

## CREDIT OPINION

16 October 2020

Update

✓ Rate this Research

### RATINGS

#### Caja Rural de Navarra

Domicile	Pamplona, Spain
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Dom Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa1
Type	LT Bank Deposits - Dom Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Caja Rural de Navarra

### Update to credit analysis

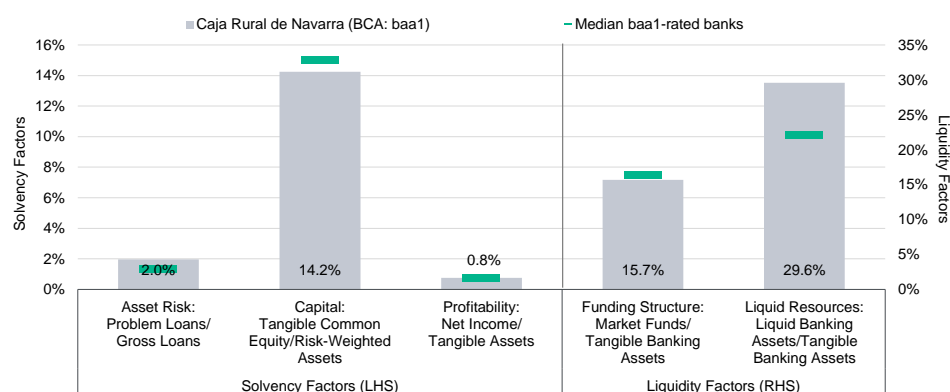
#### Summary

[Caja Rural de Navarra's](#) (CRN) Baa1/Prime-2 deposit ratings reflect the bank's Baseline Credit Assessment (BCA) of baa1; a high probability of affiliate support from the entities integrated into the Institutional Protection Scheme (IPS), which, nevertheless, translates into no uplift from CRN's BCA and consequently into an Adjusted BCA of baa1; and the result of our Advanced Loss Given Failure (LGF) analysis, which does not translate into any rating uplift. CRN's Counterparty Risk (CR) Assessment is A3(cr)/Prime-2(cr) and its Counterparty Risk Ratings (CRRs) are A3/Prime-2.

CRN's BCA of baa1 reflects the bank's sound financial fundamentals, namely, its strong asset-quality performance, sound capitalisation, and stable retail deposit base and low reliance on wholesale funding. The bank's BCA also reflects its modest profitability levels and the limited geographical diversification of its franchise, which is concentrated in Navarra and its neighbouring regions. There are downside risks to the bank's credit profile, namely, in terms of asset quality and profitability, as a result of [Spain's](#) (Baa1 stable) deteriorating operating environment because of the coronavirus pandemic.

Exhibit 1

#### Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

## Credit strengths

- » Stronger asset-quality indicators than the system average
- » Sound solvency levels
- » Low reliance on market funding, most of which is secured

## Credit challenges

- » Asset-risk profile to deteriorate because of the coronavirus pandemic
- » Lower revenue and rising cost of credit as a result of the coronavirus pandemic will hit CRN's recurrent profitability

## Outlook

The stable outlook on CRN's long-term deposit ratings reflects our view that the expected performance of the bank's financial fundamentals over the next 12-18 months is already captured in the bank's current ratings.

## Factors that could lead to an upgrade

Any upward pressure on CRN's BCA is unlikely to materialise as long as the Spanish government bond rating remains at Baa1. A bank's BCA will not typically exceed the sovereign rating under our methodology without any factor that reduces the dependency between the creditworthiness of the bank and the sovereign. Upward pressure on CRN's BCA and Adjusted BCA is also dependent on a strengthening of the creditworthiness of the IPS group.

CRN's deposit ratings could be upgraded as a result of changes in its liability structure, which indicate a lower loss given failure to be faced by deposits.

## Factors that could lead to a downgrade

The bank's BCA could be downgraded if the current economic shock because of the global spread of the coronavirus broadens and extends, leading to a worsening of CRN's asset quality and profitability beyond our current expectations. Negative pressure on the bank's BCA could also result from a downgrade of the Spanish sovereign rating.

Any change in the BCA would also likely affect the deposit ratings because they are linked to the standalone BCA. CRN's deposit ratings could also change as a result of alterations to the bank's liability structure, which would indicate a higher loss given failure to be faced by deposits.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Caja Rural de Navarra (Consolidated Financials) [1]

	12-19 <sup>2</sup>	12-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (EUR Million)	13,133.1	12,202.9	11,726.2	11,085.6	9,860.1	7.4 <sup>4</sup>
Total Assets (USD Million)	14,741.9	13,949.6	14,080.8	11,692.5	10,711.0	8.3 <sup>4</sup>
Tangible Common Equity (EUR Million)	1,212.0	1,110.7	1,036.9	943.8	872.5	8.6 <sup>4</sup>
Tangible Common Equity (USD Million)	1,360.4	1,269.7	1,245.1	995.5	947.8	9.5 <sup>4</sup>
Problem Loans / Gross Loans (%)	2.0	1.8	2.0	2.6	3.4	2.3 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	14.2	14.0	13.4	13.3	13.6	13.7 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.1	11.2	12.8	16.4	20.0	14.5 <sup>5</sup>
Net Interest Margin (%)	1.2	1.2	1.3	1.4	1.5	1.3 <sup>5</sup>
PPI / Average RWA (%)	1.5	1.4	1.6	1.8	2.0	1.7 <sup>6</sup>
Net Income / Tangible Assets (%)	0.8	0.8	0.8	0.6	0.7	0.7 <sup>5</sup>
Cost / Income Ratio (%)	57.4	60.4	56.3	54.8	53.6	56.5 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	15.7	16.2	16.9	17.4	17.4	16.7 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	29.6	26.9	31.7	31.7	29.0	29.8 <sup>5</sup>
Gross Loans / Due to Customers (%)	95.1	99.1	99.6	99.8	103.1	99.3 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

## Profile

With total assets of €15.1 billion as of the end of June 2020, Caja Rural de Navarra (CRN) is the second-largest rural cooperative bank in Spain and the first of the Spanish Rural Cooperatives Association (Asociacion Espanola de Cajas Rurales, AECR), composed of CRN and 28 other rural cooperatives.

CRN is primarily based in Navarra. The bank also operates as the only rural credit cooperative in the neighbouring regions of the Basque Country and La Rioja. With market shares of 25.8% in lending and 29.2% in deposits as of the end of March 2020 (latest available data), the bank is ranked second in Navarra, behind [CaixaBank, S.A.](#) (CaixaBank, A3/Baa1 stable, baa3)<sup>1</sup>. Despite its small size, CRN has a strong brand recognition and market position in its home region.

In March 2018, CRN integrated into an IPS, together with the 28 other Spanish rural cooperatives under the AECR and Banco Cooperativo Español, S.A. This IPS is a contractual scheme that ensures support through recourse to a private-sector fund, to which members have to contribute according to the terms and conditions established by a contractual agreement. This private fund will be an effective resource to assist IPS members in times of difficulty and before any resolution or liquidation, with the objective of preserving the financial stability of the IPS members and improving their risk profile.

Members of the IPS, including CRN, continue to be regulated on an individual basis, although they are required to publish consolidated accounts for the group.

This IPS entails some regulatory privileges for these entities, in particular capital relief on cross-sector lending and stakeholdings; higher allowances for single-borrower exposures, if these exposures are to fellow members of the group; and lower contributions to the Deposit Guarantee Fund.

## Detailed credit considerations

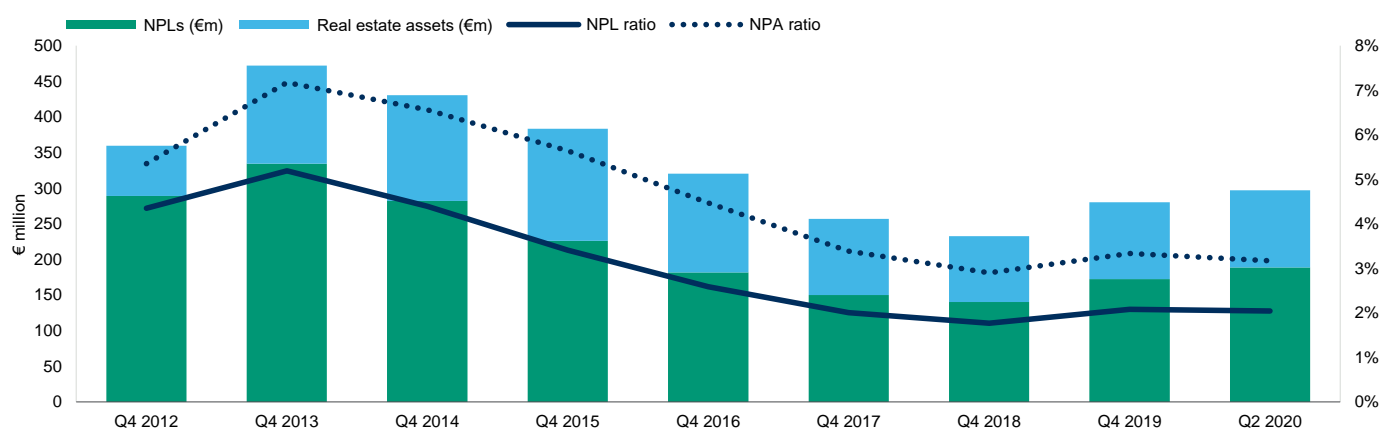
### Stronger asset-quality indicators than the system average

CRN's assigned Asset Risk score of baa1 incorporates the bank's very low level of nonperforming assets (NPA; defined as nonperforming loans (NPLs) plus real estate assets) relative to the banking system, as well as the limited geographical diversification of its franchise. We expect the coronavirus pandemic to have a direct impact on banks' asset quality, and we could reassess our current assessment of this factor depending on the breath and severity of the shock and the broad deterioration in credit quality that it will trigger.

CRN's asset-quality indicators have historically performed better than the Spanish banking system average because of the bank's more prudent risk management, with a relatively low exposure to the real estate sector and its activities being limited to its home territories. As of the end of June 2020, the bank reported an NPL ratio of 2.0%, up from 1.7% a year earlier, while the ratio for the banking system was 4.4% as of the same date. In addition to NPLs, CRN has a low amount of real estate assets repossessed over the past few years. If these assets are added to the bank's NPLs, the NPA ratio would be 3.2% as of the end of June 2020, up from 2.9% a year earlier and still comparing very favourably with the 7.1% average for its domestic peers as of year-end 2019 (latest available data) (see Exhibit 3).

Exhibit 3

#### CRN's asset-risk indicators



Sources: CRN and Moody's Investors Service

The bank's coverage ratio, defined as loan-loss reserves as a percentage of NPLs, stood at 76% as of the end of June 2020, compared with the system average of 64% for the same period, and the coverage of NPAs was 62%.

### Sound solvency levels

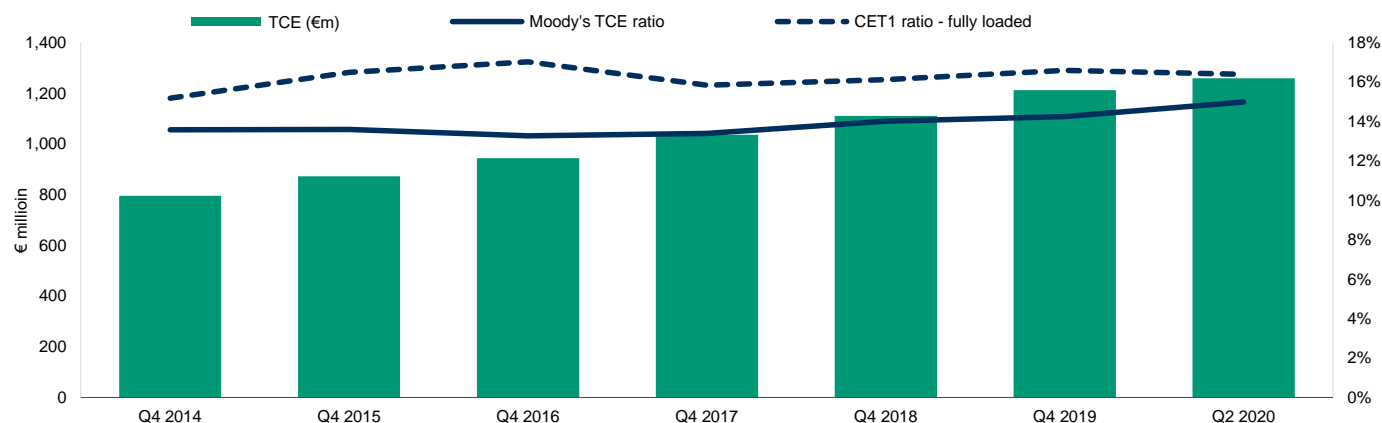
CRN's assigned Capital score of a3 reflects our assessment that capitalisation is a relative strength for the bank. As of the end of June 2020, CRN's tangible common equity/risk-weighted assets was 15.0%, up from 14.3% a year earlier. CRN's capital is mainly composed of retained earnings and contributions (the so-called aportaciones) on which it pays interest.

The bank's capital ratios as of the end of June 2020 improved because of the application of the capital requirement regulation "quick fix" (CRR 2.5)<sup>2</sup> measures, resulting in a reduction in weighting factors for loans to SMEs, as well as the high share of profit retention of CRN. In line with the Spanish legislation, CRN allocates a part of its net profit to a welfare fund, although it retains most of the profit to support capital generation and fund future growth, which translates into the bank's higher-than-average capital ratios.

In terms of regulatory capital ratios, CRN reported a fully loaded Common Equity Tier 1 capital ratio of 16.4%<sup>3</sup> as of the end of June 2020. Our more conservative capital assessment relative to regulators' capital ratios is primarily explained by the more conservative risk weighting that we apply to the sovereign exposures (at 50% for Spain's sovereign bonds) compared with regulators' risk weighting of 0%<sup>4</sup>. The supervisory measures announced by the European Central Bank (ECB) give banks significant additional leeway to absorb asset-quality declines because capital requirements have been temporarily lowered.

Exhibit 4

## Evolution of CRN's capital



Sources: CRN and Moody's Investors Service

## CRN's recurrent profitability will deteriorate

We assign a Profitability score of ba1 to CRN. Our assessment of the bank's profitability factors in our expectation that the deteriorating operating environment will result in lower operating revenue and increased cost of credit risk. CRN reported a net income/tangible assets of 0.6% as of the end of June 2020.

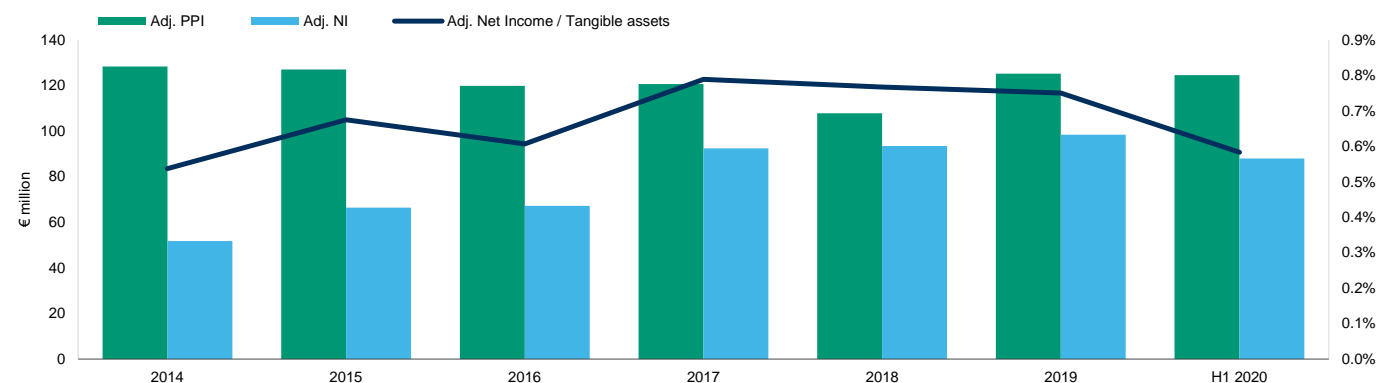
CRN's top-line earnings have been relatively stable over the past few years, as opposed to system trends (see Exhibit 5). For the first six months of 2020, the bank reported an operating income of €148 million, 2% higher than that reported for H1 2019. This was mainly as a result of a 9% increase in net fee and commission income. This increase in operating income, combined with a 1% increase in operating expenses, led to a 2% increase in the bank's pre-provision income (PPI) year over year.

Despite the increase in CRN's PPI, its net income reduced by 11% year over year as of the end of June 2020, reflecting the higher provisioning efforts than a year earlier as a result of the deteriorating operating environment.

CRN's cost-to-income ratio was maintained broadly stable at 58% as of the end of June 2020, compared with the system average of 52%, reflecting the bank's modest efficiency levels.

Exhibit 5

## CRN's profitability metrics



H1 2020 annualised.

Sources: CRN and Moody's Investors Service

### Low reliance on market funding, most of which is secured

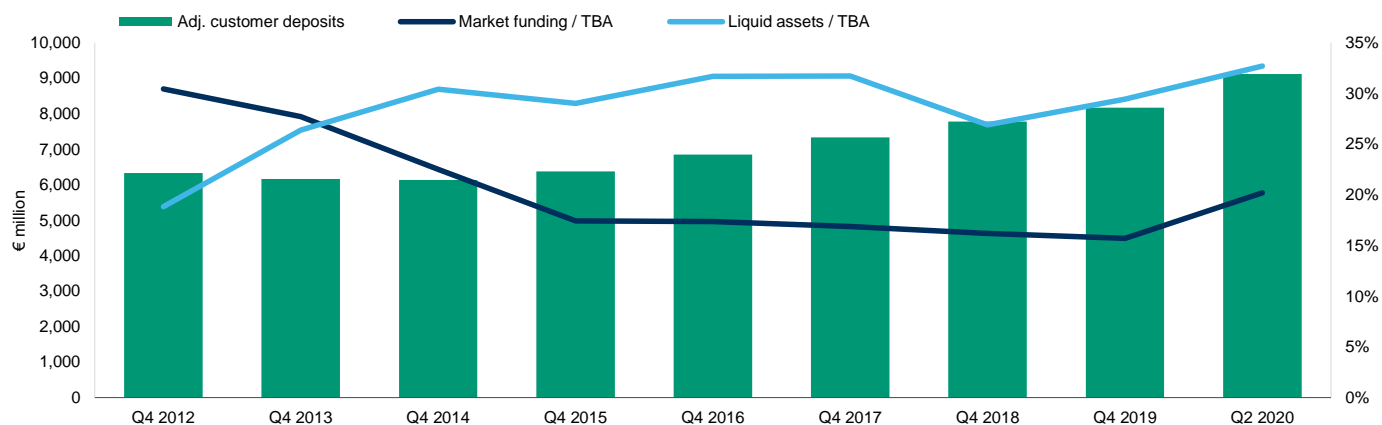
We assign a Funding Structure score of baa2 to CRN, in line with its Macro-Adjusted score, to reflect the bank's limited reliance on market funding. CRN is predominantly retail funded. As of the end of June 2020, deposits accounted for around 71% of the bank's total funding, representing 97% of its gross loans. The bank's regional identity adds a component of stability to its retail funding base, which has consistently grown over the years (see Exhibit 6).

Most of CRN's wholesale funding mainly represents covered bonds (€1.5 billion) and ECB funding (€1.9 billion), all secured funding sources. ECB funding is primarily used to take advantage of its attractive terms, especially following the TLTRO<sup>5</sup> III. In addition, CRN has tapped wholesale markets through a number of sustainable financing instruments, which form part of its sustainability framework (two €500 million sustainable mortgage covered bonds [November 2016 and May 2018] and a €100 million senior sustainable bond in June 2017).

CRN's liquid banking assets accounted for 32.7% of its tangible banking assets as of the end of June 2020. We assign a Liquid Resources score of baa3 to the bank, in line with its Macro-Adjusted score, to reflect the level of encumbrance. Global monetary easing and related initiatives triggered by the coronavirus pandemic will help relieve liquidity pressures of banks.

Exhibit 6

#### CRN's funding and liquidity profiles



Sources: CRN and Moody's Investors Service

### Environmental, social and governance considerations

In line with our general view on the banking sector, CRN has a low exposure to environmental risks. See our [Environmental risk heat map](#) for further information.

Overall, we expect banks to face moderate social risks. This includes considerations in relation to the rapid and widening spread of the coronavirus pandemic, given the substantial implications for public health and safety, and the deteriorating global economic outlook, creating a severe and extensive credit shock across many sectors, regions and markets. See our [Social risk heat map](#) for further information.

For Spanish banks, we have identified the potential litigation around the IRPH (Mortgage Loan Reference Index, Índice de Referencia de Préstamos Hipotecarios) index reference rate as a key social risk. On 3 March 2020, the European Union Court of Justice (ECJ) ruled that the use of the index falls within the remit of the European Union's directive on unfair terms (Directive 93/13/EEC), and therefore Spanish courts can consider it abusive. The number of borrowers who take legal action against banks and Spain's judicial stance will be the main determinants of the ECJ ruling's final effect on Spain's banks. The bank has not publicly disclosed its exposure to IRPH loans, and we have not incorporated any financial impact yet into CRN's scorecard.

Governance is highly relevant for CRN, as it is to all banks in the industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. We do not have any particular concern around CRN's

governance, and we believe that the bank displays an appropriate risk management framework commensurate with its risk appetite. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

## Support and structural considerations

### Affiliate support

We assign a high probability of affiliate support for CRN from the entities integrated into the IPS, which are the 29 rural cooperatives under the AECE and BCE. This support assessment translates into no uplift from CRN's BCA of baa1.

### Loss Given Failure (LGF) analysis

CRN is subject to the EU Bank Recovery and Resolution Directive, which we consider an operational resolution regime. Accordingly, we apply most of its standard assumptions. These assumptions include a residual tangible common equity of 3%, post-failure losses of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits, and assign a 25% probability to deposits being preferred over senior unsecured debt. Because we assume that CRN's deposit base is essentially retail in nature, we consider a proportion of 10% of junior deposits, below the estimated EU-wide average of 26%.

For CRN's deposits, our LGF analysis takes into consideration the likely impact on loss given failure of the combination of its own volume and subordination. Our LGF analysis indicates a moderate loss given failure for deposits, which leads us to position the bank's Preliminary Rating Assessment at the same level as its Adjusted BCA. Please refer to the Loss Given Failure and Government Support table at the bottom of the scorecard.

### Counterparty Risk (CR) Assessment

The CR Assessment is an opinion of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

#### CRN's CR Assessment is positioned at A3(cr)/Prime-2(cr)

CRN's CR Assessment is constrained by Spain's sovereign rating of Baa1. Under our "Banks" methodology, a bank's CR Assessment will typically not exceed the sovereign rating by more than one notch.

Before the government cap, the CR Assessment is positioned two notches above the bank's Adjusted BCA of baa1, based on the buffer against default provided to the senior obligations represented by the CR Assessment by subordinated instruments, amounting to 8.7% of tangible banking assets. The main difference in our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, thereby focusing purely on subordination and taking no account of the volume of the instrument class.

### Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

#### CRN's CRRs are positioned at A3/Prime-2

The CRRs are positioned one notch above the Adjusted BCA of baa1, reflecting the low loss given failure from the high volume of instruments that are subordinated to CRR liabilities. According to our methodology, a bank's CRR will typically not exceed the sovereign rating by more than two notches. Therefore, Spanish banks' maximum achievable CRRs are A2/Prime-1.

### Government support

We assign a low probability of government support for CRN's deposits, which does not translate into any uplift. Likewise, the CR Assessment does not benefit from any rating uplift from government support.

## Methodology and scorecard

### About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our rating committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.



## Rating methodology and scorecard factors

Exhibit 7

### Caja Rural de Navarra

<b>Macro Factors</b>							
<b>Weighted Macro Profile</b>		<b>Strong - 100%</b>					
<b>Factor</b>	<b>Historic Ratio</b>	<b>Initial Score</b>	<b>Expected Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	2.0%	a3	↓	baa1	Expected trend	Geographical concentration	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	14.2%	a3	↑	a3	Expected trend		
Profitability							
Net Income / Tangible Assets	0.8%	baa3	↓	ba1	Expected trend		
Combined Solvency Score		baa1		baa1			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	15.7%	baa2	↔	baa2	Extent of market funding reliance		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	29.6%	baa2	↔	baa3	Asset encumbrance		
Combined Liquidity Score		baa2		baa2			
Financial Profile				baa1			
Qualitative Adjustments				Adjustment			
Business Diversification				0			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				0			
Sovereign or Affiliate constraint				Baa1			
BCA Scorecard-indicated Outcome - Range				a3 - baa2			
Assigned BCA				baa1			
Affiliate Support notching				0			
Adjusted BCA				baa1			
<b>Balance Sheet</b>		<b>in-scope (EUR Million)</b>	<b>% in-scope</b>	<b>at-failure (EUR Million)</b>	<b>% at-failure</b>		
Other liabilities		2,937	22.4%	3,615	27.6%		
Deposits		9,691	73.9%	9,013	68.7%		
Preferred deposits		8,722	66.5%	8,286	63.1%		
Junior deposits		969	7.4%	727	5.5%		
Senior unsecured bank debt		100	0.8%	100	0.8%		
Equity		394	3.0%	394	3.0%		
Total Tangible Banking Assets		13,122	100.0%	13,122	100.0%		

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument	Sub-ordination	Instrument	Sub-ordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching	Notching	Rating Assessment
Counterparty Risk Rating	9.3%	9.3%	9.3%	9.3%	1	1	1	1	0	a3
Counterparty Risk Assessment	9.3%	9.3%	9.3%	9.3%	2	2	2	2	0	a3 (cr)
Deposits	9.3%	3.0%	9.3%	3.8%	0	0	0	0	0	baa1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	a3	0	A3	
Counterparty Risk Assessment	2	0	a3 (cr)	0	A3(cr)	
Deposits	0	0	baa1	0	Baa1	

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

Exhibit 8

Category	Moody's Rating
<b>CAJA RURAL DE NAVARRA</b>	
Outlook	Stable
Counterparty Risk Rating -Dom Curr	A3/P-2
Bank Deposits -Dom Curr	Baa1/P-2
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A3(cr)/P-2(cr)

Source: Moody's Investors Service

## Endnotes

- The ratings shown in this report are deposit ratings, senior long-term debt ratings when available and BCA.
- The aforementioned quick fix to the capital requirement regulation was approved in the European Parliament in June 2020, aimed at supporting the credit flow to SMEs and households, and mitigating the impact of the lockdown because of the coronavirus pandemic on capital.
- Not including H1 2020 net income.
- See [Moody's Adjustment to Increase the Risk Weightings of Sovereign Debt Securities in the Analysis of Banks: Frequently Asked Questions](#).
- Targeted long-term refinancing operations.

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