08 Nov 2019 | Rating Changed Outlook to Stable

# Fitch Revises Banque Internationale a Luxembourg's Outlook to Stable; Affirms at 'BBB+'

Fitch Ratings-Paris-08 November 2019:

Fitch Ratings has revised Banque Internationale a Luxembourg's (BIL) Outlook to Stable from Positive. The bank's Long-Term Issuer Default Rating (IDR) has been affirmed at 'BBB+' and the Viability Rating (VR) at 'bbb+'.

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

The ratings actions are part of a periodic portfolio review of major banks in Belgium and Luxembourg rated by Fitch.

## Key Rating Drivers

IDRS, VR AND SENIOR DEBT

The Outlook revision reflects slower-than-expected improvement in the bank's profitability, due to limited progress in strengthening the private banking franchise and cost efficiency measures taking longer than expected to feed through. The benefits for the rationalisation of the branch network are offset by necessary IT investments, including in digitalisation. The expected cost reduction from the implementation of a new core banking system will take longer to materialise than Fitch had originally expected.

BIL's ratings reflect a sound franchise in retail and commercial banking in Luxembourg, moderate risk appetite, satisfactory capital ratios and ample liquidity. The ratings also reflect the geographical concentration of BIL in a small but strong economy and its small size relative to more highly rated peers', which means that costs are high compared with its revenue-generating capacity, and its greater exposure to shocks than banks with a larger capital base.

BIL has a sound franchise in Luxembourg as one of the top three banks in retail and commercial banking, providing resilient earnings generation. Despite cost-saving initiatives, ongoing investment in a new core banking system and digitalisation will continue to weigh on the high cost base. In 1H19, the cost-to- income ratio calculated by Fitch remained high, at almost 75%, and operating profit to risk-weighted assets (RWAs), which is now below peers', declined to 1.4%. In light of the necessary IT investments, margin pressure in retail and corporate banking, and the competitive environment in private banking, Fitch expects it will take more than two years for the bank to materially improve its cost efficiency and improve earnings generation.

In 2018, the Chinese financial holding Legend Holdings became BIL's new majority shareholder. The recent decision to expand in China, principally in private banking, in Fitch's opinion reflects a slightly higher risk appetite, although this is partly mitigated by the prudent approach to growth and focus on asset-light operations.

The IFRS 9 implementation in 2018 resulted in a significant increase in BIL's impaired loans ratio (Stage 3 loans) to 4.7% at end-June 2019, which is higher than regional peers'. BIL has had a noticeable amount of forborne loans, and while a large part of them is performing, they are now included in the impaired loan ratio. Loan impairment charges remained below average at only 4bp of gross loans in 1H19. The remaining assets consist mainly of the bank's securities portfolio, which is generally of good quality and liquid with a large majority of ECB-eligible holdings.

Liquidity is a rating strength. BIL benefits from a sizeable deposit base, which significantly exceeds customer loans. The excess liquidity is invested in cash and high-quality securities. BIL benefits from a large customer deposit base provided by its retail and private banking businesses.

Capital ratios are satisfactory but the equity base is small in absolute terms, making the bank vulnerable to potential sizeable operational or compliance risk arising from its private banking business. We expect the bank to remain reliant on retained earnings to sustain its growth plan. At end-June 2019, the common equity Tier 1 ratio, excluding 1H19 net profit, was just below 12%. We expect management to maintain this ratio at around 12%. Leverage, measured by tangible common equity/ tangible assets, was satisfactory at around 4% over the past year.

Senior debt is rated in line with BIL's Long-Term IDR. Fitch views the probability of default on the senior preferred and non-preferred notes as the same as the probability of default of the bank.

The Short-Term IDR of 'F1' is the higher of two options mapping to a 'BBB+' Long-Term IDR, and reflects our assessment of BIL's sound funding and liquidity, which we score at 'a', supported by the stable and sizeable customer deposit base.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that BIL 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 participating in losses, instead of or ahead of a bank receiving sovereign support.

SUBORDINATED DEBT

Subordinated debt issued by BIL is rated one notch below its VR to reflect above-average loss severity in case of non-performance.

RATING SENSITIVITIES

IDRS, VR AND SENIOR DEBT

Upside is currently limited for BIL and would be contingent on successful and timely execution of cost- saving initiatives including the full implementation of a new core banking system, and a significant strengthening of critical mass in private banking in selected countries.

The bank's private banking business gives rise to operational risks, and the ratings could be downgraded if the bank aggressively expands into China or other higher-risk countries, or if operational losses or conduct costs result in reduced capital or if they indicate weakened risk controls.

BIL's Short-Term IDR would be downgraded if our assessment of the bank's funding and liquidity score falls below below 'a'.

The ratings of senior debt are sensitive to change in BIL's IDRs.

The senior preferred notes would achieve a one-notch uplift once the buffer of qualifying junior debt and senior non-preferred debt is sustainable and exceeds our estimate of a 'recapitalisation amount', around the bank's fully loaded minimum pillar 1 total capital requirement.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Rating or upward revision of the Support Rating Floor would be contingent on a positive change in the Luxembourg sovereign's propensity to support its banks. While not impossible, this is highly unlikely, in Fitch's view.

SUBORDINATED DEBT

The rating of subordinated debt issued by BIL is primarily sensitive to changes in its VR, from which it is notched.

ESG Considerations

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 BIL, either due to their nature or to the way in which they are being managed by BIL. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

Banque Internationale a Luxembourg SA; Long Term Issuer Default Rating; Affirmed; BBB+; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; bbb+
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----subordinated; Long Term Rating; Affirmed; BBB
----Senior non-preferred; Long Term Rating; Affirmed; BBB+
----Senior preferred; Long Term Rating; Affirmed; BBB+
----Senior preferred; Short Term Rating; Affirmed; F1

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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)

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