

Rating Action: Moody's affirms BIL's A2 deposit and senior unsecured debt ratings with a stable outlook

15 Jul 2022

Paris, July 15, 2022 -- Moody's Investors Service ("Moody's") today affirmed the long-term deposit and senior unsecured debt ratings of Banque Internationale a Luxembourg (BIL) at A2 with stable outlooks. The agency affirmed the bank's Baseline Credit Assessment (BCA) at baa2, reflecting its sound credit fundamentals. Moody's also affirmed BIL's dated subordinated and Additional Tier 1 (AT1) ratings at Baa3 and Ba2(hyb), respectively. The rating agency also affirmed the bank's short-term ratings at Prime-1 and its long-term and short-term Counterparty Risk (CR) Assessment at A1(cr) and Prime-1(cr), respectively.

Please click on this link https://www.moody's.com/viewresearchdoc.aspx?docid=PBC_ARFTL467780 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

The affirmation of BIL's BCA at baa2 reflects Moody's expectations that the performance of the bank's retail and commercial banking franchises in Luxembourg will remain satisfactory despite the weakening macroeconomic conditions. Moody's also assumes that BIL's private banking activities in Luxembourg, Switzerland and China will report improved profitability going forward.

Moody's expects that the bank's asset quality will remain robust overall, thanks to a focus on Luxembourg, with a significant proportion of residential housing loans (39% of the loan book as of year-end 2021) and secured loans to private banking clients (6%), which have historically resulted in low cost of risk. Corporate loans, representing 27% of the loan book, are riskier and more concentrated, but the cost of risk on these exposures has remained relatively contained. The bank reported a total cost of risk of 20 basis points (bps) in 2021 versus 38 bps in 2020. The problem loan ratio was 3.6% of gross loans as of year-end 2021, a level slightly higher than its two main competitors in Luxembourg.

BIL's capitalisation is solid, as illustrated by a Common Equity Tier 1 (CET1) ratio of 14.2% as of year-end 2021, well above its minimum CET1 requirement of 8.85% under the European Central Bank's Supervisory Review and Evaluation Process (SREP), but below its Luxembourg peers. The bank's Tangible Common Equity leverage ratio, which does not account for its €175 million Additional Tier 1 securities, was lower than European peers at 4.3% at the end of 2021. Nonetheless, the bank's owners, namely Chinese conglomerate Legend Holdings, holding 90% of capital shares since 2018, alongside the state of Luxembourg, have been supportive of BIL's capitalisation, as illustrated by a €58 million capital injection in 2019 and the absence of dividend payment by BIL in recent years.

In addition, BIL's funding is well balanced as the bank finances its growing activity through deposits raised by its well-established retail and private banking franchises in Luxembourg. The bank's loan-to-deposit ratio was 80% at the end of 2021, as a result of its large deposit base, although 24% of these deposits were generated by the bank's private banking activities, which Moody's considers less stable than retail deposits. The bank's Liquidity Coverage Ratio was 142% and its Net Stable Funding Ratio was 127% at year-end 2021, reflecting the strong liquidity and funding profiles of the bank.

Moody's nevertheless considers that thus far BIL has not yet fully met its strategic and profitability targets. The bank's international private banking and wealth management activities have not reached a sufficient size to generate the bank's expected returns on assets. The bank retracted from several international markets in recent years and is currently slowly expanding in China. BIL's profitability remains modest, as illustrated by a structural cost-to-income ratio well above 70%, under Moody's calculations, as a result of net interest margin pressure, high IT costs linked the replacement of the bank's core banking system and insufficient scale in private banking activities. Although some of these effects will recede, Moody's expectation is that BIL's profitability will moderately decline going forward as it remains constrained by wage indexation to inflation in Luxembourg and by the rating agency's expectation of an increase in the cost of risk due to deteriorating macroeconomic conditions.

In its affirmation of BIL's baa2 BCA, Moody's decided today to remove the one-notch downward qualitative adjustment for Corporate Behaviour which previously reflected the rating agency's view of governance risks associated with BIL's acquisition by Legend Holdings in 2018 and planned expansion in international private banking. After four years under new ownership, Moody's considers that the risks associated with a previously expected expansion into new business areas have abated, supporting the removal of the adjustment. Nonetheless, Moody's still believes that there remains moderate governance risks associated with BIL's private ownership and its track record of multiple changes in strategy. Moody's has reflected such governance risks in BIL's moderately negative Governance Issuer Profile Score (G-3) under its environmental, social, and governance (ESG) framework. BIL's ESG Credit Impact Score, which is moderately negative (CIS-3), is driven by these governance factors.

BIL's A2 long-term deposit, issuer and senior unsecured debt ratings reflect (1) the bank's baa2 BCA; (2) a two-notch uplift under Moody's Advanced Loss Given Failure (LGF) analysis, resulting from these instruments' volume and the cushion brought by subordinated instruments; and (3) government support uplift of one notch, due to a moderate probability of support from the Luxembourg government (Aaa Stable), reflecting Moody's view that the bank is systemically important to Luxembourg.

RATING OUTLOOK

The outlook on BIL's long-term deposit and senior unsecured debt ratings is stable, reflecting Moody's view that the bank's asset risk will remain moderate despite the deteriorating economic environment, while its profitability will continue to be constrained by high operating expenses and increasing cost of risk.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

BIL's BCA could be upgraded if (1) the bank's commercial development, especially in private banking and wealth management, sustainably improves its profitability whilst maintaining a low asset risk profile; and (2) the bank substantially increases its capitalisation. An upgrade of BIL's BCA and Adjusted BCA would likely result in an upgrade of all long-term ratings of the bank.

BIL's senior unsecured debt rating could also be upgraded as a result of a decrease in loss-given-failure should senior unsecured debt benefit from higher cushion in the form of subordinated instruments.

BIL's BCA could be downgraded if (1) the bank's profitability deteriorates or becomes more volatile; (2) risks stemming from the bank's investment portfolio and loan book increase in a less benign macroeconomic environment; or (3) governance risks increase due to the foreign shareholder, failures at implementing the current strategy or a more material expansion in China than currently anticipated.

BIL's senior unsecured debt rating could also be downgraded as a result of an increase in loss-given-failure should senior unsecured debt account for a smaller share of the bank's overall liability structure.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are a mix of solicited and unsolicited credit ratings. For additional information, please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website <https://ratings.moodys.com>. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL467780 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

- EU Endorsement Status
- UK Endorsement Status
- Rating Solicitation

- Issuer Participation
- Participation: Access to Management
- Participation: Access to Internal Documents
- Lead Analyst
- Releasing Office

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

Please see <https://ratings.moodys.com> for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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