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Research Update:

Banque Internationale à Luxembourg 'A-/A-2' Ratings Affirmed On Increased Capitalization And Rapid Loan Growth

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Overview

- BIL strengthened its capital position as it paid no dividend on its 2017 and 2018 profits; we expect the bank's capital policy to result in the risk-adjusted capital (RAC) ratio stabilizing at about 10.5% in the foreseeable future.
- At the same time, the bank's loan book is growing more rapidly than peers, and we expect expansion to remain dynamic for BIL in the next couple of years, which could result in supplemental credit risk.
- We believe that BIL's stronger capitalization covers additional growth risks, and that capital and risk position remain overall neutral for the rating.
- We are affirming our 'A-/A-2' long- and short-term issuer credit ratings.
- The stable outlook reflects our view that BIL's business and financial profile is unlikely to change significantly in the next two years.

Rating Action

On Nov. 22, 2019, S&P Global Ratings affirmed its 'A-' long-term and 'A-2' short-term issuer credit ratings on Banque Internationale à Luxembourg (BIL). The outlook is stable.

Rationale

This affirmation balances our view of BIL's reinforced capital policy together with its loan book's rapid expansion that could presage additional risks, notably if credit conditions were to become less supportive.

The bank's medium-term strategy remained broadly unchanged following its acquisition by the Chinese company Legend Holdings (LH), which was finalized mid-2018. We understand that the new shareholder endorses BIL's medium-term plans and is committed to support the bank's financial profile to pursue business development. BIL is the third-largest lender in Luxembourg, and had stable 13%-14% market share in loans and deposits in 2018. It has lending concentration in the narrow, but low-risk Luxembourg market, and has only second-tier franchise in private banking, in our view.

Despite BIL recently opening a representative office in Beijing, and the bank's intention to leverage on LH's local presence there to seize opportunities, we understand that business development, in particular through corporate financing to Chinese companies, is to be rolled out in a progressive manner.

We expect that BIL's capitalization will continue to benefit from predictable earnings and supportive capital management, as illustrated by LH's decision to upstream no dividend on the bank's 2017 and 2018 results. The RAC ratio stood at 10.6% at year-end 2018 and we forecast that it will stabilize at similar level by 2021.

While the bank's capitalization was reinforced, we believe it has also embarked in a more rapid expansion in lending than peers, primarily in domestic mortgage and some corporate lending. BIL's S&P Global Ratings-calculated risk-weighted assets (RWA) grew by about 9% in 2018, and a similar growth in the bank's customers loans was further observed in the first-half of 2019.

Although we understand that BIL kept its underwriting standards and risk framework broadly unchanged, we consider this level of growth as rather atypical compared with peers, including in neighbouring countries. We believe that it can pose some challenges to the bank to properly manage risks arising from this change. Rapidly growing exposures in a low interest rate environment, this could also translate into supplemental credit risk materializing, notably if the cycle turns.

Our assessment of BIL's risk profile continues to factor in the domestic concentration in its lending portfolio, as well as our view of significant operational and reputational risks that are inherent to private banking, and which are not fully captured by the S&P Global Ratings-calculated capital metric.

In its efforts to build up a sizable bail-in-able buffer, BIL issued €300 million of senior nonpreferred (SNP) notes in 2018 that mature in 2023. We calculate that the ratio of additional loss-absorbing capacity (ALAC) to our RWA for BIL was 6.96% at year-end 2018 (3.96% pro forma the revision of our assessment of capital and earnings to strong) and we project that it will stand above 7.00% in 2019 and 2020, supported by new issuances of SNP notes. We expect our ALAC metric to pass through a lower above-6.0% ratio at year-end 2021, as we will adjust it considering that the sizable inaugural SNP issuance will mature within the following 12-24 months. However, the forecast remains above our 5.50% threshold, therefore we continue to incorporate one notch of ALAC uplift in our long-term rating on BIL.

Despite the LH conglomerate's leveraged nature and lower creditworthiness than BIL, this ownership does not constrain our ratings on the bank because we believe that the latter benefits from a very high degree of insulation from its parent group. Supporting our view is the majority of members on BIL's board of directors, including two designated by the Grand Duchy, being independent; its close monitoring by the supervisory authorities; as well as related minimum requirements imposed by them regarding capital, leverage, and liquidity.

Outlook

The stable outlook reflects our view that BIL's business and financial risk profile will hold in the next two years. We expect that the bank's capitalization will stabilize, with our RAC ratio forecast standing at 10.5% at year-end 2021, and anticipate that supportive capital management will balance dynamic loan growth. Furthermore, we estimate that BIL will maintain a sufficient ALAC buffer that will serve to help protect senior preferred creditors in a gone-concern scenario. Finally, the outlook incorporates our expectation that BIL's creditworthiness will remain delinked from its parent's thanks to the bank's regulated status and to the influence of independent board members.

We could consider a downgrade if the bank deviated from its strategic plan or its exposures mix was skewed towards higher economic risk countries. We could also lower the rating if we perceived detrimental effects from BIL shareholders on management and governance standards, or if we saw deviated uses, directed by the parent group, of the bank's liquidity, funding, or capital resources. Although this is not our central scenario, any change in BIL's shareholder structure that would shift the balance of power between LH, Luxembourg, and independent directors, could lead to a negative rating action. Finally, if our RAC ratio went back to sustainably below 10%, we could revisit BIL's risk position, considering notably whether this change in capital management would come along with a deceleration in loan growth, from the current rapid pace. We would update our prospective view on BIL's exposure to credit losses and its overall capacity to absorb them.

We see an upgrade as unlikely during our outlook horizon. This is because we believe the 'A-' issuer credit rating on BIL, and the 'bbb+' group SACP are adequately positioned when compared with peers. Should BIL's ALAC buffer increase more than what we expect, an upgrade would also depend on our view of the bank's business development and performance compared with peers' rated in the 'A' category.

Ratings Score Snapshot

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	To	From
Issuer Credit Rating	A-/Stable/A-2	A-/Stable/A-2
SACP	bbb+	bbb+
Anchor	a-	a-
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Strong (+1)	Adequate (0)
Risk Position	Moderate (-1)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+1	+1
ALAC Support	+1	+1
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Banque Internationale a Luxembourg Affirmed At 'A-/A-2' Under Revised Criteria; Ratings Removed From UCO; Outlook Stable, July 16, 2019
- Banking Industry Country Risk Assessment: Luxembourg, March 29, 2019
- Banque Internationale a Luxembourg, Dec. 20, 2018
- Banque Internationale a Luxembourg's Inaugural Senior Nonpreferred Notes Rated 'BBB', Sept. 21, 2018

Ratings List

Ratings Affirmed	
Banque Internationale a Luxembourg	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Banque Internationale a Luxembourg	
Senior Unsecured	A-
Senior Subordinated	BBB
Subordinated	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.