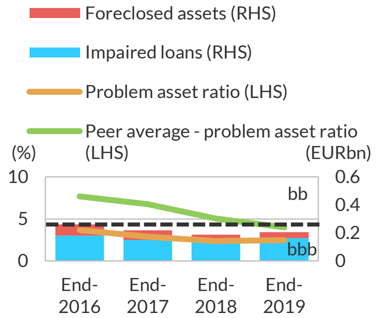
Stable Funding and Liquidity

CRN primarily relies on a granular retail deposit base (about 75% of total funding at end-2019), which results in an adequate and stable funding structure. Deposits have been growing in recent years, helped by the group's strong regional presence, resulting in a gross loans/deposits ratio of about 95%, broadly in line with peers'. Wholesale funding amounted to EUR2.9 billion at end-2019 and was mainly in the form of covered bonds.

CRN's liquidity position is adequate. At end-2019, unencumbered ECB-eligible assets accounted for about 18% of total assets, mainly in the form of public debt. Wholesale debt maturities are manageable and largely relate to secured debt issues, which free up collateral on maturity. At end-2019, the bank had good liquidity coverage and net stable funding ratios of 370% and 153% respectively.

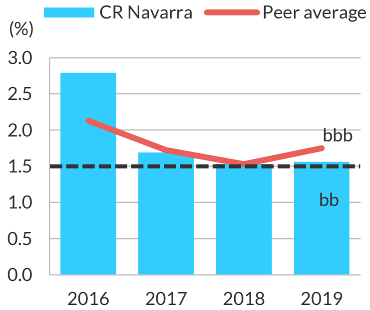
Notes on charts: Black dashed lines represent indicative quantitative ranges for core financial metrics given an operating environment score of 'bbb'. Peers include: CRN (VR: bbb+); Caja Laboral Popular Cooperativa de Credito (bbb+); Kutxabank, S.A. (bbb+); Caja Rural del Sur, SCC (bbb+); Eurocaja Rural, Sociedad Cooperativa de Credito (bbb); Credit du Nord S.A. (bbb+); Banco di Desio e della Brianza (bb+); Credito Emiliano S.p.A (bbb-)

Asset Quality



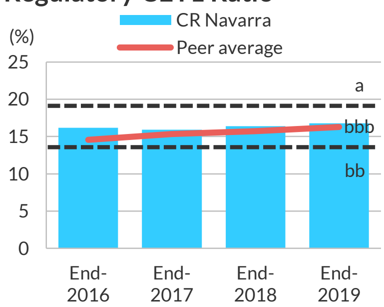
Source: Fitch Ratings, Banks

Operating Profit/RWAs



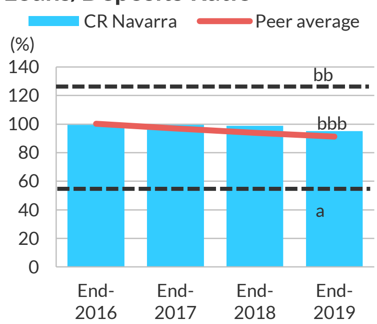
Source: Fitch Ratings, Banks

Regulatory CET1 Ratio



Source: Fitch Ratings, Banks

Loans/Deposits Ratio



Source: Fitch Ratings, Banks

Institutional Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			
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		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

CRN'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 if CRN 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 **Caja Rural de Navarra, Sociedad Cooperativa de Credito**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Caja Rural de Navarra, Sociedad Cooperativa de Credito has 5 ESG potential rating drivers

- Caja Rural de Navarra, Sociedad Cooperativa de Credito 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.

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 to 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